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The Municipal Revenue Crisis: California Problems And Possibilities

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The "crisis in our cities" is both a cliche and a condition for Californians. There is no immediate hope of relief from either. This Article will examine one aspect of that crisis, municipal revenues, by analyzing a present source, the property tax, and a proposed source, the municipal tax on income.

Many California cities are facing an ever-increasing lack of funds to finance needed services in the years ahead.[1] This is largely attributable to four factors: expanding population with its attendant urbanization; a constantly improving standard of living with a consequent demand for improved and expanded municipal services;[2]

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1. A study by the League of California Cities concludes that the cumulative deficit for California city governments will approximate one billion dollars by 1971-72 if new revenue sources are not found. League of Cal. Cities, Study Presented to the Assembly Comm. on Rev. and Tax. and the Assembly Comm. on Municipal and County Gov't at 4 (Jan. 16, 1968). Other studies have arrived at similar conclusions. For example, TEMPO, General Electric's Center for Advanced Studies, estimated in 1966 that the total revenue gap facing all United States city governments in the following ten years would be $262 billion. TEMPO, OPTIONS FOR MEETING THE REVENUE NEEDS OF A CITY GOV'T 6 (1966). *See also* CAL. LEGISLATURE ASSEMBLY INTERIM COMM. ON REV. AND TAX. pt. 6, FINANCING LOCAL GOV'T IN CAL. 37-38 (1964); CAL. SENATE FACT FINDING COMM. ON REV. AND TAX. pt. 9, PROPERTY TAXES AND OTHER LOCAL REVENUE SOURCES 34-37 (1965); M. DAVISSON, FINANCING LOCAL GOV'T IN THE SAN FRANCISCO BAY AREA (1963); INTERGOVERNMENTAL COUNCIL ON URBAN GROWTH, RECOMMENDED ROLES FOR CAL. STAT GOV'T IN FEDERAL URBAN PROGRAMS (1967).

2. A partial list of services presently provided by municipal governments includes: "[P]lanning and zoning; streets, sidewalks and bridges; sewerage and drainage systems; urban renewal and redevelopment; recreation, parks and playgrounds; landscaping, tree planting and beautification; police and fire protection; traffic control; building inspection; public health; civil defense and protection against disasters; animal control; water supply and distribution: refuse

the effect of continuing inflation on municipal service costs;[3] and the fact that political boundaries of most large cities today do not coincide with their areas of social and economic functioning.[4] One aspect of the last problem is the daily influx into cities of nonresident commuters. Municipal services have to be provided for the daytime commuter populations of cities. Yet, since commuters do not pay municipal property taxes, a large part of the increased burden falls upon resident taxpayers.[5]

The largest present source of tax revenues for California municipal governments is the property tax.[6] In addition, California local governments use numerous non-property taxes,[7] many of which

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and garbage collection and disposal; small craft harbors; hospitals; off-street parking facilities; street lighting; transportation; airports; libraries; museums; cultural facilities and the management and housekeeping functions necessary to the provision of these services." FINANCING LOCAL GOV'T IN CAL., *supra* note 1, at 88.

3. To a large extent this is due to the heavy reliance by local governments on the property tax for revenues. Inflation increases costs. Yet, to increase property tax revenues, administrative action is required: reassessment of property values or increase in tax rates. A gap between costs and revenues result in the meantime. In the case of property tax revenues, two obstacles impede the closing of the gap. One is the practical impossibility of continual reassessment; the other is public opposition to continual increases in property value assessments and tax rates. Theoretically, the gap could be closed over a period of time. However, since inflation has been continual in the United States, the gap increases each year. See also text accompanying note 66 *infra*.

4. Probably, the ultimate solution will be the replacement of the present city governments by government on a regional basis. *See, e.g., Symposium: The San Francisco Bay Region—Regional Problems and Solutions*, 55 CALIF. L. REV. 695 (1967). "The city as a concept is obsolete. The metropolitan region has taken its place as the context for the analysis and solution of domestic problems." *Id.* See also the proposal by the San Francisco mayor to create a San Francisco Bay area economic community to attack common problems. San Francisco Chronicle, March 28, 1968, at 1, col. 3. But in the meantime, perhaps at least for another ten or twenty years, city government will remain the basic local governmental unit. Moreover, some urge that strong city government needs to be retained even within the regional rule concept. Oakland Tribune, April 10, 1968, at 9, col. 1.

5. The Board of Supervisors of the City and County of San Francisco, in adopting a gross receipts tax on commuters working within San Francisco, issued specific findings that: (1) San Francisco's daily commuter population is 187,600 compared to a resident population of 756,900; (2) out of a total of $2,721,000,000 in wages and salaries earned in San Francisco, $1,267,000,000 are earned by commuters; and (3) "non-residents employed by others in San Francisco have not herctofore paid for the services furnished by the taxpayers of San Francisco which such non-residents enjoy." San Francisco Examiner, August 17, 1968, Official Advertising, at 2, col. 1. Pursuant to such findings, and to a determination of "an equitable apportionment" of the cost of services provided for commuters, San Francisco imposed a 1% gross receipts tax on commuters working in San Francisco. *Id.*

6. In the fiscal year 1964-65, general property taxes raised $487,547,813 for California cities, or 63% of their total tax revenues. CAL. STATE CONTROLLER'S OFFICE, ANNUAL REPORT OF FINANCIAL TRANSACTIONS CONCERNING CITIES OF CAL., FISCAL YEAR 1964-65, at v.

7. For example, among the more important Los Angeles city taxes are: Taxes on various trades, professions, and occupations; gross receipts taxes on businesses; taxes on coin-operated machines; hotel occupancy tax; cigarette and tobacco tax; and utility use tax. 3 CCH CAL. TAX REPORTER, CITY TAXES, ¶70.

are not suited to solving local revenue problems.[8] There are, however, two non-property taxes which have proven capable of raising substantial revenues for local governments. One is the local sales tax, the other the local income tax.[9] California at present has a local sales tax,[10] and several communities have evidenced an interest in a municipal income tax.[11]

There is no lack of potential municipal revenues. But the local revenue-collecting machinery, with its primary reliance on the property tax,[12] is inadequate. One proposed solution to local fiscal problems is increased use of federal or state grants-in-aid,[13] or outright revenue sharing with the state or federal governments.[14] This

8. Most local non-property taxes, with some exceptions in large cities, provide relatively low yields, entail high administrative costs for government as well as high compliance burdens for taxpayers, and, as a practical matter, are generally ill-administered. Moreover, as tax proliferation increases, it becomes more difficult to maintain uniformity and efficiency in the overall fiscal policies of the state. PROPERTY TAXES AND OTHER LOCAL REVENUE SOURCES, *supra* note 1, at 85-86. *See also* U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, LOCAL NONPROPERTY TAXES AND THE COORDINATING ROLE OF THE STATE (1961). In addition, many local non-property taxes may tend to distort local business relationships because of tax barriers which arise between local taxing jurisdictions. *See* S. Sato, *Municipal Occupation Taxes in California: The Authority to Levy Taxes and the Burden on Intrastate Commerce*, 53 CALIF L. REV. 801 (1965).

9. *See* SIGAFOOS, THE MUNICIPAL INCOME TAX: ITS HISTORY AND PROBLEMS (1955); Phillips, *Philadelphia's Income Tax After Twenty Years*, 11 NAT'L TAX. J. 241 (1958); Taylor, *Local Income Taxes After Twenty-One Years*, 15 NAT'L TAX J. 113 (1962); Walker, *The Inevitability of City Income Taxes*, 45 TAX DIGEST No. 2 at 8 (1967).

One other possible revenue raising device is imposition of direct fees and service charges for some of the municipal functions which cities now finance out of their general revenues. Many cities today use a limited amount of users' fees, typically for such items as garbage and refuse collecting. One study concluded that the city of Los Angeles could have increased its revenues for the year 1957 by approximately 50% by imposing direct fees and service charges on a cost basis for many of its municipal functions, including police and fire protection. Stockfisch, *Fees and Service Charges as a Source of City Revenues: A Case Study of Los Angeles*, 13 NAT'L TAX J. 97 (1960).

10. Bradley-Burns Uniform Local Sales and Use Tax Law, CAL. REV. & TAX CODE §§ 7200-7209 (West Supp. 1967).

11. *See, e.g.*, Martin, *City Problems: Varied But All Tough*, Oakland Tribune, February 4, 1968, at 15, col. 1. San Francisco is probably the first California city to devise a specific proposal for a city income tax. Letter from the Office of the Mayor of the San Francisco Board of Supervisors, March 20, 1968 on file with the *California Law Review*. *See also* San Francisco Chronicle, March 21, 1968, at 1, col. 6; text accompanying notes 132-136, *infra*.

12. See note 6 *supra*.

13. U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, THE ROLE OF EQUALIZATION IN FEDERAL GRANTS iii (1964).

14. INTERGOVERNMENTAL COUNCIL ON URBAN GROWTH, *supra* note 1, at 2, 25. As of March 15, 1967, seventy-six federal-state-local revenue sharing bills had been introduced in the first session of the 90th Congress. *Id.* at 26. *See also* FINANCING LOCAL GOVERNMENT IN CALIFORNIA, *supra* note 1, at 91; U.S. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, TAX OVERLAPPING IN THE U.S. 1964, at 231-32 (1964); *see generally* CLAREMONT SOCIAL RESEARCH CENTER, CALIFORNIA LOCAL FINANCE (1959).

is not tapping new revenue sources, but, in large part, merely reallocating the collection process:[15] The taxes would be collected by the federal or state collection machinery instead of directly by the local government, and a portion of the receipts would be returned to the community from which they were extracted. So long as municipalities, however, finance a substantial portion of their services from locally raised revenues, the search for improved methods of collecting such revenue should not be readily abandoned.[16] This Article therefore explores the feasibility of municipal taxes on income in California—their revenue, potential, as well as the possible legal obstacles involved. Since the property tax has historically been the major source of municipal tax revenues in California, an examination of its basic problems is a necessary background against which to view the cities' search for new revenue sources.

I

THE PROPERTY TAX

In recent years there has been much dissatisfaction with California property taxes.[17] Many of the complaints, however, have focused on only one or another aspect of the property tax without examining its whole structure. In addition, it is at times difficult to

15. This should not be confused with redistribution of wealth, whereby tax revenues collected from one economic or geographical area are distributed to another deemed more needy, which is also often accomplished by grants-in-aid and revenue sharing between different governmental levels. See, for example, San Francisco Chronicle, March 9, 1968, at 2, col. 7, concerning an agreement between the State of California and its counties whereby the state would provide counties with property tax relief from income derived from a 1% raise in the state sales tax. Apparently the terms of the agreement had not been worked out. Urban county officials are now asking that the sales tax be returned to the counties where it was paid, a pure reallocation of the collection process. Non-urban counties, on the other hand, are expected to ask that it be returned on some other basis which would give them more of a share, a redistribution of wealth.

16. Besides obtaining better response to fluctuating local needs, dependence on locally raised revenues also has other values. See text accompanying notes 159 to 161 *infra*.

17. For example, in the November, 1968 election, a tax initiative, Proposition 9, was placed before California voters to limit the property tax rate. It sought a ceiling on property taxes of 2% of market value and reduced this ceiling to 1% over a five year period. Under the measure, "people related" services, such as education and welfare, would no longer be financed from property taxes. The measure was being hotly debated and is one of the more controversial issues of recent times. For opposing views see Oakland Tribune, Sept. 1, 1968, at 1-C, col. 6, and at 4-C, col. 1-7. But Proposition 9 is only one manifestation of the controversy over property taxes. During the 1967 Regular Session of the California Legislature, much action was taken or proposed concerning various forms of property tax relief. Included were such things as direct property tax relief to cities and counties, postponement of payment of taxes for certain elderly persons, limitations on the ad valorem taxation of property, and an authorization for relief for fixed-income taxpayers. *Property Taxation*, LEGISLATIVE INDEX OF THE 1967 REGULAR SESSION, FINAL CALENDAR OF LEGISLATIVE BUSINESS, 1382 *et seq.*

determine whether a particular dissatisfaction is justified or whether it is merely a reflection of the perennial complaints of taxpayers about taxes in general. An examination of the property tax in operation will show that a large majority of the complaints do have a substantial basis.

The California constitution provides that: "All property in the State except as otherwise in this Constitution provided, not exempt under the laws of the United States, shall be taxed in proportion to its value . . . ."[18] Of property subject to tax in California, about 84% of gross assessed value is real property[19]—classified as land, together with any permanently attached improvements.[20] Pursuant to a "separation of revenue sources" plan adopted in 1910,[21] the state relinquished to the local governments the general property tax as a source of revenue. In the fiscal year 1963-64, local governments in California received a total of $2,805,152,000 in revenues from the property tax,[22] which was more than the state received from all state taxes combined.[23]

A. Equitable Considerations

Under several different criteria the basic unfairness of the property tax becomes apparent.

Dissatisfaction with the property tax is also evidenced at the local level. For example: The mayor of San Francisco is actively preparing a statewide initiative to allow assessment of residential and business property at different rates, San Francisco Chronicle, March 23, 1968, at 2, col. 1; the Marin County Board of Supervisors have frozen property taxes at their current rates in an effort to obtain legislative relief, San Francisco Chronicle, March 6, 1968, at 4, col. 1; the voters of the Sausalito School District defeated a property tax increase which may result in double sessions in their schools, San Francisco Chronicle, March 7, 1968, at 2, col. 6.

18. CAL. CONST. art. XIII, § 1.

19. CAL. LEGISLATURE, ASSEMBLY INTERIM COMM. ON REV. AND TAX., TAXATION OF PROPERTY IN CAL. 3 (1964) [hereinafter cited as TAXATION]. *See also* CAL. SENATE FACT FINDING COMM. ON REV. AND TAX., PROPERTY TAXES AND OTHER LOCAL REVENUE SOURCES 70 (1965): "Given the present involved structure of levies and exemptions, the property tax is no longer a general tax on wealth; rather it has evolved to become a tax on particular forms of assets, that is, on real property and certain forms of personalty."

20. CAL. REV. & TAX. CODE § 104 (West Supp. 1967).

21. By the turn of the century California had developed from an essentially rural state, to one in which business and industry played a substantial part. Tax inequities of the existing system, in which the general property tax was a basic source of revenue for both state and local governments, prompted the legislature in 1905 to create a Commission on Revenue and Taxation. Its purpose was to investigate the existing system and formulate a plan for reform. A resulting amendment to the California constitution was passed in 1910 to enable, as one of the tax reforms, a separation of revenue sources between the state and local governments. Tax reform measures continued for several years thereafter, including additional amendments to the California constitution. For a concise and informative account of the historical development of the present California tax system, see J. Gould, *The California Tax System. General Historical Background*, 59 WEST'S ANN. CAL. CODES (Rev. & Tax. Code §§ 1-6000) 8-33 (1956).

22. TAXATION, *supra* note 19, at 3.

23. *Id.*

1. Ability to Pay

One criteria for allocating tax burdens is the ability to pay.[24] Taxes are classified as *regressive*, *proportional*, or *progressive*.[25] A regressive tax is one under which the percentage of income paid decreases as income increases. A tax which is proportional to income exacts the same percentage of everyone's income. Under a progressive tax, such as the federal income tax, the percentage paid increases as income rises, so that the increase in the amount of tax paid is more than proportional to the increase in the amount of income. The property tax in California, as in most states, tends to be highly regressive.[26] This means that families with lower than average income pay a higher than average percentage of their total family income for property taxes. The percentage of income which California families in the two lowest income groups, under $2,000 and $2,000-2,999 annually, pay for property taxes is almost twice that of families in the highest income groups of $10,000 and above.[27] Since the expenditure for housing typically does not rise as rapidly as income, the regressiveness of a flat percentage-of-value property tax is inevitable.

2. Benefits Received

The other major criterion for distributing tax burdens is the benefits received.[28] Some have described the relationship between the taxpayer and the government in *quid pro quo* terms.[29] The use of this criterion, however, unrealistically assumes that the principles of voluntary exchange in the market place apply equally to taxation. The ability to pay approach at least recognizes the compulsory nature of taxation.[30] In any case, it is not possible to measure the value to individual taxpayers of all the particular municipal services paid for out of property tax receipts.[31] But it is highly unlikely that low income families, bearing a proportionally heavier burden, receive more or even the same benefits in police protection, street lighting or

24. *See generally* R. MUSGRAVE, THE THEORY OF PUBLIC FINANCE ch. 5 (1959).
25. *See, e.g.*, O. ECKSTEIN, PUBLIC FINANCE 56-57 (1964).
26. TAXATION, *supra* note 19, at 45 (Table xxx).
27. *Id.*
28. *See generally* MUSGRAVE, *supra* note 22, ch. 4.
29. *See* J. S. MILL, PRINCIPLES OF POLITICAL ECONOMY 804 (Ashley ed. 1909).
30. MUSGRAVE, *supra* note 24 at 63.
31. "Even if we were to concede that property alone is the beneficiary of . . . [municipal services paid out of the property tax], the value of individual property would be an exceedingly rough index of benefits among property owners. A valuable fireproof building might depend less on the fire department than would a valueless 'fire trap,' and an idle lot might not receive as much protection from the police department as would a less valuable automobile." H. GROVES, TROUBLE SPOTS IN TAXATION 74 (1948).

sanitation as do high income families. A high percentage of property tax revenues, for example, is expended on education. Hardly anyone would contend that educational facilities in low-income or ghetto neighborhoods are generally superior to those in middle-income neighborhoods. Yet, under the highly regressive nature of the property tax,[32] low income families pay as if that were the case. The general ad valorem property tax based on flat-rate percentages of assessed value, therefore, appears fundamentally inequitable under both the ability-to-pay and the benefits-received analyses.

3. Exemptions

Various kinds of California property are exempt from the property tax.[33] All property tax exemptions involve a shifting of the tax burden to property remaining on the tax rolls and, in general, an increase in administrative costs as refinements are added to the tax structure. The exclusive source of real property exemptions in California is the California constitution.[34] Personal property exemptions are authorized by the state legislature.[35]

A number of policies determine the allocation of property tax exemptions. Government property, for example, is usually exempted to lessen the burden of governmental activity and for administrative

32. It might be said that it is not very helpful to analyze any one particular tax for regressiveness or progressiveness since governmental finances are interrelated and overlap to such an extent today that any meaningful judgment can be made only by examining the total tax burden on various classes of taxpayers. *See generally* U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS; TAX OVERLAPPING IN THE U.S. (1964). However, it would seem that so long as some particular taxes are tied to specific expenditures and services within the taxing jurisdiction, the burdens and benefits of that tax should be equitably distributed independently of any other governmental revenue and expenditure programs. If the only justification for raising property taxes is, for example, that school costs have increased, then it is relevant to ask whether the property owners who will pay the increased tax are the ones who get the benefit of the increased expenditures for education.

33. In addition to the exemption of public property contained in article XIII, section 1 of the California constitution, exemptions exist or are allowable for: Churches, art. XIII, § 1½; veterans' property, art. XIII, §§ 1¼, 1¼a; private colleges, art. XIII, § 1a, including separate provisions in the constitution for certain specific schools, for example, Stanford University, art. IX, § 10; free museums, art. XIII, § 1; free public libraries, art. XIII, § 1; fruit and nut-bearing trees under the age of four years, grape vines under the age of three years, and "immature" forest trees, art. XIII, § 12¾; property of various "welfare" organizations used for religious, hospital or charitable purposes, art. XIII, § 1c, among which are included community centers, youth and children's camps, children's day nurseries, homes for the aged, Y.M.C.A. and Y.W.C.A. facilities, American Legion and other veterans' organizations. TAXATION, *supra* note 19, at 75-76 (Table VIII).

34. "All property in the state except as otherwise in this Constitution provided, not exempt under the laws of the United States, shall be taxed in proportion to its value . . . ." CAL. CONST. art. XIII, § 1.

35. The constitution specifically provides that the state legislature may exempt personal property from taxation. CAL. CONST. art. XIII, § 14.

reasons. Since there is no net revenue gain if a government unit taxes its own property, the administrative costs of assessing and taxing are thereby saved.[36] Special treatment of certain types of property has also occurred to create incentives or to alleviate burdens.[37] Most of the present exemptions, however, are justified by social policy: "If the property is used to provide functions which otherwise might have to be provided by government or used to further some social good, such property may be exempt from the burden of taxation."[38]

There exist at least three basic objections to the use of property tax exemptions to promote social policy. First, once granted, the favored status typically need not be reviewed annually, or even at all. This is in contrast to direct subsidies which require periodic budget appropriations. As a result, an exemption may be retained after justification, if there ever was any, no longer exists. Second, since exemptions do not require appropriations, the total cost of exemptions to taxpayers is seldom known. The California Assembly Interim Committee on Revenue and Taxation concluded that it is "virtually impossible to ascertain the total value of all untaxed property in the state."[39] Finally, if special consideration for certain groups is deemed socially desirable, conditioning such assistance on property ownership is inefficient and irrational. For example, under the constitutional exemption accorded to veterans' homes,[40] the veteran who may most need financial assistance—one who owns no real property at all—gets no help. A veteran who is a property owner, on the other hand, is economically rewarded. Thus an exemption based on property ownership may treat inequitably not only the class of people whom it is intended to reward but also the taxpayer who pays the cost of the

36. Grants of exemptions should be distinguished from sovereign immunity from taxation that is enjoyed by the federal government. McCulloch v. Maryland, 17 U.S. (4 Wheat.) 315 (1819).

37. These sorts of tax favors are usually granted by the local taxing jurisdictions themselves, typically by communities which are trying to attract industry which would provide employment for residents. Often, the tax incentive is granted in a form other than outright exemption. *See, e.g.*, the discussion of tax abatement, classification, and special assessment, Comment, *Toward Optimal Land Use: Property Tax Policy and Land Use Planning*, 55 CALIF. L. REV. 856, 873-80 (1967). See also California Land Conservation Act of 1965, note 53 *infra*, and text accompanying notes 55-56 *infra*.

38. TAXATION, *supra* note 19, at 55. Some of the exemptions are very easily abused. Exemptions from property taxation of homes for the aged presently cover luxury housing projects for elderly residents who are much better off than the average taxpayer who ends up paying for the exemptions. To remedy this situation, the Alameda County Board of Supervisors has sponsored a bill in the state legislature which would eliminate total exemption for such luxury quarters by granting each home an exemption of only $3,500 per resident. Oakland Tribune, April 16, 1968, at 1, col. 1.

39. TAXATION, *supra* note 19, at 57.

40. CAL. CONST. art. XIII, §§ 1¼, 1¼a.

exemption, for, as we have seen, the taxpayer does not know how much he pays,[41] whether the total cost is justifiable, or whether the ultimate recipients are the most deserving.

B. Effect of the Property Tax on Economic Relationships

An ideal revenue tax is one which does not disrupt the economic activity on which it is levied.[42] By this criterion, the property tax fails miserably. As indicated above,[43] the California property tax is essentially a tax on real property. As land is developed, the improvements increase its value and thus the tax burden.[44] As a result, the property tax discourages new construction, remodeling, and replacement,[45] while encouraging slums.[46] It seems that not only the investor,[47] who is expected to have an expertise in economic relationships, but even the average homeowner is aware of, and affected by, this negative aspect of the property tax. A member of the San Francisco Redevelopment Agency has testified that " . . . we discovered that *very often* when homeowners wanted to make repairs that the feeling was a great deal that the best way to have your home reassessed [and the property tax increased] was to take out a [building, remodeling, or repair] permit, *no matter how small.*"[48] Businessmen, likewise, have to decide whether the goodwill created by a new or remodeled building will offset the increased tax cost.

In some California communities, elderly pensioners have been forced to sell their homes and move away because of high property

41. A number of communities are seriously concerned over the amount of property which is removed from their tax rolls by exemptions. San Francisco, San Diego, Los Angeles, Claremont, and Santa Barbara appear to be particularly hard hit by the old age home exemption. TAXATION, *supra* note 19, at 86.

42. Revenue taxation should be distinguished from regulatory taxation, where the express purpose of the tax is to affect the relationships on which it is levied. A prominent example of regulatory taxation is the Harrison Narcotic Act of 1914, INT. REV. CODE OF 1954, §§ 4701-36.

43. Text accompanying note 19 *supra*.

44. The distribution of gross assessed value of property subject to tax in California in 1964 was: Improvements 53.7%; land 30.6%; personal property 15.7%. TAXATION, *supra* note 19, at 3.

45. *See, e.g.*, Gaffney, *Property Taxes and the Frequency of Urban Renewal*, NATIONAL TAX ASS'N, PROCEEDINGS OF THE 57TH ANNUAL CONFERENCE 272 (1964). The following computation illustrates the consequences of an annual property tax in terms of an excise tax levied once on the property at the time of construction. Using a 60 year useful life, an annual payment of $1 for 60 years has a present value, discounted at 5%, of $19, using standard annuity tables. Therefore, a rate of 1%, $1 per $100, is equivalent to an initial lump sum excise of 19%. Similarly, at a 3% rate, the equivalent initial lump sum excise, e.g., sales tax, at the time of construction would be 57% of the market value. *See also* Herzog, *The Property Tax vs. Land Value Tax as a Policy Instrument*, 9 CURRENT MUNICIPAL PROBLEMS 31, at 34 (1967).

46. *See, e.g., Tax Tricks Designed to Do in Slums*, 16 J. HOUSING 232 (1959).

47. *See, e.g.*, Comment, *supra* note 37, at 864.

48. TAXATION, *supra* note 19, at 203 (emphasis added).

taxes.[49] Farmers often find themselves in a similar position. As urban sprawl grows, nearby agricultural land becomes increasingly attractive for subdivision developments. An increase in market value results in a higher assessment and a higher property tax bill.[50] The plight of the Santa Clara County prune industry illustrates this vividly. At a time when the average value of prunes was $468 per acre, the average property tax in one area was $380 per acre, or over 81% of the value of the crop.[51] In such circumstances it soon becomes unprofitable to use the land for agriculture, and the owner is forced to sell the property to subdivision developers. Unfortunately, the total available agricultural land is limited, and much of the urban sprawl in California has affected property most naturally suited for agriculture.[52] The state legislature finally faced up to the problem and passed the California Land Conservation Act in 1965.[53] The Act essentially provides for a "freeze" of the assessed valuation of the land, in return for which the farmer must bind himself to devote the land to agriculture for a minimum of ten years.[54] This is only a piecemeal solution, however, where a comprehensive re-evaluation of the entire property tax system is sorely needed.

Another undesirable feature of the property tax is the creation of artificial barriers or incentives to the location of industry, often without regard to good zoning practices. Most cities compete with each other to attract industry, since capital investment in industrial property increases the city's tax base considerably, and yet does not increase the need for some of the expensive public services, such as schools. The result is often an inequitable distribution of revenue resources among adjoining taxing jurisdictions.[55] The Assembly Interim Committee on Revenue and Taxation has concluded that this

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49. See statement by the Los Angeles County Assessor disclaiming any responsibility for this Comment, *supra* note 37, at 861 n.19. See also the property tax relief sponsored for renters and homeowners who are 65 years of age and older. San Francisco Chronicle, March 30, 1968, at 6, col. 1; and note 17 *supra*.

50. Property is assessed not at its value for the use to which it is actually put, but at its "highest and best use," the use at which it would bring its highest rate of return. The concept of "highest and best use" apparently developed among the assessors without any statutory authorization and has been tentatively approved by the courts. Comment, *Assessment of Farmlands Under the California Land Conservation Act and the "Breathing Space" Amendment*, 55 CALIF. L. REV. 273, 285 & n.58 (1967); Comment *supra* note 37, at 860 n.17.

51. TAXATION, *supra* note 19, at 205.

52. *See, e.g.*, Ciriacy-Wantrup, *The "New" Competition for Land and Some Implications for Public Policy*, 4 NATURAL RESOURCES J. 252 (1964).

53. CAL. GOV'T CODE §§ 51200-95 (West 1966).

54. *See* Comment, *supra* note 50, at 275-80.

55. TAXATION, *supra* note 19, at 23-25.

desire of local governmental units to expand their tax bases also has a significant and undesirable impact on land use:

> "In far too many instances, local communities have granted zoning concessions to industrial or commercial developments or apartment house complexes because of the high assessed value of these improvements compared with the assessed value of existing land uses, irrespective of good planning principles or the needs of the community or region. . . . As an example, many cities and counties in the San Francisco Bay area are anxious to expand into the San Francisco Bay to increase their assessed value subject to property taxation. . . despite the adverse effects of filling tidelands on economic and open-space resource needs of the Bay Region."[56]

A suggestion has been made to reduce such interjurisdictional competitiveness and the consequent inequitable distribution of tax resources by limiting local governments to taxing only residential property, commercial and industrial property would be taxed either on a metropolitan area basis or by the state.[57] Unfortunately, any far-reaching reform of the property tax has little likelihood of ever being effected. As Professor Davisson puts it: "There is widespread agreement as to the shortcomings of the property tax and the need for modifications . . . but the main problem is to overcome the inertia that makes it particularly difficult to reform this tax."[58]

C. Administration of the Property Tax

The property tax differs importantly from other revenue taxes, such as the sales or income tax, in its unresponsiveness to economic growth. As the economy prospers, incomes rise and sales grow. As a result revenues from the sales and income tax increase automatically without any action on the part of the taxing agency. The sales and income taxes similarly keep up with inflation. Administrative action, however, is required to keep the property tax adjusted to both prosperity and inflationary trends. Not only must the assessor make a valuation of the property to be taxed, he must constantly reevaluate to keep the valuation current.

The very basis on which property taxes are levied, *valuation* of property, is so subjective that it is not possible to administer the tax equitably. California courts have reconciled themselves to the inevitability of inequities in the property tax since market values,

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56. *Id.* at 204.

57. *See* M. DAVISSON, FINANCING LOCAL GOV'TS IN THE SAN FRANCISCO BAY AREA 20 (1963).

58. *Id.* at 22.

admittedly, are "to a very large extent a matter of opinion."[59] And therefore, "mistakes or overvaluations honestly made"[60] are not grounds for challenge. Certainly the Internal Revenue Service could not confess error in assessing the amount of income tax levied and still require the taxpayer to pay it on the ground that it was "an honest mistake." Yet, judicial review of property tax assessments is in effect limited to questions of fraud or improper assessment criteria.[61]

The California Attorney General has condemned county assessors and assessment practices on the ground that the administration of assessors' offices lacks adequate safeguards and the assessors' discretion is absolute.[62] "This system not only permits a dictatorial assessor to commit extortion on taxpayers, it also encourages the widespread filing of grossly false returns [by taxpayers]."[63] It may be that reform of county assessor offices is needed.[64] Yet, this will in no way change the fact that valuation of property is and cannot help but be "to a very large extent a matter of opinion."[65]

Periodic appraisals often operate unfairly and cause added taxpayer dissatisfaction. Unfortunately, it is too costly to keep up

59. Eastern-Columbia, Inc. v. County of Los Angeles, 61 Cal. App. 2d 734, 745, 143 P.2d 992, 998 (1943).

60. Hammond Lumber Co. v. County of Los Angeles, 104 Cal. App. 235, 240, 285 P. 896 (1930). *See also* Los Angeles Gas & Elec. Co. v. County of Los Angeles, 162 Cal. 164, 121 P. 384 (1912); Eastern-Columbia, Inc. v. County of Los Angeles, 61 Cal. App. 2d 734, 745, 143 P.2d 992, 998 (1943) (conclusions of assessing officer as to value, when arrived at not pursuant to a system or rule which is discriminatory on its face, are conclusive on courts "however erroneous the conclusions may be"); Birch v. County of Orange, 59 Cal. App. 133, 210 P. 57 (1922).

61. *See, e.g.*, Bank of America v. Mundo, 37 Cal. 2d 1, 229 P.2d 345 (1951); Miller & Lux v. Richardson, 182 Cal. 115, 187 P. 411 (1920); Bank of California v. City & County of San Francisco, 142 Cal. 276, 75 P. 832 (1904); A.F. Gilmore Co. v. County of Los Angeles, 186 Cal. App. 2d 471, 9 Cal. Rptr. 67 (1960); Eastern-Columbia, Inc. v. Los Angeles County, 61 Cal. App. 2d 734, 143 P.2d 992, 998 (1943). For an informative indication of the practices of assessors and the review available by county board of supervisor hearings, as well as the cynical attitude they induce among taxpayers, see letter to the editor, Sacramento Bee, Aug. 5, 1964, § D at 4, col. 1.

62. CAL. ASSEMBLY INTERIM COMM. ON MUNICIPAL AND COUNTY GOV'T. HEARING ON THE OPERATION AND ADMINISTRATION OF COUNTY ASSESSOR'S OFFICES, Oct. 15, 1965, at 38-43 (testimony of Thomas Lynch, Attorney General).

63. *Id.* at 39.

64. The California Attorney General further criticized assessor practices: "First, he is not held to the legal standard of 'full cash value' and his assessed values often bear no relationship to the market value of the property—even when he reveals the ratios that he is using. Second, the Board of Equalization stated that it was not in a position to oversee the activities of the assessor and the law provides no guides or yardsticks that the assessor must follow. Third, since assessor's records are shrouded in secrecy, the citizen cannot find out how his assessment has been determined; also, he is denied access to the assessor's computations on comparable property." *Id.*

65. See note 59 *supra*.

with market trends and reappraise each individual parcel every year. Most California counties reassess on a continuing four to five-year rotation period with a different designated area reassessed each year.[66] Consequently, there is always a four to five year lag between the market and assessed value. This periodic lump sum increase in the property tax, and the possibility that one person's property may be reassessed one year while the property across the street remains at the old assessment for another year or two, makes the property owner acutely aware of the tax burden and resentful of any increase.[67]

Also, in a serious recession, if the taxpayer's income decreases, so will his expenditures, and in turn, his income tax and sales tax burden. On the other hand, even if the market value of his property falls, because of the time lag in reassessments he will still pay the same amount of property taxes from a now reduced income.

Another inequity is the treatment of intangible assets. Since intangible assets are thought easy to conceal, a property tax on them may therefore be too difficult administratively to collect, and as a result intangibles are generally not taxed at all.[68] Consequently, the owner of a home pays property taxes on it, while the owner of stocks and bonds pays no tax on these assets. The reason for other types of inequitable treatment is not entirely clear. At present, a taxpayer with a $20,000 home and a $15,000 mortgage, for example, pays the same amount of property tax as his neighbor who owns his $20,000 home free and clear.[69] Thus the exclusion of certain kinds of property together with periodic subjective valuations inevitably leads to administrative inequities.

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66. TAXATION, *supra* note 19, at 109.

67. This type of rotational reappraisal program was upheld in Lord v. County of Marin, 214 Cal. App. 2d 25, 29 Cal. Rptr. 248 (1963) (summary judgment against taxpayer affirmed). The taxpayer had alleged that it was illegal to add to the assessment roll any of the increased valuations resulting from such reappraisal until the reappraisal had been completed throughout the county.

68. See CAL. CONST. art. XIII, § 14, and its construction by the California supreme court in Roehm v. County of Orange, 32 Cal. 2d 280, 196 P.2d 550 (1948).

69. Other inequities result from inaccurate assessments, and sometimes outright dishonesty or discrimination on the part of assessors. See notes 64-65 *supra*, and 75 *infra*. All county assessors in California are independent public officials elected to office and are usually more able as vote-getters than as appraisers or administrators. One of the provisions of Assembly Bill 80, as introduced on March 1, 1966, in the 1966 First Extraordinary Session of the California Legislature, would have placed the qualifications of county assessors under the control of the State Board of Equalization. *See* A.B. 80, 1966 1st Extraordinary Sess. at 19. This provision, however, did not survive the numerous amendments to which the bill was subjected. Compare the final version passed on June 29, 1966. A similar measure involving assessor qualifications, Senate Bill 66, introduced in the State Senate in the same session on April 4, 1966, was allowed to die on the Senate floor without being brought to a vote, July 7, 1966.

D. Revenue Raising Limitations of the Property Tax

Future projected expenditures by local governments throughout the nation and in California are expected to rise considerably faster than the assessed value of land.[70] If the property tax is to continue providing the major portion of local revenues, property tax rate increases will be required. It therefore becomes necessary to examine two basic limitations, one economic, the other political, on the capacity of the tax to continue raising ever-increasing revenues.

1. Economic Limit

The economic limit is reached when further tax levies severely interfere with the functioning of the economy, impairing its efficiency and incentives.[71] Estimates of the economic limits of a particular tax, either in dollar amount or as a percentage of the available tax base, are difficult to determine, and it is especially hard to evaluate whether at any given moment the limits are being approached. There exist at least three situations in California, however, where the economic limit has already been reached. One is the case of agricultural land which lies near the urban fringe. The property tax in some areas consumed such a large portion of the farming income that it was no longer profitable to continue farming the land. Land value assessments had to be artificially "frozen" to prevent farmers from being taxed out of existence in these areas.[72] The economic limit has also been reached in the case of elderly homeowners, many of whom are living on a fixed income and are therefore unable to meet increases in the property tax burdens. In some areas of the state it has been suggested that elderly homeowners have been forced to sell their homes because of higher property taxes and move elsewhere.[73] In addition to the burden on the elderly taxpayers, their forced departure impairs neighborhood stability and often leads to deterioration of neighborhoods and to slums. When that occurs, property values decline and, as the tax base shrinks, the self-defeating effect of increased rates becomes apparent. The third situation is the tendency of the property tax to discourage rebuilding and remodeling once a slum condition has arisen.[74]

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70. *See* authorities cited note 1 *supra*.

71. *See generally* TAX INSTITUTE, THE LIMITS OF TAXABLE CAPACITY (1953).

72. See notes 51-54 *supra*. Special legislation had to be created to prevent farmers from being taxed out of existence in many urban-fringe agricultural areas throughout the state. Comment, *supra* note 51.

73. See note 49 *supra*.

74. See text accompanying notes 44-48 *supra*.

2. Political Limit

The political limit of a tax is reached when public opposition becomes so great that it is not politically feasible to increase rates. The public opposition may exist for a number of reasons. One obvious relationship is that between the economic burden of a tax and public opposition to it. In addition, if the burden of the tax is discriminatory, if there exist inequities in its application, and if its administration involves irregularities and misconduct by the administrators,[75] the result is public resentment and loss of confidence in the tax.[76] All these considerations are especially important in the case of the property tax because of the high "visibility" of its increasing burdens.[77] Considering all these problems, the numerous relief measures introduced in the state legislature each year and the organization of property taxpayers to *abolish* the property tax entirely are not surprising and indicate that the property tax is reaching its political limit.[78]

E. The Future of the Property Tax

Much of today's personal wealth has no relationship to ownership of property, and specifically of real property, on which the major portion of the property tax burden falls. The property tax arose in an economic and social system which no longer exists, a system in which real property was the major source of wealth and income.[79] As shown by the undesirable features discussed above, the property tax is no longer adequate as a major source of future tax revenues. Unfortunately, we are not writing on a clean slate, and there is no indication that the property tax as an institution will be abolished or even drastically reformed in the near future. Correcting some of the

75. It was hoped that the major assessment scandals which were uncovered in various parts of California in 1965 would have at least induced all other assessors to clean up any irregularities in their counties. Yet over two years later the newspapers carried accounts of another major scandal in Sonoma County. San Francisco Chronicle, Feb. 29, 1968, at 1, col. 7; Oakland Tribune, Feb. 29, 1968, at 15, col. 7.

76. "If [the taxpayer feels that] he is being cheated and the law cannot help him, surely, he might tell himself, he is justified in doing whatever he can [including bribery] to obtain a reduction that is, after all, only fair." Klein & Platt, *Aftermath of Scandal: The Ratio Becomes Rational*, 41 CAL. ST. B.J. 662, 668 (1966).

77. See text accompanying note 67 *supra*.

78. Property tax relief legislation and discontent is discussed at notes 15 and 17 *supra*. For a reference to property tax relief as a "festering sore," see Sigafoos, *The Stake of Business in the Growing Municipal Income Tax Movement*, in TAX INST. OF AM., STATE AND LOCAL TAXES ON BUSINESS 115 (1965). Concerning one organization for the abolition of property taxes in California, see Oakland Tribune, Oct. 22, 1967, § C at 6, col. 4.

79. *See, e.g.*, 1 S. DOWELL, A HISTORY OF TAXATION AND TAXES IN ENGLAND 13 (1965); R. JONES, PEASANT RENTS (1831).

injustices, such as the various exemptions,[80] is perhaps politically unfeasible. Other difficulties, such as the subjective nature of the "valuation" of property on which the tax is levied,[81] are perhaps so inherent in the property tax that they cannot be eliminated.

The simple truth of the matter is that the property tax does bring in substantial revenues, although perhaps only by default. But in view of the inequities and problems inherent in the property tax, municipalities should be encouraged to seek additional means of raising revenue. Indeed, since revenues obtained from the property tax cannot be expected to keep pace with increasing municipal needs, other revenue sources are imperative. If municipal revenue sources other than the property tax are increasingly relied upon, the impact of property tax inequities can at least be attenuated.[82]

Three principal bases exist for municipal taxation: property, income, and spending. Up to now, California municipalities have obtained most of their tax revenues from the first source by way of the property tax, with an increasing load being carried by the local sales tax. Cities in other states, faced with fiscal problems, have turned to a municipal tax on income as one alternative. Interest in such a tax has also recently been shown in California.[83] Indeed, whether any California cities now have authority to levy an income tax[84] is a matter of serious political controversy. The remainder of this Article will therefore examine that question, as well as certain revenue-raising and administrative aspects of such a tax.

II

THE MUNICIPAL INCOME TAX

Whether a California city can impose an income tax depends primarily on the validity and applicability of section 17041.5 of the

80. See text accompanying notes 33-41 *supra*.

81. See text accompanying note 59 *supra*.

82. For example, Philadelphia, which in 1938 was the first city in the United States to impose an income tax, had a property tax rate of $1.70 per $100 of assessed valuation from 1936 to 1956. In 1956 the rate was raised to $2.06 per $100 of assessed valuation. It is estimated that the yield of the income tax could be duplicated by increasing the property tax rate to $3.88 per $100 of assessed valuation, or an increase of 88%. Phillips, *Philadelphia's Income Tax After Twenty Years*, 11 NAT'L TAX J. 241, 250 (1958). Comparing the 1959 per capita property taxes of the 40 United States cities which had a 1950 population of 250,000 or more (excluding Washington, D.C.), the statistics indicate that the average per capita property tax of the seven cities which had an income tax was $35.69. The 33 remaining non-income tax cities had an average per capita property tax of slightly more than double the amount, $71.73. Taylor, *Local Income Taxes After Twenty-One Years*, 15 NAT'L TAX J. 113, 117 (1962). *See also* table, Appendix *infra*.

83. See text accompanying note 132 *infra*.

84. See notes 85, 86 and 100 *infra*.

California Revenue and Taxation Code, which appears to prohibit it. The section reads in relevant part as follows:

> "Notwithstanding any statute, ordinance, regulation, rule or decision to the contrary, no city, county, city and county, governmental subdivision, district, public or quasi-public corporation, municipal corporation, whether incorporated or not or whether chartered or not, shall levy or collect or cause to be levied or collected any tax upon the income, or any part thereof, of any person, resident or nonresident."[85]

Determining the extent to which this section is a valid prohibition upon all California city governments requires an examination of the source of local government power and the ways in which the state legislature can limit that power.

A. Article XIII, Sections 11 and 13 of the California Constitution

A preliminary question involves article XIII, sections 11 and 13 of the California constitution, the former of which provides that:

> "Income taxes may be assessed to and collected from persons, corporations, joint-stock associations, or companies resident or doing business in this State, or any one or more of them, in such cases and amounts, and in such manner, as shall be prescribed by law."

Section 13 provides:

> "The Legislature shall pass all laws necessary to carry out the provisions of this article."

The question is first whether the term "prescribed by law" in section 11 refers only to laws enacted by the state legislature as distinguished from a municipal ordinance or regulation and, if so, whether section 11 was intended to place income taxes exclusively within the jurisdiction of the state legislature.

It has been urged that the term "prescribed by law" in section 11 includes an ordinance passed by a California charter city as well as a

85. This statute was first introduced in the 1963 Regular Session of the California Legislature by then Assemblymen Nicholas C. Petris and Robert W. Crown as Assembly Bill 661. Initially, § 17041.5 was to remain in effect only for two years and was to lapse in 1965. However, the lapse provision was deleted entirely in 1965, and the prohibition is now in effect until repealed. Mr. Richard Carpenter, Executive Dirccor and General Counsel for the California League of Cities, in a telephone conversation with this writer on March 30, 1968, stated that the bill was originally intended to prevent cities from entering the field of income taxation until the state legislature had time to consider a tax reform of the entire area of state and local taxation. He also stated that the proponents of the bill at that time did not think that the prohibition would be upheld against charter cities due to their home rule powers but that it was intended at least to discourage charter cities from seeking to test its validity until a tax reform could be effected.

state statute.[86] Two reasons are given in support of this conclusion. One is the claim that the provisions of section 11 of article XIII are permissive and self-executing and that therefore section 13 of article XIII, which requires that all laws *necessary* to carry out the provisions of article XIII, is inapplicable.[87] The other is that in all other sections of article XIII, where the intent was to grant specific powers to the state legislature, it was so stated in the particular section: Sections 1, 3, 7, 8, and 12 of article XIII contain direct statements that "The Legislature shall . . . ," or "The Legislature may . . . ," exercise a particular power. The absence of such a phrase from section 11 is interpreted to mean that the term "prescribed by law" in section 11 was not intended to be limited to laws enacted by the state legislature.[88] This interpretation, however, ignores the legislative history of section 11.

Sections 11 and 13 of article XIII are both part of the constitution adopted at the California constitutional convention of 1878-79.[89] Section 13 was adopted without debate.[90] There was, however, considerable discussion by the delegates of section 11. In proposing the addition of this section, the delegate who submitted it said: "This proposition . . . provides that *the Legislature* may levy a tax. . . . I do not believe that the gentlemen are afraid to trust *the Legislature* in this matter."[91] Debate on this section continued for almost six days, with speakers constantly referring to it as giving the state Legislature power to establish an income tax.[92] In addition, an address to the people of the state was adopted at the end of the convention to explain how the 1879 constitution differed from the constitution of 1849.[93] Among other things, the address stated that under the 1879 constitution, "The Legislature is empowered to establish an income tax."[94] There is no question that "prescribed by

86. City Attorney of San Francisco, Letter Opinion No. 67-7-A, *Taxation Powers of City and County with Reference to Income Tax, Payroll Tax and Commuter Tax*, March 3, 1967. A letter opinion by the California Legislative Counsel, *Imposition of Income Taxes By Chartered Cities - #25862*, August 21, 1967, apparently assumes that § 11 includes only state statutes. See note 100 *infra*.

87. City Attorney of San Francisco, *supra* note 86, at 3-4.

88. *Id.* at 7.

89. 3 DEBATES AND PROCEEDINGS OF THE CONSTITUTIONAL CONVENTION OF THE STATE OF CALIFORNIA, 1878-79, at 1519 [hereinafter cited as DEBATES].

90. Section 13 was originally introduced as section 18 of the first draft of article XIII. 2 DEBATES 831, 945.

91. Remarks of Mr. Dudley. *Id.* at 945 (emphasis added).

92. See discussion, 2 DEBATES 945-48; also, remarks of Mr. Rolf and Mr. Dudley, 3 DEBATES 1325; Mr. Jones, 3 DEBATES 1325-26; Mr. Hale, 3 DEBATES 1326; Mr. Miller, 3 DEBATES 1470; Mr. Ayers, 3 DEBATES 1471.

93. 3 DEBATES 1521.

94. *Id.* at 1523.

law," in section 11 was intended to refer exclusively to law enacted by the state legislature.[95]

Why section 11 does not, as do other sections of article XIII, state by its own terms that it is granting power to the state legislature rather than some other governmental unit, is readily explained. The original draft of what is now article XIII had been prepared by the convention's Committee on Revenue and Taxation. The draft, as submitted to the convention, contained no provision for the taxation of income.[96] It was only after full debate on the draft had been completed that the predecessor of section 11 was introduced. The section on income taxation was introduced by an individual delegate and apparently had not been prepared by the committee as the other sections had been.[97] This would seem to explain the difference in wording of section 11 and the other sections of article XIII which by their terms state that the legislature shall, or may, exercise a particular power.

However, it seems clear that section 11 was not intended to grant the power to levy an income tax exclusively to the state, thereby prohibiting such power to other governmental units within the state. Some of the delegates to the convention thought that the legislature already had the power to impose an income tax, and that section 11 was therefore superfluous.[98] Others conceded that this might well be true, but that the issue was not entirely clear and putting the provision into the constitution would settle the matter.[99] It thus appears that section 11 of article XIII was intended only as an enabling provision, designed to grant the legislature power to levy an income tax if it didn't already have such power. It was not intended to prohibit such power to other governmental units. There is no indication anywhere in the debates and proceedings of the convention that the delegates ever considered whether municipalities should also have such power, or whether they already did have it. Nor can the terms of section 11 be reasonably interpreted to grant the legislature power to regulate income taxes which might be levied by other governmental units.[100] It is therefore necessary to look elsewhere to determine the powers and limitations of California local governments with respect to an income tax.

95. *See also* Traynor & Keesling, *The Scope and Nature of the California Income Tax*, 24 CALIF. L. REV. 493, 503-07 (1936), where the authors apparently assume that section 11 of article XIII was concerned only with the powers of the legislature.

96. 2 DEBATES 831.

97. *Id.* at 945.

98. *Id.* at 946-47.

99. *Id.*

100. The California Legislative Counsel, *supra* note 86, erroneously concludes that article XIII section 11 is a grant of power to the state legislature not merely to levy an income tax, but also

B. Sources of California Municipal Authority

A California city's self-governing authority depends upon its form of organization.[101] There are three categories of California cities: (1) *General law* cities, those cities which are organized under provisions of state general laws authorizing formation of municipal corporations;[102] (2) *charter* cities, those organized under charters approved by the state legislature;[103] and (3) *special law* cities, those organized under special laws prior to the 1879 California constitution.[104] Most of the special law cities have either reorganized as general law or charter cities, or have ceased to exist.[105] For our purposes, therefore, it is only necessary to consider general law and charter cities.

A city organized under the general laws has only such powers as are expressly granted to it under the constitution or the general laws

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to control all income taxes levied by any governmental entity within the state. He further asserts that in enacting a state income tax and prohibiting local entities from levying one, the legislature has indicated that income taxes are a matter of statewide concern. However, the assertion is not supported by legislative history. The legislature was not even considering local finances at the time it revised the state income tax, CAL. REV. & TAX. CODE §§ 17001 *et seq.* (West 1956), and a statute prohibiting local income taxes was not passed until ten years later. See note 85 *supra*. Moreover, the prohibition was originally intended to be only a temporary one. *Id.* The prohibition of local income taxes could not thus have been intended as part of a unified scheme with the imposition of state income taxes.

101. The most exhaustive examination of California municipal home rule is to be found in the series of articles by Professor Peppin: *Municipal Home Rule in California: I*, 30 CALIF. L. REV. 1 (1941); *Municipal Home Rule in California: II*, 30 CALIF. L. REV. 272 (1942); *Municipal Home Rule in California: III*, 32 CALIF. L. REV. 341 (1944); *Municipal Home Rule in California: IV*, 34 CALIF. L. REV. 644 (1946). The above articles specifically cover article XI, sections 6, 11, 12, 13, and article IV, section 25 of the California constitution. A more recent examination of the area is A. VAN ALSTYNE, BACKGROUND STUDY RELATING TO ARTICLE XI: LOCAL GOVERNMENT (Cal. Const. Revision Comm'n 1966).

102. "[T]he Legislature shall, by general laws, provide for the incorporation, organization, and classification, in proportion to population of cities and towns . . . ." CAL. CONST. art. XI, § 6.

103. "Any city or city and county containing a population of more than 3,500 inhabitants, as ascertained by the last preceding census under the authority of the Congress of the United States or of the Legislature of California, may frame a charter for its own government, consistent with and subject to this Constitution . . . ." CAL. CONST. art. XI, § 8(a).

104. Cities organized under special statutory charters prior to the adoption of the 1879 constitution were continued in existence by the following provision: "Cities and towns heretofore organized or incorporated may become organized under the general laws passed for that purpose, whenever a majority of the electors voting at a general election shall so determine, and shall organize in conformity therewith. . . ." CAL. CONST. art. XI, § 6.

105. A total of 136 special charters had been granted between 1849 and 1879. Peppin, *Municipal Home Rule in California: I*, 30 CALIF. L. REV. 1, 8 (1941), and correction of errata, 30 CALIF. L. REV. 272 (1942). Of the 64 special charters still in effect at the time of the adoption of the 1879 constitution, *id.* at 275, today there exist only two, the charters of the cities of Alviso and Gilroy. VAN ALSTYNE, *supra* note 101, at 200.

of the state.[106] It is subject to control by the general laws enacted by the legislature as to all matters.[107] It seems clear, therefore, that a general law city is effectively prohibited from levying an income tax by Revenue and Taxation Code section 17041.5. The only question that remains is the validity of the prohibition as against a charter city.

C. Home Rule of Charter Cities and "Municipal Affairs"

A charter city has full autonomy over matters which are deemed to be exclusively "municipal affairs." The only restrictions on the extent of this home rule are those which may be found in the California constitution or the city's own charter.[108] Absent constitutional limitations, local laws and regulations involving exclusively municipal affairs prevail in case of conflict with a state statute.[109] As to matters of statewide concern, however, charter cities are fully subject to and controlled by general laws, regardless of the provisions in their charters.[110] As demonstrated above, there is no basis in the California constitution for supposing a reservation to the legislature of the power to impose an income tax. Hence, whether a charter city is subject to the prohibition of Revenue and Taxation Code section 17041.5 immediately resolves itself into a question of whether the levy of an income tax by a charter city is an exclusively municipal affair.

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106. Golden Gate Bridge & Highway Dist. v. Felt, 214 Cal. 308, 5 P.2d 585 (1931); Galt County Water Dist. v. Evans, 10 Cal. App. 2d 116, 51 P.2d 202 (1935); Frisbee v. O'Connor, 119 Cal. App. 601, 7 P.2d 316 (1932).

107. City of San Mateo v. Railroad Comm'n, 9 Cal. 2d 1, 68 P.2d 713 (1937); Styring v. City of Santa Ana, 64 Cal. App. 2d 12, 147 P.2d 689 (1944); City of Mountain View v. Southern Pacific R.R. Co., 1 Cal. App. 2d 317, 36 P.2d 650 (1934).

108. "Cities and towns . . . organized under charters framed and adopted by authority of this Constitution are hereby empowered . . . to make and enforce all laws and regulations in respect to municipal affairs, subject only to the restrictions and limitations provided in their several charters, and in respect to other matters they shall be subject to and controlled by general laws." CAL. CONST. art. XI, § 6. "[Such charter] shall become the organic law of such city or city and county and supersede any existing charter and all laws inconsistent therewith." CAL. CONST. art. XI, § 8(g). "It shall be competent in any charter framed under the authority of this section to provide that the municipality governed thereunder may make and enforce all laws and regulations in respect to municipal affairs, subject only to the restrictions and limitations provided in their several charters and in respect to other matters they shall be subject to general laws." CAL. CONST. art. XI, § 8(j).

109. *Id. See, e.g.*, Raisch v. Myers, 27 Cal. 2d 773, 167 P.2d 198 (1946); City of Pasadena v. Charleville, 215 Cal. 384, 10 P.2d 745 (1932); Cramer v. City of San Diego, 164 Cal. App. 2d 168, 330 P.2d 235 (1958); Wiley v. City of Berkeley, 136 Cal. App. 2d 10, 288 P.2d 123 (1955); Mullins v. Henderson, 75 Cal. App. 2d 117, 170 P.2d 118 (1946).

110. CAL. CONST. art. XI, §§ 6 and 8(j); Mallon v. City of Long Beach, 44 Cal. 2d 199, 282 P.2d 481 (1955); Eastlick v. City of Los Angeles, 29 Cal. 2d 661, 177 P.2d 558 (1947). In addition, if a state law is deemed to affect a municipal affair only incidentally, the state law shall prevail. Wilson v. Walters, 19 Cal. 2d 111, 119 P.2d 340 (1942). See note 102 *supra*.

The term municipal affair does not have a defined or fixed meaning. It refers to matters which are primarily of local, rather than statewide, concern.[111] As conditions in the state change, what was at one time a matter of local concern may later become a matter of general statewide concern controlled by general laws.[112] Nor are the categories of *municipal affair* and *general statewide concern* necessarily mutually exclusive;[113] some aspects of a local problem may become general concerns. Unfortunately, such a situation provides few guidelines, and, as early predicted by the California supreme court,[114] each case must be decided on its own facts. The court must determine in each instance whether the particular governmental power is more appropriately allocated to the local governing body or to the state legislature. For example, it is generally appropriate to leave administrative procedures to local rule.[115] On the other hand, in such cases as the control of public transportation systems operating between cities, statewide uniformity and the danger of discriminatory treatment call for action by the state legislature.[116]

D. Municipal Income Tax: Statewide or Local Concern?

It is settled law that when a municipal corporation is created, its power to tax is necessarily implied as an essential attribute unless

111. *See* Professional Fire Fighters Inc. v. City of Los Angeles, 60 Cal. 2d 276, 384 P.2d 158, 32 Cal. Rptr. 830 (1963); City of Pasadena v. Charleville, 215 Cal. 384, 10 P.2d 745 (1932). *See also In re* Braun, 141 Cal. 204, 217, 74 P. 780, 786 (1903) (dissenting opinion of Beatty, C.J.).

112. Pacific Tel. & Tel. Co. v. City & County of San Francisco, 51 Cal. 2d 766, 336 P.2d 514 (1959); Los Angeles Brewing Co. v. City of Los Angeles, 8 Cal. App. 2d 391, 48 P.2d (1935); Helmer v. Superior Ct., 48 Cal. App. 140, 191 P. 1001 (1920).

113. *In re* Hubbard, 62 Cal. 2d 119, 396 P.2d 809, 41 Cal. Rptr. 393 (1964); City of Pasadena v. Charleville, 215 Cal. 384, 10 P.2d 745 (1932).

114. *In re* Braun, 141 Cal. 204, 214, 74 P. 780, 784 (1903) (concurring opinion of McFarland, J.).

115. *See, e.g.*, Butterworth v. Boyd, 12 Cal. 2d 140, 82 P.2d 434 (1938) (establishment of a health service system for city employees); Adler v. City of Culver City, 184 Cal. App. 2d 763, 7 Cal. Rptr. 805 (1960) (the manner of enacting city ordinances); Dynamic Industries Co. v. City of Long Beach, 159 Cal. App. 2d 294, 323 P.2d 768 (1958) (the requisite procedures for making a binding contract with the city); Dairy Belle Farms v. Brock, 97 Cal. App. 2d 146, 217 P.2d 704 (1950) (the manner of purchasing necessary materials and supplies); Cunningham v. Hart, 80 Cal. App. 2d 902, 183 P.2d 75 (1947) (procedures for administering the personnel affairs of the city). *But see* Professional Fire Fighters, Inc. v. City of Los Angeles, 60 Cal. 2d 276, 384 P.2d 158, 32 Cal. Rptr. 830 (1963) (right of city employees to join labor organization held a matter of statewide concern).

116. *See, e.g.*, Pipoly v. Benson, 20 Cal. 2d 366, 125 P.2d 482 (1942) (regulation of street traffic passing through city streets); Bay Cities Transit Co. v. City of Los Angeles, 16 Cal. 2d 772, 108 P.2d 435 (1940) (control of public transportation systems operating between cities); Young v. Superior Court, 216 Cal. 512, 15 P.2d 163 (1932) (development of a public improvement project which extends beyond city limits); Wilson v. City of San Bernardino, 186 Cal. App. 2d 603, 9 Cal. Rptr. 431 (1961) (highway development); County of San Mateo v. City

expressly prohibited.[117] The reason is that a municipal corporation is authorized to exercise various powers and to provide for governmental services at the local level, and a municipality cannot accomplish these purposes without the power to raise money.

> "[Authorization of municipal works and services] without providing the means . . . would be an idle and futile proceeding. Their authorization, therefore, implies and carries with it the power to adopt the ordinary means employed by such bodies to raise funds for their execution, unless such funds are otherwise provided. And the ordinary means in such cases is taxation. A municipality without the power of taxation would be a body without life, incapable of acting, and serving no useful purpose."[118]

Given the essentiality of the power of taxation to municipal existence and the self-government of California charter cities under the California constitution, it seems clear that any revenue taxation by a charter city should be a municipal affair free from state legislative interference, *unless* such taxation substantially affects those residents outside the city boundaries in such a way as to require state legislation.

The California supreme court has at least twice held that taxation by a charter city for raising revenue is an exclusively municipal affair and is not governed by a conflicting general law of the state.[119] A municipal income tax would undoubtedly fall into the

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Council of Palo Alto, 168 Cal. App. 2d 220, 335 P.2d 1013 (1959) (procedures for annexation of territory outside of city boundaries); Cralle v. City of Eureka, 136 Cal. App. 2d 808, 289 P.2d 509 (1955) (recording of documents); *In re* Shaw, 32 Cal. App. 2d 84, 89 P.2d 161 (1939) (administration of the judicial system and definition of the jurisdiction of the courts).

117. United States v. New Orleans, 98 U.S. 381 (1878), *cited with approval* by the California supreme court in *In re* Braun, 141 Cal. 204, 209-10, 74 P. 780, 782 (1903) and Ainsworth v. Bryant, 34 Cal. 2d 465, 469, 211 P.2d 564, 566 (1949). *See also*, Quincy v. Jackson, 113 U.S. 332 (1884); Ralls County Ct. v. United States, 105 U.S. 733 (1881).

118 United States v. New Orleans, 98 U.S. 381, 393 (1878).

119. *In re* Braun, 141 Cal. 204, 74 P. 780 (1903). A section of the former California Political Code prohibited cities from imposing a license tax for revenue. A charter city enacted an ordinance imposing such an occupation license tax. The court upheld the city ordinance, specifically distinguishing two earlier cases involving the same section of the Political Code and the same issue, on the ground that those cases, City of Sonora v. Curtin, 137 Cal. 583, 70 P. 674 (1902) and Town of Santa Monica v. Guidinger, 137 Cal. 658, 70 P. 732 (1902), involved general law cities. *Accord. Ex parte* Helm, 143 Cal. 553, 77 P. 453 (1904). There are statements found in numerous later cases that revenue taxation is a "municipal affair" which would prevail in case of a conflict with general laws. However, none of the cases appear to have actually involved a direct conflict with general laws. In most of them the issue was whether the matter was within a city's power to act at all, even without any prohibition by general laws. *See, e.g.*, City of Glendale v. Trondson, 48 Cal. 2d 93, 308 P.2d 1 (1957); City of Grass Valley v. Walkinshaw, 34 Cal. 2d 595, 212 P.2d 894 (1949); Ainsworth v. Bryant, 34 Cal. 2d 465, 211 P.2d 564 (1949); West Coast Advertising Co. v. City & County of San Francisco, 14 Cal. 2d 516, 95 P.2d 138 (1939); *Ex parte* Nowak, 184 Cal. 701, 195 P. 402 (1921); *Ex parte* Jackson, 143 Cal. 564, 77 P. 457 (1904).

category of revenue taxation rather than regulatory taxation. Two further things, however, must be noted. In each case the issue before the court involved an occupational license tax. Therefore, with respect to a tax other than a license tax, unless substantially identical considerations exist, the statement that a revenue tax is an exclusively municipal affair is mere dicta. In addition, as has been earlier noted,[120] matters which at one time were exclusively municipal affairs can later become statewide concerns as conditions in the state change. It is therefore necessary to examine whether today an income tax is a matter better handled solely on a statewide basis, or whether it can also be permitted as a revenue source for municipalities. The answer depends upon how a municipal income tax would function if one were enacted.

1. Intercity Aspects of a Municipal Income Tax

If a municipal income tax were levied only on residents of the city involved, there does not appear to be any reason why it should not be treated as a matter of purely local concern.[121] A question arises only when a city wishes to reach nonresidents—typically, commuters who are employed in the city.[122] Since nonresident commuters do constitute an added burden on municipal resources, it is certainly a matter of local concern that they pay for the municipal benefits that they receive. On the other hand, a municipality empowered to tax nonresidents might choose to discriminate unfairly against such taxpayers. The creation of economic barriers to intercity commerce is clearly a matter of statewide concern. Thus the same basic policy considerations which apply in the case of state taxation of interstate commerce apply equally to municipal taxation of intercity commerce.[123] Interstate tax burdens have been policed primarily under the commerce clause of the United States Constitution, with

120. See text accompanying note 113 *supra*.

121. See text accompanying notes 115 and 117 *supra*.

122. This desire to reach nonresidents, however, who in many metropolitan cities greatly increase the population of the city during daylight working hours and require a large increase in the amount and kind of municipal services to accommodate them, is usually one of the motivating forces for a city to adopt an income tax. See, for example, the San Francisco mayor's statement accompanying his proposal for a payroll tax on commuters: "The revenues the commuters bring into the city do not begin to match the cost to the city for added traffic policemen, parking complexes, transportation services, all the myriad other daily services presently paid for exclusively by San Franciscans." San Francisco Chronicle, March 21, 1968, at 28, col. 8 (final home edition).

123. *See, e.g.*, Sato, *Municipal Occupation Taxes in California: The Authority to Levy Taxes and the Burden on Intrastate Commerce*, 53 CALIF. L. REV. 801 (1965). "If fifty independent economic enclaves within the United States are undesirable, 387 economic enclaves within California would be intolerable." *Id.* at 818.

occasional reference to the due process and equal protection clauses of the fourteenth amendment.[124] Although the California constitution does not have a provision comparable to the federal commerce clause, the California courts have not refrained from policing burdens on intercity commerce, generally employing the concept of discrimination to invalidate taxation in this area.[125] The cases do not always state the constitutional or statutory basis for their decisions. Very often, however, it is discernible that the California courts have applied principles developed by the United States Supreme Court for analogous situations in interstate commerce.[126]

In determining the extent to which a charter city could tax the income of nonresidents as an exclusively municipal affair, some guidance may be obtained by examining the occupational license taxes already being imposed. The analogy is natural since an income tax may be viewed as one type of occupation tax.[127] The similarity between the two becomes even more apparent if the occupation license tax is based on net income, as is the case in at least one California city.[128] California cities also base their occupation license taxes on gross receipts or on the average number of employees.[129] Less than one third of the 287 California cities surveyed by the League of California Cities imposes a flat-fee occupation license tax.[130]

It is clear that a person or business entity is subject to a city occupational license tax whether or not such person or entity is a

124. *See, e.g.*, Braniff Airways v. Nebraska Bd. of Equalization, 347 U.S. 590 (1954); Ott v. Mississippi Valley Barge Line Co., 336 U.S. 164 (1949); McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944) (local sales tax on goods in interstate commerce invalidated under the commerce clause); Stafford v. Wallace, 258 U.S. 495 (1922) (federal regulation of stockyard rates and charges upheld under the commerce clause).

125. *See* Sato, *supra* note 123, at 820-21, for a full discussion of this and other grounds sometimes used by the California courts in this area.

126. *Compare, e.g.*, the court's focus on "taxable local event," in Security Truck Line v. City of Monterey, 117 Cal. App. 2d 441, 256 P.2d 366 (1953), *rehearing denied*, 117 Cal. App. 2d 455, 257 P.2d 755 (1953) *with* the decision in McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944). *See also* cases cited in Sato, *supra* note 123, at 820-21, for the California court references to such concepts as "privileges and immunities" and "equal protection" without specifically citing any constitutional or statutory bases.

127. While occupational license taxes reach only specific occupations and businesses, an income tax may reach all occupations, as in the case of a federal income tax, or it also may reach only specific occupations, as, for example, a payroll tax which only reaches the "occupation" of "employee." Just as a businessman or tradesman who comes into a city to practice his calling must pay an occupational license tax, so also, under an income tax, a wage earner who comes into a city to earn his living pays a tax on that income.

128. FINANCING LOCAL GOVERNMENT IN CALIFORNIA, *supra* note 1, at 44-45.

129. *Id.*

130. *Id.*

resident of the city.[131] The incident to which the tax attaches is the practice of the particular occupation or business within the city and is in no way related to residence. Similarly, a city should be able to tax the income earned by nonresidents within the city as well as that of residents. The incident to which the tax attaches here, the earning of income, is again unrelated to residence.

The more important, and very topical, question is the extent to which a municipality can discriminate between residents and nonresidents in imposing an income tax or any other tax. The City and County of San Francisco recently enacted an ordinance imposing a license tax measured by gross income on all nonresidents employed in San Francisco.[132] Residents are not similarly taxed. San Francisco enacted the tax pursuant to a specific finding that nonresident commuters in the past did not pay "an equitable" share of the costs of the municipal services they enjoy in San Francisco.[133] By designating the tax as an occupational licensing tax San Franciso perhaps sought to avoid the prohibition of Revenue and Taxation Code section 17041.5.[134] State legislators who represent adjoining cities responded quickly to the threat of San Francisco's commuter tax. The state legislature enacted Assembly Bill 1239, which prohibited any local legislative body from imposing a tax measured by the earnings of an employee who is a nonresident of the taxing jurisdiction, unless the same tax, with identical credits and deductions, is also imposed on the earnings of all employees who are residents of

131. This issue apparently has never even been raised. Occupational liccnses taxes imposed on nonresidents have been invalidated only where they unreasonably discriminated against nonresidents, never if they applied to resident and nonresident alike.

132. For the full text of the ordinance, which imposes a 1% tax on the gross income of all nonresident commuters employed in San Francisco as well as a statement of legislative findings on which the ordinance is based, see San Francisco Examiner, Aug. 17, 1968, at 2, col. 1.

133. *Id.* While this Article was being prepared, San Francisco's adjoining counties, Alamcda, Contra Costa, Marin, San Mateo and Santa Clara, filed suit in the Superior Court of Sonoma County, California, challenging the validity of San Francisco's newly adopted commuter tax. On November 8, 1968, the trial court, as reported in the news media, ruled against San Francisco on the following grounds: (1) Since the tax was levied only against nonresident commuters, it was unconstitutional discrimination; (2) the state of California has pre-empted that particular area of taxation; and (3) a commuter tax "would transcend the municipal affairs of San Francisco and is a matter of State-wide concern." San Francisco Chronicle, Nov. 9, 1968, at p. 1, col. 1. The judge noted, however, that he was not ruling on "whether or not if this tax were imposed upon all employed persons within the city, it would constitute a license tax or an income tax." *Id.* The mayor of San Francisco, in a press conference the following day stated: "Regardless of the means and methods we have to use, we are not going to stand for San Francisco providing $30 million worth of services to people who don't pay for it. In one form or another we are going to bring relief to the homeowner." *Id.* At this printing, the trial court's decision is being appealed by San Francisco.

134. The second paragraph of § 17041.5 provides that "This section shall not be construed so as to prohibit the levy or collection of any otherwise authorized license tax upon a business measured by or according to gross receipts."

the taxing jurisdiction.[135] Whether the state prohibition or the San Francisco tax will prevail depends on whether a charter city can validly discriminate between residents and nonresidents in levying a tax. As indicated earlier,[136] the California supreme court has in the past held that an occupational licensing tax for revenue purposes is an exclusively municipal affair and is not governed by a conflicting general law of the state.

A series of early California cases invalidated municipal occupation and license taxes which discriminated between those whose place of business was within the city and those whose business was located outside the city.[137] Later, California cases, however, appear to have abandoned that doctrine. Present law seems to be that such discrimination, when passed solely for revenue purposes and not as a protective tariff against outside businesses, is valid if it is not arbitrary or unreasonable.[138] For example, a municipal license tax has been upheld on the sale of bakery products, the amount of the tax being $150 if the bakery whose goods were being sold was not on the city tax rolls and only $50 if it was.[139] The classification was justified on the ground that local bakeries contributed additionally to city revenues by paying property taxes.

A wage earner who resides within the city where he is employed contributes no less to city revenues by paying property taxes on his residence[140] than the bakery whose property is also on the city tax rolls. It would seem therefore that a city income tax, as well as an occupational license tax, can discriminate between residents and nonresidents to take account of other taxes paid by residents. It follows, also, that there should be no objection regardless of which of the three ways the city income tax differentiates between residents and nonresidents: Taxing only nonresidents, taxing nonresidents at a higher rate than residents, or taxing both residents and nonresidents at

135. Assembly Bill 1239, signed into law by the Governor of California on July 15, 1968, implements the prohibition by adding § 50026 to the California Government Code and amending § 224 of the California Labor Code.

136. See text accompanying note 117 *supra*.

137. *In re* Frank, 52 Cal. 606 (1878); Buenaman v. City of Santa Barbara, 8 Cal. 2d 405, 65 P.2d 884 (1937) and cases cited *id.* at 408-10, 65 P.2d at 886-87. *See also* Sato, *supra* note 123, at 823-828.

138. For an analysis of the California case law development in this area see Sato, *supra* note 123, at 823-28.

139. Continental Baking Co. v. City of Escondido, 21 Cal. App. 2d 388, 69 P.2d 181 (1937). *See* Silvertsen v. City of Menlo Park, 17 Cal. 2d 197, 109 P.2d 928 (1941) (sustaining a discriminatory license tax on nonresident businesses on the ground that the difference between the tax on the residents and nonresidents was not excessive.)

140. To the extent that a city resident does not own his own home but rents an apartment, the amount of property tax that the owner of the building pays will be reflected in his rent.

the same rate but allowing a deduction from the resident's income tax for other taxes paid to the city. The following example illustrates how all three methods reach the same result.

Suppose that a city determines that to provide the same services for a nonresident that it provides for residents costs an additional $120 for each nonresident involved. This additional cost is the amount of discrimination allowable between the nonresident and the resident because the nonresident has not contributed to the basic governmental costs that are paid for out of the property tax.[141] Whether the city taxes only nonresidents with a tax of $120, or taxes both residents and nonresidents but at different rates so that the resident pays $x while the nonresident pays $(x + 120), the difference between the two classes of taxpayers is the same. Similarly, the discrimination is no different if the rate of tax on each, resident and nonresident, is the same but the former is given a $120 credit for the property taxes which he pays.[142] Which of the three methods is used in any city will be determined by administrative and political considerations.[143] But in no case would the discrimination between residents and nonresidents, if based on fair estimates of the additional cost, seem to impose a barrier to intercity commerce which would necessitate statewide regulation.

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141. As a practical matter, the determination of this difference in the cost of providing a service to a nonresident as compared to a resident may be quite difficult in some cases. In San Francisco, for example, there was sharp contrast between the figure arrived at by the city controller and the calculation of the mayor. In arriving at a proposed commuter tax rate of 1%, San Francisco's mayor estimated that $33 million of the annual cost of city government is allocable to commuters. The city controller's studies, on the other hand, indicated a sum of only $4.3 million. San Francisco Examiner, April 12, 1968, at 1, col. 5. However, it appears that under the discrimination criteria employed by the California courts in the occupational license tax cases, a very accurate finding is not necessary. The courts up to now have generally been content to uphold license taxes which imposed heavier rates on nonresidents so long as the burden was "not excessive" and not "disproportionate." See authorities cited in notes 138-39 *supra*. For what constitutes reasonable grounds for classification under the U.S. Constitution, see note 143 *infra*.

142. Considering, again, the city resident who rents rather than owns his residence in the city, the credit can be given to him directly on the basis of city residence rather than property ownership. This would be in recognition of the fact that part of his rent payments go to the city through property taxes assessed on the building in which he resides. The credit, on the other hand, may be given directly to the owner of the apartment building based on some relationship, for example, to the number of apartments in the building. Under this second method, it is assumed that this reduction in the operating expenses of the building would be reflected in lower rent payments by the residents of the building, and the ultimate result would be the same.

143. This Article discusses only the California state law questions of the legality of a municipal income tax. It does not appear that any federal Constitutional problems would be encountered by such a tax. In most California cities, out-of-state commuters probably constitute a very minimal fraction of the total city work force. Any potential commerce clause problems can therefore be avoided by merely exempting out-of-staters from the application of the tax. This would eliminate any possible necessity to apportion the tax and apply it only to such

2. Administration

Some allocation or apportionment of the income tax will be required between adjoining taxing jurisdictions. The obvious example of this is a nonresident who performs his income-producing activity partly inside and partly outside the taxing jurisdiction. A typical situation with occupational licensing taxes is the delivery man whose route includes several municipalities.[144] The rule in such cases is that the measure of a license tax can only be based on taxable events occurring within the taxing jurisdiction.[145] However, it is sufficient if the measure of the tax is based on an average rather than on the actual number of events occurring within the taxing jurisdiction.[146]

Allocating the income-performing activities of a nonresident for the purpose of levying a municipal income tax creates exactly the same problem. The criteria used may be average mileage in the case of a delivery man, average amount of time spent within the taxing jurisdiction, or average number of taxable events.[147]

A related problem is the distribution of revenues between a taxpayer's city of employment and city of residence where the two are not the same. Each can reasonably claim the right to tax his

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activities as are carried on in the state. *See* General Motors Corp. v. Washington, 377 U.S. 436, 449-62 (1964) (dissenting opinions of Brennan and Goldberg, J.J.).

The only other potential problem under the Constitution might be raised in case of a tax which is levied only on one type of income, for example, a tax levied only on wages and salaries and not on net profits of self-employed businessmen or professionals, or where a tax differentiates between residents and nonresidents, as, for example, a tax solely on commuters. However, the U.S. Supreme Court has already specifically held that a municipal income tax which differentiated between wages and salaries on the one hand, and net profits on the other, did not violate either due process or equal protection. Walters v. City of St. Louis, 347 U.S. 231 (1954). Differences in treatment of residents and nonresidents would also undoubtedly withstand both a due process and an equal protection attack. *See, e.g.*, Ferguson v. Skrupa, 372 U.S. 726 (1963); Williamson v. Lee Optical, Inc., 348 U.S. 483 (1955); Railway Express Agency v. New York, 336 U.S. 106 (1949).

144. *E.g.*, Bueneman v. City of Santa Barbara, 8 Cal. 2d 405, 65 P.2d 884 (1937); Security Truck Line v. City of Monterey, 117 Cal. App. 2d 441, 257 P.2d 755 (1953); Ferran v. City of Palo Alto, 50 Cal. App. 2d 374, 122 P.2d 965 (1942); Continental Baking Co. v. City of Escondido, 21 Cal. App. 2d 388, 69 P.2d 181 (1937).

145. *See* Sato, *supra* note 123, at 833-37.

146. Arnke v. City of Berkeley, 185 Cal. App. 2d 842, 8 Cal. Rptr. 645 (1960) (taxes based on average number of employees working within the city sustained).

147. It seems that the individual cities have considerable leeway regarding the criteria they choose to adopt in apportioning taxes. In *Ex parte* Sisto Li Protti, 68 Cal. 635, 10 P. 113 (1886). (occupational license tax), the court said: "Whether the number of persons employed in the various laundries of the city is the basis by which can best be gauged the amount of business done therein, or not, it is *one* way of doing so, and, for aught we know, the safest way. The city council cannot count the various articles of wearing apparel laundried by the various laundries." *Id.* at 636, 10 P. at 113. For the purpose of the New York City earnings tax on nonresidents, it is provided that: "If net earnings from self-employment are derived from services performed, or from sources, within and without the city, there shall be allocated to the city a fair and equitable

income.[148] Since the incident to which the tax attaches is different in each case—earning of income in one, and residence in the other—it would appear that each city could levy its income tax without regard to any requirements of apportionment. This may result, however, in heavier total income tax burdens on those who earn their income outside their city of residence than on persons who are employed in the same taxing jurisdiction in which they reside. Some state legislatures, recognizing this problem, have provided for a maximum total income tax which may be levied on any person's income, with some method of allocating it between the interested jurisdictions.[149] Some adjoining cities in other states have also worked out arrangements to this effect without any legislative coercion by the state.[150] That such apportionment may eventually be a matter for statewide regulation does not mean that other aspects of the

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portion of such earnings." N.Y. GEN. CITY LAW, § 25-m(4)(a) (McKinney 1967). OHIO REV. CODE ANN. § 718.02(a) (Page Supp. 1966) provides in part: "In the taxation of income which is subject to municipal income taxes, if the books and records of a taxpayer conducting a business or profession both within and without the boundaries of a municipal corporation shall disclose with reasonable accuracy what portion of its net profit is attributable to that part of the business or profession conducted within the boundaries of the municipal corporation, then only such portion shall be considered as having a taxable situs in such municipal corporation for purposes of municipal income taxation." In the absence of such records, three techniques are authorized by which to make the allocation: (1) Allocate on the basis of the proportionate amount of the total real and tangible personal property of the business used or located within the municipality; (2) The proportionate amount of total wages, salaries or compensation paid to employees within the municipality; or (3) The proportionate amount of total gross receipts attributable to sales made or services performed within the municipality. *Id.*

148. Within the constitutional limits of due process and equal protection, a city can impose such taxes on its residents as it deems necessary. See text accompanying notes 117 and 119 *supra*. On the other hand, the city of employment can tax all income earned within its boundaries, including that earned by nonresidents. Text accompanying note 131 *supra*.

149. KY. REV. STAT. § 91.200 (1967) authorizes cities to levy an income tax only on income earned within the city and specifies the maximum rate of tax. MD. ANN. CODE art. 81 § 323 (Supp. 1967) provides that counties and the City of Baltimore may levy an income tax only on its residents and specifies the maximum rate. MICH. COMP. LAWS ANN. § 141.651 (West 1957) authorizes cities to levy an income tax both on residents and nonresidents and specifies the maximum tax rates that may be levied on each, providing, in addition, that credit shall be given against taxes paid to another municipality. *Id.* at § 141.665. OHIO REV. CODE ANN. § 718.01 (Page Supp. 1966) specifies the maximum municipal income tax rate which may be levied. A provision for requiring tax credits between municipalities was rejected. *See* Glander, *The Uniform Municipal Income Tax Act*, 18 OHIO ST. L.J. 489, 498 n.33 (1957). The New York legislation authorizing New York City to levy an income tax specifies the exact rates to be used in taxing residents and nonresidents. N.Y. GEN. CITY LAW §§ 25-a(3), 25-m(2) (McKinney 1967).

150. In the case of a person working in one city and residing in another, Toledo, Ohio, splits the tax revenues with its neighboring cities on a 50-50 basis. Bronder, *Michigan's First Local Income Tax*, 15 NAT'L TAX J. 423, 426 (1962). Before the "City Income Tax Act" was passed in Michigan, note 149 *supra*, Detroit allowed its residents tax credit for taxes paid to other municipalities. Bronder, *supra* at 426 n.5.

municipal income tax do not remain municipal affairs within the power of California charter cities.

Most present local income taxes in other states are usually flat-rate taxes on earned income with few, if any, exemptions or deductions.[151] A municipally administered income tax cannot have a very refined and complex tax structure except in large cities with adequate administrative resources. The basic objection to a flat-rate tax levied only on earned income is its regressiveness since the exemption of unearned income, such as investments, generally benefits the higher income taxpayer. It should be noted that even though this regressive aspect exists, because of the low rates[152] of most municipal income taxes, the dollar amounts of the burdens involved are very small. To alleviate some of the administrative problems while enabling a more refined tax structure, however, smaller municipalities may be able to contract with a central agency to administer the income tax for them, as California cities today contract with counties for various municipal services.[153] Another possible alternative for reducing both compliance costs for the individual taxpayer and the administrative burdens of the taxing jurisdiction is to correlate the local income tax with either the state or federal income tax.[154]

The foregoing analysis indicates that the administrative and intercity problems which would confront California municipalities imposing local income taxes on residents and nonresidents alike are

151. This is sometimes referred to as a "Philadelphia-type" city income tax. R. SIGAFOOS, THE MUNICIPAL INCOME TAX: ITS HISTORY AND PROBLEMS 13 (1955). Philadelphia passed the first United States city income tax in 1939. It was a combination gross income tax on individuals and net profits tax on businesses and professions and has served as a model for income taxes in many other cities. *Id.* at 12-14. It is a tax which is easy to establish, relatively simple to administer, spreads the burden over a broad tax base, and has a proven record of a substantial yield even at very low rates. *Id.* at 130. *See also* Phillips, *Philadelphia's Income Tax After Twenty Years*, 11 NAT'L TAX J. 241 (1958), and Appendix *infra*. New York City has deviated the most from this relatively simple form of city income tax. *See* N.Y. GEN. CITY LAW, art. 2-D and 2-E (McKinney 1967). However, with its graduated rates, exemptions, deductions and different rates for residents and commuters, it is proving very costly to administer. In 1967 the mayor of New York City obtained legislative permission to excuse all commuters and residents with incomes under $8,000 from filing a return, although these taxpayers remain liable for the tax which has already been withheld by the employer. It is estimated that this move will reduce administrative costs by from $7 million to $3.5 million. Walker, *The Inevitability of City Income Taxes*, 45 TAX DIG. No. 2, at 8, 10 (1967).

152. *See, e.g.*, Appendix *infra*.

153. CAL. GOV'T CODE §§ 51300-51562 (West 1966). Maryland has provided that the state controller shall collect all income taxes imposed by Maryland municipalities. MD. ANN. CODE art. 81, § 323 (Supp. 1967).

154. The present California individual income tax return already corresponds very closely to the federal individual income tax return. *Compare* IRS Form 1040 *with* California Form 540. Levying the local income tax, for example, on the net taxable income as determined for either the federal or state income tax can take advantage of the respective exemption and deduction

generally no different from those associated with municipal occupational licensing taxes. The municipal income tax should, therefore, be no less an exclusively municipal affair for charter cities than is the occupational licensing tax.[155] Indeed, in view of the increasing inadequacy of the property tax, the California legislature might even consider extending to general law cities the power to levy a tax on income. It is true that some small general law cities may not be able to administer an income tax as efficiently as larger ones. However, the size of the taxing jurisdiction need not necessarily determine either efficiency in administration or effectiveness in collection. This is especially true if a jurisdiction adopts employer withholding as part of its tax. Then the presence of a dominant industry or several large employers to perform withholding functions, as well as the portion of the jurisdiction's labor force employed within the jurisdiction are important.

CONCLUSION

This Article has attempted to show that there has been sufficient experience with the municipal income tax in other states over the past thirty years to indicate that it is not only fairly easy to administer, but also is capable of raising substantial revenues.[156] On the other hand, the diagnosis and prognosis for the property tax, the traditional source of municipal revenues, is that it is inadequate to meet increasing future needs.[157] If viable municipal government is to be maintained, cities must have adequate revenue sources. The continuing importance of home rule at the local level should not be underestimated. It is certainly true that the shift in government powers and functions has been, and probably will continue to be, from smaller to larger units, from local to state and federal. In our present densely populated, highly urbanized and mobile society some problems are best handled on a large scale. But many of the social ills in our society are attributable to the depersonalizing effects of "big" cities, "big" businesses, and "big" government. Civic leaders, realizing that it is difficult for people to identify with a government whose leaders can only be seen on television or read about in the newspapers, now stress the importance of "grass roots" contacts and neighborhood organization.[158] The social values of local government

systems without taking on the burden of administration. For a number of other ways in which the local income tax can be correlated with either federal or state returns see R. SIGAFOOS, *supra* note 151, at 130-33 (1955).

155. See note 119 *supra*.

156. See text and authorities cited in part II of this Article and Appendix.

157. See text and authorities cited in part I of this Article.

158. What Alexander Hamilton said almost two hundred years ago is still valid: "It is a known fact in human nature, that its affections are commonly weak in proportion to the

are not the only ones. A locally levied tax may also induce more careful spending since the same officials who administer programs must then also raise the revenues.

In California there are additional considerations. The population distribution within the state[159] indicates that for many years to come, southern California will probably have the dominant voice in the state legislature.[160] Home rule of charter cities can perhaps provide a counterbalance for those parts of the state with the minority of population by allowing more responsiveness to local needs in matters which are not of statewide importance.

It is also important to note that if, after a few years of locally administered income taxes, it appears that some statewide uniformity is desired, the state legislature can still act even if the municipal income tax is considered an exclusively municipal affair for charter cities. Certain aspects of the tax, such as revenue allocations between adjacent taxing jurisdictions, can still be considered matters of statewide concern and subject to regulation by state general laws. Moreover, the state legislature can always make available a voluntary

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distance or diffusiveness of the object. Upon the same principle that a man is more attached to his family than to his neighborhood, to his neighborhood than to the community at large, the people of each State would be apt to feel a stronger bias towards their local governments . . . ." A. HAMILTON, THE FEDERALIST No. 17.

159. CALIFORNIA STATISTICAL ABSTRACT (1966). Seven southern California counties, Los Angeles, Orange, San Bernardino, San Diego, Santa Barbara, Riverside, and Ventura, with only ¼ of the total land area of the state, *id.* at 1 (Table A-2), in 1966 had almost ½ of the state's total population. *Id.* at 12 (Table B-7).

160. In 1965, the California supreme court ordered the state legislature reapportioned on the basis of population. Silver v. Brown, 63 Cal. 2d 270, 46 Cal. Rptr. 308, 405 P.2d 132 (1965); *mandamus proceedings*, 63 Cal. 2d 841, 48 Cal. Rptr. 609, 409 P.2d 689 (1966). The following illustrates the possible dangers of legislative interference which exist in matters of local concern. The San Francisco Bay is a valuable asset to all the communities surrounding it. It is not only an aesthetic and recreational asset, but also significantly affeets the climate of the area and supports an array of natural life. However, over the last hundred years commercial interests have filled and diked, removing over 240 square miles from the Bay. The rate of reclamation threatened the very existence of the Bay. To resolve the problem, the Bay communities persuaded the California Legislature to establish the San Francisco Bay Conservation and Development Commission. CAL. GOV'T CODE §§ 66600-53 (West 1966). Comment, *San Franciso Bay: Regional Regulation for its Protection and Development*, 55 CALIF. L. REV. 728 (1967). One of the first acts of the Commission was to enjoin the town of Emeryville from proceeding with a substantial fill projeet. People v. Town of Emeryville, Civil No. 358253 (Super. Ct., Alameda County, Cal., Aug. 21, 1967) (appealed); San Francisco Chronicle, Aug. 22, 1967, at 4, col. 1. Unable to win with the Commission and apparently expecting a negative ruling from the courts, Emeryville has prevailed on State Senator Joseph M. Kennick, of Long Beach, to introduce a "rider" on a bill, which would allow Emeryville to proceed with the project. Senator Alan Short, of Stockton, succeeded in limiting the scope of the "rider," but Emeryville's project would still be allowed to proceed if the bill passes. Oakland Tribune, April 18, 1968, at 10, col. 3. This presents a situation of a state legislator from Long Beach attempting to affect a regional problem located approximately 400 miles from his own constituency.

local income tax scheme under which the state itself would collect and administer the tax, taking these burdens off the local entities if that is found necessary. Precedent is found in the state administration of the local sales and use taxes under the California Bradley-Burns Uniform Local Sales and Use Tax Law.[161] In the meantime, the charter cities would receive much needed revenue and would obtain some experience with the local income tax so that any later statewide legislation on any aspects of the tax would have factual data upon which to rely.

In view of the importance of adequate revenues to the existence of local government, the state legislature should certainly not attempt to prohibit municipal income taxes[162] to both charter and general law cities without actually legislating itself in the field.[163]

APPENDIX†

MUNICIPAL INCOME TAXES AS CONTRIBUTORS TO CITY REVENUES

1963

City	1963 Income Tax Yield In thousands	Percentage of General Revenues[a] Contributed by: Property Tax	Income Tax	Income Tax Per Capita Yield	Income Tax Rate
Philadelphia	$83,433	32.5%	28.4%	$41.66	1⅝%
Toledo	9,106	19.8	26.6	28.60	1
Columbus, Ohio	14,022	12.2	33.5	29.75	1
St. Louis	22,737	32.2	24.1	30.31	1
Louisville	11,310	20.5	22.7	28.95	1¼
Pittsburgh	9,343	49.1	14.8	15.46	½
Cincinnati	16,033	21.5	15.3	31.90	1
Detroit	32,790	45.1	12.7	19.63	1

161. CAL. REV. & TAX. CODE §§ 7200-09 (West 1956, Supp. 1967).

162. *But see* CAL. REV. & TAX. CODE § 17041.5 (West Supp. 1967). See text accompanying note 85 *supra*.

163. An analogous doctrine has been developed by the California courts in interpreting article XI, section 11 of the California constitution. Article XI, section 11 provides that: "Any county, city, town, or township may make and enforce within its limits all such local, police, sanitary, and other regulations as are not in conflict with general laws." A local regulation is said to conflict with a general law when there is either an explicit conflict in provisions or the local regulation attempts to regulate a field which is already fully occupied by state law. It is said, however, that a mere statement by the legislature that they intend to occupy the entire field, or a prohibition by the legislature against local legislation in an area, are not enough. "The invalidity arises, not from a conflict of language, but from the inevitable conflict of jurisdiction which would result from dual regulations covering the same ground." Pipoly v. Benson, 20 Cal. 2d 366, 371, 125 P.2d 482, 485 (1942).

† From R. Sigafoos, *The Stake of Business in the Growing Municipal Income Tax Movement*, STATE AND LOCAL TAXES ON BUSINESS 118 (1965).

[a] Includes all income from local taxes, licenses, fees, and intergovernmental revenues.