

Local Taxes on Sugar-Sweetened Beverages in California

Legal Considerations and Procedural Requirements

Many California cities and counties are interested in imposing a tax on sugar-sweetened beverages or other products as a public health intervention, either to discourage consumption of the targeted product (through a potential price increase resulting from the tax) or to provide a dedicated source of revenue for local public health programs.

In California, a local business license tax is a community's only viable option. This legal memo discusses many of the legal considerations and procedural requirements for adopting a local business license tax based on the total sales of specific products, such as soda and other sugar-sweetened beverages.

Local Business License Taxes

A business license tax is an excise tax imposed on persons or entities for the privilege of conducting business within a city or county. Cities may impose a business license tax on business activities that occur within the city's jurisdictional boundaries,¹ and county governments may impose a similar tax on business activities in the unincorporated areas of the county.² Since local governments only have jurisdiction over taxable events taking place within their boundaries, most likely the tax will be imposed on retailers based on sales of sugar-sweetened beverages to consumers. However, in some instances it may be possible to levy the tax on distributors, based on their sales to retailers within the city or county.

A business license tax can be imposed either as a general tax or as a special tax (see "General Taxes versus Special Taxes," page 4).

Business license taxes are typically levied either at a flat rate or based on gross receipts, and it is fairly common for cities and counties to impose the same tax amount on all businesses within a defined class or type, such as professional services.³

A business license tax can also be imposed on businesses engaging in a specific type of activity, such as sales of automobiles⁴ or sales of firearms or ammunition,⁵ and could be imposed on businesses that sell sugar-sweetened beverages based on the gross receipts from those sales. While a local government has substantial discretion to determine what businesses to tax and at what levels, there must be some rational basis for the distinctions made between businesses.⁶

When considering a business license tax proposal, it is important to note that state law prohibits local governments from imposing a business license tax on certain types of organizations, such as clergy or religious organizations.⁷ In addition, local taxes on sales of certain products, such as cigarettes and tobacco products, are preempted by state law.⁸ However, there is no analogous state law prohibition against localities imposing a business license tax on businesses that sell sugar-sweetened beverages. (See "Sales Taxes in California," page 3, for a discussion about state law preemption of local product-specific sales taxes.)

Putting the Tax on the Ballot

Local taxes may be proposed by initiative petition or by the city council or the board of supervisors of the city or county in which the tax will apply, and must be approved subsequently by the electorate regardless of how they are proposed.⁹

A city council or board of supervisors must adopt an ordinance or resolution that sets forth the type of tax and rate, and other specific information.¹⁰ For a general tax, the ordinance or resolution proposing the tax must be adopted by a two-thirds vote of the members of the legislative body.¹¹ There is no similar legislative supermajority requirement for special taxes, and a special tax on gross receipts from sales of sugar-sweetened beverages could be placed on the ballot through a majority vote of the legislative body.¹² For charter cities, the city council may place the tax on the ballot (regardless of whether it is a general tax or a special tax) through a majority vote unless the city charter provides otherwise.¹³

All cities in California are either “charter” cities or “general law” cities. A charter city is one that has chosen to adopt a city charter (like a constitution for the city) and has local authority over municipal affairs, such as the conduct of local elections. A general law city is bound by the general law of the State of California. The League of California Cities maintains a list of charter cities in California, and other information regarding the differences between charter cities and general law cities (<http://www.cacities.org/chartercities/>).

A tax can also be placed on the ballot via the initiative process through the gathering of signatures from registered voters of the jurisdiction, similar to the process for statewide ballot initiatives.¹⁴

Approval of the Tax by the Electorate

Once on the ballot, a general tax must be approved by a majority of the electorate – the residents of a city or of the unincorporated areas of a county.¹⁵ The vote on a general tax must be consolidated with a regularly scheduled general election for members of the governing body of the local government, except when an emergency requiring an earlier election is declared by a unanimous vote of the legislators present.¹⁶

A special tax must be approved by a two-thirds vote of the electorate,¹⁷ and unlike general taxes, there are no constitutional timing restrictions on elections to approve special taxes. A special tax must also include mandatory accountability measures – the measure must state the “specific purposes” of the tax, include a requirement that tax proceeds be used only for that purpose, provide for “the creation of an account into which the proceeds shall be deposited” and require annual reporting of receipts, expenditures and “the status of any project required or authorized to be funded” by the measure.¹⁸

Proposition 26¹⁹ did not amend these procedural requirements, nor did it amend the definitions of “general tax” and “special tax.” Proposition 26 broadened the overall definition of “tax” so that more government charges would be subject to the procedural requirements set forth above.²⁰

Drafting a Tax Law/Administrative Considerations

Imposing a business license tax on those who sell sugar-sweetened beverages (or another specific product) involves many administrative and practical considerations.

When creating a tax, several choices must be made: the amount of the tax and the basis of the tax (i.e., flat rate or based on gross receipts from sales of sugar-sweetened beverages); defining the beverages subject to the tax and exceptions; and whether to specifically earmark the proceeds of the tax for particular uses and how to do so (i.e., whether to create a special tax and trigger the 2/3-voter-approval requirement.) In addition, all businesses that are subject to the tax must be issued a “business license”; or “certificate” by the city or county, and as with any tax, collection and enforcement mechanisms must be instituted.

Working within the existing tax structure of your city or county is important, as is collaborating with the agencies that will be responsible for administering the tax law. For example, making it clear what beverages are subject to the tax will help retailers comply by remitting the proper amount of tax, and will also aid in enforcement.

To prepare a draft ordinance, a good starting point is to analyze existing tax laws in the municipal code or county code to determine the landscape of existing taxes in your city or county.

Many of the policy choices involved in crafting a local ordinance to tax those who sell sugar-sweetened beverages are explained in Public Health Law & Policy’s Model Sugar-Sweetened Beverage Tax Legislation, available at www.nplanonline.org/nplan/soda-taxesfees. Several of the issues involved in a statewide tax on sellers of sugar-sweetened beverages are similar to the policy issues that will be faced by local governments.

Sales Taxes in California

Most people are familiar with sales taxes, which are imposed on sales of tangible personal property in California. Sales taxes are based on a percentage of the sales price of taxable items, computed at the time of purchase and collected from the purchaser by the retailer. Every city and county in California imposes a sales tax that is administered and collected by the State Board of Equalization under the Bradley-Burns Uniform Local Sales and Use Tax Law (“Bradley Burns Law”).²¹

The California Legislature enacted the Bradley Burns Law in 1955 to achieve statewide uniformity in rates and practice with regard to sales and use taxes.²² The Bradley Burns Law contains a comprehensive taxation scheme for California cities and counties. This scheme mandates, among other things, the adoption of a fixed tax rate and the inclusion of a long list of prescribed provisions in local taxation ordinances.

Theoretically, cities and counties may choose whether or not to comply with the Bradley-Burns tax scheme. Those who comply, however, are entitled to participate in a state tax collection and administration system managed by the State Board of Equalization. This system relieves local governments of the burden of collecting and administering local taxes. The system is so beneficial to local governments that opting out has become impracticable.

Since cities and counties participate in the statewide sales tax system, local sales taxes must include and exempt the products that are included in and exempted from the statewide sales tax. While food products are generally exempt from sales taxes, a portion of the sales of food sold through vending machines (including beverages) is subject to sales tax.²³

Excise Taxes And Sales Taxes

A **tax** is a government-imposed assessment on a person or property to raise revenue for general public needs.

A **sales tax** (also referred to as a **sales and use tax** or **transactions and use tax**) is imposed on consumers who purchase goods at retail; it is usually measured as a percentage of the sales price. Although the seller is responsible for collecting the tax on behalf of the state or local government, an essential element of a sales tax is that it is passed on to the consumer.

An **excise tax** is imposed on the performance of some act or the exercise of some privilege, and is often imposed on the business of selling a consumer product. For example, most state “tobacco taxes” are excise taxes. An excise tax on the sale of sugar-sweetened beverages would be charged to the business for the privilege of selling these beverages. This distinction is important because a sales tax on buyers of sugar-sweetened beverages is preempted (prohibited) by state law, but an excise tax on the privilege of selling such beverages would not be preempted.

In addition, carbonated beverages (whether diet or caloric beverages) are specifically non-exempt, and therefore sales of these products are subject to sales tax as well.²⁴

Additional sales taxes on “food products” beyond those already in state law are prohibited by the California Constitution, so neither the California Legislature nor local governments may impose additional sales taxes on food products.²⁵

Therefore, most cities and counties (and the state) already impose a sales tax on at least some sugar-sweetened beverages (those sold in vending machines, and carbonated beverages). However, cities and counties cannot broaden the range of beverages subject to the sales tax, cannot increase the sales tax rate on specific sugar-sweetened beverages, and cannot earmark that portion of the proceeds of the sales tax that derives from sugar-sweetened beverages. These public health goals would have to be accomplished through a business license tax on those who sell the beverages rather than a sales tax on those who buy them.

General Taxes versus Special Taxes

A business license tax could be imposed as a “general tax” (the proceeds of which are deposited in the general fund and available for any purpose) or a “special tax” (the proceeds of which are legally earmarked for specific purposes). There are important legal and practical differences between “general” and “special” taxes. General taxes can be approved by a simple majority of voters, but can be spent on any lawful government purpose. Special taxes are restricted to particular purposes, but require 2/3 voter approval.

One of the primary public health benefits of a tax on sugar-sweetened beverages is that it can raise a dedicated source of revenue for public health prevention and treatment programs; the best way to ensure that the tax proceeds will be used for specific purposes and not diverted to general governmental operations is to establish the tax as a special tax with proceeds legally earmarked for these purposes. However, note the alternative approaches discussed below.

Both terms are defined in the California Constitution, as amended by Proposition 218 in 1996:

“General tax” means any tax imposed for general governmental purposes.²⁶

“Special tax” means any tax imposed for specific purposes, including a tax imposed for specific purposes that is placed into a general fund.²⁷

Identifying a “Special Tax”

Sometimes it is not entirely clear whether a tax is a general tax or a special tax. If there is no earmarking language in a tax measure itself or elsewhere (like ballot arguments), and no other binding direction from the legislative body that states the specific purpose for the tax, a general tax is not converted to a special tax merely because the legislative body subsequently appropriates funds from the general fund for a particular purpose. Otherwise, every tax would become a special tax once a decision is made how to spend its proceeds.

Based on the definitions in the California Constitution, a tax may still be considered a “special tax” even if the proceeds are deposited in the general fund, if the tax is “imposed for specific purposes” as where the general fund is that of an agency (like a transportation agency) which has only one specific purpose.²⁸

If a tax law identifies a specific purpose for the proceeds or the expenditure of the revenues is otherwise legally limited to specific uses, the tax is a special tax, regardless of where the proceeds are retained.²⁹ Conversely, “a tax is a general tax only when its revenues are placed into the general fund and are available for expenditure for any and all governmental purposes.”³⁰

With this guidance, a legislative body could propose a “general tax” on gross receipts of sales of sugar-sweetened beverages, so long as the tax ordinance itself does not direct or specify the uses for the expenditure of the funds. If the legislative body subsequently appropriated funds from the general fund –

even in an amount equal to the proceeds of the tax – for a particular purpose, the subsequent appropriation would likely be viewed as an independent legislative act, with its own procedural safeguards, that should not convert the general tax to a special tax.

Measure A / Measure B Approach

There is a means by which a local government can propose a general tax while still giving voters some assurances as to how the proceeds of the tax will be spent, arising from a case known as *Coleman v. County of Santa Clara*.³¹ In 1996, the Santa Clara County Board of Supervisors placed two measures on the November ballot. Measure B was a sales tax increase, which stated that its proceeds could be used for general county purposes (i.e., that it was a general tax); Measure A was a nonbinding advisory measure, “advising” the board how the electorate wanted the tax proceeds to be used (for a list of specifically described transportation improvements).³² The advisory Measure A was not controlling on the board of supervisors, however. While Measure A was approved by over 77% of the voters, Measure B was approved by a simple majority (51.8%) and a group initiated a lawsuit to invalidate the tax, claiming that Measure B was a special tax that failed to receive a two-thirds vote.

The Court of Appeal held that, notwithstanding the advisory measure, the sales tax was a general tax because:

1. The proceeds were deposited into the general fund and available for general governmental purposes;
2. The advisory measure did not bind the Board of Supervisors to expend the funds for any specific purpose; and
3. The advisory measure and the tax measure were not legally connected, but rather were separate and distinct.³³

The court decided the case under Proposition 13 and taxpayer advocates often argue that the adoption of Proposition 218 in 1996 ought to require a different result. However, they do not point to specific language in proposition 218 which requires a different result and the definitions of general and special taxes stated in Proposition 218 are not meaningfully different from the definitions that existed previously. Accordingly, most public lawyers have concluded that the Measure A / Measure B approach is lawful and no challenge has been filed by taxpayer advocates to overturn the *Coleman* case.

- ¹ See Cal. Const. art. XI, § 5 (charter city municipal affairs); Cal. Gov't Code § 37101 (West 2010) (general law cities)
- ² Cal. Rev. & Tax. Code § 7284 (West 2010). Available at: <http://law.justia.com/california/codes/2009/rtc/7284-7284.7.html>.
- ³ See, e.g., Sacramento, Cal., City Code ch. 3.08 (2010) (“Business Operations Tax”). Available at: www.qcode.us/codes/sacramento/view.php?topic=3-3_08&showAll=1&frames=on.
- ⁴ See, e.g., Alameda, Cal., County Code § 3.04.260 (“Business License Tax”), imposing a business license tax based on gross receipts from sales of new or used motor vehicles. Available at: http://library.municode.com/html/16425/level2/TIT3BULIRE_CH3.04BULITA.html#TIT3BULIRE_CH3.04BULITA_3.04.030BULITA; see generally Alameda County Code chapter 3.04.
- ⁵ See Los Angeles, Cal., Municipal Code § 21.167.1, imposing a business license tax on gross receipts from sales of firearms or ammunition; see generally Los Angeles Municipal Code, ch. 2 art. 1 (“Business Taxes”). Available at: [www.amlegal.com/nxt/gateway.dll/California/lamc/municipalcode/chapterii*licensespermitsbusinessregulat?f=templates\\$fn=default.htm\\$3.0\\$vid=amlegal:lamc_ca\\$anc=JD_C2A1](http://www.amlegal.com/nxt/gateway.dll/California/lamc/municipalcode/chapterii*licensespermitsbusinessregulat?f=templates$fn=default.htm$3.0$vid=amlegal:lamc_ca$anc=JD_C2A1).
- ⁶ *Jensen v. Franchise Tax Board*, 178 Cal. App. 4th 426, 435-37 (2009) (finding that Proposition 63’s additional tax on annual incomes over \$1 million had a rational basis and thus did not violate equal protection).
- ⁷ Cal. Rev. & Tax. Code § 7284.1(a); Cal. Bus. & Prof. Code § 16000(b) (West 2010). Available at: www.leginfo.ca.gov/cgi-bin/displaycode?section=bpc&group=15001-16000&file=16000-16004.
- ⁸ Cal. Rev. & Tax. Code §§ 30111, 30462(b).
- ⁹ Cal. Const. art. XIII C, § 2(b) (general tax), (d) (special tax) (both are provisions of Proposition 218, passed in 1996).
- ¹⁰ Cal. Gov’t Code § 53724 (added by Proposition 62 in 1986 and applicable to counties and general law cities; the manner in which a tax is proposed by a charter city is governed by its charter and ordinances.)
- ¹¹ Cal. Gov’t Code § 53724(b). This requirement does not apply to charter cities: see *Traders Sports Inc. v. City of San Leandro*, 93 Cal. App. 4th 37, 49 (2001).
- ¹² For an increase in the transactions and use (sales) tax, a two-thirds vote of the legislative body is required, regardless of whether the increase is a general tax or a special tax. (Cal. Rev. & Tax. Code § 7285.9.)
- ¹³ *Traders Sports*, 93 Cal. App. 4th at 49, supra note 11.
- ¹⁴ See Cal. Elec. Code §§ 9100 et seq. (counties) and 9200 et seq. (general law cities) for more information on this process. Although many charter cities rely on the Election Code to provide for the powers of initiative and referendum, others establish their own rules by charter provision or ordinance.
- ¹⁵ Cal. Const. art. XIII C, § 2(b); Cal. Gov’t Code § 53723.
- ¹⁶ Cal. Const. art. XIII C, § 2(b).
- ¹⁷ *Id.* § 2(d); Cal. Gov’t Code § 53722.
- ¹⁸ Cal. Gov’t Code §§ 50075-50075.5. These provisions state that they are applicable to charter cities, but whether that is constitutionally permissible is open to argument. See, e.g., *Harman v. City & County of San Francisco*, 7 Cal.3d 150, 161 (1972) (election matters governed by local charter). Accountability measures are a good idea in any event, both to make clear that the tax is a special tax and to create public confidence that the proceeds of the tax will be expended appropriately.
- ¹⁹ Proposition 26 (approved by California voters on November 2, 2010) adopted constitutional articles XIII A, § 3 (applicable to the state) and XIII C, § 1(e) (applicable to local governments).
- ²⁰ A general overview of Proposition 26 will be available from the League of California Cities in early 2011 entitled “the Proposition 26 Implementation Guide.”
- ²¹ For current sales tax rates in cities and counties, see the Board of Equalization’s website: www.boe.ca.gov/cgi-bin/rates.cgi. The California state sales tax is called a “Sales and Use tax;” local add-on sales taxes are called “Transactions and Use” taxes, but are collected in addition to state sales taxes and have a similar effect. There are some differences between the tax bases of the Bradley Burns Sales and Use Tax and Transactions and Use Taxes but those differences do not affect a tax on sellers as discussed here.
- ²² See 9 B.E. Witkin, Summary of California Law, Tax § 271 (1990).
- ²³ Cal. Rev. & Tax. Code §§ 6359, 6359.2, 6359.4.
- ²⁴ *Id.* § 6359(b)(3). For a complete list of sales and use tax exemptions and exclusions, see California Board of Equalization, Publication No. 61, available at: www.boe.ca.gov/pdf/pub61.pdf.
- ²⁵ Cal. Const. art. XIII, § 34.
- ²⁶ *Id.* §1(a), added by Proposition 218 (adopted 1996).
- ²⁷ Cal. Const. art. XIII C, §1(d), added by Proposition 218 (adopted 1996). Proposition 62 (adopted 1986, adding sections 53720-53730 to the California Government Code) also attempts to clarify the differences between general and special taxes, but is less specific than the definition from Prop. 218 and does not apply to charter cities. (See Cal. Gov’t Code § 53721.)
- ²⁸ The purpose of this restriction was to overturn a California Supreme Court ruling interpreting Proposition 13 which had allowed majority voter approval requirements of taxes imposed by special-purpose agencies. *Rider v. County of San Diego* 1 Cal.4th 1, 15 (1991) (rejecting earlier rule and requiring 2/3-voter approval for jail facilities tax imposed by a special-purpose agency of San Diego County).
- ²⁹ *Howard Jarvis Taxpayers Ass’n v. City of Roseville*, 106 Cal. App. 4th 1178, 1185 (2003).
- ³⁰ *Weisblat v. City of San Diego*, 176 Cal. App. 4th 1022, 1044 (2009) (citing *City of Roseville*, 106 Cal. App. 4th at 1185).
- ³¹ *Coleman v. County of Santa Clara*, 64 Cal. App. 4th 662 (1998).
- ³² *Id.*
- ³³ *Id.*