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Paul Novak
Executive Officer
The Local Agency Formation Commission of Los Angeles County

RE: Classification of Prop 172 Funding in the Calculation of the Property Tax Exchange
for an Incorporation

You have requested an opinion regarding the following question: Should the CFA for the proposed City of East Los Angeles count the County's Proposition 172 funds as general revenues, or restricted revenues, for the purposes of calculating the property tax exchange?

After review of the applicable statutes, a prior Los Angeles County Counsel opinion on the issue, and what little caselaw addresses the issue, my conclusion is that Prop 172 funds should be classified as restricted revenue, that is "revenue required to be used for a specific purpose" within the meaning of Section 56810(c) of the Government Code for the purpose of calculating the property tax exchange. Consequently such revenue should not be included in the denominator in determining the proportion of property tax revenue to general revenue (the "Auditor's Ratio"), nor in the determination of the total net cost of services to be assumed by the new city.

Legal Analysis

In the Cortese Knox Hertzberg Act, the Legislature has set out the procedure for approval of the incorporation of new cities by local agency formation commissions, commencing at Section 56800 of the act. The process requires the LAFCo to determine whether the proposed new city will be fiscally viable. To do this, the LAFCo is required to prepare a "Comprehensive Fiscal Analysis" or "CFA". The CFA projects the expected revenue of the new city in accordance with statutory formulas and projected expenses. Section 56810 establishes the formula by which the CFA is to determine how the property tax generated within the area of the proposed new city would be exchanged between the city

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and county and other agencies that receive property tax revenue. Government Code section 56810 provides in relevant part:

(c) If the proposal would not transfer all of an affected agency's service responsibilities to the proposed city or district, the commission and the county auditor shall do all of the following:

(1) The county auditor shall determine the proportion that the amount of property tax revenue derived by each affected local agency pursuant to subdivision (b) of Section 93 of the Revenue and Taxation Code bears to the total amount of revenue from all sources, available for general purposes, received by each affected local agency in the prior fiscal year. For purposes of making this determination and the determination required by paragraph (3), "total amount of revenue from all sources available for general purposes" means the total amount of revenue which an affected local agency may use on a discretionary basis for any purpose and does not include any of the following:

(A) Revenue which, by statute, is required to be used for a specific purpose.

(B) Revenue from fees, charges, or assessments which are levied to specifically offset the cost of particular services and do not exceed the cost reasonably borne in providing these services.

(C) Revenue received from the federal government which is required to be used for a specific purpose.

(2) The commission shall determine, based on information submitted by each affected local agency, an amount equal to the total net cost to each affected local agency during the prior fiscal year of providing those services which the new jurisdiction will assume within the area subject to the proposal. For purposes of this paragraph, "total net cost" means the total direct and indirect costs that were funded by general purpose revenues of the affected local agency and excludes any portion of the total cost that was funded by any revenues of that agency that are specified in subparagraphs (A), (B), and (C) of paragraph (1).

(3) The commission shall multiply the amount determined pursuant to paragraph (2) for each affected local agency by the corresponding proportion determined pursuant to paragraph (1) to derive the amount of property tax revenue used to provide services by each affected local agency during the prior fiscal year within the area subject to the proposal....

The statutory formula for property tax exchange is applied to each agency which will transfer service responsibilities to the new city, with the primary transferring agency being the county. It begins by calculating the percentage of property tax revenue of the transferring agency to all sources of general, unrestricted, agency revenue. That ratio is commonly referred to as "the Auditor's Ratio". Then the Net Cost of Services to be transferred to the new city is calculated. That service cost is calculated, net of cost of any services which are supported by restricted revenue sources. The Net Cost of Services is then multiplied by the Auditor's Ratio to determine the amount of property tax to be transferred to the new city. This is intended to insure that the new city gets the same amount of property tax revenue to support the services it is assuming as was available to the agency that previously provided the services.

The formula for calculating the reapportionment of property taxes (at that time contained in G.C. 56842, now 56810) was reviewed and analyzed in a 1988 Attorney General's opinion (71 Ops.Cal.Atty.Gen. 286 (1988).) In referring to the revenues to be excluded from the calculation, the opinion states: "Of

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particular significance is the fact that excluded from the calculations of section 56842 are funds required under state or federal law to be used for a specific purpose and funds received to offset certain costs of various services. These revenues will continue to be received by the transferring agency or begin to be received by the new city to the extent each furnishes the specified services. Neither is thus pertinent to a determination of what property tax revenues should be transferred between the two entities." (*Id.* at p. 290.)

A key issue in calculating the property tax exchange is determining whether particular revenue sources are "available for general purposes" ("general revenue") or are "Revenue which, by statute, is required to be used for a specific purpose" (i.e. "restricted revenue"). This is because only general revenue sources are to be used in the calculation of the auditor's ratio and the net cost of services is net of any services supported by restricted revenue.

Classifying revenue sources and service costs as to whether they are restricted or general purpose is not always easy. Proposition 13 and the repeated state financial crises have spawned a myriad of revenue shifts, special subventions and other financial legerdemain that have greatly complicated the fiscal structure of local government. As result, each local revenue source must be carefully analyzed to determine which category it falls into.

Proposition 172 funding is an exemplar of the problem. During the state fiscal crisis of the early 1990's, the Legislature decided to transfer a substantial portion of the property tax from local public agencies to local school districts to maintain support of the schools. This was known as the "Educational Revenue Augmentation Fund (ERAF) property tax shift" To partially mitigate that revenue loss, the Legislature placed a measure on the ballot in November of 1993, Proposition 172, to increase the state sales tax by ½ percent. The revenue from the sales tax increase would be distributed to local government. In an effort to make the measure more attractive to voters, the measure specified that the revenue from the added sales tax was designated exclusively for public safety. The measure was approved by the voters and was added to the State Constitution as Section 35 to Article XIII.

Section 35(3) of Article XIII states: "(3) In order to assist local government in maintaining a sufficient level of public safety services, the proceeds of the tax enacted pursuant to this section shall be designated exclusively for public safety." The Legislature subsequently adopted implementing legislation at §§30051-30056 of the Government Code. In this legislation, the Legislature repeated the limitation on the purposes for which the additional monies could be spent. §30052 provides that "The amounts so allocated shall be available only for public safety services" and then in subsection (b)(1) specifically defines "public safety services" to include sheriffs, police, fire protection, county district attorneys, county corrections, and ocean lifeguards, but not courts. This limitation is repeated in §30055.

The statutory scheme also provides an allocation formula for distribution of a portion of a county's Proposition 172 funds to cities within the county providing public safety services based upon the fiscal year 1993-94 ERAF revenue shifts (Gov. Code §30054) The allocation formula provides no mechanism for cities incorporating after fiscal year 1993-94 to become eligible for any distribution of Proposition 172 revenues.

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Thus the Legislature took away local general purpose property tax revenue and partially replaced it with sales tax revenue. However, that replacement revenue source can only be used to fund one subset of governmental services, public safety and is not available to new cities.

The issue then is whether the restrictions placed upon the expenditure of Prop 172 funding require its classification as a “restricted revenue” source under §56810(c).

There is one reported case that considers the role of Prop 172 funding in the context of an incorporation, *City of Shasta Lake v. County of Shasta* (1999) 75 Cal.App.4th 1, [88 Cal.Rptr.2d 863]. Unfortunately (at least for the purposes here) that case largely turns on interpretation of a specific incorporation agreement between the City of Shasta Lake and the County of Shasta, rather than the statutes. So the case provides little guidance to the application of Prop 172 to calculation of the property tax exchange question here.¹

Even without any specific case law on the issue, application of standard rules of statutory interpretation is sufficient to resolve the issue here. In construing a statute, effect should be given according to the usual, ordinary import of the language employed in framing the statute. If the words of the statute are clear, they should not be added to or altered to accomplish a purpose that does not appear on the face of the statute or from its legislative history. (*California Teachers Assoc. v. San Diego Comm. College District* (1981) 28 Cal.3d 692, 698 quoting *Rich v. State Board of Optometry* (1965) 235 Cal.App.2d 591 and *People v. Knowles*, (1950) 35 Cal.2d 175).

Here the language of both statutes is quite clear. §56810(c) specifically defines general purpose revenue. “[R]evenue from all sources available for general purposes” means the total amount of revenue which an affected local agency may use on a discretionary basis for any purpose and does not include any of the following: (A) Revenue which, by statute, is required to be used for a specific purpose. Prop 172, Article XIII, Section 35 is equally clear that the revenue provided to local agencies is to be “designated exclusively for public safety”. Thus it is not available for “any purpose” of the local agency and cannot be considered a general revenue source.

It could be argued that Prop 172 funding for public safety services simply frees up local general purpose revenue for other purposes and therefore, as a practical matter, functions as general purpose revenue. The law however does not go beyond the express language of the statutes if there is no ambiguity. Furthermore, this argument does not take into account §30056 of the Prop 172 implementing legislation. That section specifies that if an agency reduces its level of public safety funding below the pre-ERAF baseline level, that its Prop 172 funding would be reduced proportionately. As stated in the uncodified Section 2 of Statutes of 1994 Chapter 886 “It is not the intent of the Legislature that local governmental entities use the base year level of funding established by this act as a basis to reduce local public safety

¹ The *City of Shasta Lake* case does however provide some guidance with respect to the separate issue of revenue neutrality. While not specifically addressing the revenue neutrality provisions of §56815, the Court’s holding with respect to somewhat similar language in §57384(b) suggests that any Prop 172 monies retained by the County could be considered as part of the revenue neutrality calculation.

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budgets may not reduce its general revenue support.” Thus, Prop 172 funding is intended to be supplemental to local funding, not a replacement.

I therefore conclude that Prop 172 funding must be classified as a restricted revenue source for the purposes of the §56810 calculation of the property tax exchange in an incorporation.

Sincerely,

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