Modernizing Our Tax System and a State Budget Update

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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

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

- The population is aging
- Tax growth is concentrating in distribution centers
- Major amounts kicked-back to corporations — not to public services
- Some taxable goods being replaced by non-taxed digital equivalents:
  - computer software
  - music
  - movies
  - games
  - books

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

- Housing
- Healthcare
- Food
- Entertainment
- Education
Where Your Sales Tax Goes

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

¼% Proposition 30 state sales tax effective 1/1/2013 expires 12/31/2016

City* 1.00
Co Transp 0.25
Prop172 0.50
Co Realign 1.5625
State GF 3.9375
Prop 30 0.25
Total Base 7.50%

State General Fund 4.1875%

City 1%*
Prop30**
Proposition 172 1/2%
County Realignment 1.5625%
County Transportation 1/4%

Add-On Transactions & Use (varies)

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

Services Commonly Taxed in Other States … But Not California

<table>
<thead>
<tr>
<th>Service</th>
<th>Texas</th>
<th>Florida</th>
<th>Utah</th>
<th>#States*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professional sports (34), amusement parks (34), cultural events (29), circuses/fairs (33), bowling alleys (26)</td>
<td>X</td>
<td></td>
<td>X</td>
<td>26-34</td>
</tr>
<tr>
<td>Private club memberships, golf</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>23</td>
</tr>
<tr>
<td>Garment, shoe repair or alteration</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>19</td>
</tr>
<tr>
<td>Marina services</td>
<td>X</td>
<td></td>
<td>X</td>
<td>15</td>
</tr>
<tr>
<td>Laundry / dry cleaning</td>
<td>X</td>
<td></td>
<td>X</td>
<td>21</td>
</tr>
<tr>
<td>Exterminating</td>
<td>X</td>
<td>X</td>
<td>-</td>
<td>19</td>
</tr>
<tr>
<td>Pet grooming</td>
<td>X</td>
<td>-</td>
<td>X</td>
<td>15</td>
</tr>
<tr>
<td>Carpet / upholstery cleaning</td>
<td>X</td>
<td></td>
<td>-</td>
<td>17</td>
</tr>
<tr>
<td>Remodeling – Labor</td>
<td>X</td>
<td></td>
<td>X</td>
<td>14</td>
</tr>
<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>
</tr>
<tr>
<td>Swimming pool cleaning</td>
<td>X</td>
<td>-</td>
<td>-</td>
<td>16</td>
</tr>
</tbody>
</table>

Digital downloads   | X     | -       | X    | 23       |

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

<table>
<thead>
<tr>
<th>Estimated Sales</th>
<th>State GeneralFund</th>
<th>Counties Realign</th>
<th>Local BradleyBurns</th>
<th>CoTransp ( \frac{1}{4}% )</th>
<th>Prop172 ( \frac{1}{2}% )</th>
<th>Local Add-on TrUTax (millions)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amusement Parks</td>
<td>$56.7</td>
<td>$22.9</td>
<td>$14.4</td>
<td>$10.8</td>
<td>$11.8</td>
<td>$116.2</td>
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</tr>
<tr>
<td>Sporting Events</td>
<td>$47.3</td>
<td>$18.6</td>
<td>$12.0</td>
<td>$9.0</td>
<td>$9.8</td>
<td>$96.8</td>
<td></td>
</tr>
<tr>
<td>Appliance/Furniture Repair</td>
<td>$49.6</td>
<td>$19.7</td>
<td>$12.6</td>
<td>$9.4</td>
<td>$10.3</td>
<td>$101.6</td>
<td></td>
</tr>
<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>
<td></td>
</tr>
<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>
<td></td>
</tr>
<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>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$1,532.0</td>
<td>$608.0</td>
<td>$389.1</td>
<td>$291.8</td>
<td>$318.2</td>
<td>$3,139.1</td>
<td></td>
</tr>
</tbody>
</table>

Source: Board of Equalization

Recent proposals:
- 2009-10 Governor’s Proposed Budget
- 2012 Think Long Committee
- AB 1963 (Huber 2012)
- AB 2540 (Gatto 2012)

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.
Looking For Solutions
Sales Tax

- 20% to 30% of total local taxes paid statewide are now rebated back to corporations rather than funding public services.

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.

Nearly $2 Billion

Local 1%
Sales Taxes
retained
for public
services
rebated to
Corporations

Sales Taxes
Local 1%
Nearly $2 Billion
Commercial Property Tax Reform

Problem:

- Commercial property "change of ownership" rules
  - encourage holding of property rather than development
  - create "barrier to entry" for new business
  - Like properties taxed vastly differently, unfairly
  - Commercial property paying shrinking part of the tax role

Possible Solutions

- Redefine "change of ownership"
- Require periodic reassessment of non-residential property... perhaps land only
Bad Brew in Troubled Cities

- Over-reliance on land development revenue
- Risky financing schemes
- Over-reliance on redevelopment revenues
- Unsustainable Decline in Core Revenues
- Ceding of management and policy choices to others
- Unsustainable & Intractable employee compensation, especially public safety pension and retiree health care
- Fear & Denial
- Toxic relationships
- Fear & Denial
- Unsustainable Decline in Core Revenues

The California Municipal Financial Health Diagnostic

<table>
<thead>
<tr>
<th>City of</th>
<th>Fund:</th>
</tr>
</thead>
<tbody>
<tr>
<td>The California Municipal Fiscal Health Diagnostic Financial Distress Checklist</td>
<td></td>
</tr>
<tr>
<td>Measures:</td>
<td></td>
</tr>
<tr>
<td>1. The city has recurring general fund operating deficits.</td>
<td></td>
</tr>
<tr>
<td>2. General fund reserves are decreasing over multiple consecutive years.</td>
<td></td>
</tr>
<tr>
<td>3. General fund current liabilities (including short-term debt and accounts payable within 60 days) are increasing. Cash and short-term investments are decreasing.</td>
<td></td>
</tr>
<tr>
<td>4. General fund fixed costs, salaries and benefits are increasing over multiple years at a rate faster than recurring revenue growth.</td>
<td></td>
</tr>
<tr>
<td>5. The general fund is subsidizing other enterprises or special funds.</td>
<td></td>
</tr>
<tr>
<td>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.)</td>
<td></td>
</tr>
<tr>
<td>7. The general fund budget has been balanced repeatedly with reserves, selling assets, deferring asset maintenance.</td>
<td></td>
</tr>
<tr>
<td>8. The general fund budget has been balanced repeatedly with short-term borrowing, internal borrowing or transfers from special funds.</td>
<td></td>
</tr>
<tr>
<td>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.</td>
<td></td>
</tr>
<tr>
<td>10. General fund debt service payments have been &quot;backloaded&quot; into future years.</td>
<td></td>
</tr>
<tr>
<td>11. Ongoing general fund operating costs are being funded with temporary development revenues.</td>
<td></td>
</tr>
<tr>
<td>12. Financial Reports are not being filed on time. (CAFR, Annual Audit, State Controller's Financial Transactions Report)</td>
<td></td>
</tr>
<tr>
<td>13. Public service levels are far below standards needed in this community.</td>
<td></td>
</tr>
</tbody>
</table>

For detailed indicators related to these points see the Financial Health Indicators