DRAFT

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date Enrolled:	**Enrolled**	Bill No:	**SB 27**
Tax:	**Local Sales and Use**	Author:	**Hancock**
Related Bills:			

BILL SUMMARY

This bill would prohibit a local agency from entering into an agreement that results in the payment, transfer, diversion, or rebate of any Bradley-Burns local tax proceeds when the agreement results in the reduction of Bradley-Burns tax proceeds received by another local agency from a retailer, and that retailer continues to maintain a physical presence within the jurisdiction of the originating local agency, with specified exceptions.

ANALYSIS

CURRENT LAW

The Board administers the Bradley-Burns Uniform Local Sales and Use Tax Law (Bradley-Burns Law) which authorizes counties to impose a local sales and use tax of 1 percent on tangible personal property sold at retail in the county, or purchased outside the county for use in the county.[1] All counties within California have adopted ordinances under the terms of the Bradley-Burns Law and levy the 1 percent local tax.

Cities are authorized to impose a local sales and use tax rate of up to 0.75 percent. The city sales and use tax rate is credited against the county rate so that the combined rate does not exceed 1 percent.

Of the 1 percent, cities and counties use the 0.75 percent to support general operations. The remaining 0.25 percent is designated by statute for county transportation purposes and may be used for road maintenance or the operation of transit systems. The counties receive the 0.25 percent tax for transportation purposes regardless of whether the sale occurs in a city or in the unincorporated area of a county.

In fiscal year 2007-08, $5.66 billion from the 1 percent Bradley-Burns sales and use taxes was allocated among all of the state's 58 counties and 478 cities. The Board contracts with each city and county to administer its local sales and use tax ordinance.

Place of Sale – Allocation of Bradley-Burns Local Tax. Revenue and Taxation Code Section 7205 of the Bradley-Burns Law specifies the "place of sale" for purposes of allocating local sales tax. Under this section, in general, all retail sales in California are consummated at the place of business of the retailer. **If a retailer has *only one* place of business** in California, the local sales tax derived from those sales made at the retailer's place of business are allocated to the city, county, or city and county in which the retailer's place of business is located. If title to the property sold passes to the purchaser in California, it is immaterial that title passes to the purchaser at a place outside the city, county, or city and county in which the retailer's place of business is

[1] The actual Bradley-Burns county/city tax rate is 1.25%/1.00%. During the pendency of the "Triple Flip," however, the tax rates are temporarily reduced to 1.00%/0.75%. Local jurisdictions are reimbursed for the 0.25% reduction in local sales and use taxes with property tax revenues.

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located, or that the property sold is never within the city, county, or city and county in which the retailer's place of business is located.

If a retailer has *more than one* place of business in California, the place or places at which the retail sales occur for purposes of allocating the local sales tax is determined in accordance with regulations adopted by the Board.

Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*, interprets and makes specific the laws governing the "place of sale" for purposes of allocating local tax revenues to local jurisdictions. Under paragraph (2) of subdivision (a), **if a retailer has *more than one* place of business** in California but only one place of business participates in the sale, the sale occurs at that place of business. If a retailer has *more than one* place of business in California which participate in the sale, the sale occurs at the place of business where the principal negotiations are carried on. If this place is where the order is taken, it is immaterial that the order must be forwarded elsewhere for acceptance, approval of credit, shipment, or billing.

Place of Sale - Allocation of Bradley-Burns Local Tax – Jet Fuel. Section 7205(b)(2) defines the place of sale for jet fuel for the purposes of allocating local sales tax. All jet fuel sales made are allocated to the point of delivery of the jet fuel into the aircraft, regardless of whether the seller has one or more places of business in California. Thus, the place of sale of jet fuel is the city, county, or city and county where the jet fuel is delivered into the aircraft.

For multijurisdictional airports, the tax is split between the jurisdiction in which the airport is located and the jurisdiction that owns or operates the airport, as further specified in law.

In General - Countywide Pool Allocations, Buying Companies, Use Tax Direct Payment Permits.

Countywide Pool Allocations. The countywide pool is an accounting system that indirectly distributes the local portion of the sales or use tax reported for specified transactions. When title to property transfers to the California customer outside this state, the transaction is subject to use tax regardless of whether any registered place of business of the retailer participates in the sale. The local use tax is generally allocated through a countywide pool process to each city in a county where the property is put to its first functional use. Examples of taxpayers, who report use tax allocated through a countywide pool include construction contractors who are consumers of materials furnished and installed on a construction contract, out-of-state retailers who ship merchandise directly to California consumers from a warehouse or stock of goods located outside of California, and California retailers who ship merchandise directly to California consumers from a warehouse or stock of goods located outside California. These retailers receive a supplemental schedule with their sales and use tax return to report their local use tax.[2]

[2] These retailers are issued a supplemental schedule (*Schedule B – Detailed Allocation by County of 1 Percent Uniform Local Sales and Use Tax*) with their sales and use tax returns to report their local tax. *Schedule B* lists each county within the state of California. At the end of each reporting quarter, the countywide pool totals are prorated among the cities, redevelopment areas, and the unincorporated area of each county using the proportion that the directly-reported tax for each city and unincorporated area of a county bears to the total directly-reported tax for the county as a whole. The pools account for about

Buying Companies. Under existing law, Section 6066 specifies that every person desiring to engage in or conduct business as a seller within California is required to apply for a seller's permit. Regulation 1699, *Permits*, subdivision (h), provides guidelines for issuing a permit to a buying company. The regulation defines a buying company as a legal entity that is separate from another legal entity that owns, controls, or is otherwise related to, the buying company and which has been created for the purpose of performing administrative functions, including acquiring goods and services, for the other entity. The regulation goes on to specify that a buying company formed for the sole purpose of redirecting local tax from the location(s) of the vendor(s) to the location of the buying company shall not be recognized as a separate entity for issuing a seller's permit.

In addition, Regulation 1699 (h)(2) provides that a buying company is not formed for the sole purpose of redirecting local sales tax if it has one or more of the following elements:

- Adds a markup to its cost of goods sold in an amount sufficient to cover its operating and overhead expenses.
- Issues an invoice or otherwise accounts for the transaction to show that the buying company is formed for a purpose other than the redirection of local sales tax.

Use Tax Direct Payment Permit. Section 7051.3 allows certain taxpayers to pay use tax directly to the Board that would otherwise be collected and remitted to the Board by the retailer making the sale. It provides for the direct allocation of use tax to the local jurisdiction of first use by the purchaser, rather than allocation through the countywide pool. This section applies to *use* tax transactions only.

A Use Tax Direct Payment Permit may be issued to any applicant who agrees to self-assess and pay use tax directly to the Board, and certifies to the Board either of the following:

- The applicant is the purchaser for its own use or is the lessee of tangible personal property (excludes vehicle leases) at a cost of $500,000 or more in the aggregate during the calendar year immediately preceding the application for the permit,

or

- The applicant is a county, city, city and county, or redevelopment agency.

As of December 2008, the Board has issued 167 Use Tax Direct Payment Permits, which are in active status. Of the 167 permits, 56 are held by businesses and 111 are held by local government agencies (of the 111 permits, 98 permits are held by cities).

PROPOSED LAW

This bill would add Section 53084.5 to the Government Code to prohibit a local agency from entering into any form of agreement that would result, directly or indirectly, in the payment, transfer, diversion or rebate of any amount of Bradley-Burns local tax proceeds to any person for any purpose when both of the following apply:

10% of the local sales and use tax reported, with use tax accounting for the majority of the pooled revenues.

- The agreement results in a reduction in the amount of Bradley-Burns tax proceeds that is received by another local agency from a retailer that is located within the territorial jurisdiction of that other local agency; and,
- The retailer continues to maintain a physical presence within the territorial jurisdiction of that other local agency.

This bill states that the provisions do not apply if the retailer has expanded its operations into another jurisdiction with the result that the retailer is conducting a comparable operation within the jurisdiction of both local agencies.

Definitions. This bill provides the following definitions:

"Local agency" means a chartered or general law city, a chartered or general law county, or a city and county.

"Retailer" means a retailer as defined by Section 6015 of the Revenue and Taxation Code (RTC).

"Physical presence" means the lease or ownership of any real property for the purpose of carrying on business operations.

Specified exceptions. This bill provides that its provisions do not apply to certain agreements related to the following:

- An agreement resulting in a reduction in the use tax proceeds that are distributed to the originating local agency through one or more countywide pools.
- An agreement to pay or rebate Bradley-Burns local sales and use tax revenue related to a buying company, which is defined as a legal entity that is separate from another legal entity that owns, controls, or is otherwise related to, the buying company and which has been created for the purpose of performing administrative functions, including acquiring goods and services for the other entity, as defined by the Board, and meets requirements of a buying company under RTC Sections 6066 to 6075, inclusive, and the regulations adopted pursuant to those sections.
- An agreement to pay or rebate any use tax revenue related to a use tax direct payment permit issued under RTC 7051.3.

As stated in the measure, the provisions do not apply to local tax proceeds provided by a local agency to a retailer if those proceeds are used to reimburse the retailer for the construction of public works improvements that serve all or a portion of the territorial jurisdiction of that local agency.

This bill provides that the provisions should not be interpreted to limit the ability of a local agency to contract with or otherwise enter into an agreement pursuant to subdivision (b) of RTC Section 7056.

It contains legislative findings and declarations that the economic development agreements entered into between cities and developers has resulted in an unjust reallocation of Bradley-Burns local sales and use taxes away from several cities.

As an urgency measure, it would become effective immediately.

BACKGROUND

This bill is very similar to last year's AB 697 (Hancock). The only substantive difference is that AB 697 did not contain an urgency clause and specified an operative date of October 1, 2008. AB 697 was vetoed by the Governor Schwarzenegger and the veto message states:

> "The historic delay in passing the 2008-2009 State Budget has forced me to prioritize the bills sent to my desk at the end of the year's legislative session. Given the delay, I am only signing bills that are the highest priority for California. This bill does not meet that standard and I cannot sign it at this time."

The sponsor of that bill was the City of Livermore. Based on information from the City of Livermore and various newspaper articles, the City of Fillmore entered into an agreement with two private consulting firms whereby the consulting firms agreed to bring new retail businesses to the City of Fillmore in exchange for a rebate of local sales and use tax revenues. Under this agreement, the consulting firms receive 85 percent of the Bradley-Burns tax revenues that are attributable to a retailer that works with the consulting firm to relocate its sales offices into Fillmore. The consulting firms, in turn, rebate the majority of the 85 percent local tax revenue to the relocated retailer.

During the second quarter of 2008, the Board's Allocation Group received several inquiries from cities and their consultants regarding a suspected misallocation of local tax. Staff from both the Board's Allocation Group and Local Revenue Allocation Section conducted an investigation and concluded that a misallocation of local tax had occurred. All affected local jurisdictions were notified of Board staff's decision. Certain jurisdictions have filed petitions with the Board. The Board's Allocation Group is currently reviewing those petitions and will be issuing a supplemental decision. Once the supplemental decision has been issued, if the petitioning jurisdictions do not agree with that decision, their petitions will then be forwarded to the Board's Appeals Division for the scheduling of an appeals conference.

COMMENTS

1. **Sponsor and purpose.** The bill is sponsored by the City of Livermore in an effort to prohibit cities and counties from using Bradley-Burns sales tax rebates as an incentive to draw sales tax generating activities away from other communities.
2. **The February 23, 2009 amendments** added coauthors and clarified that the provisions apply to agreements enacted after the effective date of this bill.
3. **This bill does not impact the Board's administration of the local tax.** Once the Board disburses funds to the local governments based on the Bradley-Burns laws and regulations, the locals then control how the money is spent or allocated.
4. **The bill's prohibition would not apply to certain agreements.** The bill's restrictions do not apply to agreements involving reductions in local use tax distributed through the countywide pool process and local tax agreements related to buying companies and use tax direct payment permits. In addition, the bill's provisions do not apply: 1) to local tax proceeds provided by a local agency to a retailer if those proceeds are used to reimburse the retailer for the construction of public works improvements that serve all or a portion of the territorial jurisdiction of that local agency, and 2) if a retailer that has expanded its operations into another

jurisdiction with the result that the retailer is conducting a comparable operation within the jurisdiction of both local agencies.

5. **The bill specifies that provisions would not limit the ability of a city or county to enter into an agreement pursuant to Section 7056.** Current law provides that if any county, city and county, city, or district wishes to examine sales, transactions, and use tax records to ascertain the taxes collected for that jurisdiction pursuant to a contract between the Board and that jurisdiction, it must adopt a resolution authorizing one or more of its officials, employees, or other designated persons to examine those records.

6. **2007 Legislative Analyst's Office (LAO) report discusses ways to address problems related to present local sales tax allocation system.** In 2007, the LAO prepared a report, *Allocating Local Sales Taxes,* which discusses the negative consequences of the situs-based system and how it creates counterproductive competition between local governments for sales-tax generating businesses. Among other things, the report focuses on the use of sales tax rebates and other financial incentives by local governments to encourage the relocation of sales offices for the purposes of diverting sales taxes. www.lao.ca.gov/2007/sales_tax/sales_tax_012407.pdf .

COST ESTIMATE

This bill would not impact the Board's administrative costs.

REVENUE ESTIMATE

This bill would not impact the state's revenues.

Analysis prepared by:	Debra Waltz	324-1890	05/29/09
Contact:	Margaret S. Shedd	322-2376	

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