

Date of Hearing: June 28, 2023

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT

Cecilia Aguiar-Curry, Chair

SB 862 (Laird) – As Amended June 13, 2023

SENATE VOTE: 39-0

SUBJECT: Santa Cruz Metropolitan Transit District: transaction and use tax rates.

SUMMARY: Specifies that a Transactions and Use Tax (TUT) imposed by the Santa Cruz Metropolitan Transit District (SC Metro) shall not be considered for the purposes of the 2% combined rate limit if specific conditions are met. Specifically, **this bill:**

- 1) Specifies that a TUT rate imposed by SC Metro shall not be considered for purposes of the combined rate limit established by law, if both of the following conditions are met:
 - a) The board adopts the ordinance approving a tax before January 1, 2035.
 - b) The total tax rate excluded from consideration by 1) above, from the combined rate limit established by law shall not exceed 1%.
- 2) Finds and declares that a special statute is necessary and that a general statute cannot be made applicable because of the unique fiscal pressures being experience in the County of Santa Cruz.

EXISTING LAW:

- 1) Provides that a retail TUT may be adopted by the SC Metro board in accordance with law, provided that two-thirds of the electors voting on the measure vote to authorize its enactment at a special election called for that purpose by the SC Metro board. [Public Utilities Code (PUC) § 98290]
- 2) Specifies that a TUT rate imposed pursuant to 1) above, on or before January 1, 2020, shall not be considered for the purposes of the combined rate limit established by law. (PUC § 98290)

FISCAL EFFECT: None.

COMMENTS:

- 1) **Sales and Use Taxes.** State law imposes the sales tax on every retailer “engaged in business in this state” that sells tangible personal property, and requires them to register with the California Department of Tax and Fee Administration (CDFTA), as well as collect the appropriate tax at purchase and remit the amount to CDFTA. Sales tax applies whenever a retail sale occurs, which is generally any sale other than one for resale in the regular course of business. The current rate is 7.25% as shown in the table below.

Rate	Jurisdiction	Purpose/Authority
3.9375%	State (General Fund)	State general purposes
1.0625%	Local Revenue Fund (2011 Realignment)	Local governments to fund local public safety services
0.50%	State (1991 Realignment)	Local governments to fund health and welfare programs
0.50%	State (Proposition 172 - 1993)	Local governments to fund public safety services
1.25%	Local (City/County) 1.00% City and County 0.25% County	City and county general operations Dedicated to county transportation purposes
7.25%	Total Statewide Rate	

Unless the purchaser pays the sales tax to the retailer, he or she is liable for the use tax, which the law imposes on any person consuming tangible personal property in the state. The use tax is the same rate as the sales tax, and also like the sales tax, must be remitted on or before the last day of the month following the quarterly period in which the person made the purchase.

- 2) **Transactions and Use Taxes.** The California Constitution states that taxes levied by local governments are either general taxes, subject to majority approval of its voters, or special taxes, subject to 2/3 vote (Article XIII C). Proposition 13 (1978) required a 2/3 vote of each house of the Legislature for state tax increases, and 2/3 vote for local special taxes. Proposition 62 (1986) prohibited local agencies from imposing general taxes without majority approval of local voters, and a 2/3 vote for special taxes. Proposition 218 (1996) extended those vote thresholds to charter cities, and limited local agencies' powers to levy new assessments, fees, and taxes. Local agencies generally propose to increase taxes by adopting an ordinance or a resolution at a public hearing.

State law allows cities, counties, and specified special districts to increase the sales and use tax applicable in their jurisdiction, also known as district taxes or TUTs. Prior to 2003, cities lacked the ability to place TUTs before their voters without first obtaining approval by the Legislature to bring an ordinance before the city council, and, if approved at the council level, to the voters. This was remedied by SB 566 (Scott), Chapter 709, Statutes of 2003. SB 566 also contained provisions to increase a county's TUT cap because of the possibility that certain counties were going to run out of room under their caps, if cities within those counties approved TUTs.

Generally, the combined TUT rate imposed within a local jurisdiction cannot exceed 2%. To determine whether a county has reached this rate limitation, all countywide taxes and the highest combined rate imposed by a city within the county are counted towards the county's

rate limit. For example, if a county imposes three 0.5% countywide taxes and two cities within the county each impose a 0.5% tax, the combined rate in those two cities would be 2%. In such a circumstance, the two cities could not impose another TUT, and the county could not impose another countywide TUT, absent special authority to exceed the rate limitation.

As of April 1, 2023, local jurisdictions impose a combined 411 TUTs for general or special purposes. Generally, TUTs are levied throughout the entire area of a single county, the entire unincorporated area within a single county, or a single incorporated city, except for those imposed by the Bay Area Rapid Transit (BART) District (Alameda, Contra Costa, and San Francisco counties) and the Sonoma-Marín Rail Transit District (Sonoma and Marin counties). Of the 411 TUTs, 67 are imposed countywide, four are imposed in unincorporated county areas, and 340 are imposed citywide.

- 3) **Santa Cruz County.** Santa Cruz County has eight district taxes levied within its borders—three countywide taxes (two for transportation purposes and one for public library purpose), one county unincorporated area tax, and four city-wide taxes. Currently, two of the three Santa Cruz County countywide district taxes remain subject to the 2.00% combined rate limitation, while one, the SC Metro, is exempt. The current TUT rate in the cities of Scotts Valley and Watsonville are 9.75%.

AB 723 (Quirk), Chapter 747, Statutes of 2019, exempted specified TUTs imposed by the San Francisco Bay Area Rapid Transit District (BART), the Alameda County Transportation Commission, and the SC Metro from counting against the combined tax rate limit in Alameda County and Santa Cruz County, respectively. SC Metro currently imposes a .5% TUT within Santa Cruz County.

- 4) **Bill Summary and Author’s Statement.** This bill specifies that a TUT rate of up to 1% imposed by SC Metro before January 1, 2035 is not considered for purposes of the 2% combined tax rate limit. SC Metro is the sponsor of this bill.

According to the author, “The Santa Cruz Metropolitan Transit District (Santa Cruz METRO) will soon be facing a fiscal cliff which threatens the public’s access to transit and our state’s climate goals. To address this, Senate Bill 862 will allow voters to decide if the county should raise the combined tax rate limit above 2%. If this proposal is approved, Santa Cruz METRO could go to the voters to generate additional revenue to address the agency’s fiscal needs, and continue to improve its services to meet state and local environmental, equity, and access objectives. This includes funding for its ParaCruz service, a paratransit service for those with various forms of functional needs, and making improvements to its fixed route bus service.”

- 5) **Policy Considerations.** The Committee may wish to consider the following:
 - a) **Too High?** California’s sales tax rate is currently at 7.25%, which is high compared to other states, especially when incorporating locally imposed TUTs. Some tax experts argue that sales and use taxes are regressive, meaning that the tax incidence falls more on low-income individuals than high-income individuals because those of lesser means generally spend a greater percentage of their income on taxable sales, instead of intangible products or services which are not taxed. With this bill, the sales tax rate could

grow higher than 10% in some areas of Santa Cruz County. While any increase would have to be approved by the voters, the Committee may wish to consider whether SB 862 allows for rates that are too high.

- b) **Is Clarity Needed?** In 2019, the Legislature approved, but the Governor vetoed AB 618 (Stone). This bill would have permitted the Cities of Emeryville (Alameda County) and Scotts Valley (Santa Cruz County) to impose a tax of up to 0.25% that exceeds the 2% cap. The veto message stated that it was unclear whether authorization was needed because both had room within the cap to impose the tax. In response, the Legislature enacted AB 723, which provided, among other provisions that the existing .5% SC Metro TUT did not count against the 2% cap in Santa Cruz County. This was a departure from the numerous bills directly authorizing agencies to impose a new tax above the 2% rate limit. Instead of explicitly allowing a tax above the cap, AB 723 created more room under it in Santa Cruz to impose new TUTs.

Due to the existing .5% TUT that was exempted by AB 723, the sponsors have indicated that this bill will ultimately allow SC Metro to prospectively impose an additional .5% TUT (for a total of 1%) that is not subject to the 2% combined rate limit. However, as currently drafted, it is not entirely clear how this bill will effect the exemption provided by AB 723. In order to avoid any potential confusion, the Committee may wish to consider if additional clarification is needed.

- 6) **Committee Amendments.** In response to the policy consideration above, the Committee may wish to consider amending the bill as follows:

98290. (a) A retail transactions and use tax ordinance may be adopted by the board in accordance with the provisions of Part 1.6 (commencing with Section 7251) of Division 2 of the Revenue and Taxation Code, provided that two-thirds of the electors voting on the measure vote to authorize its enactment at a special election called for that purpose by the board.

(b) Notwithstanding Section 7251.1 of the Revenue and Taxation Code, a transactions and use tax rate imposed pursuant to subdivision (a) **on or before January 1, 2020** shall not be considered for purposes of the combined rate limit established by that ~~section. section, if both of the following conditions are met:~~

~~(1) The board adopts the ordinance approving the tax before January 1, 2035.~~

~~(2) The total tax rate excluded from consideration by this subdivision from the combined rate limit established by Section 7251.1 of the Revenue and Taxation Code shall not exceed one percent.~~

(c)(1) In addition to any other taxes imposed pursuant to this section, the board may impose a retail transactions and use tax pursuant to subdivision (a) after January 1, 2024 if both of the following requirements are met:

(A) The board adopts the ordinance approving the tax before January 1, 2035.

(B) The total tax rate under this subdivision is set at a rate of no more than 0.5 percent.

(2) Notwithstanding Section 7251.1 of the Revenue and Taxation Code, a transactions and use tax rate imposed pursuant to this subdivision shall not be considered for purposes of the combined rate limit established by that section.

- 7) **Related Legislation.** AB 1256 (Wood) authorizes Humboldt County to impose a TUT that exceeds the 2% statutory limitation. AB 1256 was heard in this Committee on April 19 and passed with a 5-2 vote.

AB 1385 (Garcia) authorizes the Riverside County Transportation Commission to impose a maximum TUT of 1.5%. AB 1385 was heard in this Committee on May 3 and passed with a vote of 5-2.

SB 335 (Cortese) allows Santa Clara County to impose a TUT to support countywide programs and general services at a rate of no more than .625% that would, in combination with all taxes imposed, exceed the 2% cap established by law, if specified conditions are met. SB 335 is currently pending in this Committee.

- 8) **Prior Legislation.** AB 618 (Stone) of 2019 would have permitted the Cities of Emeryville (Alameda County) and Scotts Valley (Santa Cruz County) to impose a tax of up to 0.25% that exceeds the 2% cap. AB 618 was vetoed with a message that stated, “The Cities of Emeryville and Scotts Valley have not yet reached the statewide cap of 2 percent, making it unclear why additional tax authority is needed.”

SB 1349 (Glazer), Chapter 369, Statutes of 2020, permitted Contra Costa County, and cities within Contra Costa County, additional legal flexibility to impose local TUTs.

AB 2453 (Bennett), Chapter 286, Statutes of 2022, authorized the Ventura County Transportation Commission to impose a TUT of no more than 0.5% that does not count against the cap in Ventura County.

- 9) **Arguments in Support.** According to SC Metro, “The tax measure this bill would authorize is critical to METRO’s long-term fiscal health and to maintaining and expanding access to transit service to most vulnerable California in METRO’s service territory.

“Current law authorizes cities, counties, and special districts to increase the transaction and use tax applicable in their jurisdiction to fund local priorities, including transportation projects and services. Current law also generally caps the total of all transaction and use taxes in a county (or combined rate) at 2%. That said, the Legislature has routinely reviewed and provided exemptions to the 2% limit to localities and special districts via statute, thus authorizing greater taxing capacity in these jurisdictions, to further support local priorities. SB 862 builds on the past practice, which supports ‘self-help’ by providing that a transaction and use tax rate of up to 1% imposed by Santa Cruz METRO’s Board of Directors before January 1, 2035, is not considered for purposes of the 2% combined tax rate limit in the County of Santa Cruz. In doing so, SB 862 would authorize METRO to pursue a transaction and use tax above the combined tax rate limit in 2024, as is currently being scoped.

“Metro is pursuing a new tax measure in 2024 to: 1) address an impending fiscal cliff caused by higher capital and operating costs and the impacts of the COVID-19 pandemic on the agency’s ridership and revenue streams; 2) offset growing cost pressures associated with, and deliver service improvements to, METRO’s ParaCruz service; and 3) continue to enhance its fixed route service. In pursuing this new tax measure, METRO would be heeding the Legislature’s guidance to California’s transit agencies to take local actions to address funding challenges and to continue to improve transit service to grow ridership and deliver

environmental, mobility, and access benefits to Californians. This measure is a critical component of METRO's efforts to double its ridership and revamp its system."

- 10) **Arguments in Opposition.** According to the California Taxpayers Association, "California has the highest state-level sales and use tax rate in the country, and several cities in California, including Santa Cruz, have even higher rates. The sales and use tax is a regressive tax that has the greatest impact on low-income residents because it makes it more expensive for these taxpayers to purchase everyday necessities. Inflation has increased the cost of everyday goods, which in turn increases the sales tax that is imposed as a percentage of the retail price. Adding even more to the cost of living with a sales tax increase would harm Californians, and will disproportionately impact the state's most vulnerable residents.

"...Businesses engaged in manufacturing and research-and-development activities face a significant sales and use tax burden in California. Under existing law, when a business purchases manufacturing or R&D equipment, the purchase is subject to a one-time local sales tax of 1.25 percent plus any additional voter-approved transactions and use taxes. Taxing business inputs increases overall production costs for everyday goods produced in California. Authorizing Santa Cruz to exceed the 2 percent transactions and use tax cap would increase the cost of doing business for critical industries in the area.

"...Unlike the federal government, which receives an exemption for all state and local sales taxes, purchases made by municipal and state agencies are subject to state and local sales taxes. Increasing the local sales tax would increase costs for purchases made by cities and counties, public school districts, and universities operating in the county.

"...In 1953, the Senate Committee on State and Local Taxation recommended that California adopt a uniform state and local sales tax with a rate cap. The committee reported that with a cap, the local sales tax would have a 'minimum adverse' impact on taxpayers. The committee noted the following principles to consider when adopting sales tax changes: '[Local sales and use taxes] may and frequently do place unduly heavy compliance costs upon retailers'; and 'Local business taxes levied under various ordinances and at different rates may produce artificial and unfair discrimination between retailers in the jurisdictions.' The cap has served the state well, and should not be circumvented."

- 11) **Double-Referral.** This bill is double-referred to the Assembly Committee on Revenue and Taxation.

REGISTERED SUPPORT / OPPOSITION:

Support

Santa Cruz Metropolitan Transit District [SPONSOR]

Opposition

California Taxpayers Association

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