STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**03/25/03**	Bill No:	**AB 1221**
Tax:	**Bradley-Burns and Sales and Use Tax**	Author:	**Steinberg and Campbell**
Board Position:		Related Bills:	**AB 680 (Steinberg, 2002)** **AB 2878 (Wiggins, 2002)**

BILL SUMMARY

Among its provisions, this bill would: (1) prohibit a city from imposing a local sales and use tax at a rate not to exceed 0.50 percent; (2) prohibit a county from imposing a local sales and use tax at a rate not to exceed 0.75 percent; (3) increase the state sales and use tax rate by 0.50 percent; and (4) increase the amount of property tax revenue allocated to a county or city by that county or city's reimbursement amount, as defined, and correspondingly decrease the amount of property tax revenue allocated to a county's Educational Revenue Augmentation Fund by the countywide adjustment amount, as defined.

Although this bill affects property tax and sales and use tax, this analysis will deal primarily with the sales and use tax provisions. The property tax provisions will be discussed generally only because it is related to the sales tax provisions in this bill, but it is not within the scope of administration by the Board.

Summary of Amendments

The introduced version of this bill (dated February 21, 2003) was a spot bill that made a non-substantive change to a property tax statute.

ANALYSIS

Current Law

Sales and Use Tax

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

Currently, the state sales and use tax and local tax rate is 7.25 percent. Of the 7.25 percent base rate, 6 percent is the state portion and 1.25 percent is the local portion. 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);

- 0.50 percent state tax is allocated to the Local Revenue Fund which is dedicated to local governments to fund health and welfare programs (Sections 6051.2 and 6201.2 of the Revenue and Taxation Code);

- 0.25 percent is an additional state sales and use tax allocated to the state's General Fund which is dedicated for state general purposes (Sections 6051.3 and 6201.3 of the Revenue and Taxation Code);

- 0.50 percent 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).

The Bradley-Burns Uniform Local Sales and Use Tax Law (commencing with Section 7200 of the Revenue and Taxation Code), authorizes counties and cities to impose a local sales and use tax. The rate of tax is fixed at 1.25 percent of the sales price of tangible personal property sold at retail in the county, or purchased outside the county for use in the county. All counties and cities within California have adopted ordinances under the terms of the Bradley-Burns Law.

Under the Bradley-Burns Law, the 0.25 percent tax rate is earmarked for county transportation purposes, and 1 percent may be used for general purposes. Cities are also authorized to impose a sales and use tax rate of up to 1 percent, which is credited against the county rate so that the combined local tax rate under the Bradley-Burns Law does not exceed 1.25 percent.

Additionally, under Bradley-Burns Law, a city, county, or city and county imposing a local sales and use tax is required to contract with the Board to administer the local sales and use tax. The Board is required, at least twice during each calendar quarter, to transmit the local sales and use tax revenues to the city, county, or city and county.

Property Tax

Prior to Proposition 13, each local government with taxing powers (counties, cities, schools, and special districts, etc.) could levy a property tax on the property located within its boundaries. Each jurisdiction determined its tax rate independently (within certain statutory restrictions) and the statewide average tax rate prior to Proposition 13, under this system, was 2.67 percent. After Proposition 13, the property tax rate was limited to a maximum of one percent of a property's assessed value.

Since local jurisdictions could no longer set their own individual tax rates and instead were required to share in a pro rata portion of the maximum one percent tax rate, the Legislature was given the authority to determine how the property tax revenue proceeds should be allocated. The legislation that established the current property tax allocation system, found in Revenue & Taxation Code Sections 95 - 99.2, was Assembly Bill 8 (Stats. 1979, Ch. 282, L. Greene). The descriptive term for the allocation procedure for locally assessed property tax revenues is still commonly referred to as "AB 8," some twenty years later.

In addition to establishing allocation procedures, AB 8 also provided financial relief to local agencies to offset most of the property tax revenue losses incurred after Proposition 13. AB 8 provided relief in two ways: first, it reduced certain county health and welfare program costs and, second, it shifted property taxes from schools to cities, counties and special districts, replacing the school's lost revenues with increased General Fund revenues. (There were six counties - Alpine, Lassen, Mariposa, Plumas, Stanislaus, and Trinity – referred to as "negative bailout" counties, where the amount of property taxes allocated to the county was *reduced* because the health and welfare components of AB 8 were so favorable to those counties.)

In 1992, the Educational Revenue Augmentation Fund (ERAF), was established. ERAF partially reversed the relief provided to local agencies by AB 8. The effect of ERAF was to redirect a portion of property tax revenues previously allocated to cities, counties, and special districts to schools, thus reducing the state's General Fund obligations for funding schools under Proposition 98.

Proposed Law

This bill would amend Sections 6051, 6201, 7202, and 7203 of the Revenue and Taxation Code to do the following:

- On and after July 1, 2004, increase the state sales and use tax rate under Sections 6051 and 6201, by 0.50 percent, from 4.75 percent to 5.25 percent.
- On and after July 1, 2004, decrease the local sales and use tax rate that may be imposed by a county by 0.50 percent, from 1.25 percent to 0.75 percent.
- On and after July 1, 2004, decrease the local sales and use tax rate that may be imposed by a city by 0.50 percent (which is offset against the county-wide rate of 0.75 percent), from 1 percent to 0.50 percent.

This bill would amend Section 29530 of the Government Code to conform to the provisions of Sections 7202 and 7203 of the Revenue and Taxation Code.

This bill would add Section 97.68 to the Revenue and Taxation Code to modify the formula used to allocate property tax revenues. Specifically, this bill would do the following:

- For the 2004-05 fiscal year, increase the amount of property tax revenue allocated to a county or city in the 2003-04 fiscal year by that county or city's reimbursement amount, as defined, and correspondingly decrease the amount of property tax revenue allocated to a county's Educational Revenue Augmentation Fund by the countywide adjustment amount, as defined.
- For the 2004-05 fiscal year and each fiscal year thereafter, property tax revenue allocations made pursuant to Section 96.1 of the Revenue and Taxation Code would incorporate these allocation adjustments.
- "City reimbursement amount" means the difference between the amount of revenue that a city would have received if that city had imposed a local sales and use tax rate of 0.50 percent, and the amount of revenue that the city received for the 2003-04 fiscal year (currently, cities may impose up to 1 percent).

- "County reimbursement amount" means the difference between the amount of revenue that a county would have received if that county had imposed a local sales and use tax rate of 0.75 percent and the amount of revenue that the county received for the 2003-04 fiscal year (currently, counties may impose up to 1.25 percent, but any amount imposed by a city is offset against the county rate).
- "County reimbursement amount" means the combined total of the county reimbursement amount and each city's reimbursement amount in that county.
- Require the Board to make the calculations for the county and city reimbursement of local sales tax amounts and notify county auditors by July 14, 2004.

This bill would provide that if Section 97.68 is amended in any manner that results in a reduction in the amount of property tax revenue that is allocated to a city or county, that all provisions of this bill will become inoperative.

This bill also contains intent language regarding the intent of the Legislature that the state maintain its aggregate funding obligations for the support of school districts and community college districts.

Background

"The fiscalization of land use" refers to the concept of examining land use decisions in the context of their revenue and expenditure consequences. Because Proposition 13 reduced the revenues that would be received from property taxes from any particular development (industrial, commercial, or residential), local jurisdictions began to pay even more attention to the fiscal outcomes of land use decisions, and those uses that generated revenues in addition to property taxes have been elevated in importance.

The decision by local governments to utilize land for retail sales in order to generate sales tax revenues is one example of the fiscalization of land use. Local governments have engaged in numerous activities to encourage retail activity in their jurisdiction, such as zoning excessively for retail, providing sales tax rebates to retailers who locate in their jurisdiction, waiving developer fees, and expediting the permit process.

This bill is intended to address, among other issues, the fierce competition that local entities are now facing in getting as much local (1.0%) sales and use tax revenue as they can.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the authors in an effort to create more balanced communities by giving local governments a greater share of property taxes and cutting their dependence on shopping malls and other producers of sales tax revenues. According to Assembly Member Steinberg, "The goal of AB 1221 is to remove the incentives for communities to approve retail property over housing construction by reducing local governments reliance on sales taxes. AB 1221 would not necessarily increase revenues to cities and counties in coming years but it would help stabilize their funding because property taxes are less volatile than sales taxes."

According to Assembly Member Campbell, "There are disincentives right now for local governments to build housing. We want to remove those disincentives so that local jurisdictions are not punished for building whatever they believe is appropriate for their community. If that's apartments, if that's single family homes, if that's manufacturing or if that's shopping centers, so be it."

2. **All local jurisdictions would be required to adopt a new ordinance.** Current law imposes a local tax at a rate of 1.25 percent in a county. A city may impose a local tax up to 1 percent, which is credited against the 1.25 percent tax in the county. Cities, counties, and redevelopment agencies must adopt an ordinance to impose a local tax, which outlines what rate the local jurisdiction receives. Many of the cities receive the full 1 percent allowed under current law, but some cities reach agreement with the county to take a smaller amount. For example, Angels Camp (0.88 percent), Hayward (0.95 percent), and Santa Rosa (0.975 percent) are some of the many cities that are allocated less than 1 percent. This bill would require every city, county, and redevelopment agency in the state to adopt new ordinances reflecting the new maximum rate of 0.50 percent for cities and 0.75 percent for counties.

3. **Some local jurisdictions may not receive local sales and use tax.** Some of the current county ordinances are referred to as a “shall ordinance” while others are referred to as a “may ordinance.” A shall ordinance contains language providing that if only one city in the county fails or refuses to amend its ordinance, the county’s ordinance *shall* become inoperative as well as all of the cities ordinances within that county. If that were to occur, the tax rate within the county would be reduced by 1.25 percent for at least one quarter and the county and cities within the county would receive no local sales and use tax revenue. Such an event did occur for three quarters in 1965 in Tehema County. A may ordinance substitutes the word “may” for “shall” which gives the county the discretion to make the county and city ordinance inoperative. By decreasing the maximum rate a city may impose, some counties with a “shall ordinance” may encounter problems in getting a new ordinance from the city and jeopardizing all local sales and use tax revenues allocated within the county.

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 entities 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 would reduce the local sales and use tax rate imposed by a city to 0.50 percent, and by a county to 0.75 percent. However, the Board's administrative costs would remain the same. As a result, the ratio of administrative costs to local tax revenues would essentially double.

5. **Suggested amendment - partial local sales and use tax exemption for aircraft common carriers needs to be reduced from 80 percent to 67 percent.** This bill reduces the local sales and use tax rate imposed by a city to 0.50 percent, and reduces the local sales and use tax rate imposed by a county to 0.75 percent.

There is partial exemption of 80 percent on sales and purchases of property (i.e. parts, supplies, and equipment) to aircraft operators if: (1) the aircraft is operated by a common carrier according to the laws or California, the United States, or a foreign government; (2) the property is used or consumed directly and exclusively in the use of the aircraft as a common carrier of persons or property; and (3) the property is used or consumed principally outside the county in which the sale was made. **This exemption does not apply to the sale or purchase of fuel and petroleum products.**

As stated above, the sales and purchases of property to aircraft common carriers is exempt from the 1 percent local tax. Under Bradley-Burns, counties are authorized to impose a local sales and use tax rate of 1.25 percent. The partial exemption of 80 percent is calculated based on the 1 percent of the 1.25 percent county local tax. Therefore, since this bill would reduce the local sales and use tax rate to 0.50 percent of the 0.75 percent for a county, a corresponding reduction needs to be made to the exemption. The partial aircraft common carrier exemption needs to be reduced from 80 percent (1 / 1.25) to 67 percent (0.50 / 0.75). Without this reduction, the exemption will be overstated, resulting in an understated amount of local sales and use tax paid to the counties. Board staff is willing to work with the author's office to make these amendments.

6. **Related legislation.** Two bills introduced during the 2001-2002 Legislative Session contained provisions pertaining to local tax allocations. Assembly Bill 680 (Steinberg) would have changed the allocation method of the 1 percent local sales tax in El Dorado, Placer, Sacramento, Sutter, Yolo, and Yuba counties. Assembly Bill 2878 (Wiggins) would have modified the property tax allocation to a city or county, provide that a city may not impose a sales and use tax rate in excess of 0.85 percent except under specified circumstances, and prohibit the state from transferring money from the General Fund to cities and counties to fund vehicle license fee offsets.

COST ESTIMATE

Modifying the local sales and use tax rate a city and county may impose would require every city and county to adopt a new ordinance and a new contract with the Board. Programming and data entry would also be necessary to modify the Fund Distribution System to account for different rates allocated to the various cities and counties. Retailers would have to be notified of the change in the local tax rate. Tax returns and various Board publications would have to be revised to reflect the new rate changes. A detailed cost estimate is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

The Bradley-Burns Uniform Local Sales and Use Tax Law authorizes a county to impose a local sales and use tax at a rate of 1.25 percent. Similarly, the law authorizes a city, located within a county imposing such a tax rate, to impose a local sales tax rate of 1 percent that is credited against the county rate. This bill would prohibit a city from imposing a sales and use tax under Bradley-Burns at a rate in excess of 0.50 of 1 percent, and prohibit a county from imposing a sales and use tax at a rate in excess of 0.75 of 1 percent.

To make up for the loss in Bradley-Burns sales and use tax revenue, this bill would increase the amount of ad valorem property tax revenue allocated to county or city. This bill would correspondingly reduce the amount of ad valorem property tax revenue allocated to a county's Educational Revenue Augmentation Fund.

This bill would also increase the State sales and use tax rate by 0.50 of 1 percent.

In fiscal year 2001-02 city and county revenue from the Bradley-Burns 1 percent sales and use tax rate amounted to $4.4 billion. Reducing this rate to 0.50 of 1 percent would reduce city and county Bradley-Burns sales and use tax revenue by $2.2 billion. Conversely, by increasing the State sales and use tax rate by 0.50 of 1 percent would increase State sales and use tax revenue by $2.2 billion.

Revenue Summary

	Revenue
City and County - Loss	($2.2 billion)
State - Gain	2.2 billion
Total	$ 0

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