The Triple Flip and The VLF-Property Tax Swap

- Substantial on-going effects on your revenues
  - Sales & Use Tax
  - Vehicle License Fee
  - Property Tax
- Special issues in FY05-06
Property Tax in California

Locally collected and distributed
No property tax $ goes to the state general fund
- But property tax to K-14 schools directly affects the amount of general fund $ the state must send to schools.
The Triple Flip:
Local Sales Tax for Property Tax

- Created to finance state deficit reduction bonds under Proposition 57
- Wall Street wanted a dedicated revenue stream
- ¼ cent from sales & use tax…
  - increase special state sales & use tax,
  - reduction in local Bradley Bums SUT,
  - net taxpayer impact = 0
- Reimburse cities & counties from school property tax share (countywide ERAF)
- Reimburse schools with state general fund

ERAF calculations do not change
  - Cities & counties are reimbursed from countywide ERAF but ERAF contributions are not reduced.
- Reimbursement amounts are determined separately and subsequent to AB8 proptax shares and redevelopment TI allocations.
  - There is no impact on regular property tax or redevelopment.
- Reimb amounts are not affected by prop tax rates, shares, assessed values, supplemental role, etc.
  - Amounts are tied to actual SUT collections.
The Triple Flip: Local Sales Tax for Property Tax

- ¼ cent of Bradley Burns Sales & Use Tax to state
- Equivalent amount of property tax from ERAF to cities & counties
  - Matches what sales tax $ would have been
  - But some cash flow impacts
- Treat it as a subset of sales tax
The Triple Flip: Local Sales Tax for Property Tax

Timing

- Sales tax is paid monthly, property tax twice-a-year.
- Reimb. amounts are paid from property tax:
  - ½ of estimate in January (e.g. Jan’06 for FY05-06)
  - ½ of estimate in May (e.g. May’06 for FY05-06)
  - Settle-up based on actuals in January of the next year (e.g. Jan’07 for FY05-06)

FY04-05 Issues

- Reimbursement amounts for FY04-05 are based on the “amount not transmitted” in FY04-05. (Rev&TaxCode97.68)
- DOF “over advanced” for FY04-05
  - Estimate/Advance based on 10.5 months of SUT, now DOF says it must use 9 months.
  - Settle-up in Jan’06 for FY04-05 will include a $173 million negative “true-up.”
“Triple Flip”
Accounting Issues and Options

Accounting for Timing Differences:
– When is sales tax earned? Available?

◆ Differences in reporting periods:
  – BOE, DOF/ERAF, and GAAP

◆ Financial Statement Presentation:
  – Fund and Entity-wide statements

◆ Resources:
  – Work paper tools and reference materials

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Resources

◆ CSMFO website
  • Audio from October 2005 Bridge call
  • Workpaper Tool: Sample Excel spreadsheets

◆ CCMA
  • “White Paper”
  • Accounting and Financial Reporting guidance

◆ County Auditors
  • “SB 1096 Guidelines”
  • Cash flow timing and calculation methods

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Sales Tax Cash Flow

1% Bradley Burns Local Tax Allocation

◆ 75%
  • Received monthly
  • from Board of Equalization
◆ 25%
  • Estimated by Dept of Finance
  • Distributed from County ERAF Fund

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Sales Tax Cash Flow

◆ 75%
  • From Board of Equalization
  • No Change with Triple Flip
  • Received monthly - Two months in arrears
  • May and June retail sales:
    – Estimated advances to Cities in July and August
    – “Quarterly Settlement” (Advances vs. actual) received by Cities in September

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Quarterly Cash Flow Example

April to June Retail Sales

1st Advance (30% of quarterly estimate)  June
2nd Advance (30% of quarterly estimate)  July
3rd Advance (40% of quarterly estimate)  August
Reconciliation between advances/actual  September

Sample Quarterly Statement:
“Statement of Bradley-Burns Local Tax Distribution”

<table>
<thead>
<tr>
<th>Jurisdiction #</th>
<th>Date: 12/14/2004</th>
<th>For the Periods Shown Below</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Due</td>
<td>08/13-11/12</td>
<td>1,000,000</td>
</tr>
<tr>
<td>State Tax</td>
<td></td>
<td>(250,000)</td>
</tr>
<tr>
<td>Local Tax</td>
<td></td>
<td>750,000</td>
</tr>
<tr>
<td>Prior Advances</td>
<td>08/13-11/12</td>
<td>(673,500)</td>
</tr>
<tr>
<td>Adjusted Cost of Admin</td>
<td>08/13-11/12</td>
<td>(10,200)</td>
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<tr>
<td>Balance</td>
<td>08/13-11/12</td>
<td>66,300</td>
</tr>
<tr>
<td>Current Advance</td>
<td>11/13-12/13</td>
<td>240,600</td>
</tr>
<tr>
<td>Total Payment per Section 7203.1</td>
<td></td>
<td>306,900</td>
</tr>
</tbody>
</table>

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www.boe.ca.gov    “Local Tax”

“Local Jurisdictions”; “Allocation Calendar”;
Current Month: “Statement of Distribution”
History: “Quarterly Distribution Summary”

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Accrual Practices Prior to Flip

- **Non-exchange Transactions:**
  - Measure revenue at point of retail sale
  - GASB 22 (As updated in GASB 33/36)

- **60-Day Availability Period:**
  - Accrue BOE distributions in July and August
    (Advances for May and June sales)

- **If 90-Day or Longer Availability Period:**
  - Also accrue 2\textsuperscript{nd} quarter settlement
    (Received from BOE as part of Sept Distribution)
Accrual Practices After Flip

◆ .75%: No Change
  • Accrue July and August BOE receipts
  • Also September settlement if 90-day policy

◆ .25%:
  • 60- or 90- day policy: Nothing more
  • 7+ month policy:
    – Also accrue “true-up” of DOF estimate vs. actual as reported by BOE (not by DOF/ERAF)
    – Optional - Meets intent to “Make Whole”

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Timing Differences: What’s New

***State is adjusting/deferring the 12-month period used for 25% estimates

***Result is lower County ERAF distributions for 04-05 and for 05-06

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Timing Differences: What 12 months are we talking about?

25%
- Of the 1% Bradley Burns local tax
- As distributed to through County ERAF

State Department of Finance:
- Different measurement period than BOE and Cities (GAAP)
- “Retail Reporting Period” perspective
- “Cash Basis” receipts and distributions

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Timing Differences: What 12 months are we talking about?

DOF original 04-05 25% tax estimates:
- State’s original 04-05 estimate:
  - 10.5 months of their cash-basis receipts
- 1.5 months/State’s 04-05 receipts
  - BOE advanced to cities July/August 04 for quarter ending June 04
- Cities accrued Jul/Aug receipts in 03-04
- Cities short 1.5 months in FY 04-05
  - using normal 60/90 day availability

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What 12 months are we talking about?

05-06 County ERAF Distributions:
- To Cities January and May 2006
- Will include “true up” of 04-05 25% tax:
  - Adjustment from estimate to actual
  - Reduction from 10.5 to 9 month allocation period:
  - Net allocation period: July - March Point of Sale Tax
  - April to June 2005 taxes are in next year estimate
- Will include FY 05-06 DOF estimate
  - 05-06 estimated State tax collections
  - Based upon April 2005 to March 2006 point of sale taxes
- Net impact to 05-06 City Cash flow:
  - 25% net tax receipts will again be for 10.5 months
  - Cumulative shortfall at June 06: 3 months

Timing Differences:
City “GAAP” Revenue Recognition

- Measure revenue at Point of Sale
  - Board of Equalization Statements
- Fund Level Statements:
  - Select availability period
  - 60/90 days; 7 months
  - Defer revenues not received this period
- Entity-wide Statements:
  - Reverse deferral/full revenue recognition

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Timing Differences:
City “GAAP” Revenue Recognition

◆ 7 Month Availability = Full Revenue
  • Allows reporting of actual taxes per BOE
    – Includes subsequent January “true up”
  • Allows full 12 months of revenue
    – April to June point of sale taxes are part of the subsequent January ERAF distribution
  • Does create a large year-end receivable

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Availability Period:
Pros/Cons

◆ 60-90 Day Option:
  • Most conservative
  • Best match to cash flow
  • For 04-05 and 05-06, tax will be reduced:
    – 1.5/12 months x 25% = 3%
    – At June 06, fund balance will be short by a cumulative 6% of annual sales tax

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Availability Period:
Pros/Cons

◆ 7-12 Month Option:
  • Common with Counties
    – Grant revenue recognition
  • Allows measurement of full tax
    – Historical trend reporting reflects real underlying economic strength of local merchant base
    – State promise: “Make Whole”
  • Optional fund balance designation
    – To withhold from funds available for budgeting

Susan Mayer
VLF-Property Tax Swap

- VLF rate reduced permanently from 2.0% to 0.65%
- “VLF backfill” from state general fund eliminated
- Cities and counties receive additional property tax to replace lost VLF backfill

State General Fund

K-14 Local Schools

Property tax shifted from countywide ERAF

Property tax

State repeals VLF backfill and permanently reduces VLF rate to 0.65%

State General Fund revenue to make up for reduced property tax (ERAF) to schools

$4.4B

$4.4B

City/County M.Veh Lic Fees

VLF Backfill

VLF Fee Revenue

Additional property tax in-lieu of VLF
VLF Revenues and Allocations

After 2004

- VLF Backfill
- VLF Revenue at 0.65 rate
- Special Allocations
  - Counties Per Capita
  - Cities Per Capita
  - Admin Charges
  - H&W Realignment
- Local Revenue Fund
- Property Tax in-lieu of VLF

VLF to Cities Under the Swap

- Property Tax in-lieu of VLF
  - Grows with change in your city’s Assessed Valuation
- VLF
  - Grows with population & Statewide VLF $
VLF-PropertyTax Swap

Timing for FY04-05

- VLF is paid monthly, PropTax twice-a-year.
- For FY04-05 VLF reimbursement amounts are paid from PropTax:
  - ½ of estimate in January ’05, ½ of estimate in May ’05
  - Settle-up based on FY04-05 actuals paid in Jan’06.
  - Estimates were $318m low about 6.4% of your FY04-05 PropTax In-Lieu of VLF receipts.
  - Together with the January and May ’05 payments, this one-time positive settle-up sets your FY04-05 PropTax in-lieu of VLF base.

State VLF backfill eliminated. In FY04-05 what you didn’t get in VLF, you get from PropTax in Lieu of VLF.

In FY05-06 and beyond, your PropTax in Lieu amount is the prior year amount times growth in AV in your jurisdiction.

Treat PropTax in Lieu of VLF as a subset of property tax
FY05-06 Budget Tweaks: True-ups and Adjustments!

- Sales Tax Triple Flip negative true-up of Property Tax in Lieu.
- Property Tax in Lieu of VLF ("VLF Adjustment Amount") positive true-up.
- More "VLF Adjustment Amount" with Supplemental Property Tax.
  - I bet you didn't budget for this.
- Actual FY05-06 VLF underestimated?
  - Should be approx $6.66 times 1/1/05 population.

Resources

- **CaliforniaCityFinance.com**
  - State Controller FY04-05 VLF Adjustment Amount Settle-up Calculations
  - Dept of Finance Prop Tax in Lieu of Sales Tax (Triple Flip) Settle-up Amount Calculations of Settle-up for FY04-05
  - Links to other resources including this presentation.

- **CSMFO.org**
  - Audio from October 2005 Bridge call
  - Workpaper Tool: Sample Excel spreadsheets

- **California Committee on Municipal Accounting** (see CSMFO.org or CaliforniaCityFinance.com)
  - "White Paper"
  - Accounting and Financial Reporting guidance

- **County Auditors (see CaliforniaCityFinance.com)**
  - "SB 1096 Guidelines"
  - Cash flow timing and calculation methods