A SHORT HISTORY OF STATE TRANSPORTATION FUNDING

The excise tax on motor vehicle fuels ("the gas tax") provides the primary source of state funding for transportation in California and functions as a user-pays system for the state's highways and local streets and roads. The state first imposed an excise tax on gasoline and diesel in the 1920s, and historically revenue from the state's excise tax has been allocated to both the state and local governments.

Article XIX of the California Constitution provides that the gas tax may only be used for the "research, planning, construction, improvement, maintenance, and operations of public streets and highways (and their related public facilities for nonmotorized traffic)" and the "research, planning, construction, and improvement of exclusive public mass transit guideways (and their related fixed facilities)… ." Article XIX, therefore, prohibits using these gas tax revenues for most transit purposes, such as the purchase of buses and all operating costs.

TRANSIT FUNDING

In the post-World War II era, transit transitioned from privately provided to a local public service that was locally funded, largely from property taxes.

In the early 1970s, the Legislature passed and Governor Ronald Reagan signed the Transit Development Act (TDA) to provide a stable state subsidy program for transit. This was the state's first foray into using the sales tax, rather than an excise tax, to fund transportation.

With the passage of the TDA, the state dropped its statewide sales tax rate by a quarter percent and made up for the loss in the state's General Fund by broadening the sales tax base to include gasoline. Whenever the sales tax on gasoline produced more than enough revenue to fill that revenue hole, the state agreed to use the excess, or what was called the "spillover," to support public transportation. At the same time, the state required counties to impose a quarter-cent sales tax to be used to fund transit in urban areas and transit and roads in rural areas. Later the sales tax on diesel was also dedicated to transit.

These three sources – the local sales tax, the spillover, and the sales tax on diesel – became the primary sources of state support for transit funding. The local sales tax remains in the county of origin where transportation planning agencies allocate it to transit operators. The spillover and sales tax on diesel flowed into the state's Public Transportation Account (PTA), through which the state provides support to local transit districts and for intercity rail.

THE GAS TAX

In 1990, the voters approved Proposition 111, which the Legislature placed on the ballot and which increased the excise tax on motor vehicle fuels from 9 cents to 18 cents over a period of five years. The last of the Proposition 111 increases occurred on January 1, 1994 when the tax went up one cent to 18 cents per gallon. (This amount stood until 2010, when the Legislature enacted the "gas tax swap," which is described below.)

Through Proposition 111 the state also dedicated the increment of sales tax on the new 9 cents of gasoline excise tax to transit, a new revenue source for the PTA. In the years between full implementation of Proposition 111 and 2010, the gasoline excise tax lost over 30 percent of its purchasing power due to inflation. In its place the state provided primarily General Fund revenues, and local governments contributed funds from local, voter-approved, transportation sales tax revenues.

One of the most significant shifts of General Fund revenues to transportation occurred in 2000, when the Legislature dedicated the state sales tax on gasoline to transportation. California included this dedication in its constitution when the people approved Proposition 42 in 2002. Twenty percent of those revenues were dedicated to transit, 40 percent to the state highway system, and 40 percent to local streets and roads.

Then in 2006, Proposition 1B, which the Legislature placed on the ballot, authorized a $19 billion general obligation bond for transportation. Originally, the state General Fund repaid bonds issued under Prop. 1B, but beginning in the 2010-11 Fiscal Year, gasoline excise taxes, pursuant to the gas tax swap, provide funds to repay those bonds. (Because of the passage of Proposition 22 in November 2010, the state now uses commercial vehicle weight fees rather than gasoline excise taxes to repay these bonds.)

THE 2010 GAS TAX SWAP

Enacted in March 2010, the gas tax swap eliminated, effective July 1, 2010, the sales tax on gasoline and replaced it with an increase in the gasoline excise tax designed to generate an equivalent amount of revenue. To ensure continuing revenue neutrality in the swap, each year the Board of Equalization must adjust the gasoline excise tax such that over time the new excise tax generates the same revenue as the old sales tax on gasoline would have generated.

By eliminating the sales tax on gasoline, the gas tax swap ended the spillover and the Prop. 42 revenue stream. It thus decreased the amount of revenue dedicated to transit. Through its increase in the gas excise tax, it maintained Prop. 42-levels of funding for local street and roads and expanded funding for state highways. The swap also created a new, non-General Fund revenue stream of about $1 billion annually from the new gas tax revenues to repay existing general obligation transportation bonds, including those authorized under Proposition 1B of 2006.

To partially make up for this loss in transit funding, the gas tax swap legislation also provided for a revenue-neutral swap of (increased) sales tax on diesel and (reduced) diesel excise tax in order to increase PTA funds available for transit operations funding.

CONSTITUTIONAL LIMITS ON BORROWING TRANSPORTATION FUNDS

As the state moved away from the user-pay concept in transportation and embedded transportation in the state's General Fund, it subjected transportation to the same revenue vagaries that other General Fund programs face. During booming economic times, transportation received extra funding, but during more austere economic times the state borrowed transportation revenues or, in the case of PTA funds, used them without a plan to repay. In response, to restrict borrowing of these transportation funds, the people amended the California Constitution through:

- Proposition 2 of 1998, which limited state General Fund borrowing of state transportation funds, including gas tax revenues and funds in the Public Transportation Account. Specifically, loans to the state General Fund in any fiscal year had to be repaid within that fiscal year, except that repayment could be delayed up to 30 days after a state budget was enacted for the subsequent fiscal year. Funds could have been borrowed over a fiscal year during times of significant negative impacts on the General Fund, but such loans had to be repaid in full within three fiscal years.
- Proposition 1A of 2006, which restricted the borrowing of gasoline sales tax (*i.e*., Proposition 42) funds. It limited such borrowings to twice in a ten-year period, but it required full repayment of the first loan before a second could commence and required that any loan be fully repaid within three years.

PROPOSITION 22 OF 2010

In November 2010, the voters passed Proposition 22, which:

- Prohibits state borrowing of transportation funds, repealing the provisions of the California Constitution that Proposition 2 of 1998 and Proposition 1A of 2006 added.

- Embeds in the constitution statutory transportation funding formulas, generally providing that these could only be changed after a California Transportation Commission public hearing and reporting process and a two-thirds vote of each house.

- Precludes the Legislature from directing gas excise tax funds to pay previously issued bonds, thus undoing a major provision of the 2010 gas tax swap.

PROPOSITION 26 OF 2010 AND THE 2011 GAS TAX SWAP RE-DO

Also, in November 2010, the voters passed Proposition 26, which requires that any "change in state statute which results in any taxpayer paying a higher tax" must be enacted by a two-thirds vote of both houses and applied this requirement to any tax adopted after January 1, 2010.

Prop. 26 made any tax increase enacted after January 1, 2010 that the Legislature enacted by majority vote void November 2011. Because Prop. 26 could have been interpreted to void the increase in the gasoline excise tax but not void the elimination of the sales tax on gasoline included in the 2010 gas tax swap, the Legislature re-enacted the gas tax swap with a two-thirds vote in 2011 through AB 105 (Budget Committee), Chapter 6, Statutes of 2011.