

**Metropolitan Transportation Commission
Programming and Allocations Committee**

April 10, 2019

Agenda Item 4a

Sales Tax Policy in California and Transportation Development Act Reform

Subject: Discussion of the impacts of the *South Dakota v. Wayfair, Inc.* decision on the sales tax in California as well as information on the Transportation Development Act (TDA) Reform Task Force recently established by the State Legislature. This item follows up to a request by the Committee for more information.

Background: **Sales and Use Tax Remittance from Out of State Retailers:** The June 2018 U.S. Supreme Court decision in *South Dakota v. Wayfair Inc.* represents the most significant change to federal policy governing sales and use tax policy in decades. In the 5-4 ruling the Court held that states are allowed to require retailers with no physical presence (e.g. store, office, or warehouse) in their state to collect and remit sales and use taxes on behalf of customers located in that state.

In December 2018, the California Department of Tax and Fee Administration (CDTFA) announced that as of April 1, 2019 all retailers making sales of at least \$100,000 through a minimum of 200 separate transactions in a calendar year to customers in California, regardless of the retailer's physical location, will be required to collect and remit all statewide and local option sales and use taxes.

In 2018 an estimated 23% of the state's e-commerce retail purchases were from retailers not required to collect sales and use tax at the time of sale, placing the burden of remitting use tax wholly on the consumer (through their California state income tax filing). Not surprisingly, consumer reporting rates are incredibly low, which has resulted in a multimillion dollar "tax gap" from unreported out-of-state retailer e-commerce transactions. This "tax gap" is expected to significantly decrease following the *South Dakota vs. Wayfair, Inc.* ruling.

The CDTFA and Board of Equalization estimate that e-commerce transactions could generate \$3.4 billion annually in additional sales and use tax revenue, including \$925 million annually in revenues for local jurisdictions, with approximately \$210-\$215 million in additional revenue for the Bay Area. This estimate is based on the statewide 1.25% Bradley-Burns tax, of which 1% is allocated by the state to cities and counties to use at their discretion. The other 0.25% is distributed to counties to support transportation programs in accordance with the Transportation Development Act (TDA). Special district tax revenues and additional local add-on sales taxes, such as local self-help county sales tax revenues, vary by local jurisdiction and an average special district rate of 0.96% is used in this estimate. Details are included in Table 1 below.

Table 1. State & Local Shares of E-Commerce Retail Sales & Use Tax (in Millions of \$)

E-Commerce Revenue Type	Estimated Revenue
California Taxable E-Commerce Retail Sales	\$ 41,839
California 2016 E-Commerce Retail Tax Revenue	\$ 3,435
Local Share (Bradley-Burns plus special district taxes)	\$ 925
City and County Bradley-Burns Share (1% tax rate)	\$ 418
Transportation Development Act (0.25% tax rate)	\$ 105
Special District Share (0.96% weighted average tax rate)	\$ 402
Bay Area Share (23% of statewide sales tax revenue)	\$ 213
State Share (6.00% tax rate)	\$ 2,510

Source: MTC, based on analysis of CDTFA/Board of Equalization data

While the CDTFA policy went into effect on April 1, 2019, the State Legislature is currently considering modifications to California's policy on requiring out-of-state retailers to collect sales and use tax. One bill currently in the State Legislature is Assembly Bill (AB) 147 (Burke) which the Commission took a support position on in March 2019. AB 147 would increase the sales threshold to trigger out-of-state retailers to collect sales and use tax from \$100,000 to \$500,000 among other changes.

E-Commerce Tax Revenue Allocation (Point of Sale Issue): The state's current allocation structure for e-commerce sales and use tax revenues rewards jurisdictions with large numbers of warehouses, distribution centers, or other sales offices over jurisdictions with large numbers of residents making e-commerce purchases. State law directs California retailers to assign local (Bradley-Burns) tax revenues based on the "point of sale" for a transaction. However, this gives retailers that make Internet sales or ship goods to customers across jurisdictional borders discretion to allocate sales to various locations, including warehouses, distribution centers or sales offices. The "point of sale" is not identified as the destinations to which goods are shipped, thus depriving jurisdictions with large numbers of residents making e-commerce purchases the benefit of the tax revenue associated with those purchases.

The "point of sale" distribution of Bradley-Burns sales tax disproportionately benefits certain counties that have high concentrations of warehouses and industrial facilities. The California State Auditor conducted an analysis in 2017 which examined the share of a county's Bradley-Burns sales tax revenues which were attributed to goods shipped to a California customer outside the county. San Bernardino County, San Joaquin County, and Alameda County all have high concentrations of warehouses and industrial facilities. As a result they receive a significant 21%, 16%, and 20% respectively of their Bradley-Burns sales tax revenues from the sale of goods shipped to other counties. By contrast, the average percentage of Bradley-Burns sales tax revenues a county receives from the sale of goods shipped to other California counties is only 10-14% (there has been some variation over the last decade). In the Bay Area, counties in the North Bay and along the Peninsula with smaller warehousing and industrial sectors likely receive a disproportionately small share of their Bradley-Burns sales tax revenues from the sale of goods shipped to other counties. These counties would likely see additional revenue should the state move to a "point of delivery" (where the customer is located) system for distributing Bradley-Burns sales tax revenues (see next section).

South Dakota vs. Wayfair Inc. is a Win for Every Jurisdiction, Point of Sale Issue Creates Winners and Losers: *South Dakota v. Wayfair Inc.* will result in additional sales tax revenue for every California jurisdiction as the ruling requires sales and use tax revenues to be remitted for nearly all transactions involving a California customer. Prior to the *South Dakota v. Wayfair Inc.* ruling, State Senator Steve Glazer introduced SCA 20 (2018) and SB 1466 (2018), which would have affected retailers that have a physical presence in California but ship/deliver their goods to customers in a different California jurisdiction from where they are located. This bill would have affected a different set of retailers than those impacted by *South Dakota v. Wayfair Inc.* and as such addresses a different issue than *South Dakota v. Wayfair Inc.* SB 1466 died in the State Legislature last year based on opposition from the Inland Empire and Central Valley and concern from the League of California Cities.

SCA 20 (2018) and SB 1466 (2018) would have created “winners” and “losers” by requiring the CDTFA to redefine how it distributes Bradley-Burns sales tax revenues from a “point of sale” (where the warehouse is located) system to a “point of delivery” (where the customer is located) system. Such a shift would likely result in a decrease in sales tax revenues to jurisdictions with concentrations of warehouses for online retailers (primarily in the Inland Empire and Central Valley) and an increase in revenue for jurisdictions with high populations or wealthier populations (primarily in the Bay Area, Los Angeles County, Orange County, and San Diego County). In 2019 State Senator Glazer introduced SB 531 which would prohibit local governments from agreeing to offer economic incentives to retailers shipping goods (mostly warehouses) in exchange for that retailer attributing their sales tax for shipped goods to that local jurisdiction. MTC staff expect the “point of sale” vs. “point of delivery” issue to remain controversial and likely to reappear in the State Legislature in the future.

Transportation Development Act Reform Task Force: In August 2018 Assemblymember Jim Frazier and State Senator Jim Beall, the chairs of the transportation committees in each house of the State Legislature, wrote to the California Transit Association (CTA) calling for the establishment of a “Task Force of stakeholders . . . to thoroughly examine the current TDA performance measures for both LTF and STA and propose new, updated standards for the Legislature to consider.” A copy of the letter is included with this item as Attachment 1. A key area of focus for the Task Force is whether the TDA statutes’ focus on farebox recovery ratio (transit fare revenue divided by transit operating costs) is the appropriate measure for evaluating a transit operator’s performance in 2019. Farebox recovery ratio does little to encourage transit ridership or improvements in service focused on increasing ridership. Given the state’s emphasis on public transit as a key plank in strategies to reduce greenhouse gas emissions, reduce congestion, and promote economic opportunity, an alternative measure may be more appropriate. Over the nearly five decades since the TDA statutes were first written, dozens of exceptions and special sections have been amended into the TDA statutes, and Assemblymember Frazier and Senator Beall have expressed an interest in reducing the need for special one-off bills in the State Legislature to address performance challenges in an individual area of the state.

MTC is a member of the Task Force along with a number of other transit operators from the Bay Area and around the state including Santa Clara VTA, SamTrans/Caltrain, and the Central Contra Costa County Transit Authority. The Task Force has met twice to date, in February and March, and will continue its work throughout 2019, with the goal of drafting legislation to modernize the TDA program and its performance measures. Ideally this legislation would be considered by the Legislature in 2020.

Recommendation: Information item.

Attachments: Attachment 1 – Letter from Assemblymember Jim Frazier and State Senator Jim Beall to the California Transit Association
Presentation slides

California Legislature

August 8, 2018

Mr. Joshua W. Shaw, Executive Director
California Transit Association
1415 L Street, Suite 1000
Sacramento, CA 95814

Re: Request for Review of the Transportation Development Act

Dear Mr. Shaw:

On behalf of the transportation policy committees of the California State Legislature, we are writing to request the California Transit Association (CTA) spearhead a Transportation Development Act Policy Task Force to fully examine performance measures for our state's public transportation system and produce a legislative recommendation for any reforms or changes to the current programs.

As you are aware, the Transportation Development Act (TDA) was crafted in the 1970s to provide a funding scheme for the state's public transportation system. TDA governs the expenditure of billions of dollars of funding for a wide variety of transit services in California. Specifically, TDA is funded by a ¼ cent statewide sales tax known as the Local Transportation Fund (LTF), and the sales tax on diesel fuel known as State Transit Assistance (STA). These funding streams are distributed to transit operators and regional transportation planning agencies (RTPAs) through long held statutory formulas. Additionally, there are different performance requirements attached to the two programs and the programs are linked, so performance outcomes in one can affect the other.

It has come to our attention in recent years that the performance measures developed in TDA law, including farebox recovery ratio, may not be adequate to meet the needs and overall transportation goals of our state. Additionally, it is our understanding that other states, and even our own California State Transportation Agency (CalSTA), have revised measurements and moved to newer standards.

As the state and regions continue to work toward the goal of reducing greenhouse gas emissions, as well as cutting other forms of air pollution, increasing the mode shift from single occupant car trips to public transportation is critical for success. Additionally, providing alternative modes of transportation helps relieve congestion on our highways, increasing the quality of life for commuters and assisting with the movement of goods throughout our state. The state remains committed to providing funding for public transit. In fact, with the recent passage of SB 1 (Beall), Chapter 5, Statutes of 2017, STA funding increased by roughly 130 percent.

Mr. Joshua Shaw
August 8, 2018
Page 2

As funding partners in these systems, the state must be able to measure performance outcomes to help guide future state policies. If the current system is not adequate, then the Legislature must consider alternatives.

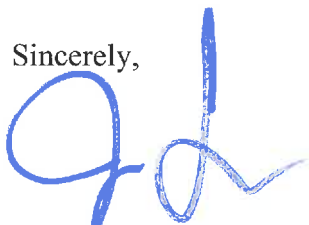
To that end, we are requesting that CTA convene a Task Force of stakeholders, including but not limited to, transit operators from both urban and rural areas; RTPAs from both urban and rural areas; the Administration; and relevant academics to thoroughly examine the current TDA performance measures for both LTF and STA and propose new, updated standards for the Legislature to consider. The Task Force should consider, but not be limited to, the following:

- Issues of overall service of transit agencies, e.g. providing reliable service to commuting populations while also providing service for the elderly and disabled;
- Issues of population and population density differences, such urban versus rural service areas;
- Issues of funding, including federal, state, and local sources;
- Issues of capital and operations, e.g how do we measure performance of both capital assets and the operation of the systems;
- Issues of state oversight, e.g. which state department or agency should be responsible for transit system oversight and reporting; and,
- General issues of TDA law that should be examined, e.g. whether LTF funds should be spent on local streets and roads.

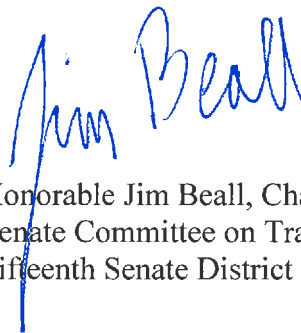
We would request that the Task Force complete their work by the Fall of 2019, so that any legislative recommendations could have full consideration during the 2020 legislative year.

We thank you in advance for taking on this monumental task and partnering with the Legislature to update TDA. Please contact Melissa White, with Assembly Transportation Committee, at melissa.white@asm.ca.gov, or Manny Leon, with Senate Transportation and Housing Committee, at manny.leon@sen.ca.gov, with any questions.

Sincerely,



Honorable Jim Frazier, Chair
Assembly Committee on Transportation
Eleventh Assembly District



Honorable Jim Beall, Chair
Senate Committee on Transportation and Housing
Fifteenth Senate District



Photo: TJX

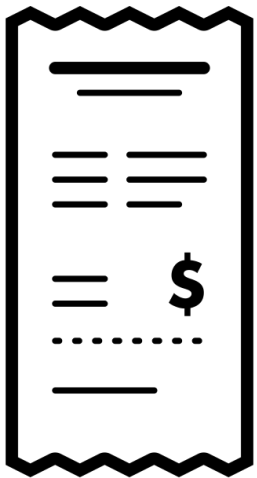


Sales Tax Policy in California and Transportation Development Act (TDA) Reform

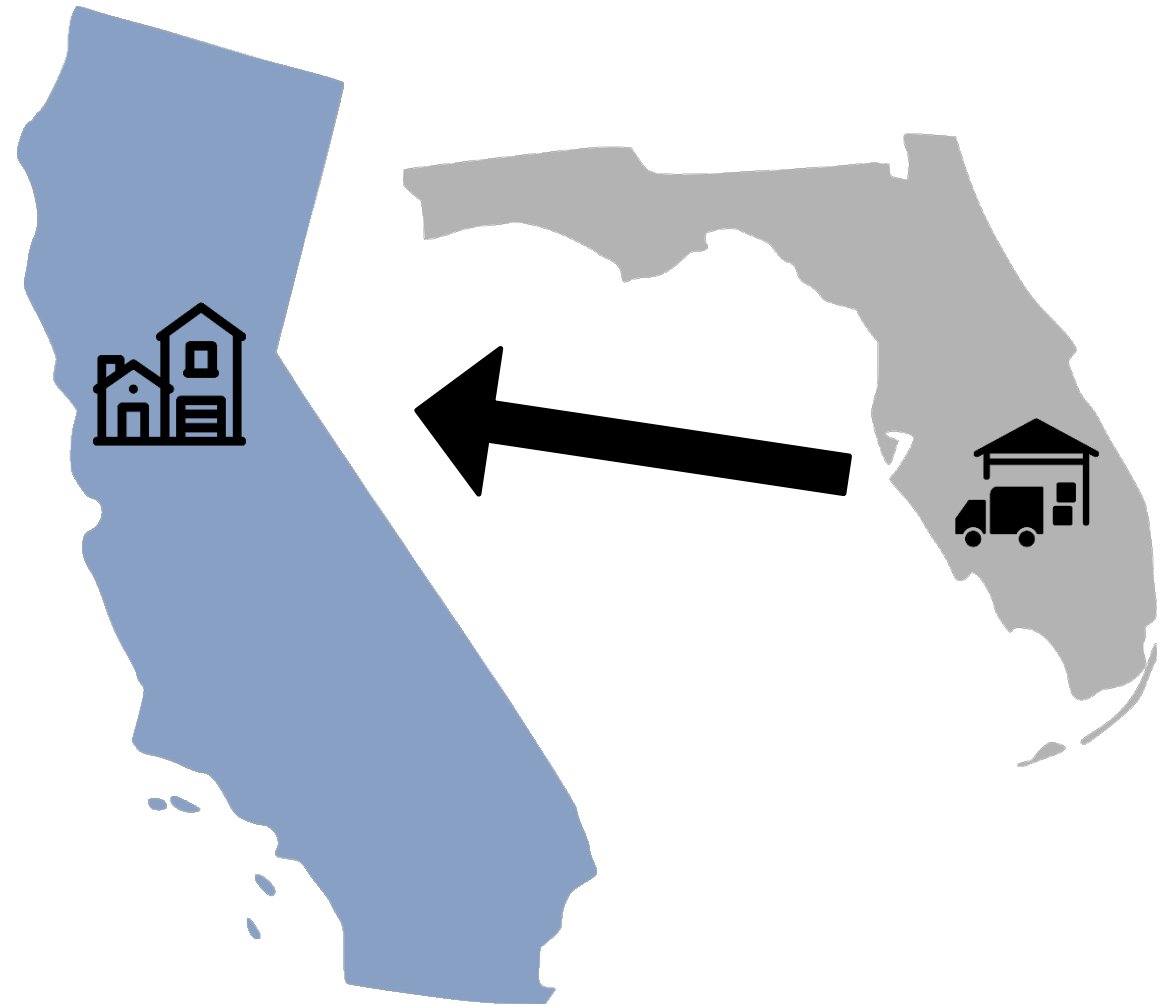
Programming and
Allocations Committee
April 10, 2019
Item 4a

South Dakota v. Wayfair Inc.

U.S. Supreme Court ruling allowing **states to require out of state retailers to collect and remit sales taxes** for sales made to their state, overturned *Quill Corp. v. North Dakota* (1992)



In this example, under the *South Dakota v. Wayfair Inc.* ruling a retailer in Florida that sells a product to a customer in San Francisco could be **required to collect the 8.5% sales tax applicable in the City and County of SF.**



***South Dakota v. Wayfair Inc.* = More Revenue for Every Jurisdiction**

Approx. **\$3.4 Billion** in new revenue statewide

Approx. **\$213 Million** in new revenue for
Bay Area local jurisdictions and special districts

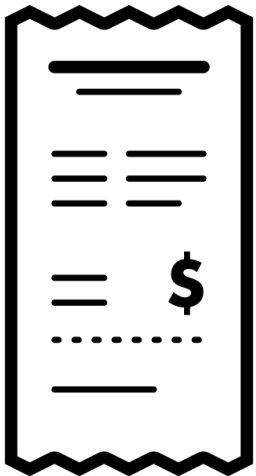


“Point of Sale” vs. “Point of Delivery”

Retailers with a physical presence in California

delivering goods to another California jurisdiction have the choice to attribute the sales tax they collect, to the “point of sale” (e.g. warehouse) or to the “point of delivery” (e.g. location of the purchaser)

Some local jurisdictions have offered businesses **subsidies** in exchange for the business attributing sales tax to their jurisdiction.



In this example a business located in Concord that is shipping a product to a customer in San Jose can decide whether to collect and attribute Concord’s 8.75% sales tax rate or San Jose’s 9.25% sales tax rate.

Depending on the decision of the business either Concord or San Jose will receive sales tax revenues



Transportation Development Act Reform Task Force

TDA law governs the use of over \$4 billion a year in funding for transit in California through several programs:

- Local Transportation Fund ¼ Cent Sales Tax - *\$430 million in the Bay Area*
- State Transit Assistance - *\$284 million in the Bay Area*
- State of Good Repair Program - *\$40 million in the Bay Area*
- Low Carbon Transit Operations Program - *\$44 million in the Bay Area*

August 2018 letter from the Legislature to the California Transit Association (CTA) calling for a TDA Reform Task Force to determine if the performance measures and qualification standards in TDA law, which focus on farebox recovery still make sense in 2019.

Task Force consists of regional agencies (including MTC) and transit operators from around the state

Goal is to make a proposal to the Legislature towards the end of the year

