



Delivering Revenue,
Insight and Efficiency
to Local Government

1340 Valley Vista Drive
Suite 200
Diamond Bar
California 91765

909.861.4335
Fax 909.861.7726
888.861.0220
www.hdlcompanies.com

August 24, 2016

Mr. Chet Simmons, Assistant City Manager
City of Westminster
8200 Westminster Blvd.
Westminster, CA 92683

Re: Analysis of transactions and use taxes

Dear Mr. Simmons,

The City of Westminster requested an analysis of the historical impact of voter-approved add-on sales taxes on sales activity in other jurisdictions. We have prepared the following report that provides this analysis, preceded by background information about our company and the mechanics of Transactions and Use Taxes (TUT).

Company Background

Founded in 1983, HdL is a consortium of three companies established to maximize local government revenues by providing a variety of audits, analytical services and software products. Its audit and consulting services include sales, use and transaction taxes, property taxes, documentary transfer fees and marijuana regulation and taxation. The firm also provides enterprise software tools for business licensing, code enforcement, animal control, building permits and false alarms. HdL's systematic and coordinated approach to revenue management and economic data analysis is utilized by over 400 agencies in six states.

HdL has developed special programs to support the sales, use and transactions tax needs of city and county governments. The firm serves 44 counties, 343 cities and 79 transactions tax districts in California. HdL pioneered the technology used in sales, use and transactions tax audits, recovery and reporting. It developed California's first computerized sales tax management program and was responsible for securing the legislation (AB 1161) that allows independent verification of state allocations. The company was also first in the state to utilize the data for economic planning and monitoring.

Many of HdL's staff have extensive local government experience after previously holding positions in municipal management, finance, planning, economic development or revenue collection. Their understanding of local government needs coupled with HdL's extensive databases and advance methodology provides for the most relevant, productive and responsive revenue recovery, forecasting and economic services available.

Transactions and Use Taxes

As of the June 7, 2016 election, there are 210 active transactions and use tax districts of which 46 are countywide and 164 are in cities. The taxes are used to finance a variety of needs including public safety

services, local hospitals, road repairs and capital projects. Approximately 90% of the state's population resides in one or more transactions and use tax district.

As with other California taxes, a transactions and use tax district must obtain a majority vote if for general purposes and two-thirds vote if for specific purposes. However, a 1988 court decision found a Santa Clara County District tax that specified that the revenues could be spent for general county purposes required only a majority vote, despite the passage of a related advisory measure stating the voters' intent that the revenues be spent on specific projects (Coleman vs. County of Santa Clara (64 Cal. App 4th 662)).

The combined district transactions tax rate cannot exceed 2.0%. This limits the total sales, transactions and use tax rate to 9.50%, except in Alameda, Contra Costa and Los Angeles Counties and the cities of El Cerrito, La Mirada, Pico Rivera and South Gate. In these jurisdictions the maximum rate is 10.00% by state law. A local agency may form more than one district but the total tax levy, including the rate of any countywide districts, must not exceed the 2.0% limit. The pertinent provisions of the California Revenue and Taxation Code are: Sections 7251.1, 7285.9 – 7285.92, 7285 – 7285.5.

How The Tax Is Distributed

With the exception of specified items sold to operators of common carrier aircraft, the transactions and use tax is imposed on the same goods and merchandise as the local sales and use tax. However, where the Bradley-Burns Sales and Use Tax is generally allocated to the jurisdiction where the sale is negotiated or the order is taken, **the transactions and use tax is allocated to the district where the goods are delivered or placed into use.**

- For “walk-in” retail stores, the Board of Equalization presumes that the merchandise will be used within the district where the store is located unless the retailer is asked to ship the merchandise outside the district as part of the sale.
- Sellers or lessors of vehicles, vessels or licensed aircraft are required to collect the transactions tax if there is one, only for the district where the conveyance is to be registered. **Residents do not escape the tax by purchasing from a dealer outside the city as dealers statewide are required to collect any transactions tax for the jurisdiction where the vehicle is registered.**
- For sales contracts that require shipment of the merchandise, the transactions tax is levied for the active district(s) at the ship to address and the seller has nexus at that location.

For sales other than “walk-in” stores, the transactions and use tax is imposed only on consumers located within the district. In projecting revenues, agencies who serve a regional market for vehicles or merchandise to be delivered elsewhere such as contractor materials or industrial equipment and goods will find that their transactions and use tax is proportionally lower than their sales tax revenues. An agency whose residents and businesses must shop outside the agency for vehicles and business and construction-related goods, will find that their transactions and use tax receipts are proportionally higher than their sales tax revenues. Retailers are only required to collect a transaction tax for sales in a specific district if they have “nexus” in that district. Nexus is established by:

- Having a permanent or temporary business location within the district including a warehouse, salesperson or office.
- Having a representative in the district for purposes of taking orders, making sales, delivery or installation.
- Deriving rental income from lease of tangible personal property within the district or selling conveyances that require registration.

If the retailer has no nexus within the district and does not collect the tax, the buyer is responsible for paying a corresponding use tax. Agencies that have implemented a transaction tax district may want to consider requiring contractors and other businesses with potential ongoing use tax liabilities to submit proof that they have applied for a California Consumer Use Tax Account (BOE-400-CSU) as part of the agency's licensing/permitting requirements.

Implementation Issues and Resources

Cities and counties are required to contract with the State Board of Equalization for administration of the ordinance imposing a transactions and use tax. There are two contracts. One is for setting up the tax; the second is for ongoing administration. Additionally, as the transactions and use tax is separate and distinct from the local sales and use tax, a separate *Resolution of Confidentiality* for access to the allocation data is required. Agencies contemplating a transactions and use tax should begin by contacting the State Board of Equalization's Local Revenue Allocation Section. A team has been established to assist agencies with the preparatory functions for placing a proposal on the ballot including proper wording of the ordinance and subsequent contracts. The specific advisor is Donna Puchalski (916.324.1371).

California Constitution Article XIII C should be reviewed with agency counsel to determine whether or not the specific tax proposal being contemplated falls under the requirements for consolidation with a regularly-scheduled general election for members of the governing body.

Analysis of Agencies that Have Adopted Similar Taxes

The confidentiality requirements imposed by Revenue and Taxation Code Section 7056, strictly limit disclosure of information from sales tax returns. The contents of this analysis are necessarily general in order to comply with Section 7056.

Our inquiry is limited to point-of-sale sales tax receipts and does not attempt to adjust for any other external or internal business factors. We compared year-over-year local tax receipts, adjusted for payment aberrations, for cities that recently implemented a transactions and use tax compared to countywide percentage changes over the same period. We analyzed this data by major industry group, including growth rates specifically for the automobile and transportation sector.

Our findings after evaluating taxable sales growth in eight cities after their implementation of a voter-approved transactions and use tax are as follows:

1. We found no conclusive evidence in the data we analyzed to point to a measurable and on-going negative impact from the implementation of add-on transactions and use taxes at rates between 0.50% to 1.0% on taxable sales.
2. While sales of general consumer goods at brick-and-mortar retail stores have been relatively weak in recent years compared to other categories, we found this trend has been driven by consumer preferences towards purchasing merchandise from online retailers located out-of-state, not from higher voter-approved transactions taxes. The sales tax collected from these transactions is pooled countywide, based on point of delivery, and the local 1% sales tax is distributed on a pro-rata basis to cities and counties. Transactions taxes for online sales are allocated directly to the local agency where the goods are shipped.
3. The average annual growth in sales tax receipts for the 8 subject cities after implemented a transactions tax was 5.13% compared to 4.24% for the overall county during the same period of time. The growth rate for most of the cities was generally within 1% of the countywide averages. Exceptions in which cities grew significantly faster than their county average can generally be attributed to new business openings during the period.
4. Generally, the average percentage change in receipts for the Automobile/Transportation sector in the subject cities were within +/-2% of the countywide percentage change in the Automobile/Transportation sector during the same time period. Fairfield was an exception in which growth exceeded the countywide percentage change due to changes in ownership/management of several automobile dealers. El Monte lagged the countywide growth due to a greater than average decline in auto sales during the depths of the Great Recession.

The following table summarizes the average annual percentage change in sales tax receipts since the date of district tax inception through the end of calendar year 2015 for each comparison agency.

City	Year Implemented	Rate	% Change City	% Change County
Culver City	2013	0.50%	3.64%	3.10%
El Monte	2009	0.50%	1.34%	2.10%
La Mesa	2009	0.75%	7.96%	5.64%
National City	2006	1.00%	0.49%	1.25%
Vallejo	2012	1.00%	5.51%	5.60%
Fairfield	2013	1.00%	8.16%	4.38%
Concord	2011	0.50%	6.60%	4.87%
Cathedral City	2010	1.00%	7.36%	6.97%
Average			5.13%	4.24%

The following table summarizes the average annual percentage change in sales tax receipts for the Automobile/Transportation sector since the date of district tax inception through the end of calendar year 2015 for each comparison agency.

City	Year Implemented	Rate	% Change City	% Change County
Culver City	2013	0.50%	11.15%	13.18
El Monte	2009	0.50%	1.88%	4.65%
La Mesa	2009	0.75%	7.96%	5.64%
National City	2006	1.00%	0.98%	1.83%
Vallejo	2012	1.00%	14.94%	15.15%
Fairfield	2013	1.00%	22.55%	14.76%
Concord	2011	0.50%	13.50%	11.59%
Cathedral City	2010	1.00%	11.15%	13.18%
Average			10.51%	10.00

We have spent a significant amount of time performing before and after analysis of our data base looking for evidence that local transactions taxes result in lower taxable sales or the relocation of sales to other jurisdictions. While it is probable that at least some businesses are impacted by the adoption of local add on taxes, we have found no conclusive evidence to support the supposition to date. Possible reasons include:

1. There is an impact but it is too small to be distinguished from other factors.
2. Californians are accustomed to having the tax added to the cost of the purchase and base their buying decision on the cost of the merchandise rather than the added percentage of sales tax.
3. The increase is too small to be worth the time and expense to travel outside of the city to avoid paying the tax.
4. Consumers who do include the total sales tax in their buying decisions have found alternatives to paying sales tax and are not a factor in the comparisons.

Please contact me at 909.861.4335 if we can provide any additional information or answer any questions related to our analysis.

Sincerely,

Andrew Nickerson
President