

*City Managers Sales Tax Working Group Meeting
August 30, 2018 – Updated*

ANALYSIS

This document includes the requested analysis per the August 2 & August 16, 2018 League City Managers Sales Tax Working Group meetings that considers:

- Financial impacts of various possible arbitrary splits (25/75; 50/50; and 75/25) between point of sale (origin) and destination for sales taxes derived from online sales.
- Magnitude and incidence (variation of effects among cities) of a shift to destination on sales/use tax revenues from business to business transactions.

The analysis quantifies the impacts of a destination-based sales tax allocation that considers several influencing variables including, city population, effective buying (household) income, and businesses with online sales that would be diverted from Bradley Burns point-of-sale to destination allocations. The basic analysis does the following:

1. Identifies all business in an agency most likely to do business online, utilizing county pool data and Transactions & Use Tax (TUT) data for those agencies with a TUT.
2. Confirms businesses that generate sales tax revenues from online transactions via TUT.
3. Determines the amount of TUT sales tax generated from online transactions in agencies that do not have a TUT. This is done through finding a correlation between sales tax data for agencies with TUT's and the demographic factor of five-year aggregate household income. The correlation between the amount of destination-based sales tax at 1% and the five-year aggregate household income of each city resulted in an R-squared value of 0.96. Zero (0) being no correlation and 1 being perfect correlation. (Source: Nielsen)

The analysis considers all city and unincorporated county five-year aggregate household income and applies the equation from the linear regression to each city and county to calculate the amount of sales tax they would receive using point-of-destination sourcing rules. We then compared that number to their Bradley Burns portion from online sales to measure the gain or loss.

A final step would be to evaluate the top 100 businesses to determine the likelihood of those business shifting to online sales – and projecting the related revenue loss. The included analysis has not taken this additional step.

APPROACH

As previously presented, Attachment A identifies five sample cities with different populations, economic development constructs, and local economies to provide a synopsis of varying degrees of impact. To clarify, these cities were randomly selected to be somewhat representative of different population and economic bases throughout the state. Any number of different cities can be selected for this analysis.

It was noted during the August 16 meeting that two cities had the same sales tax amounts, which appeared to be an error. It was not an error. The sales tax amounts were rounded, so they appeared to be the exact number. The amounts now reflect the precise numbers. These two cities have similar estimated sales tax loss amounts of about \$3 million under a 100% destination allocation. However, while the loss value is similar, these are very different cities: city #1 is a large urban city and city #3 is small suburban city. While any loss of local revenue is unacceptable, the loss for City #1 is minimal compared to that of City #3 based on overall sales tax revenues and size and composition of the cities.

DISCUSSION OPTIONS FOR A BROADER APPROACH TO REFORM

- **Modernize:** Broaden sales tax to services and digital downloads; increase flexibility of the regulations to meet the challenges and changes of the future.
- **“Pooling”:** End pooling of online retail sales, third party vehicle sales made at DMV, and lower threshold to \$100,000 from \$500,000 on out of state sales.
- **Destination Sourcing:** Allocate local sales tax to the destination of buyer for *all* on-line retail sales.
- **Exemptions:** Remove as many of the existing exemptions as politically and practically possible.
- **“Rebates” / Warehouse Distribution: Rebates/ Incentives:** “Revisit” the intent of SB 533 from 2015 as part of the overall SCA 20 and tax reform discussion and whether the law is working for all local governments. MuniServices analysis identified 90 warehouse distribution centers with the highest volume point of sale (POS) sales tax – since there are more than 90 warehouse distribution centers statewide.
 - POS that generate about \$138 million annually (excluding Amazon.com and other pool allocations) – with projected losses of tax revenue closer to \$40 - \$60 million.

POLICY UPDATE

<https://www.avenuinsights.com/2018/05/25/changing-the-way-online-sales-revenue-gets-distributed-the-issues-go-beyond-online-sales/>

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**SAMPLE CITIES - ESTIMATED IMPACTS OF DESTINATION-BASED SALES TAX DISTRIBUTION
ATTACHMENT A**

1. Large Urban City

Population: 1.3 – 1.5 million
 Economic Composition: Urban, big box, mix of residential/commercial, significant tourism
 Per Capita Effective Buying Income: \$30,104
 Distribution Centers: YES
 Sales Tax Rebate Agreements: NO
 Annual Gross Sales Tax: \$220 million - \$250 million

Potential Change in Sales Tax

Destination-based Allocation			
100%	75%	50%	25%
(3,135,250)	(2,351,437)	(1,567,625)	(783,812)

2. Medium Urban City

Population: 200,000 – 300,000
 Economic Composition: Urban, distribution centers, well-developed, robust economy, strong business to business, retail and auto sales
 Per Capita Effective Buying Income: \$38,585
 Distribution Centers: YES
 Sales Tax Rebate Agreements: NO
 Annual Gross Sales Tax: \$55 million - \$75 million

Potential Change in Sales Tax

Destination-based Allocation			
100%	75%	50%	25%
(789,266)	(591,950)	(394,633)	(197,317)

3. Small Suburban City

Population: 15,000 – 20,000
 Economic Composition: Industrial hub, no big box, industrial focus, large business to business, no rebate agreements, relatively smaller population, low household income
 Per Capital Effective Buying Income: \$17,508
 Distribution Centers: YES
 Sales Tax Rebate Agreements: NO
 Annual Gross Sales Tax: \$19 million - \$25 million

Potential Change in Sales Tax

Destination-based Allocation			
100%	75%	50%	25%
(3,180,182)	(2,385,137)	(1,590,091)	(795,046)

4. Small suburban city

Population:	15,000 – 20,000
Economic Composition:	Suburban - bedroom, limited development, limited retail, no distribution centers
Per Capita Effective Buying Income:	\$74,445
Distribution Centers:	NO
Sales Tax Rebate Agreements:	NO
Gross Annual Sales Tax:	\$875,000 – \$975,000

Potential Change in Sales Tax

Destination-based Allocation			
100%	75%	50%	25%
1,272,232	954,174	636,116	318,058

5. Medium Urban city

Population:	450,000 – 550,000
Economic Composition:	Urban, well-diversified development, mix of residential/commercial/retail/B2B/construction
Per Capita Effective Buying Income:	\$22,242
Distribution Centers:	YES
Sales Tax Rebate Agreements:	NO
Gross Annual Sales Tax:	\$65 million - \$75 million

Potential Change in Sales Tax

Destination-based Allocation			
100%	75%	50%	25%
(1,623,263)	(1,217,447)	(811,631)	(405,816)