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Assembly California Legislature



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Informational Hearing **Following the Money: How Local Sales Tax Revenues Are Allocated Among California Cities**

Wednesday, November 15, 2023
10:00 a.m. – City of Westlake Village, Council Chambers
31200 Oak Crest Drive
Westlake Village, CA 91361

AGENDA

- I. Welcome and Introductory Comments
 - **Assemblymember Jacqui Irwin**, Chair
- II. Overview of the Bradley-Burns Uniform Local Sales and Use Tax Law
 - **Nicolas Maduros**, Director, California Department of Tax and Fee Administration
 - **Seth Kerstein**, Economist, Legislative Analyst's Office
 - **Michael Colantuono**, Managing Shareholder, Colantuono, Highsmith & Whatley, PC
 - Member Questions and Answers
- III. Highlighting Local Perspectives
 - **Councilmember Miguel Arias**, City of Fresno, District 3
 - **Brian Gabler**, City Manager, City of Simi Valley
 - **Damien Arrula**, City Manager, City of Placentia
 - Member Questions and Answers
- IV. In-Person Public Comments
- V. Closing Comments



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Informational Hearing Objectives

This hearing seeks to provide both Members and the public with a better understanding of the Bradley-Burns Uniform Local Sales and Use Tax Law (Bradley-Burns) and its fiscal implications for California's cities and counties. Through the testimony of representatives from the California Department of Tax and Fee Administration (CDTFA), the Legislative Analyst's Office (LAO), and a noted expert on municipal finances and litigation, the first panel will focus on the following issues:

- (1) How a transaction's place of sale is determined under Bradley-Burns and its implementing regulations;
- (2) Why determining a transaction's place of sale is necessary to appropriately distribute collected revenues;
- (3) How the Bradley-Burns sourcing rules have given rise to various business reorganizations and revenue-sharing agreements with local governments;
- (4) Potential constitutional restrictions on statutorily altering the allocation of Bradley-Burns revenues; and,
- (5) Prior legislative efforts to regulate or prohibit revenue-sharing agreements.



The second panel will feature representatives from three California cities who will provide their perspectives on the various challenges faced by local governments, and the ways in which municipalities have benefited from or been disadvantaged by the Bradley-Burns revenue allocation regime. Finally, this hearing will provide members of the public an opportunity to express their views on this subject.

Introduction

California is among 37 states that impose both a state and local sales tax.¹ The sales tax is imposed on retailers for the privilege of selling tangible personal property (TPP) in California and is based on a retailer's "gross receipts" derived from the retail sale of TPP.² Additionally, California imposes a complementary use tax on the storage, use, or other consumption of TPP in this state that is purchased from a retailer, where California sales tax did not apply at the time of purchase.³ In other words, the use tax is imposed for storing, using, or consuming TPP in California and typically applies when TPP is purchased from outside the state or when sales tax is otherwise inapplicable.⁴ The sales and use taxes (SUTs) are mutually exclusive and complement each other by placing local retailers and their out-of-state competitors on an equal footing.

Overview of the Bradley-Burns Uniform Local Sales and Use Tax Law

In 1955, the Legislature enacted Bradley-Burns, which authorized counties and cities to impose a local SUT, but required them to contract with the State Board of Equalization (BOE) to perform all administrative functions, including tax collection and revenue allocation to the appropriate local governments. Bradley-Burns was enacted to provide an additional source of revenue for local governments, to promote a uniform and integrated SUT regime throughout the state, and to avoid retailers having to pay different taxes to different governmental entities by having the integrated SUT program administered and the taxes collected by the state.⁴

Responsibility for administering Bradley-Burns was shifted from the BOE to the CDTFA as part of the Taxpayer Transparency and Fairness Act of 2017. The tax rate is fixed at 1.25% of the sales price of TPP sold at retail in the county, or purchased outside the county for use within the county. Current law authorizes cities to impose a local Bradley-Burns SUT rate of up to 1%. The city SUT rate is "credited" against the county rate so that the combined rate does not exceed 1.25%.

Of the 1.25%, cities and counties use 1% to support general operations. The remaining 0.25% is designated by statute for county transportation purposes and restricted to road maintenance or the

¹ "State and Local Sales Tax Rates, Midyear 2023." Tax Foundation. July 17, 2023. <https://taxfoundation.org/data/all/state/2023-sales-tax-rates-midyear/>.

² Revenue and Taxation Code (R&TC) Section 6051.

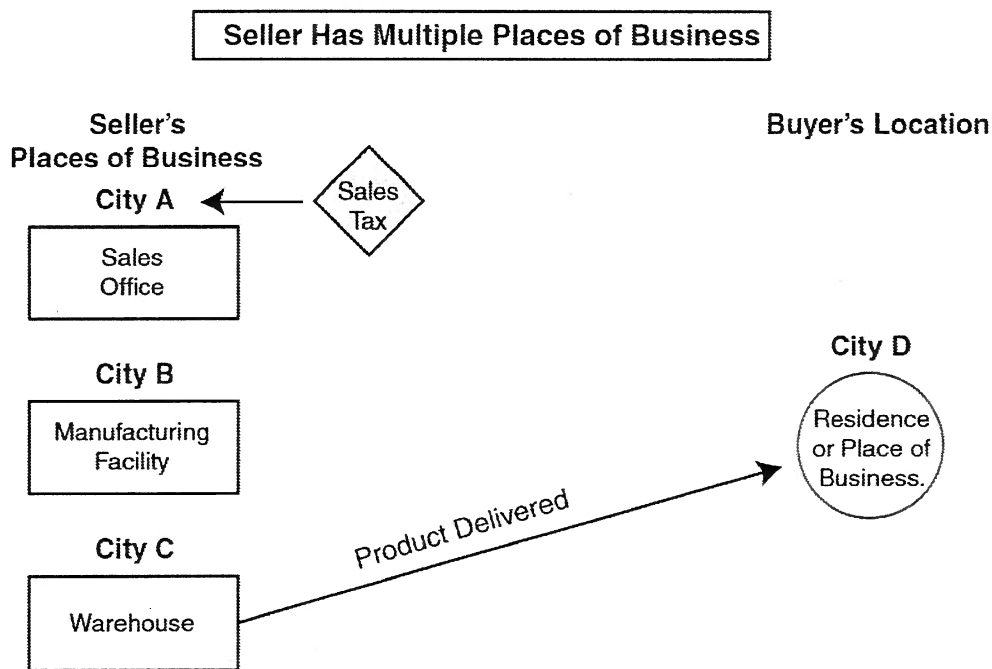
³ R&TC Sections 6201, 6202, and 6401.

⁴ *City of San Joaquin v. State Bd. Of Equalization*, 9 Cal.App.3d 365 (1970), 369-370.

operation of transit systems. Counties receive the 0.25% tax for transportation purposes regardless of whether the sale occurs in a city or in the unincorporated area of the county. In California, all counties impose Bradley-Burns local taxes at a total uniform rate of 1.25%, and most cities impose Bradley-Burns local taxes at a rate of 1.00%.⁵

Place of Sale

Bradley-Burns tax allocation varies depending on whether the transaction is subject to sales tax or use tax. The transaction is subject to sales tax if the retailer's place of business in California participates in the transaction and the sale takes place (i.e., title to the goods passes to the customer) in California. Unless both of these conditions are met, the use tax applies.



As noted above, the local sales tax is allocated to the place of sale. For purposes of local sales tax, the place of sale is a place of business of the retailer.⁶ The term "sale" means "[a]ny transfer of title or possession, exchange, or barter, conditional or otherwise, in any manner or by any means whatsoever, of [TPP] for a consideration."⁷ If a retailer has only one place of business in California, all California retail sales in which that place of business participates occur at that place of business. If a retailer has more than one place of business in this state participating in the sale, the place of sale is where the principal negotiations occur.⁸

⁵ Certain cities impose the tax at a slightly lower rate than 1.00% via agreement with their respective counties.

⁶ R&TC Section 7205.

⁷ R&TC Section 6006.

⁸ Cal. Code Regs., tit. 18, § (Regulation) 1802, subd. (a).

Local use tax is generally allocated to local jurisdictions through a countywide pool. Each local jurisdiction within a county, including the county itself, receives a prorated amount of the countywide pool (based on its proportion of the local tax that is directly allocated to jurisdictions within the county).⁹

Let's Make a Deal

The rather complicated sourcing rules described above have given many retailers a powerful negotiating tool vis-à-vis local governments. For example, imagine a concrete manufacturer with production and sales offices located throughout the state. This manufacturer could decide to restructure by consolidating all statewide sales into one California office. This sales office, as the place of principal negotiation, could then serve as the retailer's "place of sale" for Bradley-Burns purposes on all of its California sales. Before deciding where to locate its one sales office, the concrete manufacturer could negotiate with an array of cities to see which is willing to rebate the largest percentage of any new Bradley-Burns revenues back to the retailer.

Many cities have reportedly offered large companies over one-half of their new revenues in such negotiations, in the hopes of bringing jobs and economic development to their regions.¹⁰ Retailers are the obvious beneficiaries of such arrangements. It is less clear, however, whether cities similarly benefit given the nature of the jobs created and the revenues siphoned from essential public services. Critics contend that the biggest losers are the many local agencies throughout California that previously received Bradley-Burns taxes from the retailer's sales.

Redirected Revenues

In 2007, the LAO published a report on the allocation of local sales tax, which focused on agreements between cities and private businesses involving diversions of local sales taxes to lure businesses to remain or move into a particular jurisdiction.¹¹ The report concluded that the use of such financial incentives does not result in a net benefit to a broader economic region within the state, but rather simply shifts existing sales tax from one jurisdiction to another at the cost of government resources that could be used for other purposes.

⁹ "Local and District Tax Guide for Retailers." *California Department of Tax and Fee Administration*. <https://www.cdtfa.ca.gov/industry/localanddistricttaxes.htm#Local-Tax>.

¹⁰ Mahoney, Laura. "Apple's 22-year Tax Break Part of Billions in California Bounty." *Bloomberg Tax*. April 24, 2019. <https://news.bloombergtax.com/daily-tax-report-state/apples-22-year-tax-break-part-of-billions-in-california-bounty>.

¹¹ Williams, Brad. "Allocating Local Sales Taxes: Issues and Options." *Legislative Analyst's Office*. January 12, 2007. https://lao.ca.gov/2007/sales_tax/sales_tax_012407.aspx.



CDTFA

CALIFORNIA DEPARTMENT OF
TAX AND FEE ADMINISTRATION

Assembly Committee on Revenue and Taxation

Informational Hearing
Following the Money: How Local Sales
Tax Revenues Are Allocated Among
California Cities

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Components of Sales and Use Tax

- The sales and use tax rate is comprised of three parts:
 - State - 6%
 - Bradley-Burns Uniform Local Sales and Use Tax (Local) - 1.25%
 - Transactions and Use Taxes (District) - % varies
- In FY 2022-23, CDTFA collected:
 - State Sales/Use Tax - \$53.8 Billion
 - General Fund - \$34.8 Billion
 - Local Component (Realignment) - \$19 Billion
 - Local - \$11.8 Billion
 - District - \$14.4 Billion

State Sales and Use Tax

- **Sales tax**

- Enacted in 1933
- Imposed on all retailers for the privilege of selling tangible personal property (TPP) at retail in this state
- Based on a retailer's gross receipts derived from the retail sale of TPP

- **Use tax**

- Enacted in 1935
- Imposed on the storage, use, or other consumption of TPP in this state that is purchased from a retailer
- Imposed when CA sales tax does not apply at the time of purchase

Bradley-Burns Uniform Local Sales and Use Tax (Local Tax)

- Sales and use taxes are imposed by local jurisdictions under the Bradley-Burns Uniform Local Sales and Use Tax Law.
- Enacted in 1955 to bring uniformity to the local tax system.
- By 1962, all counties had adopted ordinances for CDTFA's predecessor agency to collect the local tax.

Transactions and Use Taxes (District Taxes)

- 412 voter-approved taxes imposed by local jurisdictions under the Transactions and Use Tax Law, which was enacted in 1969.
- District taxes are in addition to the 7.25% statewide rate in jurisdictions where they are imposed.
- CDTFA collects district taxes pursuant to contracts with the local jurisdictions imposing the tax.
- Distribution and allocation of district tax may differ from Bradley-Burns local tax on a particular transaction.

Local Tax Administration

- Taxpayers report and allocate local tax on Schedules B and C of their sales and use tax returns.
- CDTFA disburses local and district tax payments to all local jurisdictions (482 cities and 57 counties) three times per quarter.
 - Month 1—First Advance + Current Distributions Payment
 - Month 2—Second Advance + Current Distributions Payment
 - Month 3—Final Balance (Cleanup) Payment
- Advance payments are calculated based on taxpayer history using the same quarter from the prior year quarter.
- First and second advances each represent roughly 35 percent (35%) of the total quarterly distribution, with the final balance (cleanup) payment representing the remainder 30%.

Local Tax Administration

- Local Revenue Branch (LRB) continuously reviews taxpayer local tax reporting and allocations.
- LRB responds to petitions filed by jurisdictions.
- If LRB determines misallocations, LRB notifies jurisdictions of proposed reallocations and requests retailer to correct reporting.

Sales Tax v. Use Tax

- **Sales tax applies if:**
 - Sale occurs in California (e.g., title passes to the customer in this state) AND
 - Retailer's place of business in California participates in the transaction.
- **Use tax applies if** either one of these conditions is not met.

Place of Business

- An office, place of distribution, sales or sample room or place, warehouse or storage space, or other place of business in California
- Location of a 3rd party does not generally constitute a place of business of the retailer, including:
 - Related Entities
 - Marketplace seller, with respect to marketplace facilitators.

Allocation of Local Tax

- Local sales tax is allocated to the city or county where the sale occurs under the local tax law.
 - If only one place of business of the retailer participates in the sale → sale occurs at that place of business.
 - If more than one place of business of the retailer participates in the sale → sale occurs at place of principal negotiations.
- Local use tax is allocated via the countywide pool to the place where property is used (generally, the customer's shipping address).

Participation Authorities

- Regulation 1620(a)(2)(A)
 - Sales tax applies when the order for the property is sent by the purchaser to, or delivery of the property is made by, any . . . place of business of the retailer in this state. . . . Participation *in the transaction* in any way by the local office, branch, outlet or other place of business is sufficient to sustain the tax.
- Regulation 1802(a)(1)
 - For the purposes of the Bradley-Burns Uniform Local Sales and Use Tax Law, if a retailer has only one place of business in this state, all California retail sales of that retailer *in which that place of business participates* occur at that place of business.

Participation in the Transaction

- Participation is required for sales tax to apply for all transactions.
- Participation has the same meaning for the purposes of state tax and local tax.
- Participation “in the transaction”
 - Must serve some real purpose;
 - Have some meaningful effect in the actual sales process; and
 - Involve some genuine physical human interaction with the transaction.

Recent Developments in Local Tax Allocation

- The growth of internet, ecommerce, and other automated processes over approximately the last 25 years, has caused further development of state and local tax law as it relates to local tax allocation.
- These developments have also been caused by disputes in other areas – for example, jet fuel and medical supply and other requirements contracts – as retailers have increasingly entered into revenue sharing agreements and used buying companies and other corporate structures to direct local tax allocation.
- The BOE and CDTFA have consistently applied the law to the new scenarios presented throughout this period, to develop a framework of analysis.

Recent Developments in Local Tax Allocation

- **Appeals Bureau Decisions in 2006-2007** that were adopted by the BOE explicitly clarified that the participation requirement applies to all transactions and affirmed that the general business activities of a headquarters location do not typically constitute participation in internet transactions.
- **Appeals Bureau Decisions in 2010-2015** that were adopted by the BOE developed a framework for determining when an activity – like credit checks or handling of documents related to monthly fuel orders – may constitute participation in a particular transaction.

Appeals Bureau Decisions 2010-2015

- **2010** - "While subdivision (a)(2)(A) does not specifically define the term "participation," this term necessarily means having **some meaningful effect on the actual sales process**, for example, negotiating contracts, accepting or approving orders, approving credit, delivering goods, or billing. That is, we have consistently interpreted "participation in the transaction" as meaning literally what it says, that the California location literally **participated in the transaction** under review, that is, *the sale*."
- **2013** - "Participation in the transaction" necessarily means having some **meaningful effect on the actual sales process**, for example, negotiating contracts, accepting or approving orders, approving credit, delivering goods, or billing. That is, we have consistently interpreted "participation in the transaction" as meaning literally what it says, that the seller's California place of business literally **participated in the actual transaction** under review, that is, *the sale*. If . . . the . . . office reviewed *each and every* sale to California purchasers, and expressly approved *each and every* order prior to the sale, we would conclude that such actions constitute the requisite participation for purposes of Regulation 1620.

Appeals Bureau Decisions 2010-2015 (continued)

- **2014** - "[F]or sales tax to apply, a California place of business of the seller must participate in the actual sale under review, which we have consistently regarded as requiring some **genuine physical human interaction** with the sale in, at, or out of the retailer's place of business."
- **2015** - "Accordingly, we conclude that the participation necessary to support sales tax is **an activity by a California business location of the retailer serving some real purpose in the actual sales process and involving some genuine physical interaction with the sale** from that location, such as negotiating sales, accepting orders, approving credit, delivering goods to the customer, or billing."

Recent Decisions

- Court of Appeals Decisions:

- *City of South San Francisco v. Board of Equalization*, (2014) 232 Cal.App.4th 707
- *City of Brisbane v. Board of Equalization*, (2015) 2015 WL 1383105 (unpublished).

- Pending OTA Appeals:

- *Cities of Fillmore, et al.*, December 15, 2022 (for periods in 2007)
- *Cities of Alameda, et al.*, February 22, 2023 (for periods 2009-present).



Local Tax Allocation Example 1

- Company A has a single location, which is located in Westlake Village. California customers place orders for the sale of TPP over the internet, which Company A fulfills from inventory stored at the Westlake Village location.

- Company A's sales to California customers are subject to sales tax, and the local sales tax is allocated to its one place of business in the state that participates in the sale.



Local Tax Allocation Example 2

- Company A has a sales office in Westlake Village, out of which it negotiates contracts for the sale of TPP to California customers that are fulfilled from either its warehouse in Sacramento or its warehouse in Reno, Nevada.
 - Company A's sales to California customers fulfilled from its Sacramento warehouse are subject to sales tax, and the local sales tax is allocated to Westlake Village, its place of business where principal negotiations occur.
 - Company A's sales fulfilled from its Reno warehouse are subject to use tax because the sale takes place out of state, and the local use tax for each transaction is allocated to the jurisdiction where the customer is located.

* Example assumes standard shipping terms.



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Local Tax Allocation Example 3

- Company A is an internet retailer with corporate office locations in Westlake Village and Austin, Texas. California customers place orders for the sale of TPP over the internet, which are fulfilled from a third party's inventory stored at the third party's warehouse in San Diego.
 - Company A's sales to California customers are subject to use tax because there is no participation in the transaction by Company A's California place of business, and the local use tax for each transaction is allocated to the jurisdiction where the customer is located.



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CDTFA Help

- For Taxpayers:
 - *Find a Sales and Use Tax Rate* on CDTFA website (GIS Mapping)
 - Online Guide: *Local and District Tax Guide for Retailers*
 - Customer Service Line or Request Advice
- For Jurisdictions:
 - Online Guide: *Local Tax Guide for Local Jurisdictions and Districts*
 - Contact LRB

Questions?

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Administration
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NOVEMBER 15, 2023

Local Sales Tax Revenue Allocation

PRESENTED TO: Assembly Committee on Revenue and Taxation
Hon. Jacqui Irwin, Chair



LEGISLATIVE ANALYST'S OFFICE

Allocation of Bradley-Burns Revenue

Driven by Place of Sale. Bradley-Burns revenue goes to the jurisdiction where the retail sale occurs (origin sourcing). As a result, cities have a fiscal incentive to maximize the retail sales that occur within their boundaries.

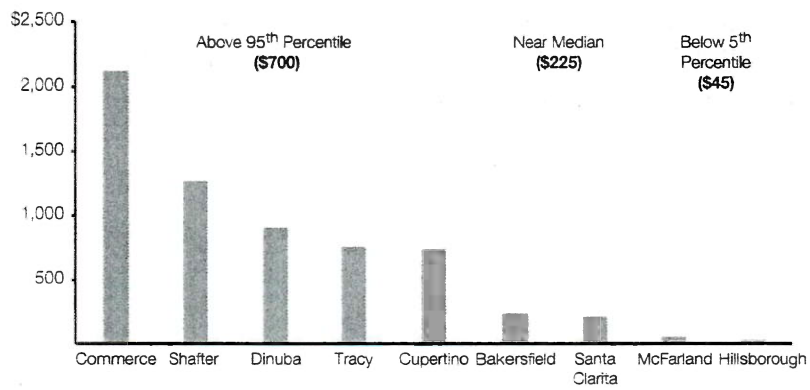
How Cities Compete for Taxable Sales. Some cities provide partial tax rebates or other incentives to retailers to increase taxable sales within their boundaries. Broadly, these approaches can take two forms:

- ***Attracting Retail Development.*** As e-commerce has grown, this retail development often has come in the form of warehouse distribution centers.
- ***Shifting the Legally Defined Place of Sale Without Changing the Location of Economic Activity.*** For example, “cardlock systems” allow businesses to purchase large amounts of fuel in advance. All Bradley-Burns revenue from these transactions goes to the city where the advance purchase occurs, even though the physical transfer of fuel occurs elsewhere.



Bradley-Burns Revenue Per Resident Varies Across Cities

Revenue Per Resident, 2022-23



Foundations of Current System

Bradley-Burns Law (1955). Allowed counties to opt in to a 1 percent uniform local sales tax. All counties opted in.

“Triple Flip” and Proposition 1A (2004). State’s complex fiscal maneuver redirected a portion of Bradley-Burns revenue. In response, constitutional amendment prohibited state from changing Bradley-Burns allocation method.



Attempts to Limit Rebates or to Make Them More Transparent

Chapter 462 of 1999 (AB 178, Torlakson). Prohibited local financial assistance for certain types of retail relocations. Chapter 781 of 2003 (SB 114, Torlakson) made this prohibition permanent.

Chapter 4 of 2009 (SB 27, Hancock) and Chapter 717 of 2015 (SB 533, Pan). Prohibited certain types of local sales tax rebates and created some disclosure requirements. In particular, prohibited such rebates only if they divert Bradley-Burns revenue from other jurisdictions where the retailer maintains a physical presence.

Chapter 803 of 2019 (AB 485, Medina). Required certain public disclosures before approving subsidies for warehouse distribution centers.

SB 531 (Glazer, 2019). Vetoed bill would have expanded the prohibitions established by SB 27 and SB 533.



Attempts to Move Towards Destination Sourcing

SCA 20 (Glazer, 2018) and ACA 13 (Oberholte, 2019). Proposed constitutional amendments would have allocated revenues from online sales based on destination sourcing rather than origin sourcing.

SB 792 (Glazer, 2021). Vetoed bill would have required certain online retailers' tax returns to specify the local jurisdictions to which their goods are delivered.

