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STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**Chapter 13 of the First Extraordinary Session**	Bill No:	**AB 7x**
Tax:	**Sales and Use Tax and Bradley Burns**	Author:	**Oropeza**
Board Position:		Related Bills:	**AB 1766 (Budget)**

BILL SUMMARY

Among its provisions, this bill would: (1) increase the state portion of the sales and use tax rate by 0.5 percent, from 6 percent to 6.5 percent; (2) decrease the local sales and use tax rate imposed by a city from 1 percent to 0.5 percent; and (3) decrease the local sales and use tax rate imposed by a county from 1.25 percent to 0.75 percent. The revenues would be dedicated to the repayment of the deficit funding bond. The provisions of this bill would become operative on July 1, 2004.

Summary of Amendments

The prior version of this bill (dated January 28, 2003) did not affect any tax programs administred by the Board. It would have eliminated the Health Professions Careers Opportunity Program at the Office of Statewide Health Planning and Development and provided other changes related to social services.

ANALYSIS

Current Law

Under current law, the statewide sales and use tax rate is 7.25 percent. Of the 7.25 percent base rate, 6 percent is the state sales and use tax portion and 1.25 percent is the local sales and use tax portion. The components of the state sales and use tax rate of 6 percent are as follows:

- 4.75 percent state sales and use tax 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 an additional state sales and use tax allocated to the state's General Fund which is also dedicated for state general purposes (Sections 6051.3 and 6201.3 of the Revenue and Taxation Code);
- 0.5 percent state tax is allocated to the Local Revenue Fund which is dedicated to local governments for program realignment (Sections 6051.2 and 6201.2 of the Revenue and Taxation Code);
- 0.5 percent state tax 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).

Under the Bradley-Burns Uniform Local Sales and Use Tax Law (commencing with Section 7200 of the Revenue and Taxation Code), counties and cities are authorized to impose a local sales and use tax. The rate of tax is fixed at 1.25 percent. Counties are authorized to impose a local sales and use tax rate of up to 1.25 percent. Cities are authorized to impose a local sales and use tax rate of up to 1 percent that is credited against the county rate so that the combined local sales and use tax rate under the Bradley-Burns Law does not exceed 1.25 percent.

Of the 1.25 percent, cities and counties use the 1 percent to support general operations. The remaining 0.25 percent is designated by statute for county transportation purposes and may be used only for road maintenance or the operation of transit systems.

Proposed Law

This bill would enact the California Fiscal Recovery Financing Act, create the California Fiscal Recovery Financing Authority, and allow the authority to, among other things, issue bonds for the funding of the accumulated budget deficit. This bill would also create the Fiscal Recovery Fund in the State Treasury and require that all revenues received from the 1/2 percent state sales and use tax rate imposed by this bill be deposited into this fund. The revenues deposited in this fund are dedicated to repayment of the deficit bonds.

This bill would add Sections 6051.5, 6201.5, and 7101.3 to the Sales and Use Tax Law to impose an additional 1/2 percent state sales and use tax. All revenues derived from this tax would be deposited into the Fiscal Recovery Fund in the State Treasury.

This bill would also add Sections 6051.6 and 6201.6 to the Sales and Use Tax Law to provide an exemption from the additional 1/2 percent state sales and use tax for sales and purchases of tangible personal property (i.e., parts, supplies, and equipment) to aircraft common carriers. This exemption does not apply to sales or purchases of fuel and petroleum products.

This bill would amend Sections 7202 and 7203 of the Bradley-Burns Uniform Local Sales and Use Tax Law to reduce the partial local sales and use tax exemption on sales and purchases of property (i.e., parts, supplies, and equipment) to aircraft common carriers from 80 percent to 67 percent. This exemption does not apply to sales or purchases of fuel and petroleum products.

This bill would add Section 7203.1 to the Bradley-Burns Uniform Local Sales and Use Tax Law to do the following:

1) During the revenue exchange period, the authority of a county or a city to impose a tax rate as specified in an ordinance adopted pursuant to Sections 7202 and 7203 of the Bradley-Burns Law is suspended, and the tax rate to be applied instead is 3/4 percent for a county and 1/2 percent for a city.
2) "Revenue exchange period" means the period on or after July 1, 2004 and continues until the Board receives notification from the Director of Finance pursuant to Section 99006 of the Government Code.
3) Provides that any change in the local sales and use tax rate during the revenue exchange period is not subject to the voter approval requirements under Article XIII C of the California Constitution.

The provisions of this bill would become operative on July 1, 2004 and would continue until the Director of Finance notifies the Board of the earliest of the following events:

1. All outstanding bonds and ancillary obligations authorized under this bill have been paid or retired;
2. Payment of the principal of and interest on all such bonds has been irrevocably provided for, as specified; or

3. The Fiscal Recovery Fund, created by this bill, holds sufficient funds to pay the principal of, and interest to final maturity on, all outstanding bonds, as specified.

Finally, this bill has an uncodified section providing that any tax exchange or revenue sharing agreements, entered into prior to the operative date of this bill, between local agencies or between local agencies and nonlocal agencies shall be deemed to be temporarily modified to account for the reduction in sales and use tax revenues as a result of this bill and would be replaced as may otherwise be provided by law.

Background

Sales and Use Tax

California's last state sales and use tax increase occurred in July 1991 with the enactment of AB 2181 (Ch. 85, Stats. 1991). The rate was increased by 1 1/4 percent in response to the budget shortfall.

Prior to that increase, for a 13-month period beginning December 1, 1989 and ending December 31, 1990, a 1/4 percent state sales and use tax increase was enacted in response to the October 17, 1989 earthquake (commonly referred to as the Loma Prieta earthquake) in the San Francisco Bay Area (SB 33X, Ch. 14X, Stats. 1990, First Extraordinary Session) .

Bradley-Burns Tax

In 1955, the Bradley-Burns Uniform Local Sales and Use Tax Law was enacted in an effort to put an end to the problems associated with the different sales and use tax rates among the various communities in the state. Initially, it was optional for counties to participate in the Bradley-Burns tax program, and the local sales and use tax rate was fixed at 1 percent. Subsequently, cities and counties were prohibited from imposing their own local sales and use tax program separate from Bradley-Burns.

The board of supervisors of seven counties (Inyo, Los Angeles, Mariposa, Mono, Orange, Sacramento, San Benito) adopted ordinances effective April 1, 1956. Subsequently, 50 other county boards adopted ordinances by June 1959, and the final county (Siskiyou) board, adopted their ordinance in December 1961. With respect to cities, as of June 30, 2003, there are 476 cities in California. All of these 476 cities have adopted ordinances which are administered by the Board.

In 1972, when sales tax was first levied on gasoline, counties began receiving 0.25 percent local tax revenue for transportation purposes. Thus, with the enactment of this tax, the local sales and use tax rate was increased from 1 to 1.25 percent.

COMMENTS

1. **Sponsor and Purpose.** The Assembly Budget Committee is the sponsor of this bill. According to the author's office and the findings and declarations in the bill, "It is the intent of the Legislature to provide for an efficient, equitable, and economical means of funding the accumulated budget deficit in order to preserve public education and critical health and safety programs."
2. **Impact of rate change on the Board.** Tax rate changes historically have had a significant effect on the Board. However, this impact is minimized when the rate change takes place on the first day of a calendar quarter and when the Board has sufficient lead time prior to the rate change. Since the proposed tax rate increase would become effective on July 1, 2004, the Board would have sufficient lead time to properly inform the public and prepare revised publications and tax returns.

3. **Cities and counties would not be required to adopt new ordinances.** Section 7203.1, subdivision (a) provides that, during the revenue exchange period only, the authority of a county or a city to impose a tax rate as specified in an ordinance adopted pursuant to Sections 7202 and 7203 [Bradley-Burns Local Tax Law] is suspended, and the tax rate to be applied instead would be 0.75 percent for a county and 0.5 percent for a city. Subdivision (c) of Section 7203.1 provides that, subdivision (a) of Section 7203.1, is a self-executing provision that operates without regard to any decision or act by a local government.

   Section 7203.1 contains self-executing provisions that operate without regard to any existing tax ordinances which impose a different rate other than the new rates provided for in the bill. Therefore, because the provisions of Section 7203.1 are self-executing, Board staff would not require cities and counties to adopt new ordinances and would continue to administer the Bradley-Burns local sales and use tax at the rates specified in the new Section 7203.1.

4. **Even though the local sales and use tax rate would be reduced, the Board's administrative costs would remain the same.** Existing law requires the Board to charge local jurisdictions for the services it provides in administering the local entity's tax ordinance. The amount to be charged is determined by the Board with the concurrence of the Department of Finance based on the local entity's total computed cost, including direct, shared, and central agency costs. These costs are deducted from the quarterly allocation of taxes collected by the Board.

   This bill reduces the local sales and use tax rate imposed by a city to 0.5 percent, and by a county to 0.75 percent. However, even though the local tax rate is reduced, the work in administering the local entity's tax would remain the same. As a result, the ratio of administrative costs to local tax revenues would essentially double.

5. **Partial tax exemptions would apply to the new 1/2 percent state sales and use tax.** There are several partial sales and use tax exemptions: farm equipment and machinery, timber harvesting equipment and machinery, diesel fuel used in farming activities and food processing, racehorse breeding stock, manufacturing equipment, teleproduction and post production activities, and the rural investment tax exemption. These partial tax exemption statutes contain provisions that exclude the exemptions from any taxes levied pursuant to Bradley-Burns Uniform Local Sales and Use Tax Law and Transactions and Use Tax Law. These partial tax exemptions also do not apply to taxes levied pursuant to Section 6051.2 and 6201.2 of the Revenue and Taxation Code (also known as the Local Revenue Fund tax), and pursuant to Section 35 of Article XIII of the California Constitution (also known as the Local Public Safety Fund tax).

   Thus, the partial tax exemption statutes apply only to the state general fund portion of the sales and use tax rate. The state general fund portion was 5 percent; however, with the enactment of this bill, the new state general fund portion is increased by 0.5 percent to 5.5 percent. With respect to Bradley-Burns local taxes, district taxes, and the two 0.5 percent statewide local taxes (Local Revenue Fund and Local Public Safety Fund), there is no partial tax exemption that applies to these taxes. Thus, the partial tax exemptions would be subject to the 0.75 percent Bradley-Burns tax, district taxes, and the two 0.5 percent statewide (local) taxes. For partial tax exemptions, the total tax base (not including district taxes) would be 1.75 percent (0.75% + 0.5% + 0.5% = 1.75%).

6. **New state sales and use tax rate of 0.5 percent will not be included in the calculation of the sales tax prepayment rate on motor vehicle fuel, diesel fuel, and aircraft jet fuel.** Suppliers and wholesalers of motor vehicle fuel (gasoline), diesel fuel, and aircraft jet fuel are required to collect a prepayment of a portion of the sales tax when they remove fuel at the terminal rack, enter the fuel into California, or sell the fuels at any point after removal from the terminal rack. The Board determines the sales tax prepayment rates on these fuels. The rate of prepayment is based upon 80 percent of the combined state and local sales tax rate on the average selling price of the fuel as specified in industry publications.

   Effective April 1, 2003, the prepayment rates for fuels (per gallon) are as follows: motor vehicle fuel at a rate of $0.09 per gallon, diesel fuel at a rate of $0.07 per gallon, and aircraft jet fuel at a rate of $0.045 per gallon. These rates are scheduled to remain in effect through March 31, 2004. If the price of these fuels increases or decreases and results in prepayments that consistently exceed or are significantly lower than the fuel retailer's sales tax liability, the Board may adjust these rates. The Board is required, by November 1 of each year, to establish the prepayment tax rate for these fuels.

   Section 6480.1 of the Revenue and Taxation Code requires the Board to establish the sales tax prepayment rates. The specific language in the statutes provides that "the required prepayment shall be established by the board based upon 80 percent of the combined state and local sales tax rate established by Sections 6051, 6051.2, 6051.3, and 7202 of the Revenue and Taxation Code and Section 35 of Article XIII of the California Constitution on the average selling price as determined by the State Energy Resources Conservation and Development Commission in its latest publication of the Quarterly Oil Report."

   Because Section 6480.1 includes the code sections of each state and local tax component, the new 0.50 percent tax needs to be added to the statute. Without this amendment to the statute, the prepayment rate will be based on a total tax rate of 6.75 percent, instead of the current tax rate of 7.25 percent. The effect is that retailers will pay a lower prepayment amount and then pay a higher amount when they file their sales and use tax returns.

   For these reasons, Section 6480.1 should be amended to add Section 6051.5 which imposes the new 0.50 percent state sales tax.

7. **This bill reduces the local sales and use tax rate for cities to 0.5 percent and for counties to 0.75 percent.** The new Section 7203.1 provides that, operative July 1, 2004, the authority of a city or a county to impose a tax rate as specified in an ordinance adopted pursuant to Bradley-Burns law is temporarily suspended, and the new tax rates to be applied instead are 0.5 percent for cities and 0.75 percent for counties.

   Under current law (operative date of this bill is July 1, 2004) cities are authorized to impose a local tax rate of "1 percent or less," defaulting the balance of the 1 percent rate to the county in which the city is located. Many cities adopted ordinances imposing a local tax rate of less than one percent. Angels Camp (0.88 percent), Clovis (0.90 percent), Hayward (0.95 percent), and Santa Rosa (0.975 percent) are some of the cities that receive less than the 1 percent. The reason that a city elected to impose less than 1 percent, was to use the balance of the 1 percent to pay the county for services. However, under the language of Section 7203.1, cities are to impose a rate of 0.5 percent allowing no portion of it to go to the county.

Thus, under the provisions of this bill, cities cannot impose less than a 0.5 percent defaulting any balance of the 0.5 percent to the county to pay for services.

8. **Related Legislation.** Assembly Bill 1766 (Ch. 162, Committee on Budget) is a companion bill to this bill, and among its provisions, does the following: (1) reduces the amount of property tax revenue allocated to a county's Educational Revenue Augmentation Fund by an amount attributable to the 1/2 percent reduction in the local sales and use tax rate, and instead, require this amount to be deposited into the Sales and Use Tax Compensation Fund that will be established by this bill in each county; (2) requires the county auditor to allocate moneys from the Sales and Use Tax Compensation Fund to cities and counties to reimburse them for local sales and use tax revenue losses attributable to the 1/2 percent reduction in the local sales and use tax rate; and (3) requires the Board, on or before August 15th of each fiscal year, to report to the Director of Finance the taxable sales in a county for the prior fiscal year.

COST ESTIMATE

Changes to the tax rates have a substantial impact on the Board's administrative costs. Tax returns and various Board publications would have to be revised to reflect the new rate changes. Programming and data entry would also be necessary to reflect the new rates, in addition to costs to notify all taxpayers registered with the Board prior to the rate changes.

A detailed cost estimate is pending.

REVENUE ESTIMATE

The bill would provide for an additional 0.5 percent state sales and use tax. This bill would also would reduce the local sales and use tax rate imposed by a city from 1 percent to 0.50 percent and reduce the local sales and use tax rate imposed by a county from 1.25 percent to 0.75 percent. These rate changes would become operative on July 1, 2004.

Estimated taxable sales applicable to fiscal year 2004-05 would be $487 billion.

As previously stated, there are currently seven partial sales and use tax exemptions: farm equipment and machinery (Section 6356.5), timber harvesting equipment and machinery (Section 6356.6), diesel fuel used in farming activities and food processing (Section 6357.7), racehorse breeding stock (Section 6358.5), manufacturing equipment (Section 6377), teleproduction and post production activities (Section 6378), and the rural investment tax exemption (Section 6378.1).

The manufacturing equipment exemption (also known as Manufacturing Income Credit) under Revenue and Taxation Code Section 6377 is due to sunset on December 31, 2003. The Rural Investment Tax Exemption Credit is currently not used.

These partial sales and use tax exemptions apply to the state general fund portion of the sales and use tax rate of 5 percent, but do not apply to taxes levied pursuant to Bradley-Burns Uniform Local Sales and Use Tax Law and Transactions and Use Tax Law. These partial tax exemptions also do not apply to taxes levied pursuant to Section 6051.2 and 6201.2 of the Revenue and Taxation Code (also known as the Local Revenue Fund tax), and pursuant to Section 35 of Article XIII of the California Constitution (also known as the Local Public Safety Fund tax).

Beginning July 1, 2004, this bill would increase the partial exemptions by 0.50 percent, from 5 percent to 5.50 percent. Estimated sales transactions applicable to these exemptions for the calendar year 2002 are as follows:

Exemptions	**Exempt Transactions**
Farm Equipment	1,236,000,000
Timber Harvesting Equipment	21,000,000
Diesel Fuel – Farming & Food Processing	321,000,000
Racehorse Breeding Stock	11,000,000
Teleproduction Equipment	241,000,000
Total	$1,830,000,000

Revenue Summary

A state sales and use tax rate increase of 0.5 percent would increase state sales and use tax revenues for fiscal year 2004-05 by $2.4 billion.

A 0.50 percent reduction in the local sales and use tax rate would reduce local sales and use tax revenues by $2.4 billion.

With respect to partial sales and use tax exemptions, a state sales and use tax rate increase of 0.50 percent would increase the partial exemptions by the same amount. However, this would reduce the state sales and use tax revenues by $9.2 million annually ($1,830,000,000 x 0.50%).

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EFFECT OF AB 7X AND AB 1766 ON COMBINED STATE AND LOCAL SALES AND USE TAX RATE

OLD TAX RATE STRUCTURE

RATE	COMPONENT
4.75%	State (General Fund)
0.50%	State (Local Revenue Fund)
0.25%	State (General Fund - 7/15/91 state tax increase)
0.50%	State (Local Public Safety Fund)
1.25%	Local (City/County) 1.00% City and county general operations 0.25% County transportation funds
*7.25%	Total Statewide Base Sales/Use Tax Rate

*Excudes District Taxes

NEW TAX RATE STRUCTURE **(effective July 1, 2004)**

	RATE	COMPONENT
	4.75%	State (General Fund)
	0.50%	State (Local Revenue Fund)
	0.25%	State (General Fund - 7/15/91 state tax increase)
	0.50%	State (Local Public Safety Fund)
-	0.75%	Local (City/County) 0.50 City general operations 0.25 County transportation funds
+	0.50%	State (Fiscal Recovery Fund)
	*7.25%	Total Statewide Base Sales/Use Tax Rate

STATE

+ 0.50% Increase
New State Special
Fund

↓

FISCAL RECOVERY FUND
(To pay off deficit bonds)

LOCAL

- 0.50% Decrease
Bradley-Burns
Local Tax

Cities and counties reimbursed for local sales and use tax revenue losses attributable to 0.50 percent decrease from SUTCF. Payments made to cities and counties in January and May of each fiscal year.

Decrease property tax revenues allocated to ERAF by an amount equal to the total local sales and use tax revenue loss of the county and each city in the county, and instead allocate these amounts to the SUTCF to reimburse the cities cities and counties for their local tax revenue losses.

SALES AND USE TAX COMPENSATION FUND (SUTCF)

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COUNTY EDUCATIONAL REVENUE AUGMENTATION FUND (ERAF)

STATE GENERAL FUND → ERAF reductions to schools will be replaced with additional state General Fund revenue under Proposition 98 minimum-funding guarantee. → SCHOOLS