STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**08/23/04**	Bill No:	**SB 1115**
Tax:	**Bradley-Burns Local**	Author:	**Committee on Budget and Fiscal Review**
Related Bills:	**SB 1096 (Committee on Budget and Fiscal Review,) SCA 4 (Torlakson) AB 2115 (Committee on Budget)**		

BILL SUMMARY

This bill makes technical corrections and clarifying changes to SB 1096 (Committee on Budget and Fiscal Review, Chapter 211, Statutes of 2004), the local government Budget trailer bill. Among its provisions, this bill would provide that, during the revenue exchange period (also known as the "Triple Flip") the applicable local sales and use tax rate in the case of a county is 1 percent, and in the case of a city is 0.75 percent or less (this change replaces the language that required a county or a city to impose a sales and use tax at a rate as specified in the local ordinance as of January 1, 2004, reduced by 0.25 percent). The provisions of this bill would take effect immediately.

Although this bill affects property tax, sales and use tax, and vehicle license fee revenues, this analysis will discuss the sales and use tax provisions only. The property tax and vehicle license fee provisions will not be discussed because they are not within the scope of administration by the Board.

Summary of Amendments

The previous version of this bill was a spot bill intended to be used as a budget trailer bill to enact statutory changes related to the local government portion of the 2004-05 Budget Act.

ANALYSIS

Current Law

The Sales and Use Taxes Law (commencing with Section 6001 of the Revenue and Taxation Code), provides that a sales tax is imposed on retailers for the privilege of selling tangible personal property at retail. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased from a retailer. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless specifically exempted or excluded from the tax.

The statewide sales and use tax rate is 7.25 percent. Of the 7.25 percent base rate, 6 percent is the state portion and 1.25 percent is the local portion. However, beginning July 1, 2004, the state tax rate increased by 0.25 percent, from 6 to 6.25 percent, and the local tax rate decreased by 0.25 percent, from 1.25 to 1 percent. The revenues from the 0.25 percent state tax rate increase are to be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the deficit bonds.

The components of the state sales and use tax rate of 6 percent are as follows:

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- 4.75 percent is allocated to the state's General Fund which is dedicated for state general purposes (Sections 6051 and 6201 of the Revenue and Taxation Code);
- 0.25 percent is allocated to the state's General Fund which is dedicated for state general purposes (Sections 6051.3 and 6201.3 of the Revenue and Taxation Code);
- 0.50 percent is allocated to the Local Revenue Fund which is dedicated to local governments to fund health and welfare programs (Sections 6051.2 and 6201.2 of the Revenue and Taxation Code);
- 0.50 percent is allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution).

The Bradley-Burns Uniform Local Sales and Use Tax Law (commencing with Section 7200 of the Revenue and Taxation Code), authorizes a county to impose a local sales and use tax at a rate of 1.25 percent, and similarly authorizes a city to impose a local sales and use tax rate of 1 percent that is credited against the county rate. Beginning on July 1, 2004, and continuing through the revenue exchange period, existing law temporarily suspends the authority of a county or a city to impose a tax under the Bradley-Burns Law, and instead provides that the applicable rate is the rate that was specified in the local ordinance as of January 1, 2004, reduced by 0.25 percent.

Existing law also provides that this reduction in the local tax rate will be increased by 0.25 percent when the DOF has made a specified notification to the Board, pursuant to Section 99006 of the Government Code, that the $15 billion Economic Recovery bond has been repaid.

Proposed Law

This bill makes technical amendments to the Triple Flip as made by SB 1096 (Committee on Budget and Fiscal Review, Chapter 211, Statutes of 2004), a local government budget trailer bill. SB 1096 enacted statutory changes related to the local government portion of the 2004-05 Budget Act, and also made technical amendments to the Triple Flip. This bill would make additional technical amendments to the Triple Flip. Among other things, this bill would amend Section 7203.1 of the Revenue and Taxation Code to provide that, during the revenue exchange period, the applicable local sales and use tax rate is: (1) in the case of a county, 1 percent; and (2) in the case of a city, 0.75 percent or less.

This bill provides legislative findings and declarations that the provisions of this bill are in its entirety an "interim measure" within the meaning of Proposition 65. If Proposition 65, The Local Taxpayers and Public Safety Protection Act, on the November 2, 2004 general election ballot, is approved by the voters, the effect and operation of this bill would be suspended pending approval of this bill by the voters at the first statewide election, following the passage of Proposition 65.

The provisions of this bill would become effective immediately.

Background

The original "Triple Flip" bills, Assembly Bill 7x (Chapter 13 of the First Extraordinary Session, Oropeza) and Assembly Bill 1766 (Chapter 162, Committee on Budget) were signed by Governor Davis on August 2, 2003, as part of the 2003-04 Budget Plan. AB 7x enacted the California Fiscal Recovery Financing Act and authorized the issuance of $10.7 billion in bonds to finance the cumulative 2002-03 budget deficit. AB 7x would have increased the state tax rate by 0.50 percent but would have decreased the local tax rate by 0.50 percent (cities and counties would be reimbursed for their local tax

revenue losses through property tax revenues). The revenues from the 0.50 percent state sales and use tax increase would be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the deficit-financing bonds.

AB 1766 implemented the property tax component of the "Triple Flip." Under AB 1766, cities and counties are reimbursed for the 0.50 percent reduction in the local sales and use tax rate (in AB 7x) through property tax revenues. Property tax revenues otherwise allocated to the ERAF would be diverted to the Sales and Use Tax Compensation Fund (SUTCF) established in each county. The state, in turn, would make schools whole with increased General Fund support, as required under Proposition 98. The provisions of AB 7x and AB 1766 were to become operative on July 1, 2004.

On December 12, 2003, Governor Schwarzenegger signed Assembly Bill 9 (Chapter 2 of the Fifth Extraordinary Session, Oropeza), which reduced the amounts proposed under the original "Triple Flip" bills (AB 7x and AB 1766). AB 9 enacted the Economic Recovery Bond Act and authorized the issuance of up to $15 billion of bonds to finance the accumulated budget deficit. The voters approved Governor Schwarzenegger's $15 billion bond measure (Proposition 57) on March 2, 2004. AB 9 became operative July 1, 2004.

AB 9, among other things, reduces the increase in the state portion of the sales and use tax rate, from 0.50 percent to 0.25 percent (dedicated to the repayment of the deficit bonds), and decreases the related reduction in the local sales and use tax rate from 0.50 percent to 0.25 percent (local governments will be reimbursed for their local tax revenue losses with increased property tax revenues). This bill requires that the revenues from the 0.25 percent state sales and use tax rate increase be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the deficit bonds.

As previously stated, the provisions of AB 9 provide that cities and counties will be reimbursed for the reduction in the local sales and use tax revenues through property tax revenues from the ERAF. The DOF, in conjunction with Board staff, will prepare an annual estimate by September 1 of each fiscal year of the local sales and use tax revenue losses attributable to the reduction in the local sales and use tax rate. This estimate is based on prior year distributions of local sales and use tax revenues. Cities and counties will receive the property tax replacement revenues twice a year—in January and May. At the end of each fiscal year, the property tax replacement revenues will be adjusted to reconcile with the actual amount of local sales and use tax revenues *not* transmitted as a result of the 0.25 percent reduction in the local sales and use tax rate.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Senate Committee on Budget and Fiscal Review to make technical corrections and clarifying changes to the Triple Flip as made by SB 1096 (Senate Budget and Fiscal Review Committee, Chapter 211, Statutes 2004), the local government finance Budget trailer bill. According to staff from the Senate Committee on Budget and Fiscal Review, after the passage of SB 1096, a number of errors were identified. This cleanup bill addresses various technical issues raised by local governments, the State Controller's Office, the Board of Equalization, and Legislative staff.
2. **The August 23, 2004 amendments** make the technical corrections detailed previously. The previous version of this bill was a spot bill intended to be used as a budget trailer bill to enact statutory changes related to the local government portion of the 2004-05 Budget Act.

3. **This bill amends subdivision (a) of Section 7203.1 to address those cities with ordinances imposing less than the full 1 percent rate or that have scheduled rate changes.** Section 7203.1, added by AB 9 (Committee on Budget, Chapter 2, Statutes of 2003), set the rate at 1 percent for a county and set the rate at 0.75 percent for a city. By setting the rate at a fixed amount, cities were prohibited from imposing a rate of less than 0.75 percent and, thus, defaulting the balance of the 0.75 percent rate to the county in which the city is located.

   SB 1096 amended Section 7203.1 (a) to address those cities that imposed a rate of less than 1 percent. However, during the implementation of the Triple Flip, Board staff saw problems with the language. Those problems are:

   - The amendments enacted by SB 1096 did not provide for rates that could change but set another fixed rate, this time the rate in effect on July 1, 2004, reduced by 0.25 percent;
   - Those cities that were not at 1 percent prior to the Triple Flip (operative date of Triple Flip is July 1, 2004) could never go up to 0.75 percent;
   - Cities that have ordinances with scheduled rate changes (e.g., rate on January 1, 2004 is 0.80 percent, rate on January 1, 2008 increases to 0.85 percent, and rate on January 1, 2010 increases to 0.95 percent and remains at that rate thereafter) would be stuck at 0.80 percent (minus 0.25 percent) for the duration of the Triple Flip;
   - Cities with revenue sharing agreements would be restricted to the rate as specified in their ordinance on January 1, 2004, for the duration of the Triple Flip, even if the revenue sharing agreement expired before the end of the Triple Flip;
   - New cities organizing during the Triple Flip period that wished to enter into revenue sharing agreements with their counties would be almost forced to establish an initial tax rate of 0.75 percent and then vary their rate pursuant to their agreement rather than establish the initial rate at the rate the new city and the county desire.

   Board staff believes that the amendment to Section 7203.1 in this bill resolves these problems.

4. **Related legislation. SCA 4 (Resolution Chapter 133, Torlakson)** places a constitutional amendment to protect local government revenues before the voters at the November 2, 2004 general election (Proposition 1A – Protection of Local Government Revenues). Among other things, this constitutional amendment would: (1) prohibit the Legislature from restricting the authority of a city or county to impose a rate under the Bradley-Burns Local Sales and Use Tax Law, as that law reads on November 2, 2004; (2) allow the Legislature to change the method of distributing local use tax revenues in order to participate in an interstate compact or to comply with federal law; and (3) prohibit the Legislature from extending the revenue exchange period (also known as the "Triple Flip"). This constitutional amendment would supersede Proposition 65, the local government initiative, also on the November 2, 2004 general election ballot, if both measures are approved and this measure receives a higher number of votes. **AB 2115 (Committee on Budget)** is identical to this bill.

COST ESTIMATE

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

REVENUE ESTIMATE

This bill would not impact state's revenues.

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