

MEMORANDUM



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To: Board of Directors
California State Association of Counties

From: Paul McIntosh
Executive Director

Re: **Constitutional Protections for Realignment – ACTION ITEM**

At a special meeting on January 5, the CSAC Board of Directors reaffirmed that obtaining a constitutional guarantee of revenues to support the 2011 realigned programs, as well as protecting counties from costs associated with future changes to those programs, remained the top priority of the Association. The board also voted to suspend all efforts by CSAC to qualify an independent ballot measure, leaving the measure filed by Governor Brown (*The Schools and Local Public Safety Protection Act of 2012*) as the only available vehicle to achieve those constitutional protections.

On January 19, the CSAC Executive Committee considered the Governor's proposed ballot measure and voted to recommend to the Board of Directors that CSAC take a SUPPORT position on the measure.

This memo is intended to provide information to the Board of Directors to assist in considering that recommendation.

Background

Realignment in 2011 shifted responsibility for nearly \$6 billion in public safety and social service programs to California's counties. CSAC's support of realignment was premised on assurances from Governor Brown and the Legislature that the funding for realigned programs would be constitutionally protected and counties' exposure to future programmatic costs would be limited. Without these guarantees and protections, California counties remain significantly exposed to increased costs and program responsibilities.

In September 2011, after the Legislature failed to approve Senate Constitutional Amendment 1X (SCA 1X) – the measure that included the negotiated constitutional protections – the Board of Directors authorized CSAC staff to begin to prepare a ballot measure and evaluate the efficacy of moving forward on a realignment-only measure. CSAC's measure, *The Local Taxpayers, Public Safety and Local Services Protection Act of 2012*, was filed with the Attorney General on November 2, 2011 and received title and summary from the Attorney General and a fiscal analysis from the Legislative Analyst's Office on December

29, 2011. CSAC was joined by the California State Sheriffs' Association and the Chief Probation Officers of California in pursuit of the realignment-only measure.

Subsequently, the Governor filed his own sponsored initiative, "*The Schools and Local Public Safety Protection Act of 2012*," on December 5, 2011. The Governor's measure received title and summary from the Attorney General on January 18. That title and summary, as well as the Legislative Analyst's fiscal analysis, are attached. The title given to the measure by the Attorney General reads "TEMPORARY TAXES TO FUND EDUCATION. GUARANTEED LOCAL PUBLIC SAFETY FUNDING. INITIATIVE CONSTITUTIONAL AMENDMENT."

At a special meeting of the CSAC Board of Directors on January 5, the Board voted to suspend all activities related to the *Local Taxpayers, Public Safety and Local Services Protection Act of 2012*, leaving the Governor's proposed ballot measure as the only vehicle with which to obtain the guaranteed funding and constitutional protections sought. The Board of Directors reaffirmed, during that meeting, that obtaining the guarantee and protections were the top priority for the Association.

The Governor's measure provides for a temporary (five year) increase in the personal income tax for high income (over \$250,000) earners as well as a temporary (four year) ½ cent increase in the state sales and use tax. Proceeds of the taxes are dedicated to a new fund, the Education Protection Account and can only be spent on K-14 education. The measure bars use of the funds for administrative purposes. From the analysis of the Legislative Analyst's Office, details of the proposed temporary taxes are:

Under current law, the maximum marginal Personal Income Tax (PIT) rate is 9.3 percent, and it applies to taxable income in excess of \$48,209 for individuals; \$65,376 for heads of household; and \$96,058 for joint filers. This measure temporarily increases PIT rates for higher incomes by creating three additional tax brackets with rates above 9.3 percent. Specifically, this measure imposes:

- A 10.3 percent tax rate on income between \$250,000 and \$300,000 for individuals; \$340,000 and \$408,000 for heads of household; and \$500,000 and \$600,000 for joint filers.
- A 10.8 percent tax rate on income between \$300,000 and \$500,000 for individuals; \$408,000 and \$680,000 for heads of household; and \$600,000 and \$1 million for joint filers.
- An 11.3 percent tax rate on income in excess of \$500,000 for individuals; \$680,000 for heads of household; and \$1 million for joint filers.

These tax rates would affect roughly 1 percent of California PIT filers due to the high income threshold. The tax rates would be in effect for five years starting in the 2012 tax year.

This measure temporarily increases the state Sales and Use Tax (SUT) rate by 0.5 percent. The higher tax rate would be in effect for four years—from January 1, 2013 through the end of 2016. Under the measure, the statewide average SUT rate would increase to 8.6 percent

Since virtually all of the income earners impacted by the proposed temporary increase in personal income taxes itemize their deductions on state and federal tax returns, a significant portion of the increase in state taxes paid through this provision could be offset by a reduced federal tax liability.

The revenues raised by the temporary taxes are in addition to the funding guarantee for the realigned programs. The revenues generated from these temporary taxes are exclusively dedicated to school entities (K-12 education and community colleges) and are subject to the Proposition 98 calculation. The revenues raised by the measure are deposited directly into a newly created fund and allocated to schools, bypassing the Legislature. This essentially means that these revenues are first to fill the “bucket” of the state’s annual Proposition 98 calculation, thus saving the state about half of that amount that can otherwise be used for other state General Fund purposes.

In addition to the temporary increase in taxes for education, the measure provides a constitutional guarantee of the funding dedicated to the 2011 realignment (an amount equal to 1.0625% of the state sales tax and certain vehicle license fees) as well as the protections of those programs sought last Spring in SCA 1X.

Discussion

Under normal circumstances, CSAC does not take a position on ballot measures until they have qualified for the ballot. However, CSAC policies and procedures provide that *“in the event that a proposed ballot measure has a direct impact on county government ... the CSAC officers may direct”* that action be taken on the measure prior to actual qualification. This measure affects nearly \$6 billion of funding for realigned programs and certainly has a dramatic, direct impact on California’s counties. Therefore, the CSAC Officers have determined that it is in the best interest of the Association to move forward to quickly support the measure.

CSAC has enjoyed a unique, strong relationship with Governor Brown. He spent his first full day in office, January 4, 2011, meeting with CSAC officers and senior staff regarding his efforts to divest state programs to counties. He followed that up with a meeting with the CSAC Board of Directors in March 2011 and worked closely with CSAC officers and staff during the summer in an effort to gain passage of SCA 1X.

For the past five years, CSAC has pursued a strategy that California counties are partners with the State of California in the delivery of vital services to our citizens. The politics of confrontation, followed by some, do not seem to have borne fruit. Certainly when one compares the impacts that state budget reductions had on California counties in the 1980s and 1990s with the impacts of the past few years, counties have fared very well. It continues to be in the best interests of

counties to work cooperatively with the Administration and Legislature to assist them in addressing the final vestiges of this recession.

It has long been CSAC policy to support a balanced approach to resolving the chronic state budget deficit and under that policy CSAC has supported increased revenues in the past. For instance, in 2009 the CSAC board supported an increase in the gas tax when the Legislature proposed to permanently divert the entire local share of the Highway User Tax Account (HUTA) to fund debt service and provide \$1 billion a year in General Fund relief. This tax increase generated an additional \$750 million per year.

Governor Brown inherited a combined \$26.2 billion budget deficit when he took office last year and whittled that down to a \$9.2 billion deficit for the next 18 month period. The Governor's proposed 2012-13 budget is balanced through a combination of budget cuts and the proposed tax increases. If the tax increases are not supported, triggers cuts — primarily in education — would automatically kick in. The temporary taxes contained in the Governor's ballot measure are about half of the taxes that would have been extended by SCA 1X. CSAC voted 45-4 to support SCA 1X due primarily to the fact that it contained the constitutional protections sought as part of realignment, as does the Governor's proposed measure.

Through his proposed budget, the Governor projects that these taxes would be temporary and that growth in the state's economy would produce future tax revenues sufficient to offset the loss of the temporary taxes when they expire.

Beginning in 1991, the State of California has relied upon temporary tax increases to assist the state in recovering from severe recessions. In 1991, Governor Wilson proposed, and the Legislature enacted, high-income taxes by adding incremental tax rates of 10 and 11 percent on those upper income levels. These rates expired after five (5) years in 1996. In addition, a temporary ½ cent sales tax was imposed, set to expire in 1993. Even those increased tax revenues, though, did not prevent that state from diverting \$4.3 billion of local property taxes to a state Education Revenue Augmentation Fund (ERAF) to fund part of the state's obligation to K-14 education in 1992-93 and 1993-94 as the recession lingered.

Also in 1991, CSAC supported an increase in the sales tax (½ cent) and an adjustment to the depreciation schedule of the vehicle license fee that generated \$1.98 billion that was then designated to the 1991 realignment programs. Both of those tax sources remain in effect today and generate approximately \$4 billion for California counties to use on those programs.

In part to offset the impacts of those tax diversions in 1993, the Legislature placed Proposition 172 on the ballot. This measure offered voters the opportunity to continue the ½ cent sales tax that was to expire at the end of 1993

and dedicated the funding from the ½ cent sales tax to public safety. CSAC supported Proposition 172; it passed by a strong margin and remains in effect today.

In 2009, under Governor Schwarzenegger, the Legislature adopted temporary income tax rates at the higher level, a temporary 1 cent increase in the sales tax, and a temporary Vehicle License Fee rate increase, a portion of which was dedicated to local public safety. These temporary taxes were in place for two years and expired at the end of June 2011. These were the taxes that would have been extended for five years under SCA 1X.

State Budget Cuts

There is no question that California and the rest of the nation have been wracked by one of the worst and prolonged economic recessions since the Great Depression. The impact first hit California in 2008 and has been felt in every budget since.

In response, California has made significant cuts in state expenditures. It is difficult to make an apples-to-apples comparison of budget gaps and deficits as those figures seem to change continuously. However, if you compare the actual budget figures for the state’s general fund, you can see that the State of California has made real reductions in spending, while demand for services has continued to climb.

<i>In Billions</i>	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
General Fund	\$102.137	\$103.373	\$91.547	\$87.335	\$91.48	\$85.937

The 2011-12 Budget cut General Fund spending as a share of the economy to its lowest level since 1972-73. State Supplementary Payment grants were reduced to the level in effect in 1983. CalWORKs grants were reduced to below the level in effect in 1987. State support for its universities and courts was cut by about 25 percent and 20 percent, respectively. The Adult Day Health Care program, redevelopment agencies, Williamson Act subventions, Home-to-School Transportation, and the refundable child care and dependent tax credit were all eliminated. The Department of Corrections and Rehabilitation’s expenditures will be reduced by approximately 18 percent once realignment is fully implemented. K-14 education funding remains \$9 billion below the funding level in 2007-08.

The Governor has proposed further cuts to K-14 education should his measure fail in November. Furthermore, such a failure would exacerbate the structural deficit that has plagued the state since 2000.

The Governor’s Campaign

While any statewide tax measure faces an uphill battle, the Governor's measure does appear to have strong initial support among voters. CSAC conducted a poll of the Governor's measure in December 2011 and found that 62% of those polled support a plain language description of the measure. The ongoing cuts to public education are the most persuasive arguments. In this same poll, a range of 65% to 71% of likely voters expressed concerned about funding for K-14 education.

As more information about the measure is distributed, voters' concerns about education and support for the measure seem to increase. The Public Policy Institute of California conducted a comprehensive survey in January, in the wake of the release of Governor Brown's proposed budget for the next fiscal year. That survey found 72% of adults and 68% of likely voters favored the proposed temporary tax increases. A copy of the survey is attached.

As of this writing, the Governor has raised over \$2 million in support of his measure and is currently collecting signatures throughout the state to qualify. We anticipate significant funding from business, labor and education groups in support of the Governor's efforts. The Governor has in fact indicated a broad range of supporters, from labor to business interests. To date, the following groups have made financial contributions to the Governor's campaign:

- American Beverage Association
- Occidental Petroleum
- Blue Shield of California
- Californians to Protect Chiropractic Patient Rights
- California Attorneys in State Employment
- Members' Voice of the State Building Trades
- California Association of Hospitals and Health Systems
- California Tribal Business Alliance
- Lytton Band of Pomo Indians
- Paskenta Band of Nomlaki Indians
- Morongo Band of Mission Indians
- Agua Caliente Band of Cahuilla Indians
- KP Financial Services
- GTech
- Yocha DeHe Wintun Nation
- Education Management LLC
- American Federation of State and City Municipal Employees
- Kaiser Permanente

As of this writing, the following groups or businesses have publicly supported the Governor's initiative:

- Chief Probation Officers of California
- California Business and Industry Association

California Medical Association
Community College League of California
California Teachers Association
Building and Construction trades Council
Service Employees International Union
American Federation of State and City Municipal Employees
Los Angeles County (Letter attached)
Contra Costa County (Letter attached)

Interestingly, in his association's statement regarding support for the measure, California Teachers Association President Dean Vogel is quoted as saying:

"Educators know that California cannot continue to cut its way out of ongoing budget problems. We also know that not everyone in California is paying their fair share, and that's why we are supporting the governor's tax proposal, which taxes the wealthiest Californians in order to bring additional revenue to our schools, colleges and other essential public services.

"The governor's initiative is the only initiative that provides additional revenues for our classrooms and closes the state budget deficit, **and guarantees local communities will receive funds to pay for the realignment of local health and public safety services that the Legislature approved last year.** It's time to put California back on track and this initiative is the best way to do that. It's the right choice for our students and their families, our communities and our state." [*Emphasis added.*]

The Governor has also committed to an ongoing dialogue with counties regarding implementation issues for realigned programs, as well as other issues of statewide concern. We continue to have an active and constructive dialogue with Administration officials on the implementation of AB 109 and realignment generally.

An important factor that will influence the Governor's success will be the extent to which he can clear the field of other tax initiatives, most importantly the other measures seeking to raise the personal income tax. In particular, there are two other ballot measures aimed at November 2012 that contain personal income tax increases to fund education. As of this writing, both of these campaigns have indicated they plan to proceed with signature gathering and qualification. Neither of these measures contains provisions protecting realignment funding:

A group called *The Coalition for Restoring California* has proposed a "millionaires' tax". A key member of this coalition is the California Federation of Teachers (CFT). Starting with tax year 2012, the measure raises the personal income tax (PIT) an additional 3% on the portion of a taxpayer's income between \$1 million and \$2 million and 5% on any income above \$2 million. As with the current mental health surcharge, the brackets would be the same for single, joint, and head-of-household returns and would not be indexed for inflation. Most of the funding,

estimated at \$6 to \$9.5 billion per year, would go to K-14 education, but funding would also go to several county-managed programs - county programs for seniors, children, the disabled, and public health (25%); county public safety programs (10%); and, county road and bridge maintenance (4.9%). The campaign recently reported a \$500,000 contribution from the CFT and a \$200,000 contribution from an organization "California Calls". The California Nurses Association have also indicated their support for this measure.

The second measure is sponsored by *Our Children, Our Future*, whose primary benefactor is Molly Munger, a civil rights attorney in Los Angeles and the daughter of Charles Munger, partner to Warren Buffet. Their proposal increases the personal income tax (PIT) rates on all but the lowest income bracket, beginning in 2013 and ending in 2024. The additional marginal tax rates would be higher as taxable income increases. For income of PIT filers currently in the highest current tax bracket (9.3% marginal tax rate, excluding the mental health tax), additional marginal tax rates would rise as income increases. The income levels in the tax brackets would be indexed for inflation. The current mental health tax would continue to be imposed.

In 2013-14 and 2014-15, all revenues raised by this measure (estimated to be between \$10 and \$11 billion per year) would be allocated for schools and Early Care and Education (ECE) programs (85% for schools, 15% for ECE). Beginning in 2015-16, total allocations to schools and ECE programs could not increase at a rate greater than the average growth in California personal income per capita in the previous five years. The measure also prohibits monies from being used to replace state, local, or federal funding that was in place prior to November 1, 2012. All revenue collected by the measure and allocations made to schools are excluded from the calculation of the Proposition 98 minimum guarantee. Ms. Munger has contributed \$900,000 to this campaign as of this writing, and recently indicated that she would spend "whatever it takes" to qualify her measure for the ballot.

Both of these measures are currently circulating petitions to gain enough signatures to qualify for the November ballot. It is unclear whether the *Coalition for Restoring California* has sufficient means to qualify its measure and run an effective campaign. *Our Children, Our Future* appears to have sufficient funding to do both, and they show no sign of abating their effort.

Governor Brown has pledged that if his November 2012 measure fails, due to a crowded ballot or other issues, he will not hesitate to bring back another ballot measure to provide the guarantees and protections sought by California counties.

Recommendation

The Schools and Local Public Safety Protection Act of 2012 remains the only viable vehicle for California Counties to obtain the constitutional protections and guaranteed funding for realigned programs that remains the top priority of the Association. While the measure polls well as of this writing, competing measures could weaken its chances of passage. Association support of the measure is important to garner the votes necessary to pass the measure. Furthermore, Association support is very important should the measure fail and it becomes necessary for the Governor to follow through on his commitment to bring the protections back in another election.

The Executive Committee has recommended that the Board of Directors vote to **SUPPORT** *The Schools and Local Public Safety Protection Act of 2012*.

Attachments

- (1) Los Angeles County Letter dated January 25, 2012
- (2) Contra Costa County Letter dated January 31, 2012
- (3) Title and Summary dated January 18, 2012
- (4) Legislative Analyst's Letter dated January 11, 2012
- (5) PPIC Statewide Survey, January 2012