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March 30, 2004

To: Members, California State Senate
Members, California State Assembly

From: Steven C. Szalay, Executive Director

Re: **Vehicle License Fees and the Realignment "Poison Pill"**

The California State Association of Counties (CSAC) strongly urges your support for immediate resolution of an impending funding crisis in realignment. As of March 1, 2004, California counties have not received the Vehicle License Fee (VLF) revenue that is dedicated to fund health, mental health, and social services programs under 1991 realignment. This situation results from the triggering of one of the poison pill provisions in the realignment statutes and can be remedied by legislative action.

Background. At issue is the indigent health care poison pill, which triggers the repeal of the increase in the VLF (which occurred via a change in the depreciation schedule) if a final judicial determination is made by a California court of appellate jurisdiction that counties are owed additional funds for indigent health care under law of 1982. In 1982, state law transferred responsibility for medically indigent adults from the state to the counties. This poison pill would not repeal the entire VLF, just the 1991 increase that generates revenue for realignment.

In 1990, San Diego County sued the state to recover costs for transfer of the Medically Indigent Adults (MIA) program from the state to counties. The State and County remained in court for a number of years. On September 24, 2003, the court of appeal entered a decision finding that the county is entitled to recover \$3.4 million from the State. Both the State and San Diego County filed appeals with the Supreme Court. On December 24, 2003, the Supreme Court denied the petitions. The Supreme Court's action makes the appellate court decision final.

Problem. The final adjudication of the San Diego County case resulted in a letter sent from the Department of Finance to the Department of Motor Vehicles (DMV) in February 2004. The letter indicated that the poison pill had been triggered and that the VLF depreciation schedule and DMV's authority to transfer funds to the Local Revenue Fund (the fund source for realignment) would be repealed as of March 1, 2004. DMV immediately enacted emergency regulations restoring the VLF depreciation schedule, effective March 1; however, DMV still lacks the authority to transfer VLF revenues otherwise dedicated to realignment to the Local Revenue Fund. These funds are being held by DMV until a legislative solution can occur.

On March 26, counties received about \$66 million in VLF revenues for realignment; this represents about half a month's payment. Annual estimated VLF revenues for realignment programs near \$1.5 billion. These revenues primarily fund health and mental health programs; counties remain responsible for these costs, regardless of whether adequate revenues are received.

Solution. The Administration has sponsored legislation that would resolve the issues brought about by the poison pill. AB 5 (5X), by Assembly Member Kevin McCarthy, makes the statutory changes to ensure that counties continue to receive realignment funding for critical county programs. Without this legislative fix, counties will be legally responsible for funding these mandated services without the resources to pay for them. At the very least, legislation should be approved to allow the DMV to transfer funds to the Local Revenue Fund through this fiscal year.

We want to be clear: these solutions do not increase taxes. When realignment was enacted, the pre-1991 depreciation schedule remained in statute. As of 2000, that depreciation schedule was repealed. Thus, the elimination of the 1991 depreciation schedule would result in no depreciation schedule for purposes of the VLF. All vehicles would be subject to a fee of 2 percent of the value of



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the vehicle, determined by the purchase price. We believe that failure to maintain the 1991 depreciation schedule would result in a tax increase and in increased State general fund costs for additional VLF backfill.

In closing, we respectfully urge your strong support of a swift solution to this matter. Lack of action could result in a funding crisis for California counties.

Please do not hesitate to contact me or my staff if we can provide additional assistance.

cc: Patricia Clarey, Chief of Staff, Governor's Office
Michael Gennest, Deputy Director, Department of Finance
S. Kimberly Belshé, Secretary, California Health and Human Services Agency