

Sales Tax – Understand the hidden nuances

- Sales and Use Tax Primer (HdL)
- Sales Tax: A National Perspective (Avenu)
- Seeking Equity: Building Consensus (CMSTWG Facilitator)
 - Prior Group; New Group
- CMSTWG [City Mgrs Sales Tax Wkg Gp] (CalCities Staff)
 - Policy Committee [Rev & Tax] Recommendations
 - Phase 2 Tasks
- *Submit your questions during the session to the moderator via email at QuestionsCalCities@gmail.com*

Sales & Use Tax Primer

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Purpose

To better understand the factors guiding the distribution of local tax allocations with a focus on online transactions.

Business-to-Consumer

- Generally taxable sales that you would associate with your own personal shopping.
- Ex. Apparel, Department Stores, Gas Stations, Grocery, Electronics, Autos

Local Tax

Business-to-Business

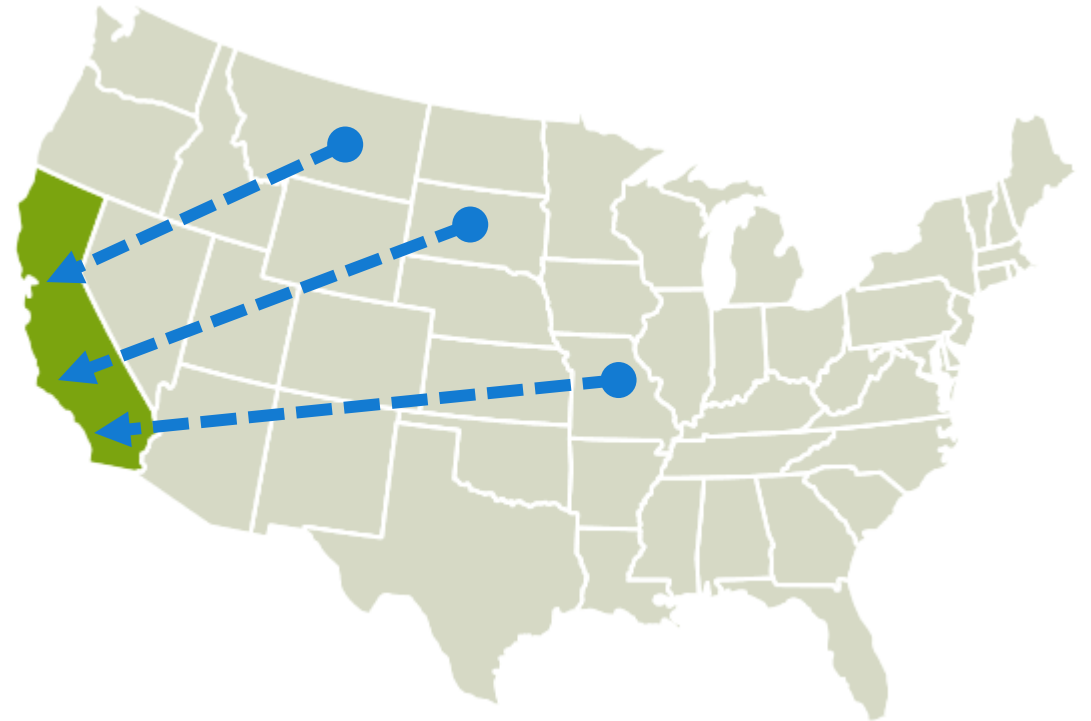
- Includes taxable sales to or purchases by businesses such as supplies and equipment.
- Excludes wholesale transactions, or manufacturing inputs.
- Ex. Office Supplies, Medical Supplies, Equipment



Sales Tax vs Use Tax: Bradley-Burns

Sales Tax applies if a California place of business of the retailer participates in the sale and the sale occurs in California.

Use Tax applies to goods shipped from out-of-state.



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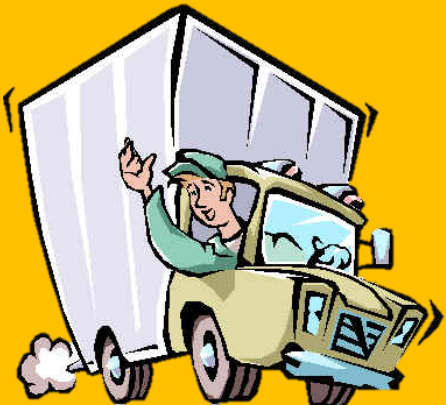


District Taxes (aka Transactions Taxes)

Transactions Tax is allocated to the district where goods are delivered or placed in to use. Tax is destination sourced.

**DELIVERIES INTO
CITY**

TUT tax collected



**CITY WITH LOCAL
TUT**

**DELIVERIES OUT OF
CITY**

TUT tax NOT collected





Local (1%) Sales Tax Allocation

Direct Allocation (jurisdiction)

- Generally, Sales Tax
- Retailers hold a sellers permit with registered places of business (sub-outlets)

Indirect Allocation (pools)

- Traditionally, Use Tax
- Allocated through countywide pools based on place of use
- Increased due to online sales & marketplace facilitators

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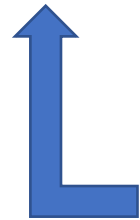
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Most Common Exceptions



Large Sales
subject to use tax
> \$500K

Auction events
with taxable sales
in aggregate >
\$500K

Construction
Contracts
> \$5 Million
(jobsite permit)



Online Sales

Who's place of business is fulfilling or participating?

Fulfilled by Retailer

- In-State warehouse participates
 - Direct Allocation
- Out-of-State warehouse participates
 - Indirect Allocation

Fulfilled by 3rd Party

- In-State warehouse participates
 - Indirect Allocation
- Out-of-State warehouse participates
 - Indirect Allocation

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What about online Marketplace Facilitators?

Who's place of business is fulfilling or participating?

Fulfilled by Marketplace Facilitator (Retailer)

- In-State warehouse participates
 - Direct Allocation
- Out-of-State warehouse participates
 - Indirect Allocation

Fulfilled by Marketplace Seller (3rd Party)

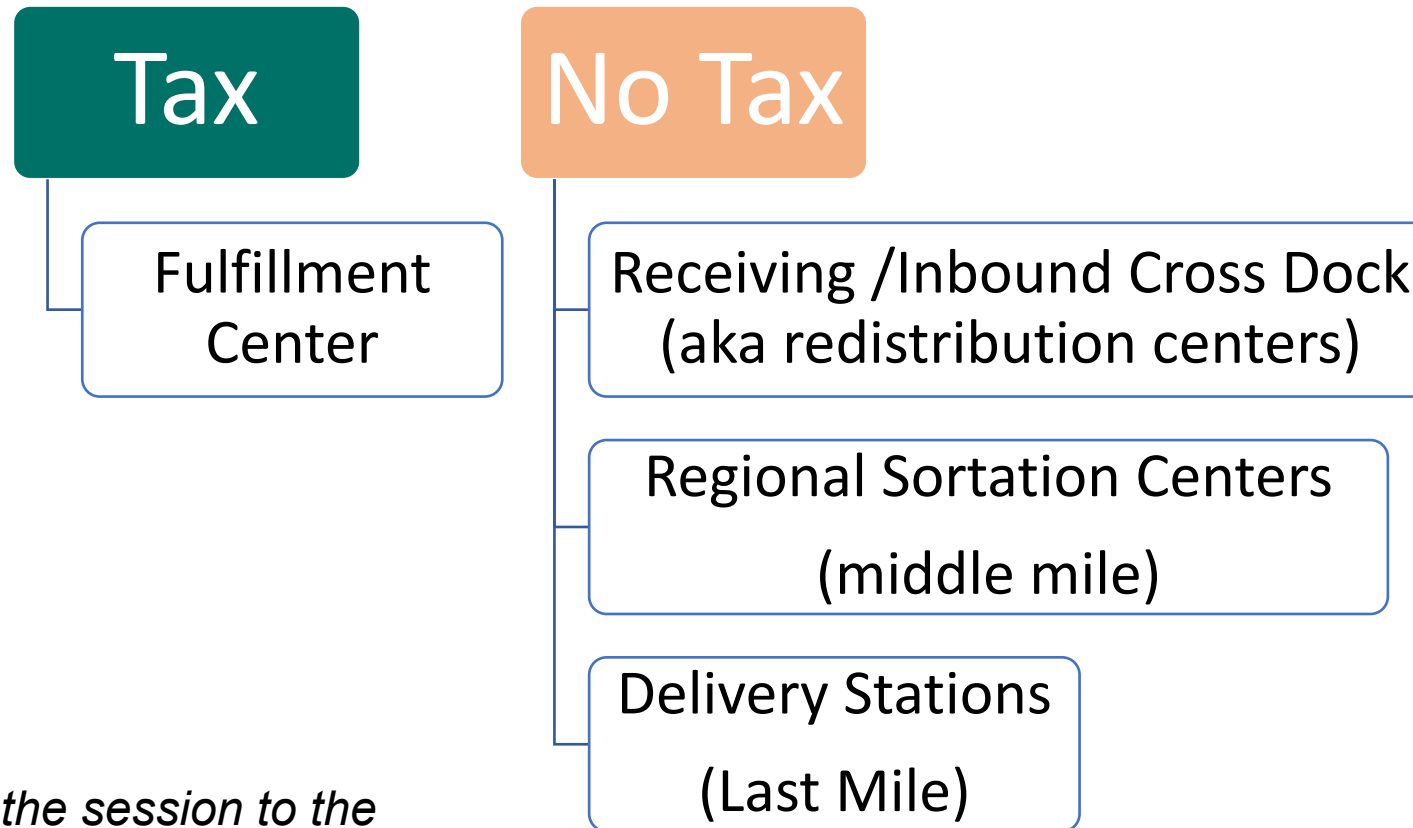
- In-State warehouse participates
 - Indirect Allocation
- Out-of-State warehouse participates
 - Indirect Allocation

**Direct allocation will only happen if an in-state place of business of the retailer (marketplace facilitator) participates in the sale.*



Logistics Facilities

There are many types of warehouses, not all of them will be considered a place of sale. Below are just a few examples...

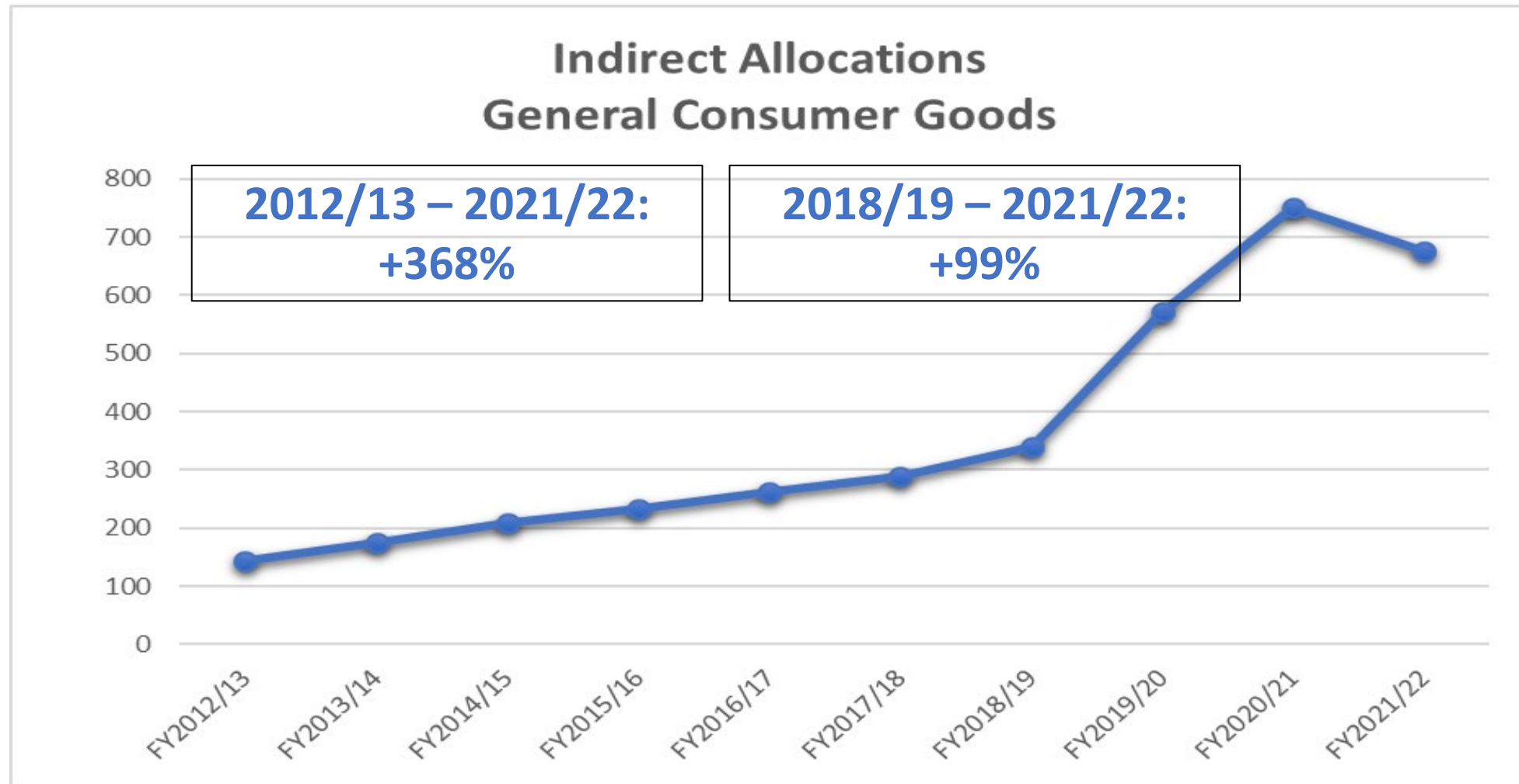


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Indirect: General Consumer Goods

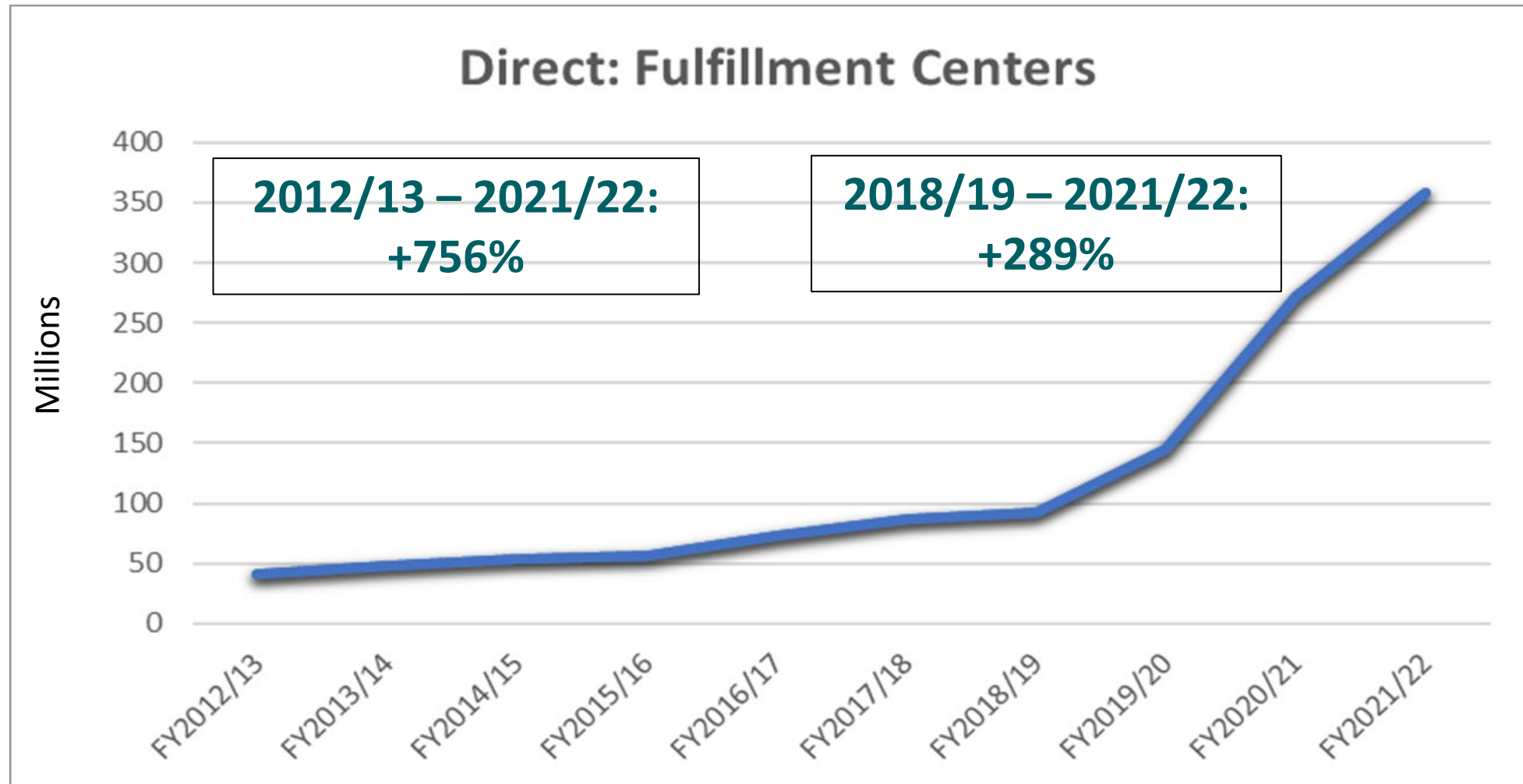
We talk a lot about online retail sales...





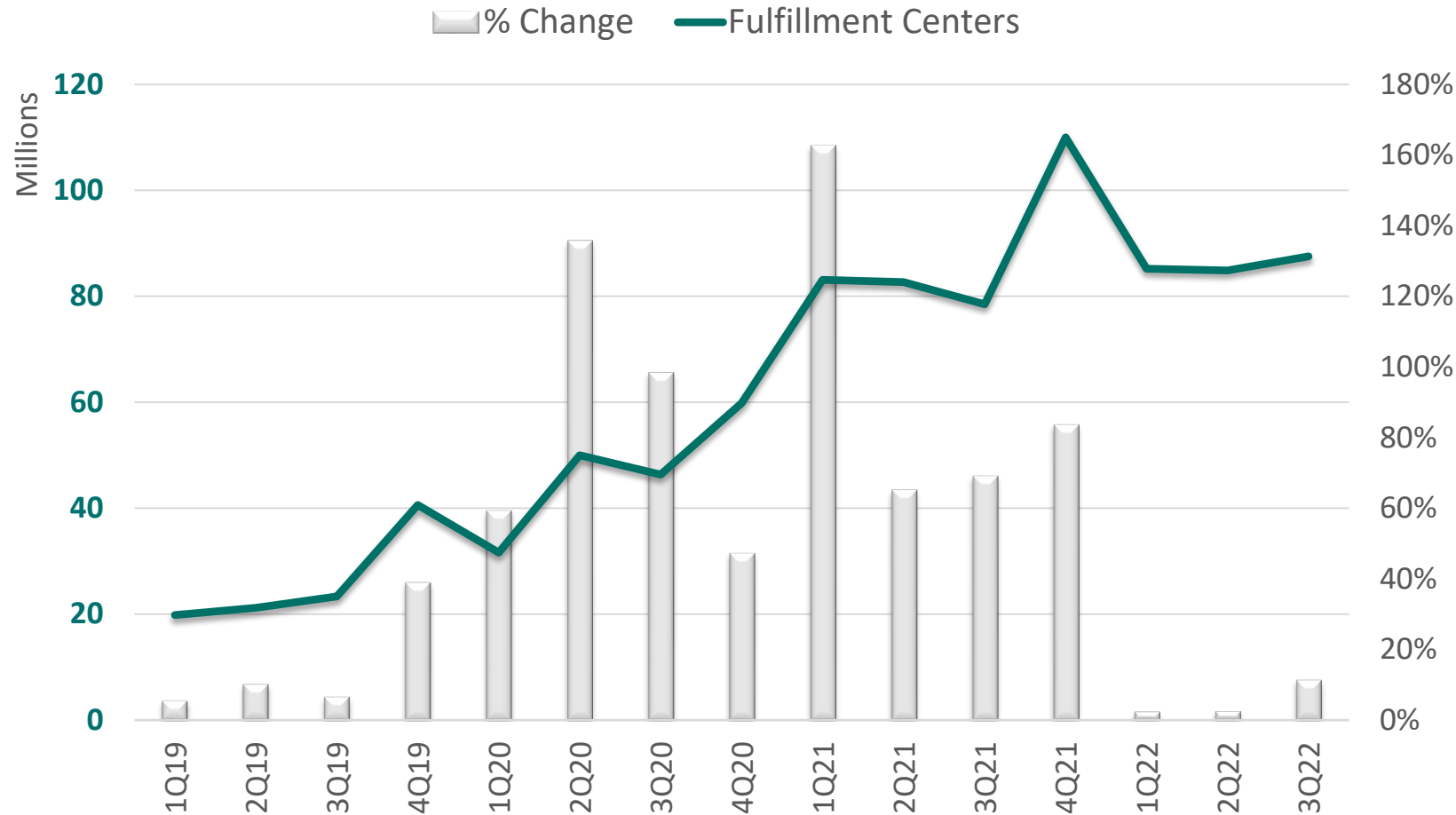
Direct: Fulfillment Centers

We talk a lot about online retail sales...





Fulfillment Centers



Place-of-Sale direct allocations to local agencies

4Q19 – 3Q20: Growth from AB147, Marketplace Facilitators, pandemic behavior shifts

4Q20: Continued pandemic behavior shifts to online shopping

1Q21 – 4Q21: Shifts of some local tax reporting due to business structure changes from indirect to direct reporting

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Sales Tax: A National Perspective

Past, Present and Future

Presented by:

Fran Mancia, Vice President of Government Relations

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Sales Tax

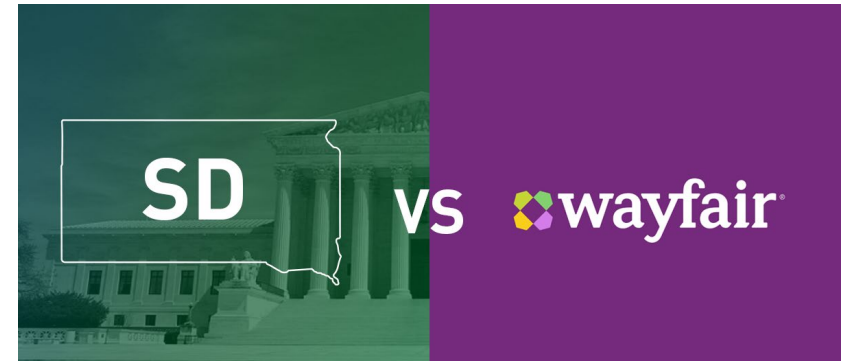
What's Changed

More revenue from third party sellers than expected

- ❖ Double the amount sold by Amazon warehouse locations
- ❖ More local jurisdictions have passed TUT measures
- ❖ Receiving revenue based on destination

Wayfair Decision: Wayfair v. South Dakota

- ❖ National issue not just state specific
- ❖ Streamline Sales Tax Agreement
- ❖ Efforts to pass federal legislation



Avenu has and continues to actively participate in the Wayfair Decision

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The Past and Future

1994: Regulation 1802

- ❖ Prepared by Avenu at the request of Cal Cities
- ❖ Provided recommendations about situs allocation and pooling
- ❖ Goal was to make CA and cities more competitive in retaining and attracting manufacturing jobs and business
 - ❖ Priority was fairness and equity
 - ❖ Rewarded cities for retaining and attracting businesses

2022: Sales Tax - The goals have not changed

- ❖ Rules established in the 1990s are still in place and working

How have the dynamics and revenue streams changed?

- ❖ More revenue from new sources of revenue

California's tax base and revenue have dramatically grown since the 2018 Wayfair Decision ruled on by Supreme Court and subsequent legislation passed

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Wayfair Decision - Texas

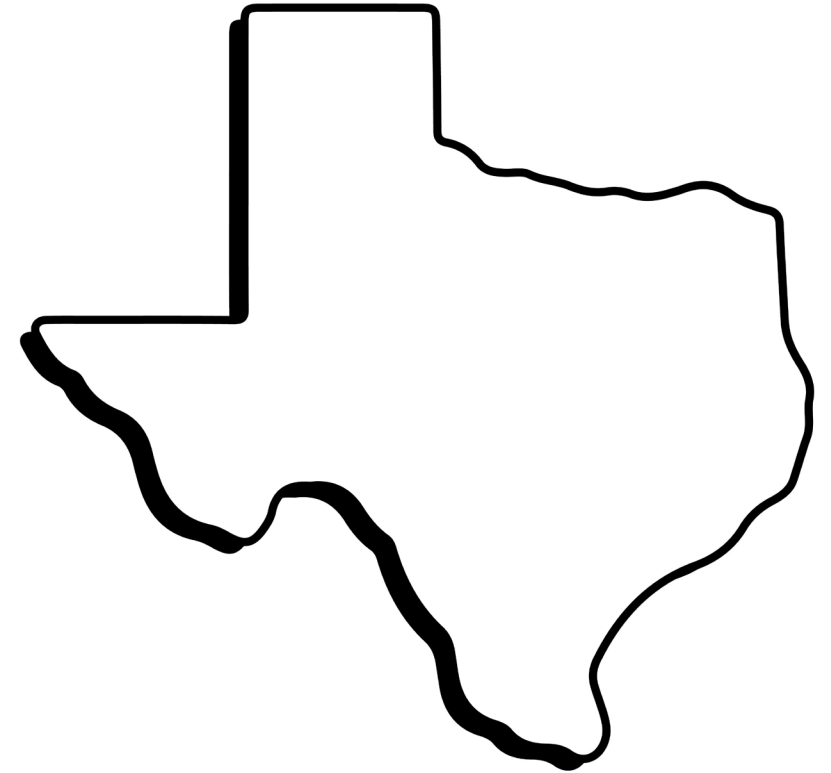


- ❖ Texas has passed seven pieces of legislation to implement the Wayfair Decision
- ❖ All Wayfair sales and use tax is distributed via destination
- ❖ Destination sourcing is a challenge in Texas, especially for the oil and gas industry
- ❖ Impacted E-commerce nationwide

Provided for a national solution

Examples from Texas

- ❖ **Avenu helped draft and support SB 190**
 - ❖ Allowed cities the right to review detailed sales tax information from the Texas State Comptroller
- ❖ **Avenu helped prevent the passage of HB 4072**
 - ❖ Would have changed local sales and use tax sourcing from origination to destination
- ❖ **Texas implemented Rule 3.334 after HB 4072 passed**
 - ❖ Created a bifurcated system where businesses will have to source sales tax differently depending on the communications method by which they receive an order
 - ❖ changed the definition of a “place of business” of the retailer for sales tax purposes
 - ❖ Multiple cities poised to file suit against Rule 3.334
 - ❖ Governor has called for a special session to address pending issues



Avenu represents over 350 cities in Texas

Examples from Louisiana

Destination State & Home Rule State

Sales and Use tax is administered at the local level

- ❖ Cities, Parishes, School and Public Safety receive direct sales tax revenues
- ❖ Audits: 80% adjustments identify issues with reporting by address

The Louisiana state legislature passed laws directing the Louisiana Department of Revenue to establish an online seller's portal

- ❖ All out of state E-commerce transactions are to be collected and remitted via a state portal
- ❖ Easier for all involved business and locals.
- ❖ Factors in different rates
- ❖ Tax is sourced based on destination

Recent Sales Tax Related Legislation

- ❖ SB 235
- ❖ HB 681
- ❖ SB 95



Avenu administers the portal for the State of Louisiana and for most of the parishes in the state

Examples from Kansas, Tennessee and Washington

Outcomes for states shifting to destination

Kansas

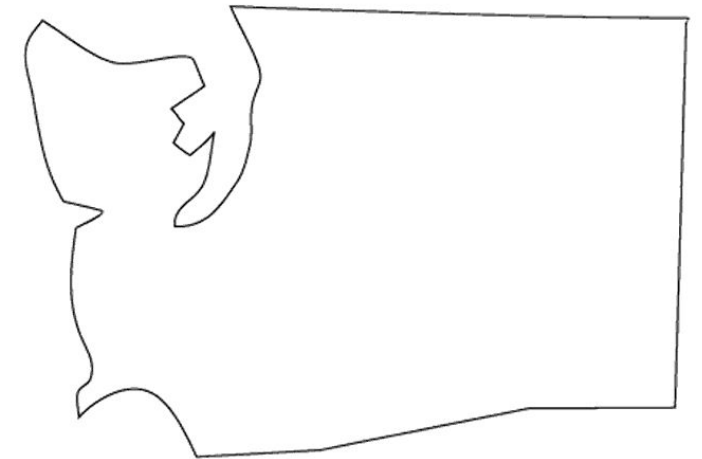
- ❖ 2003/2004 implemented destination sourcing
- ❖ Opposed by businesses
- ❖ Politicians who supported changes all lost elections

Tennessee

- ❖ In 2009, joined SSTA with the goal to be compliant by 2019
- ❖ Kicked the can down the road and have given up

Washington

- ❖ 2008/2009 changed to destination
- ❖ Established a mitigation fund to help balance winners and losers
 - ❖ Goal was to make everyone “whole”
 - ❖ Mitigation fund was expected to last only a few years
 - ❖ Still in effect
 - ❖ Lawsuits on going



Inflation/Recession?

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2020Q1			2020Q2			2020Q3			2020Q4		
2.5%	2.3%	1.5%	0.3%	0.1%	0.6%	1.0%	1.3%	1.4%	1.2%	1.2%	1.4%
2021Q1			2021Q2			2021Q3			2021Q4		
1.4%	1.7%	2.6%	4.2%	5.0%	5.4%	5.4%	5.3%	5.4%	6.2%	6.8%	7.0%
2022Q1			2022Q2			2022Q3			2022Q4		
7.5%	7.9%	8.5%	8.3%	8.6%	9.1%	8.5%	8.3%	8.2%	7.7%	7.1%	6.5%

U.S. Federal Reserve Chair Jerome Powell says whether the U.S. can tackle inflation and keep the economy growing at the same time likely depends on events that are happening outside the country, and beyond the Fed's sphere of influence.

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How's the recovery going for CA Taxable Sales?

If stable average growth had been maintained								
Fiscal Year	14-15	15-16	16-17	17-18	18-19	19-20	20-21	21-22
<i>Projected</i>	\$633.5	\$660.7	\$689.1	\$718.8	\$749.7	\$781.9	\$815.5	\$850.6
Change	4.3%	4.3%	4.3%	4.3%	4.3%	4.3%	4.3%	4.3%

Actual Taxable Sales - Cash Basis								
Fiscal Year	14-15	15-16	16-17	17-18	18-19	19-20	20-21	21-22
Actual	\$633.5	\$650.0	\$668.3	\$661.5	\$767.9	\$715.2	\$805.6	\$936.1
Change	4.3%	2.6%	2.8%	-1.0%	16.1%	-6.9%	12.6%	16.2%
Transition from SBoE to CDTFA: delays early 2018				Average = 7.5%			Ten Percent Ahead of Trend	
Payments accelerated by 1 month 2018				Average = 6.9%				

In billions - includes Local Taxable Sales + County Pools + State Pool

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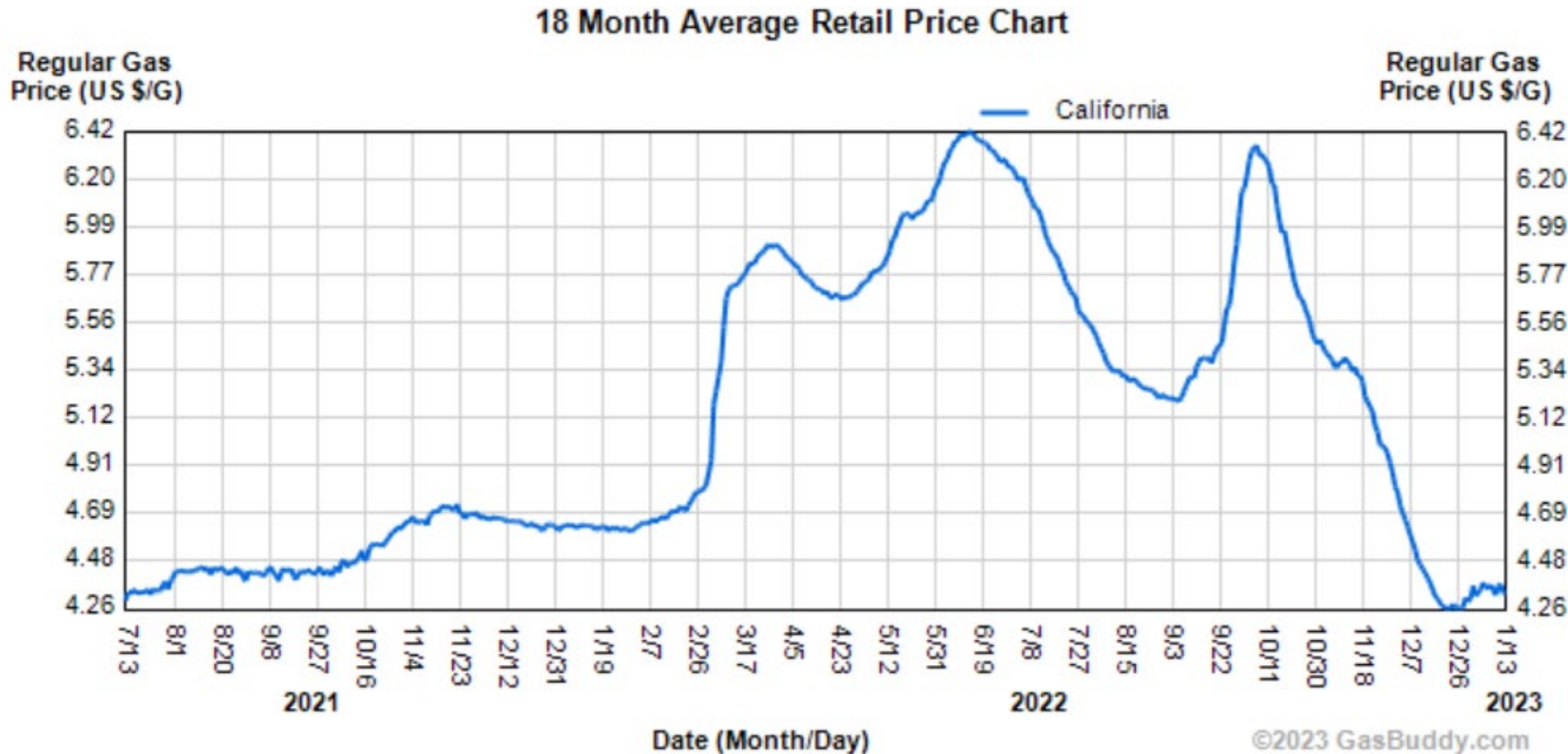
CA 1% Local Taxable Sales (Includes Pools)

	<div> <div>Economy begins to slow</div> <div>New Wayfair / AB147 \$</div> <div>CA COVID Lockdown begins, many taxpayers file extensions</div> <div>CARES ACT: \$2 TRILLION 3/25/2020, many taxpayers that extended in Q1 catching-up.</div> <div>Summer Rally</div> <div>Consolidated Appropriations Act: \$900 billion 12/20/2020</div> <div>COVID Resurgence</div> <div>American Rescue Plan: \$1.9 trillion 3/11/2021</div> <div>Recovery, Rising Energy Prices, Rising Inflation</div> <div>Russia Invades Ukraine, pushing energy prices, inflation even higher</div> <div>Inflation Reduction Act: \$437 billion 08/16/2022</div> <div>Federal Reserve begins taking aggressive approach to fighting inflation, set 2% target</div> </div>												
JURISDICTION OR REGION	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4	2021Q1	2021Q2	2021Q3	2021Q4	2022Q1	2022Q2	2022Q3
Federal Funds Rate (Top of Target Range) >>>			0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	1.75%	3.25%
Santa Ana T&UT 1 1/2%				18.6%	15.3%	0.5%	44.9%	32.4%	13.6%	23.0%	16.7%	6.6%	5.6%
OTHER SOUTHERN	-12.5%	15.4%	-29.5%	5.9%	2.9%	-6.0%	48.1%	17.9%	14.1%	20.0%	26.1%	-0.4%	-2.0%
CENTRAL COAST	-10.7%	5.3%	-25.9%	-8.8%	2.0%	-2.2%	38.9%	28.7%	11.4%	18.2%	20.5%	4.0%	8.5%
SOUTH COAST	-7.8%	5.5%	-20.8%	-10.7%	-3.9%	-10.5%	29.2%	34.6%	18.7%	28.7%	21.1%	5.7%	7.8%
S.F. BAY AREA	-11.5%	5.7%	-20.0%	-11.2%	-4.9%	-10.3%	23.2%	26.1%	13.6%	20.2%	19.8%	5.6%	10.4%
STATEWIDE	-8.8%	5.3%	-18.9%	-6.0%	-0.2%	-5.8%	32.8%	32.1%	17.6%	25.4%	19.1%	5.0%	7.5%
INLAND EMPIRE	-8.7%	4.7%	-17.6%	1.8%	8.8%	3.6%	49.9%	37.5%	21.9%	30.4%	19.1%	6.8%	8.3%
SACRAMENTO VALLEY	-8.2%	2.3%	-15.3%	5.6%	5.7%	-0.9%	35.4%	27.8%	16.7%	22.8%	15.9%	2.0%	5.6%
CENTRAL VALLEY	-7.2%	6.0%	-11.5%	8.1%	10.2%	8.6%	44.6%	33.7%	19.9%	24.3%	14.2%	3.7%	5.7%
NORTH COAST	-6.0%	7.1%	-11.0%	3.2%	13.1%	5.2%	37.6%	24.5%	5.7%	6.4%	2.8%	-5.3%	-4.1%
OTHER NORTHERN	-11.0%	7.7%	-9.2%	3.8%	11.1%	7.9%	34.5%	26.5%	9.2%	9.3%	5.6%	-4.9%	1.2%
Inflation (U.S. CPI-U) >>>			2.1%	0.3%	1.2%	1.3%	1.9%	4.9%	5.4%	6.7%	8.0%	8.7%	8.3%
CA Gasoline Average Retail >>>			4.0%	-26.8%	-13.5%	-19.5%	2.7%	41.9%	36.6%	44.7%	42.2%	46.8%	28.9%

Quarter over Quarter Percent Change



Sales Tax Forecast Assumptions



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Recessions are characterized by high unemployment and declines in Real GDP

U.S. Real GDP Forecast (Year over Year)

	No Recession	Recession
2022Q1	3.7%	3.7%
2022Q2	1.8%	1.8%
2022Q3	1.8%	1.8%
2022Q4	0.9%	0.9%
2023Q1	1.5%	1.4%
2023Q2	1.6%	1.0%
2023Q3	1.3%	-0.3%
2023Q4	1.2%	-1.2%
2024Q1	1.7%	-0.6%
2024Q2	2.4%	0.8%
2024Q3	2.6%	2.4%
2024Q4	2.3%	3.1%

From UCLA Anderson Forecast

UCLA Anderson Forecast:
Forecasts indicate that inflation remains higher than we have typically experienced over the last decade, we expect it will begin to moderate compared to last year. By 2024 Q4, our forecast is for year-over-year inflation ranging between 2.5% and 3.5%.

Next Steps

- ❖ Be mindful of ongoing changes
- ❖ May take multiple corrections to mirror global uncertainties
- ❖ Avoid sweeping changes
- ❖ Statewide ballot measures may be costly and lengthy
- ❖ Continue to work as a cohesive group to find solutions

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Thank you

Background

2017 Sales Tax Working Group

In 2017, a working group of city managers, representing a diverse array of cities, was convened by the City Managers Department to **identify common interests on rapidly evolving e-commerce trends** and their effects on the allocation of local sales and use tax revenue.

Reconvening the Sales Tax Working Group

Purpose

To convene a **diverse and representative** group of California city officials dedicated to examining local government sales tax issues and providing recommendations that:

- Equitably benefit California cities,
- Further fiscal sustainability, and,
- Strengthen the viability of the sales tax.

2022-2024 Working Group Leadership

Leyne Milstein

Assistant City Manager,
Sacramento
Working Group Co-Chair

Clara Miramontes

City Manager,
Perris
Working Group Co-Chair

John Gillison

City Manager,
Rancho Cucamonga
Immediate Past President,
City Managers Department

Justin Hess

City Manager,
Burbank
President,
City Managers Department

Working Group Membership

- 32** Regional Division Appointees
- 8** City Managers Department Appointees
- 7** Ex-Officio Members

CMSTWG Group Focus Questions

1. Given significant transformations in consumer behavior and improved tax collection, what changes, if any, to the distribution of local Bradley Burns 1 percent sales and use tax are needed?
2. Does the existing sales and use tax system fairly and equitably distribute revenues? If not, how do we improve the system?
3. What are the outcomes of any changes and how can they be equitably and fairly implemented?

Seeking Equity and Building Consensus

Building Consensus



Establish a transparent and inclusive process for member cities to participate in the activities of the working group.

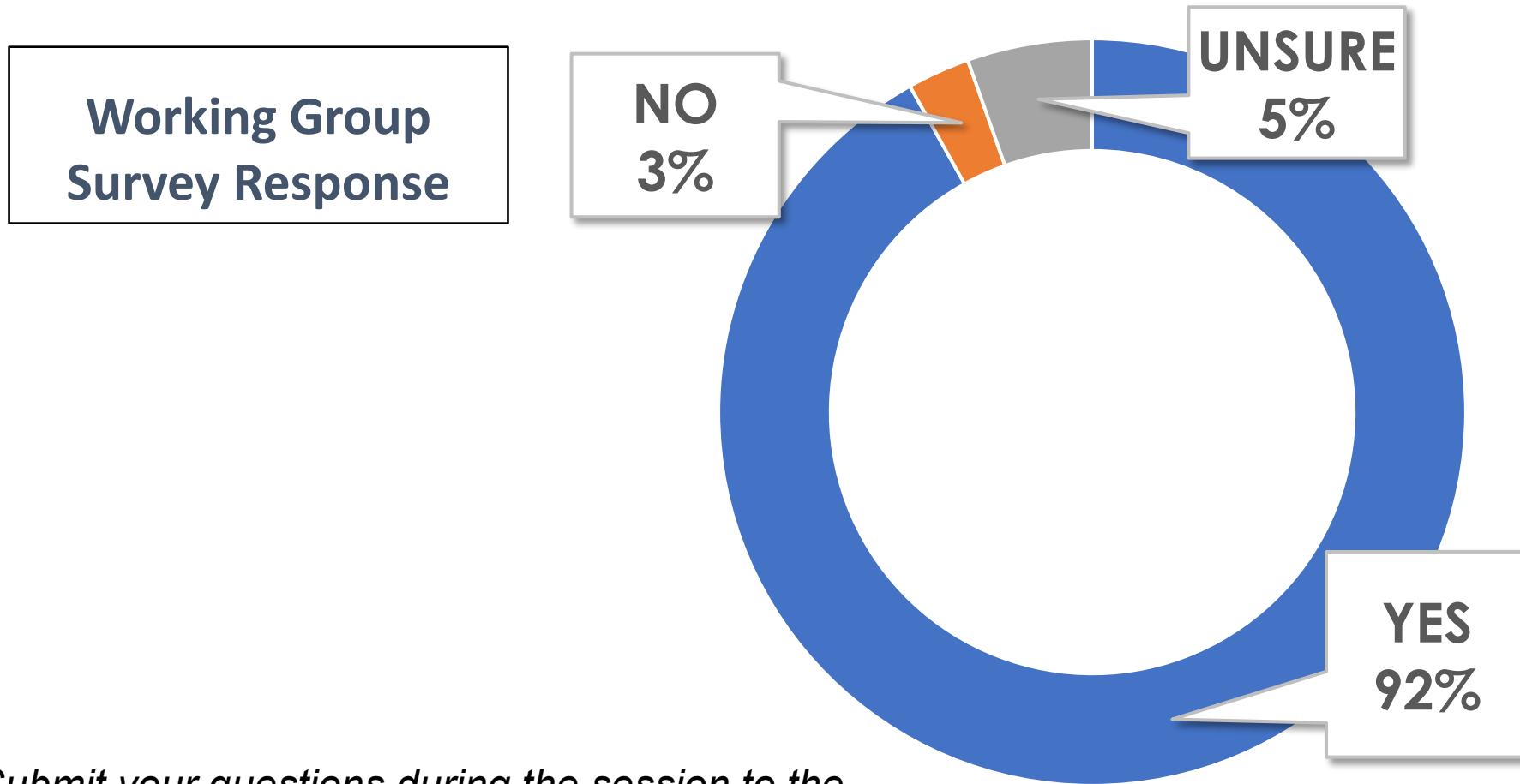


Form a group of city officials that represent the diversity of fiscal and policy interests, geographies, economies, demographics, and expertise.



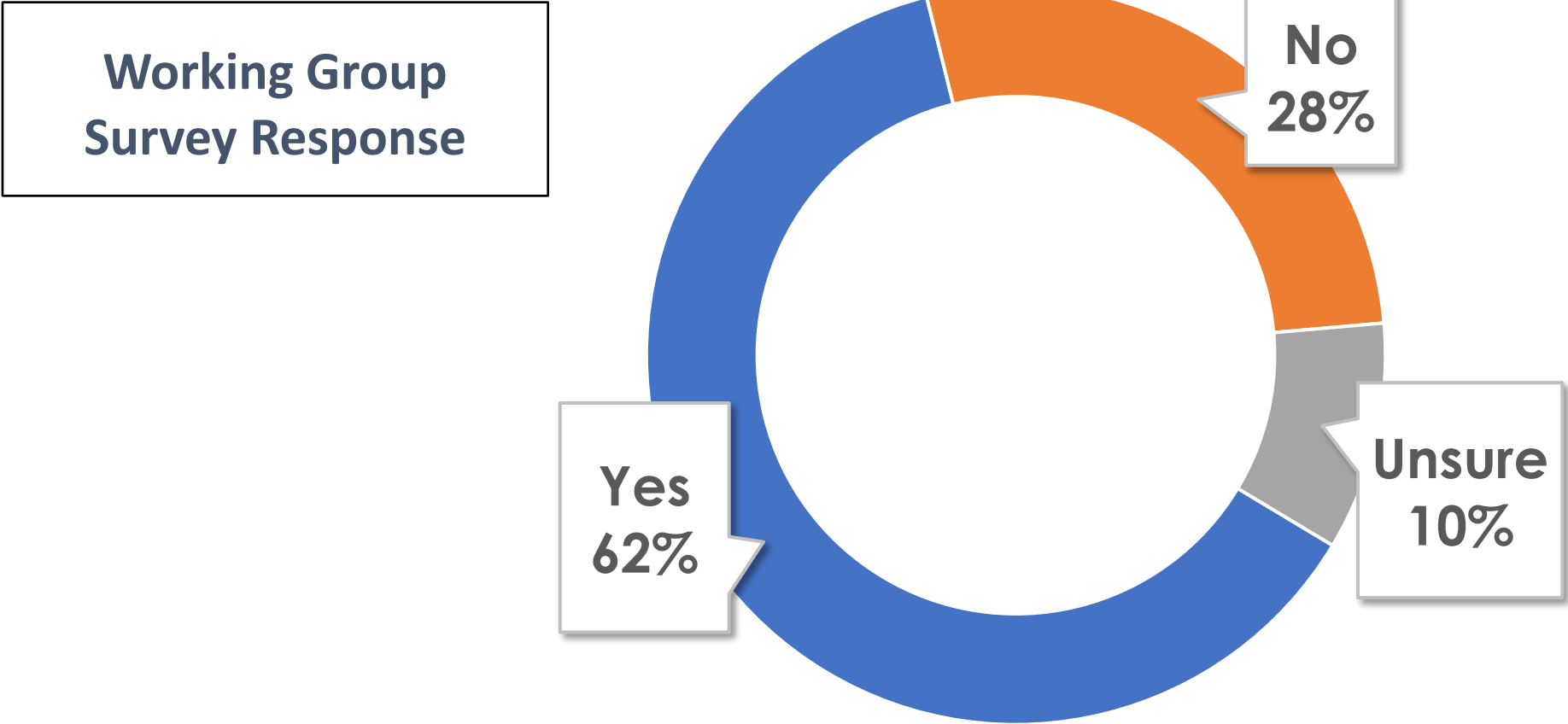
Regularly convene and provide the group with organizational assistance.

Should any changes recommended by this Working Group be prospective in nature?



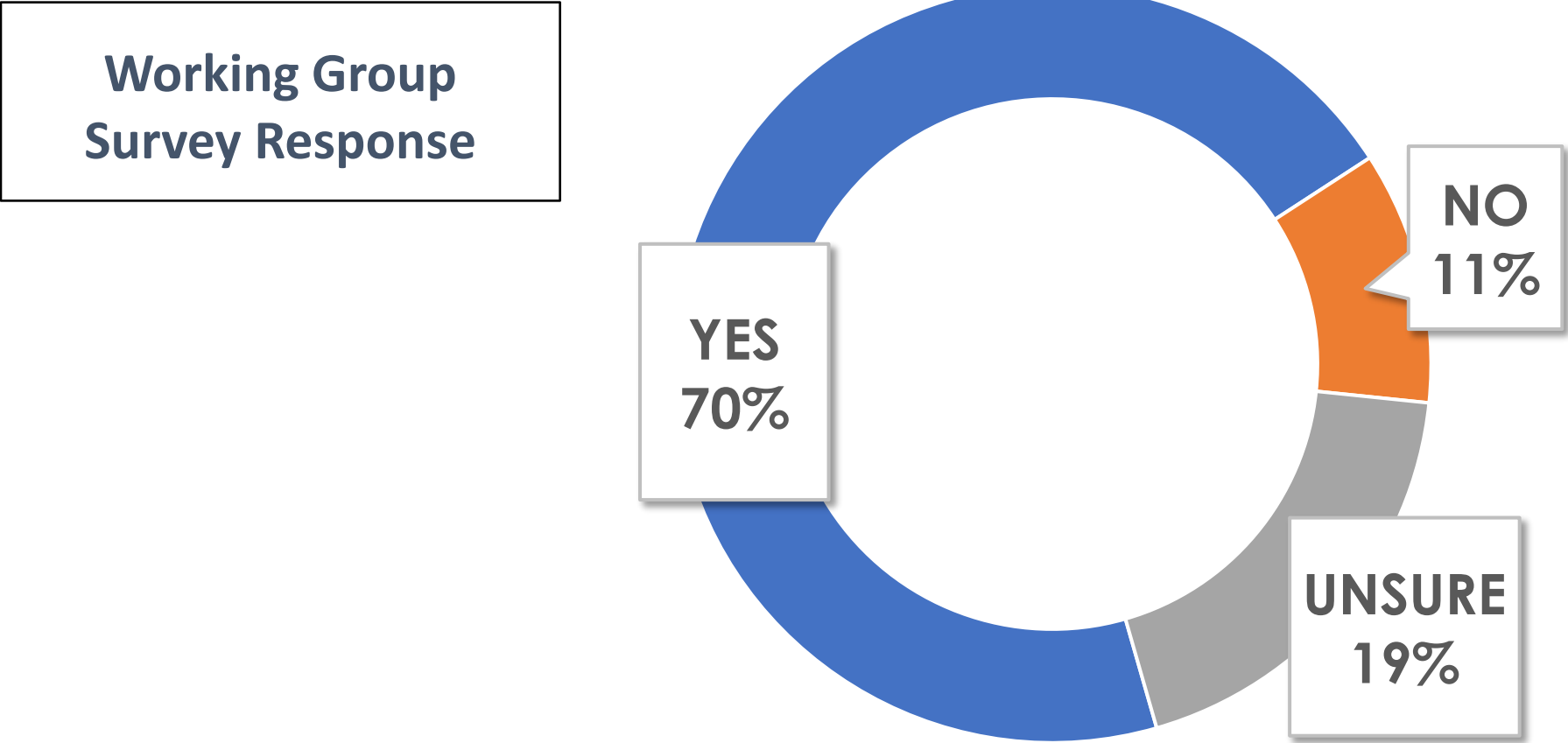
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Would you support legislative efforts to limit future (prospective) sales tax sharing agreements?



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Should measures be taken to reduce competition for situs-based sales tax revenue?



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Working Group Progress

Building knowledge and consensus

**Conducted 8 meetings
throughout 2022**

2 Working Group Surveys

**Consensus on 3
short-term proposals
reached**

**Groundwork laid for
long-term proposals**

Planning and Action Phases

Given the availability and **growing consensus** to develop recommendations on several matters, while more time is needed to support a robust discussion on tax sourcing rules, the group has identified the content of “**short-term**” and “**long-term**” work plan actions in the form of **two distinct phases**.

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Phase 1:

Equity Statement

Construction Jobsite Allocations

Sales Tax Sharing Agreements

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Equity Statement: Equitable E-commerce Sales Tax Revenue Distribution

"The equitable allocation of remote revenues from e-commerce recognizes both sides of the transaction and their contribution to sales tax generation...."

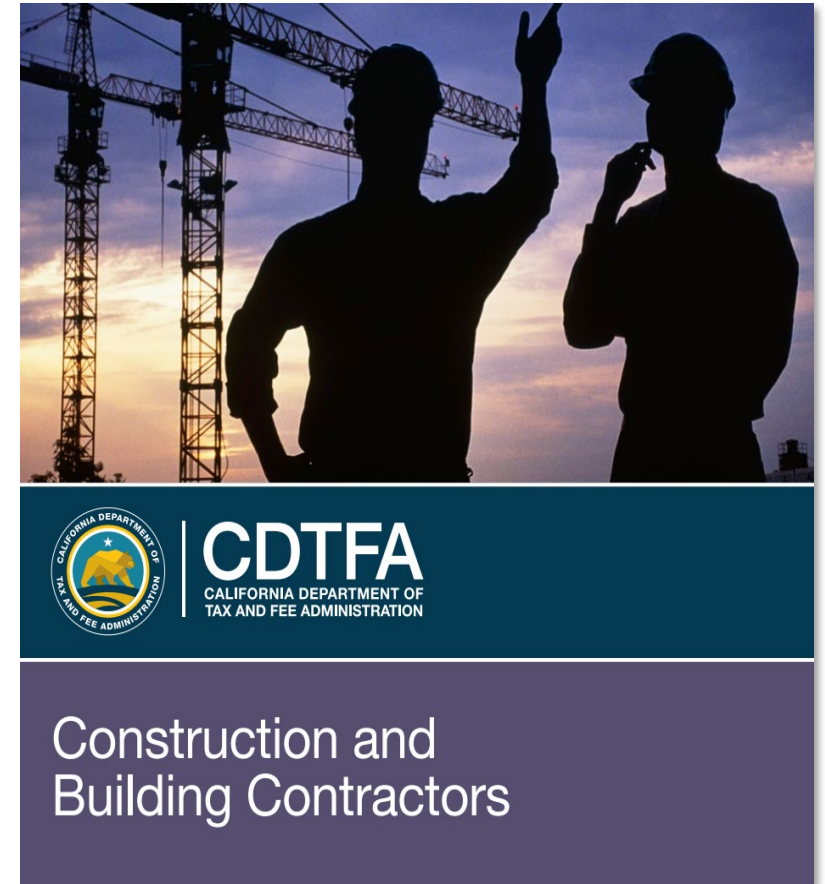
Working Group Recommendation:

Adopt the guiding definition of equitable e-commerce sales tax revenue distribution to contextualize equity within the evolving landscape of consumer preferences, technological advances, and the needs of cities.

Construction Jobsite Allocations

Contractors who enter into contracts equal to or greater than **\$5 million** may elect to obtain a sub-permit for the jobsite. Similar process for large sales (\$500k threshold).

This allows a **direct allocation** to the jobsite jurisdiction rather than an indirect allocation through the countywide pool.



Construction Jobsite Sub-Permit Allocations

Working Group Recommendation:

Remove the word “**may**” and replace it with “**shall**” to require contractors to submit appropriate documentation for direct allocation when eligible.

Lower the \$5 million threshold to **\$1 million.**

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Large Out-of-State Transactions

Existing CDTFA Regulation 1802(d)(1): Retailers shall report the local use tax for transactions of \$500,000 or more to the participating jurisdiction where the first functional use is made.

Working Group Recommendation:

Lower the \$500,000 threshold to \$100,000.

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Sales Tax Sharing Agreements

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Prospective and targeted limits to sales tax sharing agreements to reduce competition for situs-based sales tax revenue between cities.



Phase 2:

Advocate for Phase 1 Recommendations
Explore changes to the allocation of e-commerce sales tax revenues

Allocation of Online Sales Tax Revenues

Seek quality data on e-commerce activity at the city-county level.

Data remains constrained by state reporting, collection requirements , tax data confidentiality laws, and use level of the destination-based transactions and use tax.

Develop models that can be used to appropriately identify the effects any reform recommendations on in-state Bradley Burns sales and use tax sourcing rules.

THE END (for now....)

Questions & Comments

salestax@calcities.org

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Online Sales

Example 1

Online/eCommerce Platform

- Orders are placed and processed online and fulfilled by an in-state fulfillment center.
- The in-state fulfillment center is deemed the place of business participating in the sale (*preparing/packaging items & 1st human interaction*).
- The fulfillment center is a place of business of the retailer, therefore there is an in-state place of participation to allocate local tax directly.
- Local tax is allocated directly.



Online Sales

Example 2

Online/eCommerce Platform

- Orders are placed and processed online and fulfilled by an **out-of-state** fulfillment center.
- The out-of-state fulfillment center is the deemed the place of business participating in the sale (*preparing/packaging items & 1st human interaction*).
- The fulfillment center is a place of business of the retailer but there is no in-state participation in the sale, therefore the sale subject to use tax.
- Local tax is allocated **indirectly** through the county pool.



Online Sales

Example 3

Online/eCommerce Platform

- Orders are placed and processed online and fulfilled by a marketplace sellers in-state or out-of-state warehouse.
- The seller's fulfillment center is the deemed the place of business participating in the sale (*preparing/packaging items & 1st human interaction*).
- The fulfillment center is not a place of business of the retailer (marketplace facilitator), therefore there is no in-state place of participation of the retailer to allocate local tax directly.
- Local tax is allocated indirectly through the county pool.

Sales and Use tax is administered at the local level

- ❖ Cities, Parishes, School and Public Safety receive direct sales tax revenues
- ❖ Audits: 80% adjustments identify issues with reporting by address

The Louisiana state legislature passed laws directing the Louisiana Department of Revenue to establish an online seller's portal

- ❖ All out of state E-commerce transactions are to be collected and remitted via a state portal
- ❖ Easier for all involved business and locals.
- ❖ Factors in different rates
- ❖ Tax is sourced based on destination

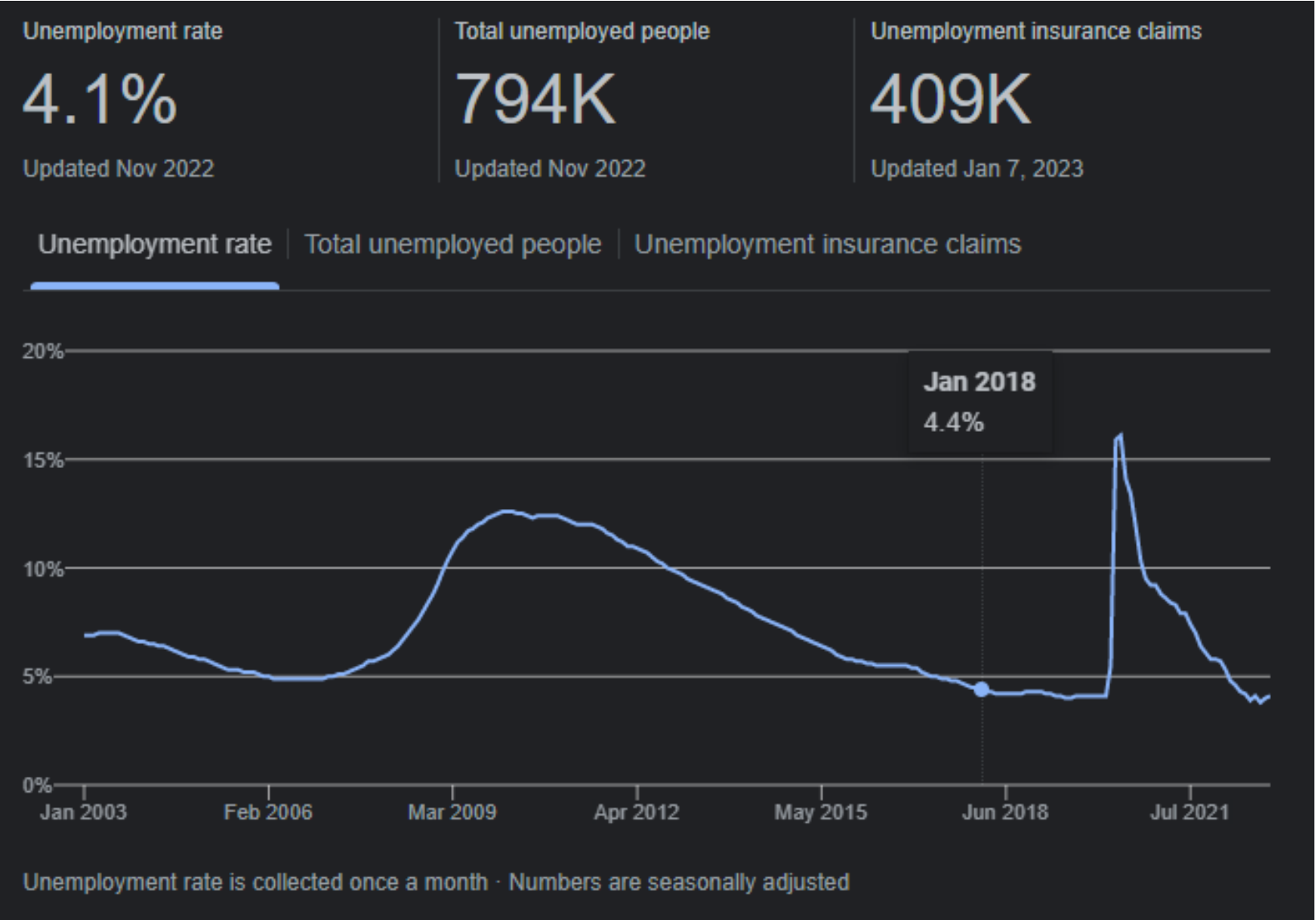
LARS System Collections

- ❖ Over \$1 billion in December 2022
- ❖ Parish eFile: 17,272,874 sales tax returns processed since 1999
- ❖ Over 2 million returns for over \$3 billion per year



Avenu administers the portal for the State of Louisiana and for most of the parishes in the state

California Unemployment



Unemployment rate

Total unemployed people

Unemployment insurance claims



