

**THE ECONOMY IS CHANGING**

How should policy with respect to local taxes change to reflect this reality? This report looks at:

- SB 8 (HERTZBERG), TAXATION
- SB 533 (PAN), CITIES AND COUNTIES: SALES AND USE TAX AGREEMENTS
- USE TAX COLLECTION AND “MARKETPLACE FAIRNESS”
- FAA “INTERPRETATION” OF THE AIRPORT AND AIRWAY IMPROVEMENT ACT AND IMPACT ON LOCAL TAXES IMPOSED ON JET FUEL

SB 8 (HERTZBERG), TAXATION

SB 8 (Hertzberg), known as the proposed “Upward Mobility Act,” was introduced early in the 2015-16 Session. SB 8’s intent is to broaden the sales tax base to include services and then would, potentially, lower the income tax rates.

- **New amendments:** The introduced version of SB 8 included intent language; the February 10, 2015 amendments propose an addition to the Revenue and Taxation Code for a section on the taxation of “services.” The amendment language is broad and remains a starting place for the discussion on expanding the retail tax to services.
- **Impact on local voter-approved measures:** The current language states that the Upward Mobility Act seeks to make three broad changes to the tax code including: “Broaden the tax base by imposing a sales tax on services to increase revenues. Local jurisdictions would not be authorized to increase sales tax on services, as they now can do with the sales tax on goods. Though the new revenues would be collected by the state, the ownership of those funds allocated to local government under this measure will be controlled by local government using traditional allocation mechanisms. Health care services and education services would be exempted from the tax, and very small businesses with under \$100,000 gross sales would be exempted from the sales tax on services.”
- **Other provisions:** Keeping in mind that SB 8’s language is being developed we will watch to see how “services” is classified. For example, under SB 8, as currently drafted, “services” is not part of voter-approved taxes and may be part of the Bradley Burns law. The bill also considers changes to corporate taxes that enhance the State’s business climate and examines the impacts of a lower income tax.
- **Bill location in the legislative process:** SB 8 was referred to the Senate Governance and Finance Committee; a hearing date has not been set. Early conversations with the author’s office indicate SB 8 may be a two-year bill.
- **In the news:** *Comstock’s* March 2015 edition (comstocksmag.com) gives a dual perspective on the issue of ‘upward mobility’ for interested readers.
- **Local sales tax erosion challenges, conditions and alternatives:** MuniServices presented interesting facts during the League’s 2014 Finance Seminar. Please let us know if you would like a copy of the presentation sent to your city.

**SB 533 (PAN), CITIES AND COUNTIES: SALES AND USE TAX AGREEMENTS**

Sales tax rebate agreements are gaining increased attention as a legislative issue. With California cities competing not only with each other, but also with other States for jobs, there needs to be some discussion about how to handle rebates. There is some impetus toward banning them altogether, but the broader consequences of this activity in the marketplace for jobs should also be considered. MuniServices does not support many types of sales tax rebates, especially when the revenue from the sales tax is taken away from one jurisdiction and given to another, however we are strong proponents of local control and believe that these types of decisions are best left to each city, especially the flexibility and ability to retain and attract business which is a critical city decision.

SB 533 would, effective January 2016, prohibit a local agency from entering into agreements that would prohibit payments, transfer, diversion or rebate of Bradley-Burns to any person if the agreement results in a reduction of revenue of another local agency. The bill includes language that would require a) 60-day notification to the local agency that will be impacted, and b) that any proposed agreement to be posted on a local agency website at least 30 days prior to ratification or approval. SB 533 is eligible to be considered on or after March 29.

Readers are encouraged to refer to MuniServices' website (www.muniservices.com) for previously published reports on this issue, including those related to last year's proposed SB 983 (Hernandez) which led to a broader discussion on local control and decision making with respect to place of sale and local sales taxes.

USE TAX COLLECTION (MARKETPLACE FAIRNESS ACT)

"Marketplace Fairness" is an attempt by Congress to compel out-of-state retailers to collect and remit use tax on online sales. Representative Goodlatte (R-VA), a key gatekeeper on the legislation, is circulating a draft, hybrid-origin version of this legislation.

The hybrid-origin requires the sale to be reported to the origin state where the sale occurs and not the location of the customer. Destination-states would receive a portion of the sales tax from the origin state at the origin state's tax rate. This could undermine California's expanded nexus rules and apply a lower tax rate to transactions that are currently taxable at California's tax rates.

The League of California Cities is currently exploring ways use tax allocation could be shifted so a city may get more direct reporting of its use tax. The pooling procedures were established because it was too difficult in the 1950's to determine the destination of the goods. In this age of big data, it is time to reassess whether this is true and, if not, whether it makes sense to directly allocate use tax.

**FAA INTERPRETATION OF THE AIRPORT AND AIRWAY IMPROVEMENT ACT WILL REQUIRE LOCAL TAXES IMPOSED ON JET FUEL TO BE USED FOR THE BENEFIT OF AIRPORTS**

In November of 2014, the FAA adopted a new interpretation of an old rule. The interpretation requires local taxes of all sorts imposed on jet fuel to be used for the benefit of airports. The FAA gave governments until the end of 2015 to submit a plan explaining how they will comply with the interpretation by the end of 2017.

At issue is a new interpretation of the Airport and Airway Improvement Act. According to the FAA, the 1982 law was supposed to ensure that taxes levied on airline fuel are spent to upgrade airports, help build runways and improve facilities for air travellers. But some state and local governments had been interpreting the law differently and concluded that if an airport was managed by an independent airport authority instead of by a state or locality, the state or locality could spend the fuel-tax revenue however it wanted. Certain states and localities with airports could lose millions annually unless they comply with the ruling requiring them to spend revenues from jet fuel taxes only on air travel-related expenses.

The state currently taxes 1.2 billion gallons of jet fuel a year at 2-cents a gallon. While predicting jet fuel prices is difficult sources indicate the state's general fund could lose close to \$10 million a year if it does not comply with the FAA ruling. The impact could be up to \$100 million when the other sales taxes assessed by the state on all fuels, along with sales taxes imposed by local jurisdictions, are counted.

We have been in discussions with stakeholders including the League of California Cities, the State Board of Equalization and Legislative Staff. The State of California and other states are weighing whether to fight this change - that fight may be political, in the form of policy or even legal action. Once we have more detail on strategy or suggestions we will be in touch. This issue is an example where a change was made based, apparently, without the Federal government listening to the voice of the local governments.

As the landscape changes, your voice becomes more and more important. We look forward to working with you to shape a landscape in this century that recognizes the increasing urbanization of the population and the need for the fiscal tools to meet the growing demand for your jurisdiction's services.