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TO: No on 40 - Californians to Protect Funding for Schools, Healthcare and Public Safety

FROM: Kurt Oneto and Jennifer Kent[1]

RE: Health Care & Education Funding Under Proposition 40 (2026)

- **SUMMARY**

Proposition 40 would impose a new one-time tax on certain individuals and trusts, with 90% of the revenues intended for health care and the remaining 10% for education or food assistance. The measure states that its revenues "shall not be used to supplant existing state funds" for these purposes.

Proposition 40's ability to guarantee additional state spending for health care and education is flawed in two important respects.

First, historical and judicial precedent demonstrate that even more robust non-supplantation language in other ballot measures has repeatedly failed to prevent state officials from sweeping new revenues and using them to support existing services–instead of expanding or improving services.

Second, Proposition 40 contains language that expressly permits the State to back out billions of dollars in existing funding and replacing it dollar-for-dollar with Proposition 40 revenues—a giant loophole that could allow the Legislature to effectively divert Proposition 40 revenue to non-health care and non-education purposes. That means there is no guarantee Proposition 40 will increase funding for health care at all.

The measure could also have other harmful, long-term impacts on California. The State's Legislative Analyst's Office ("LAO") warns that Proposition 40 could have a lasting negative impact on California's budget by reducing state income tax revenues and putting long-term funding for essential public services at risk.[2]

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[1] Jennifer Kent is a co-author of this report, but it not a member of Nielsen Merksamer LLP.
[2] LAO, "*Prop. 40.*" https://lao.ca.gov/BallotAnalysis/Proposition?number=40&year=2026.

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As the LAO analysis explains, some billionaires may respond to the new wealth tax by leaving California, taking their income tax payments with them. That could create an ongoing decline in state revenues, extending beyond Proposition 40's one-time tax collection and potentially increasing pressure on funding for schools, health care, and other essential services.[3]

- **ANALYSIS**

1. Historical and Judicial Precedents Demonstrate the Limits of Non-Supplantation Language.

California has a lengthy history of ballot measures promising that new revenues will supplement, rather than replace, existing government spending.

In 2016, voters approved Proposition 56, which imposed additional tobacco taxes to provide increased funding for Medi-Cal. Proposition 56 expressly provided that its revenues "shall not be used to supplant existing state general funds for these same purposes." (Rev. & Tax. Code § 30130.55.) Nevertheless, the Brown Administration used Proposition 56 revenues to cover ongoing Medi-Cal costs, retroactive drug rebate payments, and previously miscalculated costs that otherwise would have been paid from the General Fund.[4]

Proposition 56 was not an isolated case. In 1984, voters approved Proposition 37 to establish the California Lottery, with lottery profits dedicated to public schools. The initiative stated that lottery revenues "shall not be used to substitute funds but rather shall supplement the total amount of money allocated for public education in California." (Gov. Code § 8880.1.) Nonetheless, former Superintendent of Public Instruction Jack O'Connell acknowledged that lottery revenues are often used to supplant General Fund tax dollars that should be going to schools, and that lawmakers routinely ignored the measure's non-supplantation clause. Similar non-supplantation provisions accompanied Proposition 99 in 1988, which increased tobacco taxes for health-related programs and Proposition 28 in 2022, which provided additional funding for arts education. In each instance, instead of expanding services, lawmakers used revenues raised by these measures to backfill reductions in General Fund support.[5]

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[3] *Ibid.*
[4] Taryn Luna, *Jerry Brown Doesn't Want to Give Doctors a Cut of New Tobacco Tax Money,* SACRAMENTO BEE, Jan. 12, 2017.
[5] Michael Gardner, *State OKs Joining Mega Millions' Huge Lottery,* SAN DIEGO UNION TRIBUNE, Feb. 9, 2005; Douglas Shuit, *Spending Plan for Tobacco Tax Income Draws Fire from 2 Sides,* LOS

Courts have likewise been reluctant to interpret non-supplantation provisions as requiring the state to preserve funding for individual programs. In *Mental Health Assn. v. Schwarzenegger* (2010) 190 Cal.App.4th 952, the Court of Appeal allowed the state to eliminate an existing mental health program despite the requirement under 2004's Proposition 63 that its revenues shall not supplant existing state or county mental health funding. The court concluded that if Proposition 63 intended to preserve funding for a particular program, it could have expressly required that result.

Lastly, the voters passed Proposition 35 in November 2024 with overwhelming support. Funds from this measure were specifically dedicated to several core components of the Medi-Cal program (i.e., primary, specialty, hospital, clinic services and family planning). In spite of extremely detailed non-supplantation language, the budget has largely ignored the specific appropriations for these areas and, as the Legislative Analyst's Office detailed in its most recent overview of the state's 2026-27 state budget, "the largest is a $1.7 billion shift that uses Proposition 35 (2024) managed care organization (MCO) tax funds to cover provider payment increases that otherwise would have been supported by the General Fund."[6]

Together, these examples demonstrate the difficulty of enforcing such provisions.

2. Proposition 40 Expressly Allows its Revenues to Backfill Reductions in Existing State Spending

The more fundamental problem with Proposition 40 is contradictory language in the measure itself that expressly allows replacement of existing state funding.

Section 16355(d) states that Proposition 40 revenues shall not "supplant existing state funds" for health care, education, or food assistance. But subdivision (b)(1) of the same section provides that 90% of Proposition 40 revenues may be used for expenditures to "restore or address any reductions in federal funding or <u>state appropriations</u>" for health care. Section 16355(b)(2) provides the same authority for the 10% allocated to education and food assistance.

The measure then defines "reductions in state appropriations" to include decreases in state appropriations for health care, education, or food assistance below fiscal year 2024-25 levels. (Gov. Code § 16355(h)(2).)

ANGELES TIMES, Feb. 2, 1989; *Howard Blume, Proposed Bill Would Strip Protection for School Arts Funding, Former L.A. Supt. Beutner Warns,* LOS ANGELES TIMES, July 29, 2026.
[6] LAO, "The 2026-27 Budget: Overview of the Spending Plan," https://lao.ca.gov/Publications/Report/5197.

Thus, while one provision says Proposition 40 revenues cannot supplant existing state funding, another expressly allows those revenues to restore state spending whenever it falls below the 2024-25 baseline.

The practical consequences could be substantial. In fiscal year 2024-25, California spent approximately $115.3 billion on K-14 education and approximately $65 billion in state and local funds on health care.[7] Those amounts establish the relevant baseline under Proposition 40.

Section 16355(c) authorizes the Legislature to spend as much as $22.5 billion annually from the Proposition 40 health account and $2.5 billion from the education and food assistance account. The Legislature could therefore reduce ongoing education spending to $112.8 billion and use $2.5 billion of Proposition 40 revenues to restore spending to the $115.3 billion baseline. Similarly, it could reduce ongoing health care spending to $42.5 billion and use $22.5 billion of Proposition 40 revenues to restore spending to the $65 billion baseline.

In that scenario, as much as $25 billion in existing government spending could effectively be replaced by Proposition 40 revenues each year, freeing up an equivalent amount of unrestricted General Fund dollars that the Legislature can spend on any purpose it pleases—while producing no corresponding increase in overall education or health care spending. General Fund money could be freed to spend for other priorities while health care and education spending remain essentially unchanged.

- **CONCLUSION**

Proposition 40 promises that its revenues will supplement rather than supplant existing state funding. But California's experience with previous ballot measures demonstrates the limitations of such protections, and Proposition 40's own language creates an even more significant problem: it expressly authorizes its revenues to replace existing General Fund support for health care and education. The bottom line is that it is perfectly legal for the Legislature to spend Proposition 40 revenues in a manner that produces **<u>zero</u>** net benefit for health care and education.

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[7] CA Budget & Policy Ctr, "*The 2024-25 California State Budget Explained*," July 2024, https://calbudgetcenter.org/resources/the-2024-25-california-state-budget-explained/#:~:text=Budget%20Actions%20Increase%20the%20Prop.%2098%20Minimum,*%20%24103.7.%20*%20%2498.5.%20%248.3.%20*%20%24115.3; CA Health Care Foundation, "*Medi-Cal and the Federal Government – Policy at a Glance*," Jan. 22, 2025, https://www.chcf.org/resource/2025/01/22/medi-cal-federal-government/.