Updating Our Tax System to Respond to the “New Economy”

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Sales Tax Collections

Source: California State Board of Equalization (Sales Tax), CA Dept of Finance (Population), CA Dept of Industrial Relations (CPI)
Local 1% Sales Tax Revenue as a Percent of Personal Income

- The population is aging
  - spending on taxable items declines with age

- Tax growth is concentrating in distribution centers

- Major amounts kicked-back to corporations - not to public services

- Consumer spending growth is in:
  - Housing
  - Healthcare
  - Food
  - Entertainment
  - Education

- Some taxable goods being replaced by non-taxed digital equivalents:
  - computer software
  - music
  - movies
  - games
  - books

Source: California State Board of Equalization (Sales Tax), US Dept of Commerce Bureau of Economic Analysis (California Personal Income)
Where Your Sales Tax Goes

- City: 1.00
- Co Transp: 0.25
- Prop172: 0.50
- Co Realign: 1.5625
- State GF: 3.9375
- Prop30: 0.25
- Total Base: 7.50%

- City: 1%
- Prop172: 172 1/2%
- County Realign: 1.5625%
- County Transportation: 1/4%
- Proposition 172: 0.50
- Co Realign: 1.5625
- State GF: 3.9375
- Prop30: 0.25
- Total Base: 7.50%

* For taxable sales in unincorporated areas, the local 1% rate goes to the county.

** 1/4% Proposition 30 state sales tax effective 1/1/2013 expires 12/31/2016

* Local 1% rate includes 1/4% Triple Flip reimbursement.

Services Commonly Taxed in Other States … But Not California

<table>
<thead>
<tr>
<th></th>
<th>Texas</th>
<th>Florida</th>
<th>Utah</th>
<th>#States*</th>
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<tr>
<td>Professional sports</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>26-34</td>
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<td>Amusement parks</td>
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<tr>
<td>Cultural events</td>
<td></td>
<td></td>
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<tr>
<td>Circus/fairs</td>
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<td>Bowling alleys</td>
<td></td>
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<tr>
<td>Private club memberships</td>
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<td>X</td>
<td>X</td>
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<tr>
<td>Golf</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Garment, shoe repair</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>19</td>
</tr>
<tr>
<td>Alteration</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Marina services</td>
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<tr>
<td>Laundry / dry cleaning</td>
<td>X</td>
<td>-</td>
<td>X</td>
<td>21</td>
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<tr>
<td>Exterminating</td>
<td>X</td>
<td>X</td>
<td>-</td>
<td>19</td>
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<tr>
<td>Pet grooming</td>
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<td>X</td>
<td>15</td>
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<td>Carpet / upholstery cleaning</td>
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<td>-</td>
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<td>17</td>
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<tr>
<td>Remodeling – Labor</td>
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<td>-</td>
<td>X</td>
<td>14</td>
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<tr>
<td>Health clubs</td>
<td>X</td>
<td>-</td>
<td>-</td>
<td>21</td>
</tr>
<tr>
<td>Landscaping / lawncare</td>
<td>X</td>
<td>-</td>
<td>-</td>
<td>20</td>
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<tr>
<td>Swimming pool cleaning</td>
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<tr>
<td>Digital downloads</td>
<td>X</td>
<td>-</td>
<td>X</td>
<td>23</td>
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Source: Mazerov "Expanding Sales Taxation of Services: Options and Issues, Center on Budget and Policy Priorities

*States plus District of Columbia
Looking For Solutions

Sales Tax: Expanding the Base

### Estimated Sales and Use Tax Revenues

<table>
<thead>
<tr>
<th></th>
<th>State General Fund</th>
<th>Counties Realignment</th>
<th>Local BradleyBurns</th>
<th>CoTransp %</th>
<th>Prop172 %</th>
<th>Local Add-on TrUTax</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amusement Parks</td>
<td>$56.7</td>
<td>$22.5</td>
<td>$14.4</td>
<td>$10.8</td>
<td>$11.8</td>
<td>$116.2</td>
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<td>Sporting Events</td>
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<td>$18.6</td>
<td>$12.0</td>
<td>$9.0</td>
<td>$9.8</td>
<td>$96.8</td>
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<tr>
<td>Appliance/Furniture Repair</td>
<td>$49.6</td>
<td>$19.3</td>
<td>$12.6</td>
<td>$9.4</td>
<td>$10.3</td>
<td>$101.6</td>
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<tr>
<td>Golf</td>
<td>$64.7</td>
<td>$25.7</td>
<td>$16.4</td>
<td>$12.3</td>
<td>$13.4</td>
<td>$132.6</td>
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<tr>
<td>Vehicle Repair</td>
<td>$641.0</td>
<td>$254.3</td>
<td>$162.8</td>
<td>$122.1</td>
<td>$133.1</td>
<td>$1,313.3</td>
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<tr>
<td>Veterinarians</td>
<td>$672.9</td>
<td>$267.0</td>
<td>$170.9</td>
<td>$128.2</td>
<td>$139.7</td>
<td>$1,378.7</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>$1,532.0</strong></td>
<td><strong>$608.0</strong></td>
<td><strong>$389.1</strong></td>
<td><strong>$291.8</strong></td>
<td><strong>$318.2</strong></td>
<td><strong>$3,139.1</strong></td>
<td></td>
</tr>
</tbody>
</table>

Source: Board of Equalization

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Defining Situs

Where Does the Sale Take Place in Remote Sales?

What is the location of the sales transaction (the situs)?

- Seller’s location? Location of product receipt? Product location?
- California currently uses “origin sourcing,” the situs is the retailer’s place of business where negotiations take place.

**Origin sourcing often => concentration of tax revenue**

- far in excess of service costs at the office or warehouse location
- economic activity, service impacts also occur elsewhere (i.e., where product is used)

To lure jobs and tax revenues, some cities have entered into rebate agreements with corporations.
20% to 30% of total local taxes paid statewide are now rebated back to corporations rather than funding public services.

Looking For Solutions
Sales Tax

Local 1% Sales Taxes
- Retained for public services
- Rebated to corporations

Nearly $2 Billion

Possible Solution
Strictly limit or prevent new sales tax rebate agreements.
- Eliminate loopholes that allow rebates where there is no net new economic benefit among California communities.

Possible Solution
Redefine sourcing rules to situs of receipt:
- Does not change over the counter sales.
- Allocates remote sales to receipt (user's location)
  - Broader distribution among all cities.
  - Closer distribution to overall economic activity / service impact.
  - Could phase-in and/or split source (origin/receipt).
- Reduces incentive for sales tax rebate agreements.
- Returns as much as $1 billion back to city general funds.
Bad Brew in Troubled Cities

Over-reliance on land development revenue
Over-reliance on redevelopment revenues
Risky financing schemes
Fear & Denial
Toxic relationships

Unsustainable & Intractable employee compensation, especially public safety pension and retiree health care

Unsustainable Decline in Core Revenues
Ceding of management and policy choices to others

The California Municipal Financial Health Diagnostic

<table>
<thead>
<tr>
<th>City of</th>
<th>Fund:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tr>
</tbody>
</table>

1. The city has recurring general fund operating deficits.
2. General fund reserves are decreasing over multiple consecutive years.
3. General fund current liabilities (including short-term debt and accounts payable within 90 days) are increasing. Cash and short-term investments are decreasing.
4. General fund fixed costs, salaries and benefits are increasing over multiple years at a rate faster than recurring revenue growth.
5. The general fund is subsidizing other enterprises or special funds.
6. The city council's authority to make changes is constrained by charter, contract, or law (e.g., binding arbitration, minimum spending, minimum staffing or compensation formulas, etc.)
7. The general fund budget has been balanced repeatedly with reserves, selling assets, deferring asset maintenance.
8. The general fund budget has been balanced repeatedly with short-term borrowing, internal borrowing or transfers from special funds.
9. General fund pension liabilities, post-employment or other non-salary benefits have been repeatedly deferred or costs have not been determined, disclosed or actuarially funded.
10. General fund debt service payments have been "backloaded" into future years.
11. Ongoing general fund operating costs are being funded with temporary development revenues.
12. Financial Reports are not being filed on time. (CAFR, Annual Audit, State Controller’s Financial Transactions Report)
13. Public service levels are far below standards needed in this community.

For detailed indicators related to these points see the Financial Health Indicators.
Local Tax and Bond Measures November 2014

- Record 268 local tax and bond measures
- 113 School bonds totaling $11.7 Billion
  - 90 pass = $9.2 Bil.
Local Tax and Bond Measures November 2014

School Tax & Bond Measures November 2014
- 55% Vote Bond: Since 2001 83% (82/112)
- 2/3 Vote Parcel Tax, Bond: Since 2001 60% (89/140)

City / County / Special District Tax & Bond Measures November 2014
- General Tax Majority Vote Measures: Since 2001 66% (68/105)
- Special Tax 2/3 Voter Measures: Since 2001 47% (53/112)

Resources
- League of California Cities
  - City Advocate Weekly Regional Managers
  - League Alerts Conferences / Seminars
- Institute for Local Government (ILC)
- Government Finance Officers Association GFOA.com
- The California Municipal Finance Almanac
  - www.CaliforniaCityFinance.com