Board of Equalization

RESPONSE TO THE SUPPLEMENTAL REPORT
OF THE 2004 BUDGET ACT

Special Tax Jurisdictions

An Analysis of Alternative Methodologies for Allocating the Administrative Costs of Collecting the Sales and Use Tax and the Transactions and Use Tax

November 2004

RESPONSE TO THE SUPPLEMENTAL REPORT OF THE 2004 BUDGET ACT SPECIAL TAX JURISDICTIONS

RESPONSE TO THE SUPPLEMENTAL REPORT OF THE 2004 BUDGET ACT SPECIAL TAX JURISDICTIONS

INTRODUCTION

In its "Supplemental Report of the 2004 Budget," the Legislative Analyst's Office requested that the Board of Equalization (BOE) provide an analysis of methodological approaches to allocating the administrative costs of collecting the sales and use tax and the transactions and use tax among and between the state General Fund, special funds, Bradley Burns, and local option taxes. This analysis is due to the Chair of the Joint Legislative Budget Committee (JLBC) and chairs of the fiscal committees of the Legislature by December 1, 2004. The Supplemental Report of the 2004 Budget Act requires that the analysis and report shall be prepared in consultation with the Legislative Analyst's Office, the Department of Finance (DOF), and appropriate local government representatives. It requires that the report contain detailed information regarding cost allocation methodologies for various activities based on workload or other factors, including their fiscal implications.

BOE staff prepared this report in consultation with the Legislative Analyst's Office, the Department of Finance (DOF), and appropriate local government representatives. Board staff conducted team meetings and held "interested party" presentations. This report contains detailed information regarding cost allocation methodologies for various activities based on workload or other factors (see Section III), including a summary of their fiscal implications.

BOE staff conclude that this report forms a basis for discussing the future administrative charges to the special taxing jurisdictions and presents alternatives to policymakers in the Administration and the Legislature.

EXECUTIVE SUMMARY

Current Law

This report recommends four alternate approaches to the existing model for allocating sales tax program administrative costs between the State and local governments. Each of these proposed alternatives provides a simpler, more effective way to allocate costs and an easier way to identify and explain these costs to local governments.

Under current law, voters can approve special taxes that qualify as ballot measures and are imposed as an additional sales tax within the boundaries of a specified geographic area, district, or "jurisdiction." Currently the BOE administers the collection and distribution of tax revenues for 45 Special Tax Jurisdictions (STJs) as well as the Bradley-Burns Uniform Local Sales and Use Tax (BB) which supports the operations of city and county governments

The BOE charges local entities a fee for administering the local tax programs on their behalf based on current law. Current law also requires the BOE to use a costing model that is based upon recommendations issued in two reports by the Office of the Auditor

General. Beginning with the 1998-99 fiscal year, the Legislature imposed a “cap” (or maximum charge) on the amount the BOE could charge an individual STJ. The cap is a percentage of revenue and varies depending on the STJ tax rate.

During the 2004-05 budget development process, the Legislative Analyst’s Office (LAO) considered removing the cap from STJ assessments. However, the 2004 Budget Act retained the cap, while the LAO recommended in its Supplemental Report of the 2004 Budget Act that the BOE provide a report on alternate methodological approaches for allocating administrative costs.

This report recommends four alternate approaches to the existing model for allocating administrative costs between the State and local governments. Each of the proposed alternatives is simpler to administer than the existing model, making it easier to identify and explain the fees to local governments.

The Existing Model

There are two distinct processes involved in determining the local government fees. First, the total cost of the sales tax program is allocated to the State, BB, and STJs. The existing model does this by first identifying those costs directly related to administering the BB and STJ taxes. The remaining costs are consider to be shared between the State, BB, and STJs and are allocated to each based on revenue.

The second part of the process is to allocate the total BB and the total STJ cost to each BB and STJ jurisdiction. The existing model allocates BB cost to each jurisdiction based on revenue. The STJ cost is allocated to each jurisdiction using complex workload factors recommended by the Auditor General.

The Proposed Alternatives

The proposed alternatives take a simpler approach to both processes. A simpler approach was taken because the complexity of the existing model has made it cumbersome to administer and difficult to explain to local government entities. Furthermore, the added complexity does not necessarily provide greater accuracy.

Therefore, the proposed alternatives do not separately identify direct and shared costs when allocating the sales tax program to the State, BB, and the STJs. Most of the tasks performed in the administration of the sales tax program benefit all three taxing entities, making it difficult to separately identify costs associated with administering just the State, BB, or STJ workloads. Instead, a single pattern or patterns is applied. Simple patterns are also used to allocate the BB and STJ cost to each jurisdiction, rather than using complex workload factors.

Allocating the Sales Tax Program Cost to the State, BB, and STJ

There are four proposed alternatives for allocating the sales tax program cost to the State, BB, and the STJs. However, the fourth alternative includes three different options. The alternatives are:

Alternative 1 – Use the 2003-04 established fees as a base level. Future fees will be established by applying the percentage change in the sales tax program to the prior year fees.

Alternative 2 – Allocate the sales tax program cost to the State, BB, and STJs based on the ratio of permits for each entity.

Alternative 3 **-** Allocate the sales tax program cost to the State, BB, and STJs based on the ratio of total revenue from all activities for each entity.

Alternatives 4a, 4b, and 4c **-** Allocate the cost of each element of the sales tax program (Registration, Returns, Audit, and Collections) to the State, BB, and STJs based on a pattern representative of the element's cost. Registration cost is allocated on the revenue received through the normal returns process, Audit cost is allocated based on absolute tax change, including both over and under reporting of tax, and Collections cost is allocated based on delinquent taxes billed by our collection program including non-paid or underpaid taxes reported on returns filed (self-assessed liabilities) and Board determinations for failure to file returns or additional taxes due in excess of reported amounts (Board assessed liabilities).

The Returns element cost is allocated using information from the sales tax return. Ratios were established based upon how many lines on the return are associated with the State, BB, or STJs. Since some of the lines on the return relate to all three entities (subtotal lines, total lines, etc.) three different options are presented for allocating the generic lines.

Alternative 4a (shared approach) **–** Allocate the generic lines equally to each entity (1/3 to State, 1/3 to BB, and 1/3 to STJs).

Alternative 4b (marginal approach) **–** Allocate the generic lines entirely to the State, since the generic lines would be needed even if there were no BB or STJ taxes. The assumption is that the marginal cost of processing the generic lines for BB and STJs is zero.

Alternative 4c (revenue approach) – Allocate the generic lines based on total revenue.

The table below illustrates the percentage and cost allocations for the existing model and each of the alternatives for allocating the Sales Tax program cost to the State, BB, and the STJs.

ALLOCATING THE COST OF THE SALES TAX PROGRAM –
COMPARISON OF EXISTING MODEL AND PROPOSED ALTERNATIVES

		%					COST			
Alternative	**Description**	**State**	**BB**	**STJs**	**Total**		**State**	**BB**	**STJs**	**Total**
							($ millions)			
	Existing Model	72%	13%	15%	100%		$204	$36	$41	$281
1	Base (+ -)	72%	13%	15%	100%		204	36	41	281
2	Permits	24%	32%	44%	100%		67	90	124	281
3	Revenue	79%	13%	8%	100%		222	37	22	281
4a	Element – Shared	63%	21%	16%	100%		176	60	45	281
4b	Element – Marginal	73%	16%	11%	100%		206	45	30	281
4c	Element – Revenue	70%	17%	13%	100%		197	48	36	281

Allocating the BB and STJ Cost to Each Jurisdiction

As stated above, the proposed alternatives also use a simple approach for allocating the BB and STJ cost to each jurisdiction. There are three alternative methods proposed:

Alternative A – Allocate the cost to each jurisdiction based on the revenue ratio. (The existing model uses this method for allocating BB cost.)

Alternative B – Allocate the cost to each jurisdiction based on the permit ratio.

Alternative C **–** Allow BB and the STJ jurisdictions to provide the methodology for allocating their respective costs to each jurisdiction.

In the event that they do not provide a methodology, a default methodology would be used, possibly one of the other alternatives.

The table below illustrates the percentage and cost allocations for the existing model and each of the alternatives for allocating the sales tax program cost to the State, BB, and the STJs.

ALLOCATING THE BB AND STJ COST TO EACH JURISDICTION -
COMPARISON OF EXISTING MODEL AND PROPOSED ALTERNATIVES

Alternative	**BB**	**STJs**
Existing Model	Revenue	Workload Factors
Alternative A	Revenue	Revenue
Alternative B	Permits	Permits
Alternative C	BB Input	STJ Input

Summary

The complexity of the existing model makes it cumbersome to administer and with over 50 new or continuing STJ issues on the November 2004 ballot the situation will not improve. Most of the existing model complexity results from using complex workload factors that don't always translate into increased accuracy, but identifying and maintaining accurate workload factors is not practical.

The workload factors for the existing model also reduce the cost for countywide STJs within the same county based upon the Auditor General recommendations. The intent is that there should be some cost efficiencies associated with administering two STJs within the same boundary. However, these efficiencies may be overstated in the existing model. Most of the workloads associated with an STJ are unique to that STJ, and the workload level is not reduced by the addition of another STJ within the same jurisdiction. Therefore, the proposed alternatives do not consider any efficiencies for STJs within the same jurisdiction.

The existing model also caps the maximum cost chargeable to an individual STJ based on revenue, and also provides for an adjustment mechanism to adjust any differences between actual and estimated costs. Any of the proposed alternatives could also incorporate a cap and actual cost adjustment if desired.

This report was prepared with input from local governments. Appendix B is a letter from Ms. Sara West of the Self-Help Counties Coalition which supports Alternative 4c for allocating the sales tax program cost to the State, BB, and STJs. The coalition made no recommendation regarding how the BB and STJ cost should be allocated to individual jurisdictions.

I. BACKGROUND

A. State Board of Equalization (BOE)

1. <u>BOE Programs Generally</u>

The BOE administers 30 tax and fee programs that generated a total of almost $42 billion in annual revenue in Fiscal Year 2002-03. The BOE's sales and use tax program, administered by its sales and use tax department, generated $35.7 billion during that period.[1] Sales tax applies to all retail transactions not subject to special exemptions provided by law. Use tax applies to the storage, use, or other consumption of tangible personal property purchased at retail from a retailer for use in this state without payment of sales tax. As of July 1, 2004, the statewide sales-and-use tax (sales tax) rate was 7.25%.

The current 7.25% sales tax rate is made up from the California Sales and Use Tax (Rev. & Tax. Code §§ 6051 et. seq. & 6201 et. seq.) and the Bradley-Burns Uniform

[1] State Board of Equalization 2002-03 Annual Report ("2002-2003 Annual Report") (May 2004), pp. 4 & 11.

Local Sales and Use Tax (§§ 7200-7212).[2] These two taxes will be referred to as "State" and "BB" throughout this report. Pursuant to the latter, the counties of California impose a 1.00% tax on all sales within their boundaries. Each city within a county also imposes a local sales tax at rates up to 0.75%. This tax is offset against the county tax so that the rate within each county is a uniform 1.00%.

In 1969, the Legislature enacted the Transactions and Use ("District") Tax Law (§ 7251 et. seq.). Under enabling statutes in various codes, local jurisdictions may impose transactions (sales) and use taxes at varying rates on the gross receipts from the sales within the jurisdiction of tangible personal property sold at retail or of the sales price of property whose use, storage, or consumption within the jurisdiction is otherwise subject to tax (§§ 7261(a) & 7262(a)). Although counties and cities, as well as STJs, may also impose such taxes, for the sake of convenience in this report, we shall refer to all entities imposing such taxes as "STJs."[3] No matter where the enabling authority is found, the BOE administers all district taxes under the District Tax Law.

Voters within a taxing entity approve a measure authorizing a district tax. About half of such taxes are levied to finance transportation agencies or authorities. Others finance open space protection, hospitals, and libraries. Generally, a special district will have the same boundaries as a county. Of the 45 STJs in existence as of July 1, 2004, 28 have county boundaries, 14 are cities, and 3 district taxes are levied by the City and County of San Francisco, which makes it count, for the purposes of this report, as 3 STJs.[4] One STJ, the Bay Area Rapid Transit District, encompasses all of three counties and a part of a fourth, and another, the City of Avalon Municipal Hospital and Clinic Tax, does not take in all of Catalina Island. The former Fresno Metropolitan Projects Authority, whose tax was declared invalid operative March 20, 1996, was bigger than the City of Fresno but smaller than Fresno County. Appendix A contains a listing of the STJs, their tax rates, and their year of implementation, including district taxes no longer in effect.[5]

2. Administration of the Sales and Use Tax Program

BOE administration of the state and local sales and use and district taxes encompasses four elements:

---

[2] Unless otherwise stated, all statutory citations are to the Revenue and Taxation Code.

[3] The District Tax Law uses the term "district" to define an entity levying a Board-administered transaction and use tax. (§§ 7252-7252.30.) The reports regarding the Board's development and allocation of administration costs for the district tax system issued by the Auditor General in 1992 and the Bureau of State Audits in 1996, and the 2004 Budget Act charter for this Report, all used the term "special tax jurisdiction (STJ)." For that reason, this Report uses the latter term as well. STJs are distinguished from "local governments," which levy local taxes under the Bradley-Burns system. The taxes levied by STJs, however, are still cited as "district" taxes.

[4] Even though there are only 42 entities levying district taxes, there are 43 such taxes. The Los Angeles County Transportation Commission levies two district taxes – one operative July 1, 1982, and a second operative April 1, 1991. BART covers three counties, which adds up to 45 separate STJs.

[5] Since Appendix A was created, three new citywide district taxes have been approved for the Cities of Trinidad, Sonora, and Fort Bragg. The operative dates are October 1, 2004, for Trinidad and January 1, 2005, for Sonora and Fort Bragg. In addition, approximately fifty-one district taxes are up for approval at the November 2004, election. Seven are for continuation of current taxes. Twenty-eight are citywide taxes.

- Registration of taxpayers;
- Processing of tax returns and payments;
- Auditing taxpayers; and
- Collecting delinquent taxes.

Registration of taxpayers – Personnel in the BOE's field offices register taxpayers. Registration activities enable the BOE to furnish sellers and consumers with proper tax forms and instructions for the reporting allocation of sales and use tax. Registration also ensures that sellers properly comply with permit requirements.

Processing of tax returns and payments – The returns filed by taxpayers are processed by BOE staff in order to deposit revenue, verify accuracy and proper reporting of tax according to law, and to properly allocate and distribute tax revenues.

Auditing taxpayers – Auditing of taxpayers is necessary to ensure uniform compliance with tax laws and to protect the state and local tax base. Accounts are selected for audit based on those taxpayers most likely to make substantial errors in reporting that will result in significant tax deficiencies.

Collecting delinquent taxes – Field offices are primarily responsible for the collection of delinquent sales and use taxes. The effort expended on each delinquency is consistent with the amount due. The BOE uses the Automated Compliance Management System (ACMS) to assign and manage collection accounts.

3. Distinctions between Sales Taxes and Transactions Taxes

There are two significant distinctions between state and local sales taxes and district taxes. First, sales taxes are assessed based on the "point-of-sale" whereas transactions taxes are assessed based on the "point-of-delivery" or "point-of-use." Point-of-sale taxes are based on the tax rate in effect at the location where the sale is negotiated. For example, when a retailer sells an item to a consumer, the retailer is responsible for reporting the tax amount associated with the 7.25% sales tax rate in effect in the county where the retailer's sales office that negotiated the sale is located. On the other hand, point-of-use taxes are based on the total (i.e., 7.25% plus district, if any) tax rate in effect at the location an item is first used (generally the place of delivery).[6] For example, if a retailer in a county without an STJ delivers an item to a purchaser who lives in another county that charges a 0.50% transactions tax rate, the transaction is subject to not only the tax amount associated with the 7.25% state and local sales tax rate but also the tax amount associated with the district tax at the rate in effect (if any) in the STJ to which the item is delivered. The purchaser is required to pay the district use tax, and the retailer is required to collect the tax if the retailer is engaged in business in the STJ.

The second distinction is that, while the state and local sales tax rate is uniformly applied statewide, transactions tax rates are not. As of July 1, 2004, the state and local sales and use tax rate in all 58 counties in California was 7.25%. However, the rates for

[6] In over-the-counter transactions the point of sale and the point of use are, of course, the same.

STJ district taxes range from 0.125% for the library STJs to 0.50% levied by most STJs.[7] Sales in, or for use in, places that do not have STJs are subject to only the 7.25% statewide sales and use tax.

The distinctions between the two types of taxes result in costs to the BOE that it would not incur if it administered only state and local government sales and use taxes. For example, when auditing, the BOE not only determines whether a retailer properly reported the sales tax in the county of purchase, but also whether the retailer properly reported the district tax, if any, in the county of delivery or first use. Especially with citywide district taxes, persons living across the street from each other may or may not be subject to the tax. Therefore, the BOE assesses the STJs the entire costs related to auditing the point-of-delivery or first-use nature of the district tax in addition to the part of the costs related to auditing the state and local sales tax.

B. Preparation Costs

Under Section 7272, an STJ must pay to the BOE its preparation costs, including its direct and indirect costs. Such costs are capped at $175,000.

Preparation costs are not part of the administrative cost model that is the subject of this report. Consequently, they are mentioned briefly here for background purposes only, and will not be discussed further.

C. Administrative Costs (beginning March 1992)

1. Prior to the 1993-94 Fiscal Year

Prior to the 1993 amendments, section 7273 set a rate at which by the State charged the cities, counties and STJs for administering their tax programs. For the 1991 amendment to the statute, the Legislature directed the BOE to determine a rate for STJs. The BOE determined the rate by dividing total estimated costs—the sum of the central, shared, and direct costs—by estimated revenue. By dividing the total estimated costs by the estimated revenue, the BOE determined that the administration rate should be set at 1.49%. Thereupon, the Legislature amended the statute accordingly (Stats. 1990, Ch. 1077, § 2.).

2. March 1992 Auditor General Report

The Auditor General audited the BOE to determine if the cost model was conceptually sound and reasonably supported by detailed calculations. The Auditor General found that the BOE's policy was to share the costs of the tax administration system among the parties that benefit from the tax collection system based on a percentage of revenue collected. The BOE recognized that the State, cities, counties, and STJs each have an interest in the established tax collection system in the amount of their respective percentages of total revenues, and accordingly, each should pay for the tax collection

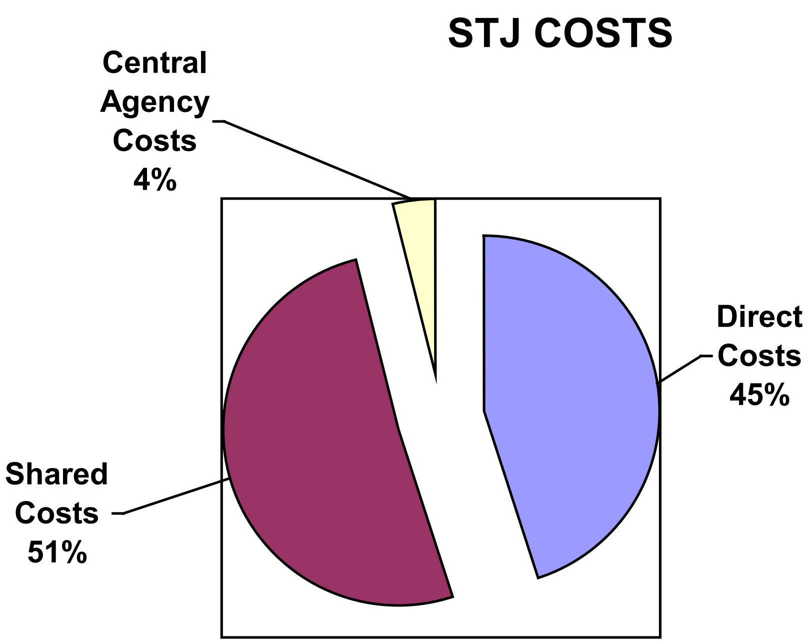
[7] The City of Clovis Public Safety Transactions and Use Tax in Fresno County is levied at 0.3%. The Fresno Metropolitan Projects Authority tax, declared unconstitutional in 1996, was levied at 0.1%.

system to the degree that each benefits from it. In addition, the BOE's policy was consistent with the policy of full recovery of costs for services[8] and the directives of the State Administrative Manual.[9] In addition, the BOE allocated most costs among counties with STJs based on the proportionate share of revenue they generated rather than workload factors.[10]

According to the Auditor General, the costs that the BOE identified for administration of STJs fell into the three general categories of direct, shared, and central agency costs. The cost categories are described below:

- Direct Costs – Costs associated directly with each of the tax programs that are developed based on workload standards and other forms of cost measurement.
- Shared Costs – The cost of the tax collection system that benefits the State, cities/counties, and STJs individually and jointly but that cannot be separately identified as being directly incurred by the State, cities/counties, and STJs.
- Central Agency Costs – The estimated costs of services incurred by central service departments for the benefit of all state departments, such as the State Controller issuing warrants and the State Treasurer cashing warrants.[11]

The proportion that the three cost centers bore to the entire costs as of the date of the Auditor General report (March 1992) is shown in the pie chart below:



[8] Govt. Code §11256
[9] St. Admin. Man., § 8752
[10] There were no citywide STJs at the time.
[11] These definitions were developed in 1969 by the Board in conjunction with the Department of Finance and are derived from our State Administrative Manual, Section 8752

The 1992 Auditor General Report made a number of recommendations for changes to the BOE's costing model. The most important, for the purposes of this report, were:

- Exclude the costs that are related to counties that do not have STJs from costs that are shared between the State, BB, and STJs;
- Use a workload standard basis for allocating total STJ costs between STJs located in counties with one STJ and STJs located counties with two STJs; and
- Incorporate an adjustment mechanism into the model that considers the over or under collection of the reimbursement during the previous period.

3. <u>1993 Amendments to Section 7273</u>

AB 102 (Stats 1993, Ch. 75, § 4) amended Section 7273 to set the policy that controls the BOE's costing model to the present. The Legislation specifically declared: "The amount charged to each entity shall be based on the recommendations incorporated in the March 1992 report by the Auditor General entitled 'The Board of Equalization Needs to Adjust Its Model For Setting Reimbursement Rates for Special Tax Jurisdictions'" (§ 7273(a)(1)).

The Statute incorporated, among other recommendations:

- The amount charged shall be based on the total STJ costs reflected in the annual Budget Act. This amount comprises the categories of direct, shared, and central agency costs incurred by the BOE.
- The amount charged may be adjusted in the current fiscal year to reflect the difference between the BOE's budgeted costs and any significant revised estimate of costs. Any adjustment shall be subject to budgetary controls included in the Budget Act.
- The amount charged shall be adjusted to reflect the difference between the BOE's recovered costs and the actual costs incurred by the BOE during the fiscal year two years prior.

4. <u>1996 Bureau of State Audits Report</u>

The 1996 Bureau of State Audits Report made additional recommendations regarding the costing model.

- State policy makers should examine whether STJs should bear a percentage of the infrastructure costs associated with administering sales taxes.
- The costing model should not charge STJs for the costs of administering the two statewide half-cent sales taxes.
- Use workload factors that are based on workload studies and periodically update the workload factors.
- Allocate costs to individual STJs based on workload factors, rather than revenue.

II. EXISTING MODEL

A. Direct Costs

The existing model attempts to identify those costs directly associated with processing BB and STJ workloads. Direct costs are the marginal costs that the BOE would not incur if it were not for the local administered taxes. The State and BB incur few direct costs because the existing model identifies few activities from which only they derive benefits. For the 2004-05 Estimated Costs, the direct STJ costs amount to 6.5% and direct BB costs amount to 1.0% of the total sales tax program costs (for a total of 7.5%). The remaining 92.5% of the cost was shared cost.

Except for the BOE's Local Revenue Allocation Section (LRAS), all other units supporting the sales tax program support State, BB, and STJ activities. The LRAS is the only BOE unit that exclusively supports BB and STJ workloads. The workload in the LRAS consists of reviewing scheduled returns, verifying the tax on the allocation schedule with the amount of tax reported on the return, and determining that proper transactions and use tax for BB and the STJs has been reported. When tax is reported in the wrong district, fund adjustments must be made to correct the distribution of taxes received. The current model allocates approximately 58% of the LRAS to the STJs and the remainder to BB.

All the other direct STJ costs are calculated as a portion of other BOE units that also support State activities. These units include the Refund Section, Taxpayer Records Section, Return Analysis Section, headquarters audit support units, and field offices that perform audits. Direct STJ cost in the other headquarters units is based on return ratios or staff estimates of the time their unit spends on STJ workload. Direct STJ costs for field audits are based on the total audit hours worked in each field office, which are then prorated based on permits to the various STJs within the area served by the district office. It is important to note that the existing time reporting system does not directly capture STJ time because it would be difficult and impractical to do so. Most of the sales tax program activities performed do not clearly distinguish between State, BB, and STJ workloads. Therefore, the direct costs are based on patterns that are assumed to reasonably approximate the direct costs associated with STJ workloads.

As stated above, the existing model only identifies 7.5% of the total costs as direct costs and most of that direct cost is for STJs. The only BB direct cost is from the LRAS, and there are no direct costs associated with State workloads.

B. Shared Costs

To calculate shared cost, the existing model begins with the cost of each of the four sales tax program elements (Registration, Returns, Audit, and Collection) as reflected in the approved Governor's Budget. From each element total the model subtracts the direct costs as described above so that there is not a double charging of direct costs. Interagency agreement costs are also netted out because they already include central agency costs. Lastly, the cost of administering the State and BB taxes in counties that do not have STJs is subtracted because there is no STJ benefit to the cost of tax administration in these counties. (It is recognized that some STJs do benefit from the registration, returns processing, auditing and taxes receivable collected in counties that do not have STJs. However, the benefit is small and becomes even less significant as more and more counties enact STJs.) After these deductions, the remaining cost is the shared costs in counties that have STJs that will be allocated to the State, BB, and STJs.

To calculate how much of the shared cost will be assessed STJs, the model uses revenue. As stated above, this ratio is calculated using only the revenue in counties that have STJs. The total STJ revenue in these counties, divided by the total revenue in these counties, determines the percentage of STJ revenue in counties that have STJs. This percentage is then applied to the shared cost of counties that have STJs to determine the STJ shared cost assessment. The remaining shared cost, plus the cost of counties that do not have STJs, is allocated to the State and BB based on revenue.

C. Central Agency Costs

Central Agency costs are those costs incurred by the State's central service departments for activities that benefit all state departments, including the BOE. Examples of these activities include the State Controller, the State Treasurer, the Department of Finance, and the Department of Personnel Administration. Central Agency costs represent about 4% of the total sales tax program cost and are prorated to the State, BB, and STJs based on their total direct and shared cost. The state policy is for departments to recover full costs whenever goods or services are provided to others. According to the State Administrative Manual, Section 8752, the full cost of goods or services includes all costs attributable directly to the activity plus a fair share of indirect costs that can be ascribed reasonably to the good or services provided. The cost elements included, as defined by Section 8752.1, are direct costs, shared costs, and central agency costs.

Through interagency agreements, the BOE is charged by two other state agencies, the Department of Motor Vehicles (DMV) and the Housing and Community Development agency (HCD), for the work they perform in collecting State and local sales tax revenues. Since the amount billed by these agencies already includes central agency costs, their cost is added after the central agency costs have been calculated.

SUMMARY OF EXISTING MODEL COSTS ($ in thousands)

Cost Category	Total		State	BB	STJs
Direct Cost	$21,162			$2,822	$18,340
Shared Cost	242,097		$190,935	30,549	20,613
Central Agency Cost	10,714		7,771	1,358	1,585
DMV and HCD Cost	6,758		5,254	1,001	503
Total sales tax program Cost	**$280,731**		**$203,960**	**$35,730**	**$41,041**

After the total costs have been calculated for the State, BB, and the STJs, the BB amount and the STJ amount must be allocated to each BB and STJ jurisdiction. For BB, the existing model simply allocates the total BB cost to each BB jurisdiction based on revenue. For STJs, the allocation is more complex.

The existing model tracks the total STJ cost by each sales tax element (Registration, Returns, Audit, and Collection). The STJ registration cost is allocated to each STJ based on permits. The returns cost is allocated on number of returns, the audit cost is allocated on the number of audit hours, and the collection cost is allocated on accounts receivable revenue. The existing model also discounts the fees in counties that have more than one STJ based on the recommendations of the 1992 Auditor General Report. The application of the workload factors recommended by the 1992 Auditor General Report results in a significant cost reduction to STJs located within the same county.

For example, if County A is a one-STJ county with 50,000 total permits, the total 50,000 permits are used as the workload factor to allocate registration costs to the STJ in County A. However, if County B is a two-STJ county and also has 50,000 total permits, only half of the total permits, or 25,000, are allocated to each STJ within County B. Therefore, each STJ within County B is allocated only half as much shared cost as the STJ in County A.

Although some cost efficiencies exist associated with administering more than one STJ within the same geographical area, most of the BOE's activities involve tracking each STJ's cost and revenue separately. Therefore, allocating only half of a workload factor to each STJ within a two-STJ county probably understates the true administration cost for each.

Prior to the Auditor General recommendation, the BOE charged a flat rate of 1.49% of revenue for one-STJ counties and 1.30% of revenue for two-STJ counties. The rate reduction was to recognize efficiencies in two-STJ counties. However, it is important to note that the discount given to two-STJ counties was only 13% ([1.49–1.30]/1.49=13%), significantly less than the existing model discount based upon the Auditor General recommendation.

After costs are allocated to each STJ, there are two other items considered in developing the final STJ cost assessment – the Cap adjustment and the Prior Year adjustment.

D. The Cap Adjustment

The existing model includes a cap on the amount that the BOE can assess individual STJs. The cap was put in place by legislation effective with the 1998-99 fiscal year. The following table illustrates the maximum allowable fees the BOE can charge an individual STJ.

STJ Tax Rate	Allowable Fee
0.50% or greater	1.50% of Revenue
0.25% to 0.49%	3.00% of Revenue
Less than 0.25%	5.00% of Revenue

The legislation also directed that for any existing STJ, their permanent cap shall be the lesser of the statutory cap (shown above) or their cost as a percentage of revenue in the 1998-99 fiscal year. For STJs that come into existence after 1998-99, their permanent cap shall be the lesser of the statutory cap or their cost as a percentage of revenue in their first full year of existence.

Based upon the above language, many existing STJs have a permanent cap that is actually lower than the statutory cap. The current cap for 0.50% or greater STJs ranges from 1.00% to 1.50% of revenue. The current cap for 0.25% to 0.49% STJs ranges from 1.60% to 3.00% of revenue. The current cap for STJs with a rate of less than 0.25% ranges from 3.70% to 5.00%. Under the existing model, if the estimated or actual fees are greater than the cap level, the STJ is only charged the cap level. When that occurs, their fee calculation becomes strictly a percentage of revenue based upon their individual cap level. Therefore, because of the cap, the actual fees charged to an STJ may not reflect cost as calculated by the existing model and may be inconsistent with the fees charged to other STJs due to differences in their respective cap levels.

E. Prior Year Adjustment

Based upon the recommendations in the 1992 Auditor General report, the BOE incorporates an adjustment mechanism into the fee process. Each year the BOE estimates the cost to administer each STJ's tax using estimated cost and estimated revenue data for the upcoming fiscal year. Upon completion of the fiscal year, the actual costs and revenues are used to determine the actual cost of administering each STJ's tax for that fiscal year. Any difference between the estimated and actual cost, after considering cap limitations, becomes an adjustment in the fiscal year two years after the actual cost is determined. The adjustment cannot be made in the next fiscal year because actual costs and revenues are not known at the time.

There is no prior year adjustment incorporated into the development of BB fees.

III. PROPOSED ALTERNATIVES

As with the existing model, the proposed alternatives determine the local administration fees in two steps. First, the cost of the sales tax program is allocated between the State, BB, and STJs. Then the total BB and STJ cost is allocated to each BB jurisdiction and each STJ.

A. Allocating Costs Between the State, BB, and STJs

In order to determine local administrative fees, the proposed alternatives begin with the cost of the sales tax program as reflected in the approved Governor's Budget. Since central agency costs are not reflected in the Governor's Budget, these costs are added based on the overall central agency percentage. The approved cost, plus central agency costs, is the total sales tax program cost.

In order to allocate the total sales tax program cost to the State, BB, and the STJs, the proposed alternatives consider only the total sales tax program cost. There are no calculations to determine direct costs and shared costs. However, Alternatives 4a, 4b, and 4c do go into additional detail by applying a separate cost pattern to each of the four individual elements of the sales tax program (Registration, Returns, Audit, and Collections) rather than applying one pattern to the total.

The reason the proposed alternatives do not consider direct and shared cost is because it is difficult to determine direct costs associated with each taxing entity. Most workload activities do not clearly distinguish tasks specifically for the State, BB, or STJs. The workload factors used by the existing model to identify direct costs, while considered reasonable, are difficult to validate and measure accurately. Additionally, certain assumptions are made that, while reasonable, may not precisely represent actual costs. For example, the number of audit hours performed by a district office are allocated among the STJs served by that office based on permits. If County A has 45% of the permits served by a district office it is allocated 45% of the audit hours. However, if most of the businesses in County A are small, compared to the businesses in the other counties served by the district office, more audit hours may be allocated than were actually performed since smaller businesses are less likely to be audited than larger ones. Even if the BOE could implement a more detailed time reporting system to track audit hours by location, the proliferation of STJs would make such a system cumbersome to administer, especially with the enactment of more and more city STJs. Furthermore, patterns such as the number of permits are just a "snapshot" at a point in time and thus do not reflect the actual number of permits which is constantly changing.

The LRAS is the only unit in the BOE that works exclusively on BB and STJ activities. However, the cost of the LRAS is only 2% of the total sales tax program cost. As stated earlier, the existing model only identifies 7.5% of the total costs as direct. Furthermore, most of the direct cost identified by the existing model is STJ direct cost, with a small amount for BB. It is possible that there are direct costs associated with State activities, but they are not identified.

Therefore, the approach taken by this report is to present alternatives that do not rely on complex workload factors to calculate direct costs because they are cumbersome to administer and yet this increased complexity does not necessarily produce greater accuracy. Furthermore, by taking a simpler approach, the alternatives proposed can readily accommodate the addition of numerous future STJs, while a model based on complex workload factors would be less adaptable.

1. Alternative 1 – Base Level Approach

   This alternative considers the 2004-05 estimated fees for BB and each STJ as the base level. Note that the 2004-05 fees were computed by using the existing model. Beginning with the 2005-06 fiscal year, and each year thereafter, the fees will be established by applying the percentage change in the total sales tax program cost to the prior year fee level. Therefore, if the change in the sales tax program cost from 2004-05 to 2005-06 was an increase of 2%, the local fees would increase by 2%. Similarly, if the overall sales tax program cost decreased by 2%, the local fees would decrease by 2%. The fee established in 2005-06 would become the new base, to which the 2006-07 percentage change would be applied.

   For new STJs not in existence in 2004-05, a base would have to be calculated in the year they are established. This could be done as a fixed percentage of their estimated revenue or by comparing them to an STJ with similar revenue to establish a comparable base.

2. Alternative 2 – Allocate Cost Based on Number of Permits

   This alternative allocates the total sales tax program cost to the State, BB, and STJs based on their respective number of permits. The following chart illustrates the cost allocation based on number of permits.

SUMMARY OF ALTERNATIVE 2 ($ in millions)

Entity	Number of Permits & Sub-outlets	Cost Allocation	%
State	795,204	$67	24%
BB	1,048,413	90	32%
STJs	1,469,198	124	44%
Total	**3,312,815**	**$281**	**100%**

   The total number of BB permits is greater than the State total because each sub-outlet for a BB permit is considered a separate entity and generates its own level of workload. Likewise, the number of STJ permits is greater than the State total because many STJs overlap (two in the same county and/or a citywide STJ within the same county). For example, if a county with 50,000 total permits has two countywide STJs, there would be 100,000 STJ permits because each one must be processed separately.

3. Alternative 3 – Allocate Cost Based on Total Revenue

   This alternative is the simplest and is based solely on benefit received. The total cost of the sales tax program is allocated based on total revenue received from all activities. The following chart illustrates the cost allocation based on revenue.

SUMMARY OF ALTERNATIVE 3 ($ in millions)

Entity	Revenue	Cost Allocation	%
State	$31,037,653	$222	79%
BB	4,966,024	37	13%
STJs	3,301,388	22	8%
Total	**$39,305,065**	**$281**	**100%**

4. Alternatives 4a, 4b, and 4c – Allocate Each Element of the Sales Tax Program on a Pattern Representative of that Element's Cost

   The cost of each sales tax program element is displayed in the Governor's Budget. Central agency charges are then added to each element based on the overall central agency percentage. The sum of the costs for each element, including their central agency cost, equals the total sales tax program cost.

SUMMARY OF SALES TAX PROGRAM COST ($ in millions)

	Approved Budget	Central Agency	Total
Sales Tax Program	**$270**	**$11**	**$281**
Registration	50	2	52
Returns	73	3	76
Audit	112	5	117
Collection	35	1	36

This alternative considers each of the four elements of the sales tax program independently. Three of the elements (Registration, Audit, and Collections) are allocated on a revenue pattern that most nearly represents the workload in the element. Registration cost is allocated on the revenue received through the normal returns process, Audit cost is allocated based on absolute tax change, including both over and under reporting of tax, and Collections cost is allocated based on delinquent taxes billed by our collection program including non-paid or underpaid taxes reported on returns filed (self-assessed liabilities) and Board determinations for failure to file returns or additional taxes due in excess of reported amounts (Board assessed liabilities).

The remaining element is the Returns element, which is not allocated on a revenue pattern. Instead, there are distinct, measurable workload factors within the Returns element that can be used to allocate costs to the State, BB, and STJs. These workload factors are found on the sales tax return. The return contains some lines that are specifically used to calculate the State, BB, or STJ tax amount. There are also generic lines on the return (total taxable tales, subtotals, totals, etc.) that do not apply to specifically to the State, BB, or the STJs but are necessary to process the return.

Using this information on the return, patterns were developed to determine, on average, the percentage of workload associated with processing the lines on the return that were specifically for State taxes, for BB taxes, and for STJ taxes. (The averages were calculated by considering actual data entered on the return. If a line was blank, it was not included in the calculation.)

The remaining lines on the return are the generic lines which do not relate directly to any of the tax entities. Under Alternative 4, these lines are allocated to the State, BB, and the STJs in three different ways. Therefore, there are three different options associated with Alternative 4, designated Alternatives 4a, 4b, and 4c.

<u>Alternative 4a - Shared Approach</u>: The generic lines were allocated equally to each entity, 1/3 to the State, 1/3 to BB and 1/3 to STJs.

<u>Alternative 4b - Marginal Approach</u>: Since the generic lines are needed to process the return even if there were no BB or STJ taxes, the generic lines are allocated entirely to

the State. The assumption is that the marginal cost of processing the generic lines for BB and the STJs is zero.

Alternative 4c - Revenue Approach: The generic lines are allocated to the State, BB, and STJs based on total revenue.

Alternative 4 Summary

Alternatives 4a, 4b, and 4c all allocate Registration costs based on total revenue, Collections cost based on accounts receivable revenue, and Audit costs based on audit revenue. It is only the Returns element cost that is allocated three different ways, resulting in the three different alternatives associated with Alternative 4.

Summary of Alternatives 4a, 4b, and 4c ($ in millions)

ALTERNATIVE 4a, 4b, and 4c - Allocation of Registration, Audit, and Collections Cost

	Registration Cost			Audit Cost			Collections Cost	
Entity	**Cost**	**%**		**Cost**	**%**		**Cost**	**%**
State	$41	79%		$90	77%		$29	79%
BB	7	13%		15	13%		4	12%
STJs	4	8%		12	10%		3	9%
Total	**$52**	**100%**		**$117**	**100%**		**$36**	**100%**

ALTERNATIVE 4a, 4b, and 4c - Allocation of Returns Cost

	Returns Cost - Alt 4a			Returns Cost - Alt 4b			Returns Cost - Alt 4c	
Entity	**Cost**	**%**		**Cost**	**%**		**Cost**	**%**
State	$16	22%		$46	61%		$37	49%
BB	34	44%		19	24%		22	29%
STJs	26	34%		11	15%		17	22%
Total	**$76**	**100%**		**$76**	**100%**		**$76**	**100%**

ALTERNATIVE 4a, 4b, and 4c - Summary of Costs

	Alternative 4a			Alternative 4b			Alternative 4c	
Entity	**Cost**	**%**		**Cost**	**%**		**Cost**	**%**
State	$176	63%		$206	73%		$197	70%
BB	60	21%		45	16%		48	17%
STJs	45	16%		30	11%		36	13%
Total	**$281**	**100%**		**$281**	**100%**		**$281**	**100%**

SUMMARY OF EXISTING MODEL AND ALL PROPOSED ALTERNATIVES

The table below illustrates how the Existing Model and the proposed alternatives allocated the total sales tax program cost to the State, BB, and STJs.

Alternative	Description	%					COST			
		State	BB	STJs	Total		State	BB	STJs	Total
							($ millions)			
	Existing Model	72%	13%	15%	100%		$204	$36	$41	$281
1	Base (+ -)	72%	13%	15%	100%		204	36	41	281
2	Permits	24%	32%	44%	100%		67	90	124	281
3	Revenue	79%	13%	8%	100%		222	37	22	281
4a	Element – Shared	63%	21%	16%	100%		176	60	45	281
4b	Element – Marginal	73%	16%	11%	100%		206	45	30	281
4c	Element – Revenue	70%	17%	13%	100%		197	48	36	281

B. Allocating Costs to the Individual BB and STJ Jurisdictions

As stated earlier, the existing model allocates the total BB cost to each BB jurisdiction based on total revenue while the total STJ cost is allocated to each STJ jurisdiction based on various workload factors. Each element of the sales tax program is allocated using a different workload factor. Registration cost is allocated on the number of permits, Returns cost is allocated on the number of returns, Audit cost is allocated on audit hours, and Collection cost is allocated on collection revenue.

1. Alternative A – Revenue Basis

   Alternative A recommends using revenue to allocate both the BB and STJ total cost to each entity. Essentially costs are allocated based on benefit received. This is the method that was used prior to the 1992 Auditor General Report which recommended using workload factors to allocate costs among the STJs. (The Auditor General Report did not recommend changing the revenue approach for allocating BB cost to each BB jurisdiction.) Note that allocating costs based on revenue would eliminate any cost efficiencies associated with administering more than one STJ within the same geographical area. However, as stated above, most of the BOE's activities associated with administering STJ workload treat each STJ as a separate entity. Therefore, any efficiency associated with administering two STJs within the same geographical area would be minimal.

2. Alternative B – Permit Basis

   Alternative B recommends using the number of permits within each BB jurisdiction and each STJ to allocate cost to each entity. The use of permits as the method to allocate costs would not be consistent with benefit received, nor would it necessarily be consistent with workload since all permitees would be given equal weight. For example, some permitees are small accounts, therefore generating fewer returns, fewer audits, and generally less workload than the workloads associated with larger, more complex accounts.

3. Alternative C – Allow BB and STJ Jurisdictions to Provide the Methodology to Allocate Administration Fees Among Their Jurisdictions

   Under this alternative, the BOE would only determine the total BB and STJ costs. Once the total was established, the allocation amount to each BB and STJ jurisdiction would be determine based upon the pattern or methodology provided by the BB and STJ jurisdictions. Delegating the cost allocation to the local level has been done for other local fees, most notably Trial Court funding and some Calworks programs. In the event the local jurisdictions cannot or do not provide a methodology, a default methodology must be available. This could be one of the other proposed alternatives.

   The table below illustrates the percentage and cost allocations for the existing model and each of the alternatives for allocating the sales tax program cost to the State, BB, and the STJs.

ALLOCATING THE BB AND STJ COST TO EACH JURISDICTION -
COMPARISON OF EXISTING MODEL AND PROPOSED ALTERNATIVES

Alternative	BB	STJs
Existing Model	Revenue	Workload Factors
Alternative A	Revenue	Revenue
Alternative B	Permits	Permits
Alternative C	BB Input	STJ Input

IV. OTHER MATTERS FOR CONSIDERATION

A. Existing Model Complexity

The 1992 Auditor General Report stated:

> The administration of the STJ-imposed transaction and use tax program may become unduly cumbersome and expensive as additional STJs are formed. It is more complicated than the administration of the Bradley-Burns Uniform Sales and Use Tax program (Bradley-Burns tax) through which taxes are collected for cities and counties. The city/county taxes are uniform in that all counties have them and all counties have the same rate. However, only some counties have STJs, and the counties that do have STJs have different tax rates depending on the rate set for the STJ and the number of STJs in the county. Furthermore, while the Bradley-Burns tax relates to the point of sale, the STJ tax relates to the point of sale or use. As a result, businesses incur expense accounting for where an item is sold as well as for whether items were delivered to one of 21 counties containing

> STJs. In addition, the board [BOE] incurs expense processing and auditing data related to where an item is sold as well as significant additional expense processing and auditing data to ensure that the location of delivery in one of 21 counties containing STJs, if any, was correctly recorded (Page 22).

In the 12 years since this report was issued, the number of STJs has more than doubled and there are now also STJs for individual cities. Currently there are STJ tax rates of 0.125%, 0.25%, 0.30%, and 0.50%. In the current fiscal climate it is likely that the number of STJs will continue to grow – more than 50 STJ proposals are on the November 2004 ballot. This proliferation of STJs has made the existing model extremely cumbersome to administer, not to mention the additional workload on BOE staff regarding the daily operations of administering the STJs.

B. The Proposed Alternatives and the Bureau of State Audits Reports

Section 7273 directs the BOE to assess central agency costs, direct costs, and shared costs to STJs to help pay for its tax administration system. However, several STJs have questioned the reasonability and equitability of the cost model used to calculate STJ assessments. First, the cost model reflects a significant policy decision to allocate the BOE's infrastructure costs of operating its tax administration system to STJs and local governments. Second, the application of the cost model creates an apparent imbalance between the proportion of revenue STJs earn and the proportion of costs they pay. The proportion of costs the STJs pay is in excess of the portion of revenue they earn. This occurs because the STJs are assessed a large amount of direct costs, while the State and the local governments are assessed few direct costs. Finally, the application of the model results in STJs with tax rates of less than 0.50% paying a higher proportion of their revenue to the BOE for administrative costs than do STJs with tax rates of 0.50%. This happens because it generally costs the BOE the same amount to administer a tax with a 0.125% rate as one with a 0.50% rate.

Because the cost model used by the BOE reflects a legislative policy decision to allocate infrastructure costs to the entities that benefit from the BOE's tax administration system, the State's policy makers may wish to examine that policy decision. Specifically they might consider whether it is reasonable and equitable for STJs and local governments to bear a percentage of the infrastructure costs associated with the BOE's tax administration system. In the alternative, should the STJs be charged only the marginal costs of operating the district tax system, if accurate marginal costs could be determined? This decision should be made before considering any alternative to the current model as the result will affect what alternatives are considered. If, for example, it is determined that the STJs should not bear any infrastructure costs, then alternatives that build such costs into their models need not be discussed.

The prior Auditor General Report in 1992 and the Bureau of State Audits Report in 1996 emphasized the use of workload factors, rather than revenue, as a more accurate way of allocating the STJ total cost to each individual STJ. However, these reports did endorse using revenue to determine how the shared costs should be allocated to the State, BB, and STJs, which is over 90% of the total cost. Furthermore, the reports supported using revenue to allocate the total BB cost to each individual BB jurisdiction. Workload factors that precisely determine State, BB, and STJ costs do not exist at this time. Many of the key workload factors used by the existing model only approximate actual workloads.

If it is the intent of the Legislature to assess fees based on workload factors, a much more detailed study of this process would be required, which was not possible in the short time frame available to produce this report.

C. Efficiencies in Counties with more than one STJ

None of the alternatives proposed to allocate costs to each STJ consider cost efficiencies for areas that have more than one STJ. Therefore, under the proposed alternatives it is likely that fees for multiple STJs within the same county would increase while fees for single STJs would decrease. However, as mentioned earlier, the current model may overstate any efficiencies related to processing workload in counties with multiple STJs. Most of the workloads associated with an STJ handle the STJ as a unique entity; therefore, actual workloads are not significantly reduced with the addition of another STJ within the same jurisdiction.

D. Direct Costs

None of the proposed alternatives consider direct and shared costs. As explained, it would be impractical for the existing time reporting system or cost allocation methods to track direct costs. The LRAS is the only unit within the BOE that works exclusively on BB and STJ workloads. Therefore, one option would be to first allocate the cost of the LRAS to BB and STJs, and then allocate the remaining costs using one of the proposed alternatives. However, to identify only a portion of the direct costs and then allocate the remaining cost to all entities would result in the unidentified direct costs being spread to all entities. The more equitable approach is to either identify all the direct costs or none of the direct costs. Since it is not currently feasible to identify all the direct costs, the proposed alternatives treat all costs as shared.

E. The Cap

The existing cap, or something similar, could be included with any of the proposed alternatives as well. However, as explained earlier, the manner in which the current cap is applied is inconsistent because STJs with identical tax rates can have different cap levels. Also, whenever the cap is invoked, the charges for that STJ are based solely on a percentage of revenue, completely disregarding the methodology calculations. Under the existing model, any cost reductions to STJs because of the cap results in an increase in the cost to the State and BB.

F. Prior Year Adjustment

A prior year adjustment mechanism could continue to be utilized with any of the proposed alternatives.

G. Input from Local Governments

As required by the LAO's Supplemental Report of the 2004 Budget Act, the BOE solicited input from local governments in the preparation of this report. Two "interested party" meetings were held where the BOE explained the existing model and shared the proposed alternatives. As a result of this interaction, the BOE has received a letter from Ms. Sara West, Executive Director of the Self-Help Counties Coalition. In this letter, Ms. West expresses support for Alternative 4c. A copy of her letter is incorporated into this report as Appendix B.

Current District Taxes, Rates, and Effective Dates

As of 7/1/04

Tax Area	*District Name and Initials*	*Rate*	*Effective Date*	*End Date*
Alameda County	Alameda County Essential Health Care Services Transactions and Use Tax (ACHC)	0.50%	07-01-04	
	Alameda County Transportation Improvement Authority (ACTI)	0.50%	04-01-02	
	Alameda County Transportation Authority (ACTA)	0.50%	04-01-87	03-31-02
	Bay Area Rapid Transit District (BART)	0.50%	04-01-70	
Contra Costa County	Contra Costa Transportation Authority (CCTA)	0.50%	04-01-89	
	Bay Area Rapid Transit District (BART)	0.50%	04-01-70	
Del Norte County	Del Norte County District (DNCD)	0.50%	07-01-93	06-30-98
El Dorado County				
(In City of Placerville only)	City of Placerville Public Safety Transactions and Use Tax (PLPS)	0.25%	04-01-99	
Fresno County	Fresno County Public Library Transactions and Use Tax (FCPL)	0.125%	04-01-99	
Fresno County	Fresno County Transportation Authority (FCTA)	0.50%	07-01-87	
Clovis (City)	City of Clovis Public Safety Transactions and Use Tax (CCPS)	0.30%	04-01-00[1]	
Fresno (City+)	Fresno Metropolitan Projects Authority (FMPA)	0.10%	07-01-93	03-20-96
Imperial County	Imperial County Local Transportation Authority (IMTA)	0.50%	04-01-90	
Calexico (City)	Calexico Heffernan Memorial Hospital District (CXHD)	0.50%	10-01-92[2]	
Inyo County	Inyo County Rural Counties Transactions Tax (INRC)	0.50%	10-01-88	
Lake County				
(In City of Clearlake only)	City of Clearlake Public Safety Transactions and Use Tax (CLPS)	0.50%	07-01-95	
Los Angeles County	Los Angeles County Transportation Commission (LATC)	0.50%	04-01-91	
	Los Angeles County Transportation Commission (LACT)	0.50%	07-01-82	
Avalon (City)	City of Avalon Municipal Hospital and Clinic Tax (AMHC)	0.50%	10-01-00[3]	
Madera County	Madera County Transportation Authority (MCTA)	0.50%	10-01-90	
Mariposa County	Mariposa County Healthcare Authority (MCHA)	0.50%	07-01-00	06-03-04
Mendocino County				
(In City of Point Arena only)	City of Point Arena Transactions and Use Tax (PARS)	0.50%	04-01-04[4]	
(In City of Willits only)	City of Willits Transactions and Use Tax (WCRS)	0.50%	10-01-03[5]	
Napa County	Napa County Flood Protection Authority Tax (NCFP)	0.50%	07-01-98	
Nevada County	Nevada County Public Library Transactions and Use Tax (NVPL)	0.125%	10-01-98	
Truckee (City)	Town of Truckee Road Maintenance Transactions and Use Tax (TRSR)	0.50%	10-01-98[6]	
Orange County	Orange County Local Transportation Authority (OCTA)	0.50%	04-01-91	
Riverside County	Riverside County Transportation Commission (RCTC)	0.50%	07-01-89	

Response to the Supplemental Report of the 2004 Budget Act – Special Tax Jurisdictions (Continued)
Appendix A

Tax Area	*District Name and Initials*	*Rate*	*Effective Date*	*End Date*
Sacramento County	Sacramento Transportation Authority (STAT)	0.50%	04-01-89	
San Benito County	San Benito County General Fund Augmentation (SBTU)	0.50%	01-01-94	12-31-97
	San Benito County Council of Governments (SBCG)	0.50%	01-01-89	12-31-98
San Bernardino County	San Bernardino County Transportation Authority (SBER)	0.50%	04-01-90	
San Diego County	San Diego County Regional Transportation Commission (SDTC)	0.50%	04-01-88	
San Francisco City	San Francisco County Public Finance Authority (SFPF)	0.25%	10-01-93	
	San Francisco County Transportation Authority (SFTA)	0.50%	04-01-90	
	Bay Area Rapid Transit District (BART)	0.50%	04-01-70	
San Joaquin County	San Joaquin Transportation Authority (SJTA)	0.50%	04-01-91	
San Mateo County	San Mateo County Transportation Authority (SMTA)	0.50%	01-01-89	
	San Mateo County Transit District (SMCT)	0.50%	07-01-82	
Santa Barbara County	Santa Barbara County Local Transportation Authority (SBAB)	0.50%	04-01-90	
Santa Clara County	Santa Clara County Transactions and Use Tax (SCGF)	0.50%	04-01-97	
	Santa Clara County Transit District (SCCT)	0.50%	10-01-76	
Santa Cruz County	Santa Cruz County Public Library Transactions and Use Tax (SZPL)	0.25%	04-01-97	
	Santa Cruz County Earthquake Recovery Bond (SCER)	0.50%	04-01-91	03-31-97
	Santa Cruz Metropolitan Transit District (SCMT)	0.50%	01-01-79	
Santa Cruz (City)	City of Santa Cruz Transactions and Use Tax (SZGT)	0.25%	07-01-04[1]	
Solano County	Solano County Public Library Transactions and Use Tax (SLPL)	0.125%	10-01-98	
Sonoma County	Sonoma County Open Space Authority (SCOS)	0.25%	04-01-91	
Sebastopol (City)	City of Sebastopol Transactions and Use Tax (SEGR)	0.125%	04-01-03[2]	
Stanislaus County	Stanislaus County Library Transactions and Use Tax (STCL)	0.125%	07-01-95	
Tulare County	Tulare County Transactions and Use Tax (TCTU)	0.50%	10-01-95	12-31-97
Visalia (City)	City of Visalia Transactions and Use Tax (VPST)	0.25%	07-01-04[3]	
Yolo County				
(In City of Davis only)	City of Davis Transactions and Use Tax (DAGT)	0.50%	07-01-04[4]	
(In City of West Sacramento only)	City of West Sacramento Transactions and Use Tax (WSTU)	0.50%	04-01-03[5]	
(In City of Woodland only)	City of Woodland General Revenue Transactions and Use Tax (WOGT)	0.50%	07-01-00[6]	

1. For sales made within the city limits of Santa Cruz (in addition to Santa Cruz County district taxes).
2. For sales made within the city limits of Sebastopol (in addition to Sonoma County district taxes).
3. For sales made within the city limits of Visalia.
4. For sales made within the city limits of Davis.
5. For sales made within the city limits of West Sacramento.
6. For sales made within the city limits of Woodland.

SELF-HELP
COUNTIES COALITION

Alameda Co. Trans.
Improvement Authority

Contra Costa County
Transportation Authority

Fresno County
Transportation Authority

Imperial County
Dept. of Public Works

L.A. County
Metro. Trans. Authority

Madera County
Transportation Authority

Orange County
Transportation Authority

Riverside County
Transportation Commission

Sacramento County
Transportation Authority

San Bernardino County
Associated Governments

San Diego County
Association of Governments

San Francisco County
Transportation Authority

San Joaquin County
Council of Governments

San Mateo County
Transportation Authority

Santa Barbara County
Association of Govs.

Santa Clara Valley
Transportation Authority

Mr. Joel Kaspick
BOE
Board of Equalization
450 N Street
Sacramento, CA 95814

October 5, 2004

Dear Mr. Kaspick:

On behalf of the Self-Help Counties Coalition, the organization of county agencies delivering voter-approved transportation improvement programs, thank you for the tremendous job you did compiling data and answering our many and detailed questions. I also thank you for graciously accepting our input to develop alternative 4C. Our Coalition supports that alternative and will encourage the BOE Board to recommend Alternative 4C in its report and to the State Legislature.

Alternative 4C is also described as the Revenue Line Approach for Returns Element. Under this simple and fair solution each component of the sales tax program is allocated on a pattern representative of that element's cost. The registration element is allocated on total revenue. The audit element is allocated on audit revenue. The collection element is allocated on accounts receivable revenue. The returns element is determined by assigning the lines on the return specifically associated with the State, Bradley Burns or STJ workload to each entity. The remaining generic lines on the return are assumed to benefit all three entities and are allocated to each based on total revenue. The approach recommended by Alternative 4C is simple and fair.

Last year the member agencies of the Self-Help Counties Coalition contributed over $2.4 billion to California's transportation system, close to the $2.9 billion raised by the gasoline tax and truck weight fees. Collectively, our member agencies have contributed in excess of $20 billion toward the construction and maintenance of California's transportation infrastructure. One third of this money goes directly to the State Highway System, which is ultimately the State's responsibility. Another third goes to transit capitol and operations, moving people off the crowded state highway system. The remaining funds support local road repair, which has become the cornerstone of local financing due to the State's continued borrowing from transportation accounts supported by gasoline tax revenue.

926 J Street, Suite 815, Sacramento, CA 95814
(916) 442-7195 FAX (916) 442-7198

According to the California Transportation Commission (CTC), transportation has lost in excess of $5 billion over the past three years, most of that because transportation funds have been transferred and/or loaned to help the state rebound from the budget shortfall. The continued borrowing has led to the delay and/or defunding of transportation projects throughout California. As a result, many of our members have made loans to the State to ensure that Caltrans meets its commitment to deliver projects programmed in the STIP. The Self-Help Counties Coalition believes these contributions to State resources should also be considered as part of any equation to reevaluate administrative fees charged for the collection of our local measure tax revenues.

I would like to underscore this position by firmly stating that the Self-Help Counties want to pay their fair share. While a case can be made for each of the alternatives, and one alternative would actually cost our members less, we believe Alternative 4C most fairly distributes the cost of collecting the state's sales taxes. Thank you again for your quick and accurate response to our questions and suggestions.

Sincerely,

Sarah West

Sarah West
Executive Director
Self-Help Counties Coalition

CALIFORNIA CODES
REVENUE AND TAXATION CODE
SECTION 7270-7274

7270. (a) Prior to the operative date of any ordinance imposing a transactions and use tax pursuant to this part, the district shall contract with the board to perform all functions incident to the administration and operation of the ordinance. If the district has not contracted with the board prior to the operative date of its ordinance, it shall nevertheless so contract and, in that case, the operative date shall be the first day of the first calendar quarter following the execution of the contract.

(b) The contract shall contain a provision that the district shall reimburse the board for and hold the board harmless from any and all costs, losses, or refunds of any kind whatsoever.

(c) The contract shall also contain a provision that, in the event that a legal action is commenced challenging the validity of the tax in its entirety, as opposed to its application to an individual taxpayer, the district shall place the tax proceeds into an interest-bearing escrow account until the legality of the tax is finally resolved by a final and nonappealable decision rendered by a court of competent jurisdiction. That provision shall be enforceable by any interested person in a proceeding for a writ of mandate.

(d) The district shall be entitled to indemnity for any and all costs, losses, or refunds from any entity, except the state, that participated in the imposition of the tax. For the purposes of this part, "participated" means any involvement in procuring the legislation that authorized the tax, or in enacting or administering the ordinance imposing the tax. Any organization that is a member of the legislative body of the district imposing the tax has participated in the imposition of the tax within the meaning of this section.

7270.5. Any action or proceeding filed on the basis that a tax ordinance provided for in this part or Part 1.7 (commencing with Section 7280) or the issuance of any bonds thereunder or any of the proceedings in relation thereto is contested, questioned, or denied on the basis that the tax ordinance is unconstitutional or otherwise invalid and filed for the sole purpose of contesting the validity of the district transactions and use tax, shall be commenced pursuant to Chapter 9 (commencing with Section 860) of Title 10 of Part 2 of the Code of Civil Procedure. The state shall not be made a party to the action or proceeding. That action shall not be filed more than 60 days after the approval of the enabling ordinance by the voters unless the authorizing legislation specifies a longer period. If no action is filed within that period, the tax, the bonds, and all proceedings in relation thereto, including the adoption and approval of the ordinance, shall be held to be valid and in every respect legal and uncontestable.

7271. All transactions and use taxes collected by the board pursuant to contract with the district shall be transmitted by the board to the district periodically as promptly as feasible. The transmittals shall be made at least twice in each calendar quarter.

7271.05. (a) On or before March 1, 1992, the Controller shall calculate the total amount that has been transmitted to the Santa Cruz Metropolitan Transit District pursuant to Section 7271.03, and provide those calculations to the State Board of Equalization.

(b) Beginning on July 1, 1992, and for each year thereafter to July 1, 1997, inclusive, the State Board of Equalization shall reduce the amounts that would otherwise be transmitted to the Santa Cruz Metropolitan Transit District pursuant to Section 7271 by an amount sufficient to recover one-fifth of the amount transmitted to that district pursuant to subdivision (c) of Section 7271.03, plus interest after January 1, 1992, or the other applicable date, at the annual rate of 31/2 percent. The board shall distribute the reductions in transmittals over the fiscal year in the manner it determines to be least disruptive to the district.

(c) The board shall transmit the amounts withheld from the Santa Cruz Metropolitan Transit District and the interest amounts pursuant to subdivision (b) to the Special Fund for Economic Uncertainties.

7271.1. (a) For purposes of this section:

(1) "Quarterly taxes" means the total amount of transactions and use taxes transmitted by the board to a district for a calendar quarter.

(2) "Refund" means the amount of transactions and use taxes deducted by the board from a district's quarterly taxes in order to pay the district's share of a transactions and use tax refund due to one taxpayer.

(3) "Offset portion" means that portion of the refund which exceeds the greater of fifty thousand dollars ($50,000) or 20 percent of the district's quarterly taxes.

(b) Except as provided in subdivision (c), if the board has deducted a refund from a district's quarterly taxes which includes an offset portion, then the following provisions apply:

(1) Within three months after the board has deducted an offset portion, the district may request the board to transmit the offset portion to the district.

(2) As promptly as feasible after the board receives the district' s request, the board shall transmit to the district the offset portion as part of the board's periodic transmittal of transactions and use taxes.

(3) The board shall thereafter deduct a pro rata share of the offset portion from future transmittals of transactions and use taxes to the district over a period to be determined by the board, but not less than two calendar quarters and not more than eight calendar quarters, until the entire amount of the offset portion has been deducted.

(c) The board shall not transmit the offset portion of the refund to the district if that transmittal would reduce or delay either the board's payment of the refund to the taxpayer or the board's periodic transmittals of transactions and use taxes to other districts.

7272. The district shall pay to the board its costs of preparation to administer and operate the transactions and use taxes ordinance. The district shall pay such costs monthly as incurred and billed by the board. Such costs include all preparatory costs, including costs of developing procedures, programming for data processing, developing and adopting appropriate regulations, designing and printing of forms, developing instructions for the board's staff and for taxpayers, and other necessary preparatory costs which shall include the board's direct and indirect costs as specified by Section 11256 of the Government Code. Any disputes as to the amount of preparatory costs incurred shall be resolved by the Director of Finance, and his or her decision shall be final. The maximum amount of all preparatory costs to be paid by the district shall not, in any event, exceed one hundred seventy-five thousand dollars ($175,000).

7273. In addition to the amounts otherwise provided for preparatory costs, the board shall charge an amount for its services in administering the transactions and use tax determined by the board, with the concurrence of the Department of Finance, as follows:

(a) Beginning with the 1993-94 fiscal year, the amount charged shall be based on the total special taxing jurisdiction costs reflected in the annual Budget Act. This amount comprises the categories of direct, shared, and central agency costs incurred by the board and shall include the following:

(1) The amount charged to each entity shall be based on the recommendations incorporated in the March 1992, report by the Auditor General entitled "The Board of Equalization Needs To Adjust Its Model For Setting Reimbursement Rates For Special Tax Jurisdictions."

(2) The amount charged may be adjusted in the current fiscal year to reflect the difference between the board's budgeted costs and any significant revised estimate of costs. Any adjustment shall be subject to budgetary controls included in the Budget Act. Prior to any adjustment, the Department of Finance shall notify the Chairperson of the Joint Legislative Budget Committee not later than 30 days prior to the effective date of the adjustment.

(3) For the 1995-96 fiscal year and each fiscal year thereafter, the amount charged shall be adjusted to reflect the difference between the board's recovered costs and the actual costs incurred by the board during the fiscal year two years prior.

(b) The board shall, by June 1 of each year, notify districts of the amount that it anticipates will be assessed for the next fiscal year. The districts shall be notified of the actual amounts that will be assessed within 30 days after enactment of the Budget Act for that fiscal year.

(c) The amount charged a transactions and use tax district that becomes operative during the fiscal year shall be estimated for that fiscal year based on that district's proportionate share of direct, indirect, and shared costs.

(d) The amounts determined by subdivision (a) shall be deducted in equal amounts from the quarterly allocation of taxes collected by the board for a given district.

(e) For the 1998-99 fiscal year and each fiscal year thereafter, the amount charged to a district by the board shall not exceed the lesser of the amount as a percentage of revenue the board would have charged for the 1998-99 fiscal year, or the first full year of a new district's operations under this section as it read prior to the amendments made by the act adding this subdivision, or the following percentages:

(1) For districts imposing a transactions and use tax of one-half of 1 percent or greater, the amount charged by the board shall not exceed 1.5 percent, for the 1998-99 fiscal year and each fiscal year thereafter.

(2) Beginning with the 1998-99 fiscal year and in each fiscal year thereafter, the amount charged to a district imposing a transactions and use tax ranging from one-quarter of 1 percent up to but less than one-half of 1 percent shall not exceed 3 percent.

(3) Beginning with the 1998-99 fiscal year and in each fiscal year thereafter, the amount charged to a district imposing a transactions and use tax below one-quarter of 1 percent shall not exceed 5 percent.

7273.2. The board shall annually prepare a report showing the amount of both reimbursed and unreimbursed costs incurred by it in administering transactions and use taxes imposed by districts pursuant to this part.

7274. The board shall make available to all licensed vehicle, vessel, and aircraft dealers who hold seller's permits in this state information concerning the cities and counties located within districts which impose transactions and use tax ordinances and the applicable tax rates in those cities and counties.