

[Assembly Bill 755](#) (Ridley-Thomas)

Date: 04/14/15

Program: Sales and Use Tax

Sponsor: Author

Revenue and Taxation Code Section 6362

Effective: Immediately, but operative January 1, 2016

Michele Pielsticker (Chief) 916.322.2376

Sheila T. Waters (Analyst) 916.445.6579

Joe Fitz (Revenue) 916.445.0840

Summary: Exempts from the state General Fund (3.9375%) sales and use tax rate sales by a small business whose property line abuts or faces the rail corridor of specified construction projects.

Purpose: To mitigate the impact and provide tax relief to small businesses affected by the Los Angeles County Metropolitan Transportation Authority's construction of three future rail transit lines.

Fiscal Impact Summary: Estimated annual state General Fund revenue loss of \$1.7 million.

Existing Law: Except where the law provides a specific exemption or exclusion, California's Sales and Use Tax Law¹ imposes the sales tax on all retailers for the privilege of selling tangible personal property at retail in this state or the use tax on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer.

California's sales and use tax rates. Since January 1, 2013, a statewide 7.5% sales and use tax rate applies to tangible personal property sales and purchases. The following table shows California's various sales and use tax rate components (the table excludes voter-approved city and county district taxes, which range from 0.1% to 2.5%):

Rate	Jurisdiction	Purpose/Authority
3.9375%	State (General Fund)	State general purposes (Revenue and Taxation Code (RTC) Sections 6051, 6051.3, 6201, and 6201.3)
1.0625%	Local Revenue Fund 2011	Realignment of local public safety services (RTC Sections 6051.15 and 6201.15)
0.25%	State (Fiscal Recovery Fund)	Repayment of the Economic Recovery Bonds (RTC Sections 6051.5 and 6201.5)
0.25%	State (Education Protection Account)	Until 01/01/17, schools and community college funding (Section 36, Article XIII, State Constitution)
0.50%	State (Local Revenue Fund)	Local governments to fund health and welfare programs (RTC Sections 6051.2 and 6201.2)
0.50%	State (Local Public Safety Fund)	Local governments to fund public safety services (Section 35, Article XIII, State Constitution)
1.00%	Local (City/County) 0.75% City and County 0.25% County	City and county general operations (RTC Section 7203.1, operative 7/1/04); Dedicated to county transportation purposes
7.50%	Total Statewide Rate	

¹ Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code (RTC).

Proposed Law: This bill provides a 3.9375% state General Fund sales and use tax exemption for tangible personal property sold by, or purchased from, a qualifying retailer during the period in which specified rail projects are under construction.

The partial exemption applies only to retailers that are small businesses, as defined, and whose property line abuts or faces the rail corridor or a designated construction staging or storage area, and includes a small business located in a mall or strip-mall that is similarly situated.

The bill defines the following terms:

(1) "Project" means the Crenshaw/LAX Transit Corridor Light Rail Line, the Regional Connector Transit Corridor Light Rail Line, and the Westside Subway Extension Light Rail Line.

(2) "Small business" means a retailer that remitted less than \$200,000 in tax for the previous four calendar quarters.

(3) "Small business" also means a retailer that has been in operation for less than four calendar quarters and remitted less than an average of \$50,000 in tax for each calendar quarter of operation.

As a tax levy, the bill becomes effective immediately upon enactment, but is operative January 1, 2016.

Background: Construction of these light rail lines began in 2014, and all three lines' construction is currently ongoing with anticipated completion dates between 2018 and 2023. To also mitigate the impact to affected small businesses, the Pacific Coast Regional Small Business Development Corporation administers a "Business Interruption Fund." This fund provides financial assistance to small businesses directly affected by the rail construction for their fixed operating expenses, such as utilities, insurance, rent or mortgage, and payroll. For each qualifying small business, the maximum grant allowed is the lesser of \$50,000 or 60% of the annual business revenue losses per business. For this fund's purposes, a small business is defined as a for-profit business or non-religious, non-profit with 25 or fewer total employees. The first checks totaling \$66,310 were recently distributed to four small business owners impacted by these rail lines' construction. A total of \$10 million has been allocated for these purposes.

Commentary:

- 1. Effect of the bill.** This bill partially exempts sales by and purchases from small businesses affected by the Los Angeles County Metropolitan Transportation Authority's construction of specified light rail lines.
- 2. The proposed exemption would continue while rail lines are "under construction."** Even though actual construction may be completed on a certain date, there may be equipment obstacles, barriers, testing, etc. that continues after construction that prolong the impact on businesses adjacent to these rail lines. We suggest "under construction" be clearly defined to avoid any misunderstanding and underreporting. Also, retailers often wait for official notice from the BOE for changes to their reporting requirements. The bill should specify that the proposed exemption shall cease to be operative on the last day of the month following the date construction ends, or 14 days after construction ends, whichever ends later. This should provide the BOE with sufficient time to notify affected retailers.
- 3. Some affected retailers would have to bear cash register programming costs twice.** Some retailers that rely on electronic registers or other computer software to compute the applicable tax may have to hire outside programmers to make the electronic system modifications to adjust rates during and after construction. It is unclear whether the "Business Interruption Fund" described previously would cover these costs. If not, the retailers would bear the costs.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

- 4. Should the exemption apply only to retailers *directly* affected by the construction?** The previously described “Business Interruption Fund” requires, among other things, that the business be “directly affected” by the construction. A similar requirement for this proposed exemption would clarify to which retailers the exemption applies.

Administrative Costs: The BOE will incur some implementation costs related to notifying affected retailers, programming for the exemption’s partial rate, and answering inquiries. When construction ends, additional notification costs, programming costs, as well as return processing costs will be incurred. Return processing costs relate to errors associated with completing returns with sales during and after the construction period and potentially having different rates during the middle of a reporting period. Historically, rate changes during the middle of a reporting period confuses retailers when preparing returns, and results in more return reporting errors and administrative workload. These costs would be commensurate with the number of retailers this bill affects, and are currently pending.

Revenue Impact:

Background, Methodology, and Assumptions. The BOE does not have information regarding all potentially affected retailers that would fall under the bill’s provisions. Therefore, staff has made a number of assumptions to provide an order of magnitude.

Construction for the three transit lines collectively will extend over 19 miles and all retailers of tangible personal property whose properties face or abut the rail line corridors or construction sites would qualify for the partial exemption. The 19 miles include the following Los Angeles areas:

- The Crenshaw/LAX Transit Project is an 8.5-mile light-rail line that will run between Crenshaw District, Inglewood, Westchester and surrounding areas,
- The Regional Connector Transit Corridor Light Rail Line will be a 1.9-mile underground light-rail system in downtown Los Angeles, and
- The Westside Subway Extension Light Rail Line will be a nine mile stretch along Los Angeles’ Westside.

In 2013, 264,000 retailers in Los Angeles County were registered with the BOE, with about \$140 million in taxable sales for the year. For purposes of this order of magnitude, staff has made the following assumptions:

- ✓ Annual taxable sales by each Los Angeles County business averaged 530,000 (\$140 million/264,000).
- ✓ Each affected business’ sales declined by 50% during construction.
- ✓ U.S. Census Bureau data indicate that in 2013, about 20 percent of the Los Angeles County establishments were in either retail trade or food services.
- ✓ 800 businesses face or abut the rail lines or construction sites.
- ✓ 160 retailers of tangible personal property qualify (800 x 20%) based on information about two rail lines. We do not have information on the number associated with the third line.²
- ✓ Construction for the three transit lines will continue in 2016 and 2017.

Revenue Summary. Based on these assumptions, a 3.9375% sales and use tax exemption would amount an annual \$1.7 million ($\$530,000 \times 50\% \times 160 \times 3.9375\% = \$1,669,500$) state revenue loss during the three rail lines construction period.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

² <http://touch.latimes.com/#section/-1/article/p2p-82116425/>
<http://www.rafu.com/2015/04/metro-program-to-help-small-businesses-in-construction-zone/>

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE’s formal position.