The Municipal Income Tax and State Preemption in California

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California cities may be opening a pandora’s box of local taxes in their search for new sources of revenue. The primary source of revenue for municipalities, the property tax, is inadequate, inequitable, and outdated. Cities, frustrated in their attempt to find an adequate, alternative source of revenue, are forced to impose a multitude of levies on the resident, non-resident, and visitor to the city. Cities levy a variety of license, sales and use taxes in their search for new sources of revenue. Levying numerous low yield taxes is objectionable for two reasons. First, the system is perpetually inefficient. The many distinct, unrelated taxes create greater administrative costs which result in lower revenue yields. This unsatisfactory yield, in turn, requires taxation of new activities, goods, and services. Secondly, the body of taxes and system of taxation which evolves is not based on ability to pay. Therefore, the inequities of local taxation under such a system increase.

The solution obviously lies in utilizing another single, reliable source of revenue. A municipal income tax appears to be this necessary solution. One hundred seventy cities throughout the United States have proven that a municipal income tax is an adequate, efficient, and reliable source of revenue. However, California cities are deterred from imposing a local income tax because the state has preempted the field. The state legislature has expressly prohibited all California cities from levying a local income tax.

The aim of this comment is to analyze the nature of the taxing power of California cities and the legislature’s authority to preempt the field of local income taxation. This comment’s analysis will be divided into six basic categories. The first three sections deal with the status of California law regarding the guarantee of home rule and the power of local taxation. This necessarily includes an analysis of the constitutional basis for preemption of the field of income taxation. The remaining three sections will analyze and weigh the interests of the city against the interests of the state in an attempt

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1 See Januta, The Municipal Revenue Crisis: California Problems and Possibilities, 56 Calif. L. Rev. 1525 (1968) [hereinafter cited as Januta].
3 Cal. Rev. & Tax. Code § 17041.5 (West 1970). “Notwithstanding any statute, ordinance, regulation, rule or decision to the contrary, no city, . . . 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.”
to show that California cities have the right to levy a municipal income tax.  

**HOME RULE AND THE POWER OF TAXATION**

The issues involved in the municipality's power to levy an income tax concern only home rule chartered cities as distinguished from general law cities. The general law of the state governs general law cities making the state's preemption of income taxation binding. However, with regard to charter cities, the general law is not necessarily binding if the subject matter involved is of municipal concern. California adopted home rule provisions intending to provide California cities with some autonomy in governing municipal affairs. The home rule sections provide that any city with 3,500 inhabitants may frame a charter for its own government. Pursuant to the adoption of such charter, the city may make and enforce all laws and regulations regarding municipal affairs subject only to the restrictions and limitations provided in the city's own charter and the California Constitution. Local ordinances concerned with strictly municipal affairs govern over any conflicting laws of the state. However, in all other matters, the city is subject to the general law of the state.

A fundamental power guaranteed in the home rule grant is the power of taxation for local purposes. California courts have long concluded that the power of taxation is an essential, inherent power of the city.

A municipality without the power of taxation would be a body without life, incapable of acting, and serving no useful purpose. When such a corporation is created, the power of taxation is vested in it, as an essential attribute, for all the purposes of its existence, unless its exercise be in express terms prohibited.

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4 The Superior Court of Sonoma County upheld the state legislature's preemption of the field of income taxation in *County of Alameda v. City & County of San Francisco*, No. 60398, Nov. 7, 1968. Appeal is now pending, 1 Civil No. 26558, 1st App. Dist., Div. 2 (filed Feb. 17, 1969).

5 The object of amending California Constitution article XI, § 6 in 1896 from "cities and towns and charters thereof, should be subject to and controlled by the general law" to "except in municipal affairs" was to secure to the municipality that had "adopted a charter for its own government, the maintenance of its charter provisions in municipal matters, and to deprive the legislature of the power . . . to interfere in the government and management of the municipality. *Ex parte* Braun, 141 Cal. 204, 209, 74 P. 780, 782 (1903).

6 Id. art. XI, § 8(a).

7 Id. § 6.

8 West Coast Advertising Co. v. City & County of San Francisco, 14 Cal. 2d 516, 95 P.2d 138 (1939); *Ex parte* Braun, 141 Cal. 204, 74 P. 780 (1903).

The power of cities operating under freeholder's charters to raise money by taxation for municipal purposes does not find the source in any grant by the Legislature. Such power has been directly granted by the people of the State by the provisions of the Constitution. 10

Since the city's power to tax is essential to its very existence, it is apparently entitled to be relatively free from legislative interference. The difficulty lies in determining to what degree the city's power to tax should be free from legislative interference. The Constitution prohibits the legislature from taking over the city's power to tax for municipal purposes. 11 However, the problem is to determine the extent to which the state may limit the city's taxing power. The traditional statement is that municipal taxation for municipal purposes is a "municipal affair." 12 If this is the rule, apparently the state has no authority to limit the city's taxing power. However, the rule is not absolute. The city cannot adopt a tax policy which would be significantly injurious to the state as a whole. 13 The expression that municipal taxation for municipal purposes is a "municipal affair" represents an attempt to protect the city's right to exercise its fundamental power of taxation within reasonable limits. To define these reasonable limits, we need to analyze the possible basis for state preemption under the constitutional home rule section itself.

THE BASIS FOR PREEMPTION UNDER ARTICLE XI
SECTION SIX OF THE CALIFORNIA CONSTITUTION

The home rule guarantee, Article XI section six of the California Constitution, provides that a charter city is empowered "to make and enforce all laws and regulations in respect to municipal affairs, subject only to the restrictions and limitations provided in

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10 Ex parte Braun, 141 Cal. 204, 209, 212-13, 74 P. 780, 782, 783 (1903) quoting United States v. New Orleans, 98 U.S. 381, 393 (1878); accord, City of Glendale v. Trondsen, 48 Cal. 2d 93, 308 P.2d 1 (1957); 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).


12 City of Glendale v. Trondsen, 48 Cal. 2d 93, 308 P.2d 1 (1957); 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); Keyes v. City & County of San Francisco, 177 Cal. 313, 173 P. 475 (1918); Ex parte Braun, 141 Cal. 204, 74 P. 780 (1903).

their several charters, and in respect to other matters they shall be subject to and controlled by general laws.\textsuperscript{14} The legislative basis for preemption under section six depends on the California courts' interpretation of "municipal affairs." The courts, in regulatory areas, give a narrow interpretation to "municipal affairs." In tax matters, however, the court's position is not so clear. The problem, then, is deciding at what point local taxation for municipal purposes is no longer a municipal affair but becomes a matter of state concern sufficient to justify preemption. Resolving this problem necessarily demands an understanding of the preemption doctrine and its effect on the constitutional guarantee of home rule.

The doctrine of preemption has a significant impact on the home rule guarantee. When the legislature preempts a particular field, no local legislation on the matter is allowed. The state has occupied the field to the exclusion of municipal legislation.\textsuperscript{15} The effect of the preemption doctrine on the home rule guarantee demands that the court adopt a balancing test as the basis for finding state preemption. The test for finding preemption should in some degree preserve the constitutional guarantee of home rule to charter cities and yet allow the state an appropriate degree of freedom to deal with matters of state interest without fear that their policies may be frustrated by a particular city.

In regulatory matters, as distinguished from tax matters, California courts utilize three tests for finding a particular field impliedly preempted by the legislature. In the case of \textit{In re Hubbard},\textsuperscript{16} the California Supreme Court held a particular field to be preempted when:

1) the subject matter has been so fully and completely covered by general law as to clearly indicate that it has become exclusively a matter of state concern; 2) the subject matter has been partially covered by general law couched in such terms as to indicate clearly that a paramount state concern will not tolerate further or additional local action; or 3) the subject matter has been partially covered by general law, and the subject is of such a nature that the adverse effect of a local ordinance on the transient citizens of the state outweighs the possible benefit to the municipality.\textsuperscript{17}

The first method is based on a quantitative approach. However, the mere quantity of legislation provides no guidance in determining whether the legislature intended to preempt the particular field. The

\textsuperscript{14} \textit{CAL. CONST.} art. XI, § 6.
\textsuperscript{16} 62 Cal. 2d 119, 396 P.2d 809, 41 Cal. Rptr. 393 (1964).
\textsuperscript{17} \textit{Id.} at 128, 396 P.2d at 815, 41 Cal. Rptr. at 399.
task is to determine whether the legislation is so interrelated that the court "can detect a patterned approach to the subject." The latter two methods are based on a qualitative approach. California courts hold a particular field preempted by state legislation whenever a paramount state interest is involved or when the adverse effects on transients in the state caused by local legislation outweigh the benefits to the municipality.

Presumably the court will utilize the same bases to uphold express legislative preemption as it uses to uphold implied legislative preemption. As the California Supreme Court held in *Bishop v. City of San Jose,* "the Legislature is empowered neither to determine what constitutes a municipal affair nor to change such an affair into a matter of statewide concern." The court will determine whether the particular matter is a municipal affair and, consequently, whether the legislature may preempt a particular field to the exclusion of local legislation.

The rationalization for holding a particular field impliedly preempted in regulatory matters is the inherent need for uniformity of regulation. To prevent unnecessary confusion and uncertainty, the state legislation must control. This is especially true where criminal penalties are involved. Therefore, California courts have severely limited the city's home rule powers in matters of regulation. The California Supreme Court interprets section six of Article XI to mean that local legislation prevails over general law only when the subject matter is "exclusively," "solely," or "strictly" a municipal affair. In any matter where a state interest is involved, general law governs. Thus, in regulatory matters the Constitution prohibits the city from passing an ordinance which is in conflict with the general laws. An ordinance conflicts with general law if it is identical to the state law, authorizes what the general law prohibits,

20 Id. at 63, 460 P.2d at 141, 81 Cal. Rptr. at 469.
23 Id.
24 *Ex parte* Nowak, 184 Cal. 701, 704, 195 P. 402, 403 (1921).
or prohibits what the legislature authorizes.\textsuperscript{27} Thus, the city’s main role in regulatory matters is merely one of passing supplementary ordinances for unique local problems if the field is not preempted.\textsuperscript{28}

The vital question now is whether the tests for preemption by implication in regulatory matters should be utilized in matters of taxation. To determine the basis for state preemption, the court must remember that the power of taxation is an essential, inherent power of the city fundamental to its existence. The bases for preemption of a field of taxation should protect the charter city’s right to tax. However, the city’s right to determine its own local tax policies should only enjoy protection to the extent that the state, as a whole, does not suffer significantly.

With the above objective in mind, the “comprehensive state legislation” basis for finding preemption by implication cannot apply. Even though the state has extensive legislation covering a particular type of taxation, this is not a proper basis for finding the field preempted. It is evident that there may be concurrent, identical state and local forms of taxation. The state and city both levy sales taxes, license taxes, and personal property taxes.\textsuperscript{29} To hold that extensive state legislation on a particular form of taxation is a basis for preemption would make the city’s taxing power completely dependent upon legislative authority; a result California courts have rejected.\textsuperscript{30} The city, through the home rule grant, may have concurrent taxing powers with the state. Thus, the field of local income taxation is not preempted simply because the state has a comprehensive scheme of state income taxation.

The proper basis for state preemption of a field of local taxation should parallel the last two tests the California Supreme Court enunciated in the case of \textit{In re Hubbard}: 1) the area of taxation is of such paramount state concern that further local taxation cannot be tolerated; or 2) the particular local tax adversely affects transient citizens in such a manner as to outweigh the possible benefits to the municipality.\textsuperscript{31} These tests would both protect the state as a whole and preserve some of the autonomy guaranteed a charter city by the California Constitution. In tax matters, these tests must be strictly applied because we are dealing with a fundamental, constitutionally

\textsuperscript{27} \textit{In re Hubbard}, 62 Cal. 2d 119, 128, 396 P.2d 809, 812, 41 Cal. Rptr. 393, 396 (1964).
\textsuperscript{28} See 17 Hastings L.J. 603.
\textsuperscript{29} See Calif. Assembly Interim Comm. on Revenue and Taxation, Financing Local Government in California, Vol. 4 No. 13 (1964) [hereinafter cited as Financing Local Gov’t].
\textsuperscript{30} \textit{Ex parte Braun}, 141 Cal. 204, 74 P. 780 (1903).
\textsuperscript{31} \textit{In re Hubbard}, 62 Cal. 2d 119, 128, 396 P.2d 809, 812, 41 Cal. Rptr. 393, 396 (1964).
guaranteed power of the city. The state's interests must clearly outweigh those of the city in order to justify legislative interference with the city's autonomous taxing power. If not, the long established principle that a charter city should enjoy autonomy in local tax matters is meaningless.

A recent decision, *Century Plaza Hotel Co. v. City of Los Angeles*, causes some confusion. The California Court of Appeal for the second district upheld the state legislature's preemption of the field of taxation on the sale of alcoholic beverages when the local tax exceeds one percent. The court noted that taxation and regulation of alcoholic beverages are interrelated because high taxation of alcoholic beverages could result in a return to illegal trafficking. Therefore local taxation of liquor for revenue purposes was not a municipal affair but one of statewide concern. Although the court indicated that the legislature could preempt a field of taxation wherever there was "any state interest" involved, the decision seemed to be based on the fact that the case involved a fairly high tax on the sale of alcoholic beverages. Despite the fact that the tax was intended to raise revenue, the court's decision was based on the tax's regulatory effect. The court was careful to limit its decision to the area of taxation of alcoholic beverages.

The "any state interest" basis for state preemption of a field of local taxation is unacceptable. Justice Peters, dissenting in *Bishop v. City of San Jose*, noted that almost every controversy brought before the court involved both municipal and state interests. Since this is true, the "any state interest" test would make the city's inherent power of local taxation completely dependent upon the legislature and state tax policy. The legislature has a valid state interest in maintaining a favorable tax climate throughout the state—favorable at both state and local levels. Should California courts follow the "any state interest" test indicated in *Century Plaza Hotel*, a city's attempt to levy an income tax must fail and the constitutional guarantee of home rule is completely meaningless.

Consequently, the proper basis for legislative preemption of a field of taxation should be: 1) the area of taxation is of such paramount state concern that further local taxation cannot be tolerated;

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32 See note 5, supra.
34 Id. at 626, 87 Cal. Rptr. at 173.
35 Los Angeles attempted to impose a local excise tax of 5% upon the purchase price of alcoholic beverages. Id. at 618, 87 Cal. Rptr. at 167.
37 Id. at 67-69, 460 P.2d at 144-46, 81 Cal. Rptr. at 472-74 (dissenting opinion).
or 2) the particular local tax adversely affects transient citizens in such a manner as to outweigh the possible benefits to the municipality.

However, before applying these tests to the issue of local income taxation another constitutional issue arises. California has specific constitutional provisions authorizing the taxation of income. Since a California charter city's home rule powers are limited both by its charter and the California Constitution, it is necessary to determine whether the constitutional income tax provisions limit the power of income taxation to the state.

THE BASIS FOR PREEMPTION UNDER ARTICLE XIII, SECTIONS ELEVEN AND THIRTEEN OF THE CALIFORNIA CONSTITUTION

California Constitution Article XIII, section eleven provides that "[i]ncome 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 thirteen of the same article provides that "[t]he Legislature shall pass all laws necessary to carry out the provisions of this article."

Section eleven is an enabling provision authorizing California government to levy an income tax. Unfortunately section eleven does not indicate which California governmental body may levy a tax on income. Two interpretations of section eleven have been proposed. These interpretations attempt to lodge the exclusive power to tax income in the state legislature. One interpretation emphasizes the phrase "as shall be prescribed by law." Supposedly the use of the word "law" indicates an intent that all laws dealing with the taxation of income must be prescribed by the state legislature. Presumably, this interpretation is based on the customary description of legislative enactments as "laws" while enactments by the city are generally referred to as "ordinances." This interpretation is unacceptable. Our constitutional framers did not use such subtle distinctions to express their intent. The framers of section eleven could have easily and clearly said income taxes may be assessed and collected as the legislature shall prescribe. Significantly, they did not.

39 Id. art. XI, § 6.
40 Id. § 11.
41 Id. art. XIII, § 13.
42 See Januta, supra note 1, at 1541-43, analyzing the phrase "as shall be prescribed by law" and the contention that it refers exclusively to state statutes.
Even if the word "law" indicates the proper governmental body authorized to tax income, the only reasonable interpretation is that both the city and the legislature are so authorized. The home rule section refers to enactments of the city as "laws and regulations." The subtle distinction between laws and ordinances does not seem to be recognized by the Constitution. The California Supreme Court has held that the phrase "as may be provided by law" refers not only to legislative enactments but also to charter provisions of a California city. The only realistic interpretation of the phrase "as shall be prescribed by law" is that it embodies the fundamental principle of taxation under representative government: No tax may be imposed by inference or implication but rather the bounds of a tax must be measured by express enactment.

The second interpretation emphasizes the word "state" in section eleven. The use of the word "state" is significant because it is the only geographical criterion utilized. Therefore, the power to tax income in the scope prescribed by section eleven must belong exclusively to the state legislature. This argument is also unacceptable. Reliance on such subtle interpretations of the Constitution cannot be accepted in order to defeat the intent of the section. If the constitutional framers of section eleven intended the legislature to have the exclusive power to tax income, they could have made a direct and clear statement of such intent. There are at least 30 instances in the tax and revenue articles of the Constitution where the legislature is specifically directed or authorized to take particular action. In this light, it is significant that section eleven does not specifically identify the legislature. The only reasonable conclusion to be drawn from section eleven is that California governments may tax income.

Section eleven and section thirteen read together state that if an income tax is levied by California government, the legislature shall pass all necessary laws for assessment and collection. This reading is a better indication of the Constitution's intention to deposit the exclusive power to tax income in the state legislature. The command word "shall" used in express reference to the legislature arguably indicates an intent to deposit the exclusive power in

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43 CAL. CONST. art. XI, § 6.
44 Rothschild v. Bantel, 152 Cal. 5, 8-10, 91 P. 803, 805 (1907).
47 CAL. CONST. art. XIII, §§ 1, 1(c), 1(d), 1¾(a), 1¾(b), 1½, 2.8, 3, 7, 9, 9.5, 13, 14, 14¾(e)(3), 14¾(i), 15, 16(1)(b), 16(2), 19, 21(2), 21(3), 21(4), 21(5), 21.5, 22, 23, 25.5, 26, 27, 28.
that body. However, if this interpretation is adopted, the logical consequence is that legislative enactments are supreme in all fields of taxation mentioned in Article XIII. Conceivably, the state may totally preempt the city's power to tax real and personal property. The power to tax, essential to a city's existence, would be impotent if the only sources of revenue free from legislative interference are taxes not enumerated in Article XIII. A charter city's power to tax would become completely dependent upon the state legislature. But California courts have rejected this result. The courts have long established the principle that local taxation for municipal purposes is a municipal affair free from legislative interference.

The legislature's power under Article XIII must be read in light of the home rule provisions. The home rule provisions created a power of taxation in charter cities concurrent with, not dependent upon, the state legislature. Article XIII can be the basis for legislative preemption of a charter city's taxing power only where there is specific language to that effect. Accordingly, when we read section eleven along with section thirteen, the legislature has no authority under these provisions to preempt the field.

The key word in section thirteen is "necessary." The state is limited to passing legislation "necessary" to the imposition of a state income tax. "[The legislature] is not authorized, required, or empowered to pass laws that are not necessary to carry [the provisions of Article XIII] into effect..." Since preemption deals with prohibition and not with assessing and collecting an income tax, there is no constitutional basis for the legislature's express preemption of the income tax field under sections eleven and thirteen of Article XIII.

The constitutional convention debates concerning section eleven provide some help in resolving this dilemma. The income tax

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48 See note 46, supra.
49 CAL. CONST. art. XIII, § 1.
50 Id. § 14. Note, the field over 1% for personal property taxes is preempted by the Bradley-Burns Uniform Local Sales & Use Tax Law for cities utilizing the collection advantages of this act. CAL. REV. & TAX. CODE §§ 7200-7209 (West 1970).
51 See note 12, supra.
52 "Where the power of taxation has been lodged in the state to the exclusion of municipalities and other entities of that character, it has customarily been done by specific language expressive of such purpose." Ainsworth v. Bryant, 34 Cal. 2d 465, 472, 211 P.2d 564, 568 (1949).
53 People v. Central Pac. R.R., 83 Cal. 393, 405-6, 23 P. 303, 307 (1890). Any language asserting that the legislature has the sole authority to determine who may tax cannot be used to limit a charter city's taxing power. The case was heard in 1890 prior to the 1896 and 1914 adoptions of the home-rule provisions.
54 2 DEBATES AND PROCEEDINGS OF THE CONSTITUTIONAL CONVENTION OF THE
provision was adopted for some enlightening reasons. The delegate who introduced the provision and those who supported him did so primarily because of the “injustice and inequality of the [existing] system of taxation.” California, at the time, relied primarily on a property tax system, with some reliance on poll and license taxes, for its revenues. The aim of section eleven was to adopt a system of taxation which would relieve Californians of the inequities of the property tax system. Ironically the inequities the income tax provision was intended to relieve are the same inequities existing in our local system of taxation. Property is not always a valid indicator of ability to pay, yet the property tax is the city’s primary source of revenue. A fundamental rule of constitutional interpretation is to interpret constitutional provisions liberally in order to accomplish the objects of its establishment. In order to curb increasing inequities of the property tax system and preserve a respectable degree of home rule, a California charter city must have concurrent authority to levy an income tax under section eleven of Article XIII of the California Constitution.

THE MUNICIPAL INCOME TAX AS A SOURCE OF REVENUE

The city income tax is important because it has proven to be a reliable source of revenue and is based on the best practical indicator of ability to pay. The typical city income tax is a flat rate tax levied on gross earnings of the individual and net profits of business. Some may object that this tax is regressive and inequitable. However in order to maintain a productive source of revenue and to keep administrative costs low, the city must levy a flat rate on gross earnings. The inequities which result from a flat rate municipal income tax are kept at a minimum due to the low rate imposed. Cities levying an income tax in the United States tax at a rate ranging from .5 percent to 2 percent, with a majority of the cities taxing at a rate of 1 percent or less. Moreover, gross income is still a better indicator of ability to pay than property.


55 Id. at 945.
56 Id.
58 See note 2, supra.
The desirable tax system should not only tax according to ability to pay but also according to benefits received. A property tax only taxes the resident, while the non-resident earning an income in the city contributes nothing for the benefits he receives while in the city. A local income tax remedies this problem. The tax is on income earned in the city whether earned by a resident or a non-resident. Thus, the non-resident is forced to contribute something according to the benefits received. Certainly the city should tax the non-resident at a lower rate than the resident because the non-resident does not receive the same amount of benefits. The legislature would be justified in placing a ratio limitation on the rate a city may tax income of the non-resident.

Administrative costs in levying an income tax are relatively low. "[T]heorists once made gloomy predictions about administration and compliance problems . . . . But actual experience has . . . demonstrated that the city income tax may be administered with reasonable efficiency . . . ." The low administrative costs incurred in levying the local income tax are explained largely as a consequence of its simple structure and withholding procedure. The average city cost for collection was 4.4 percent of the total revenue received. In larger jurisdictions these costs dropped to 3.9 percent.

The local income tax does not impose great compliance burdens on the taxpayer. The wage earner experiences almost no burden since deductions are usually taken from his wages by his employer. The added cost to employers to make these deductions in the age of the computer appears to be minimal. Deductions are already required for federal income taxes. The added administrative cost of deducting local taxes would not be too burdensome.

A municipal income tax seems to be the necessary solution to preserve California cities' constitutional guarantee of home rule. Projected California local government revenue needs for 1973 are about ten and one half billion dollars. Five and one quarter billion

62 See FINANCING LOCAL GOV'T at 42. The California Assembly committee on Revenue and Taxation suggested various criteria to consider in selecting future sources of local revenue.
63 The aim of the commuter tax in San Francisco was to make the non-resident working in the city pay for some of the benefits he receives. San Francisco, Cal., Ordinance 246-68, § 2, Aug. 19, 1968.
64 For example, the legislature may limit the city's power to tax non-resident income at one half the rate imposed on its residents.
65 CITY INCOME TAXES at 22-24.
66 Id.
67 Id. at 24.
68 Reports from ten firms gave deduction costs ranging from ten to five hundred dollars. Id. at 25.
dollars is estimated to come from the property tax. Further reliance on the property tax is economically and politically infeasible. The general public opposition to increased property taxes indicates that if increased taxation is necessary, the property tax cannot be the source. Where is the balance to come from? Certainly a portion should come from state and federal subsidy. However, further reliance on subsidies means that the city will not have the final determination of what public services it will provide. Rather, such determinations will be made in the Congress or state legislature. The city, to preserve some degree of autonomy, will be forced to levy a multitude of low yield taxes which are even more undesirable. The necessary alternative is to recognize the California cities' right to levy a municipal income tax.

**WEIGHING THE STATE INTERESTS**

The legislature fears that municipal income taxation may have several detrimental effects. The state believes that a municipal income tax will have an adverse effect on the individual; that it will have an unfavorable impact on state and local economies; and that it will promote conflict and competition for tax dollars between neighboring cities. Any one of these interests may be of sufficient paramount interest to justify state preemption. Although great weight will be given to the legislature’s conclusions, the California Supreme Court has declared that the court will decide whether the basis for preemption is valid. The court’s duty then is to determine whether the legislature’s fears of the local income tax are warranted.

The legislature fears that local income taxation will adversely affect the individual in two ways. The first fear is that combined federal, state and local taxation of income will be too burdensome on the individual. Secondly, the legislature fears that municipal income taxation will impede the individual’s search for employment. Concerning the first contention, evidence from cities levying an income tax is quite revealing. Although not conclusive, the evidence indicates that per-capita total taxes in income tax cities are

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69 FINANCING LOCAL GOV'T at 38.  
70 Januta, supra note 1, at 1538.  
71 President Nixon's proposal for revenue sharing with the cities would provide cities with new and unrestricted funds. However, Congress is not likely to allow federal funds to pass without any restrictions. See Nixon, *State of the Union Message*, 37 VITAL SPEECHES OF THE DAY 226, 228 (February 1, 1971).  
72 Bishop v. City of San Jose, 1 Cal. 3d 56, 63, 460 P.2d 137, 141, 81 Cal. Rptr. 465, 469 (1969).  
73 Cal. Stats., 1968, ch. 1265, § 2, at 2388-89 (1968). See also FINANCING LOCAL GOV'T at 42.  
equivalent to or lower than those in other cities. That they would
tend to be lower is logically explained. A local income tax broadens
the tax base considerably taking in residents and non-residents. This
results in a lower per-capita share of the tax burden. This fact, and
the experience of states levying state and municipal income taxes
should dispel the legislature's fear that combined federal, state and
local tax rates would make taxation on income prohibitory.

Concerning the second contention, the legislature has declared
that it is contrary to state policy to have any unnecessary barriers
to the mobility of the individual to seek employment. The concern
that a local income tax will impede the individual's mobility to
search for employment is unacceptable. The local income tax rate
is so low that its deterrent effect on the mobility of the individual
is doubtful. States utilizing a municipal income tax have no evidence
that the tax acts as an impediment to the individual's search for
employment. An attempt to classify a local income tax on residents
and non-residents as an "unnecessary" barrier to seeking employ-
ment is arbitrary and unfounded. Occupation taxes certainly seem
to be an impediment to the professional seeking to locate in a certain
municipality. High property taxes may also be said to be an imped-
iment to mobility. Yet, presumably, these taxes fall into the category
of "necessary." There is no rational basis for concluding that local
income taxation is an "unnecessary" barrier. Rather, in light of
increasing property taxes, increasing inequities under the property
tax system, and increasing revenue needs, local income taxation
seems to be the "necessary" solution.

The legislature fears that municipal income taxation will have
an unfavorable impact on state and local economies. On the local
level, the state believes that municipal income taxation may be a
further impetus to the migration of business and industry from
the central city to the suburbs. The legislature fears that an un-
favorable local tax climate will reinforce economic factors causing
the migrational trend that is increasing the deterioration of our
inner cities.

Local tax structures do appear to be swing factors in intrastate
locational decisions of industry and business. However, as to turn-

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75 CITY INCOME TAXES at 31.
76 Alabama, Kentucky, Missouri, New York and Pennsylvania levy both state
and local income taxes.
77 See note 74, supra.
78 Taylor, Local Income Taxes After Twenty-One Years, 15 Nat'l Tax J. 113,
124 (1962).
79 See note 74, supra.
80 U. S. Advisory Commission on Intergovernmental Relations, State-Local
ing back the migrational trend of business and industry, the conclusion seems to be that the forces for decentralization are so potent that a favorable business tax climate in the inner city will have no countering effect.\textsuperscript{81} To reverse the migrational trend, the inner city must change its image by providing better services both in the aesthetic and functional areas. Better public services demand new revenues. The income tax seems to be the only reasonable and effective solution.

The state's preemption of income taxation causes more harm than good. First, the legislature denies the city the right to provide a more equitable tax structure for its inhabitants. Secondly, the city is denied an effective, reliable source of revenue.\textsuperscript{82} Lastly, this denial threatens the city's constitutional guarantee of home rule. The local income tax has proven to be a resourceful and equitable source of revenue. Higher property taxes are becoming economically and politically infeasible.\textsuperscript{83} To cover growing costs, the city is forced either to levy a multitude of low yield, nuisance taxes or to surrender more of its autonomy for federal and state subsidies. The cities' interests in levying a municipal income tax certainly outweigh the uncertain benefits preemption may provide.

The legislature also desires to prevent the migrational trend of people and business from the inner city to protect federal and state tax dollars poured into urban renewal programs.\textsuperscript{84} These tax dollars will be wasted unless the migrational trend is reversed. However, the uncertain effects that preemption will have on the migrational trend, do not outweigh the benefits that the city will enjoy from levying a local income tax. What is even more significant in this area is that the bulk of redevelopment dollars comes from the federal government. Yet, the federal government has expressed no fear that local income taxation may defeat redevelopment programs.

The state and federal governments are not the only agencies concerned with the city's condition. Preserving our cities demands a joint effort on the part of federal, state and city government. The city itself has an interest in its welfare and survival. The deterioration of the city is probably related to its financial condition. If the city feels that a local income tax will cause more good than harm, the city should have the power to act in its own behalf.

\textsuperscript{81} Id. at 69.
\textsuperscript{82} See note 2, supra.
\textsuperscript{83} See note 70, supra.
\textsuperscript{84} See note 74, supra.
Another reason the legislature preempted the field was to prevent the chaos of overlapping taxing jurisdictions.\textsuperscript{85} Allowing local income taxation seems to promote conflict and competition among neighboring jurisdictions.\textsuperscript{86} The risk that the non-resident may be subjected to double local income taxation by his resident municipality and his work municipality seems to be a valid fear.\textsuperscript{87} But, the remedy to this possibility already exists. California courts have long held that the taxing powers of a city extend only to its city limits. Dealing with occupation taxes based on gross receipts, California courts hold that the city may base its tax only on income earned within the city boundaries.\textsuperscript{88} The same territorial limitation should apply to a local tax on income. The municipality could only tax earnings within its city limits.\textsuperscript{89}

Probably the greatest threat the local income tax presents is placing an unfair local tax burden on the individual who works in one city and lives in another. This individual may be subjected to an income tax in his work municipality and also a high property tax in his home municipality. The total tax burden on the non-resident worker would be greater than on the individual who lives and works in the same city. The non-resident worker will pay more for the benefits he receives. The legislature may have a legitimate interest in preventing a city from levying an income tax on such non-residents. But, this interest should not justify prohibiting a city from levying an income tax on its residents. The local income tax remains very important to the city. The city would be able to place a ceiling on increasing property taxes and provide its inhabitants with a more equitable tax structure. Increased revenue needs would come from a tax based on ability to pay.

The legislature may be justified in preempting income taxation of non-resident workers who live in city’s that do not levy a local income tax. The preemption would be justified only because of the likelihood of high property taxes in the non-resident’s home city. However, once neighboring jurisdictions begin to levy an income

\textsuperscript{85} Calif. Senate Fact Finding Committee on Revenue and Taxation, A Study of the Feasibility of Increasing State and Local Government Revenues From Selected Taxes at 33 (1963).

\textsuperscript{86} See 7 Harv. J. Legis. 271, 277-81.


\textsuperscript{89} Id.

\textsuperscript{89} This limitation would favor the inner city. However, the inner cities' greater needs may justify such favor. See Holtmann, Migration to the Suburbs, Human Capital, and City Income Tax Losses: A Case Study, 21 Nat'l Tax J. 326 (1968). See also 22 Nat'l Tax J. 313 which discusses the impact of various local income tax policies on the inner city and its surrounding suburbs.
tax, a ceiling would be placed on their increasing property taxes. The justification for preemption would no longer exist. Cities should then be able to tax the income of its non-resident workers who live in cities which also levy an income tax. California's local tax structure would slowly evolve to a system based not only on ability to pay but also according to benefits received.

The property tax does not suit our changing commuter society. The property tax is inflexible. It is designed for a society which lives and works in the same city. The income tax enables city's to keep its local tax structures responsive to our urban make-up.

The last fear the legislature has is that local income taxation in California will have an adverse effect on the state's economy. The legislature fears that allowing California charter cities to levy local income taxes will nullify the state's efforts to create a favorable state tax climate attractive to business. A study of state and local taxation reveals that American business generally dislikes an income tax structure. Businessmen generally favor sales and use taxes. The legislature's concern certainly seems warranted. Local income taxation may have an adverse effect on the state's attempts to create a favorable tax climate. However, whether it is a sufficient basis for preemption is questionable.

Are the state's interests paramount to the city's? The state is interested in maintaining a favorable tax climate. Studies reveal that state tax structures do influence industrial and business locational decisions. However, their effect on these decisions are limited. Many other factors such as labor and material supplies are more fundamental. However, when several basically similar locations are available, the local tax climate may become a swing factor. The city's interests appear to be equal or paramount to the state's. The city is interested in maintaining a reliable source of revenue. The local income tax would not only provide the city with a sufficient reliable source of revenue but also enable it to provide its inhabitants with a more equitable tax structure. Also, the court cannot overlook the fact that it is dealing with an essential power of the city inherent in the constitutional guarantee of home rule. The court should recognize that the state and city interests are equal.

90 The desire to maintain a favorable tax climate attractive to business can be found in the legislature's declaration that it intends to make sales and use taxes rather than the income tax its chief source of revenue. Cal. Stats., 1968, ch. 1265, § 2, at 2388-89 (1968).
91 Taxation and Industrial Location at 65.
92 Id. at 60.
93 Id.
The proper basis for state preemption of the field of income taxation should parallel the tests enounced in the case of *In re Hubbard*: 94 1) The area of taxation is of such paramount concern that further local taxation cannot be tolerated; or 2) the particular local tax adversely effects transient citizens in such a manner as to outweigh the possible benefits to the city. 95 Hopefully, these tests would provide a proper balance between the city's right to tax and the legislature's right to determine general state tax policies. The "any state interest" test followed in regulatory matters is improper as a basis for preemption in tax matters. 96 This test would make California charter cities' taxing powers completely servient to general state tax policies. The city's power to tax would become completely dependent on the legislature. The legislature could preempt any local tax which has any adverse effect on the state. If the "any state interest" test is adopted, the legislature's preemption of the field of income taxation must be sustained.

If the "balancing tests" are applied, the legislature's preemption may be overruled. Certainly the state's preemption cannot be sustained under the "adverse effects on transients" test. The possible adverse effects a local income tax may have on transient citizens do not outweigh the possible benefits to the city. Local income taxation will not be burdensome on the majority of California employees. Evidence shows no difference in per-capita tax burdens between cities levying an income tax and those which do not. 97 Neither will a local income tax be a deterrent to the mobility of the majority of Californians seeking employment. 98 Undoubtedly, the income tax may have a deterrent effect on those in the upper income brackets. But, this adverse effect certainly does not outweigh the benefits the city will derive from a local income tax. The city will be able to provide its inhabitants with a more equitable tax structure; place a ceiling on increasing property taxes; and have a reliable source of income relatively low in administrative costs. 99 These definite benefits to the city outweigh the possible adverse effects on some transients of the state.

In this author's opinion the "paramount state interest" test cannot sustain the legislature's preemption of income taxation. The

94 See discussion in text accompanying notes 16-32, supra.
96 See discussion in text accompanying notes 33-37, supra.
97 See note 75 and accompanying text, supra.
98 See p. 22, supra.
99 See pp. 18-20, supra.
interests of the state are not paramount to those of the city. The legislature's fears of a local income tax are too uncertain. The city's benefits from a local income tax are very real. The city's alternatives emphasize the necessity of a local income tax even more. Facing growing costs and insufficient revenues, the city seeking to be somewhat self-sufficient has no alternative but to levy a multitude of low yield sales and use taxes. The property tax is becoming inadequate. Reliance on federal and state subsidies means the surrender of more of the city's independence in deciding its own fiscal policies. The necessary alternative is the municipal income tax.

CONCLUSION

Determining whether a city may levy an income tax despite express legislative prohibition is no easy task. The easy solution is to adopt the "any state interest" test espoused in Century Plaza Hotel. However, such an approach is not realistic. The "any state interest" test denies the city its constitutional guarantee of home rule. It renders the city's power to tax completely subject to state tax policies. California courts must define a basis for preemption in areas of taxation which will balance the interests of the city against those of the state. The "paramount state interest" test or the "adverse effects on transients" test recognize this need for balancing. The courts must recognize these tests if the home rule provisions of the Constitution are to have any meaning. The application of such tests is difficult but necessary. Under these tests, this author believes that the city should be able to exercise its inherent taxing power to tax income. The legislature's preemption of the field would be invalid.

Ronald Hansen

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100 Century Plaza Hotel Co. v. City of Los Angeles, 7 Cal. App. 3d 616, 87 Cal. Rptr. 166 (1970).