

THE CITY ATTORNEY

CITY OF SAN DIEGO

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MEMORANDUM OF LAW

DATE: August 10, 2011

TO: Russ Gibbon, Economic Growth Services

FROM: City Attorney

SUBJECT: Proposed Business Cooperation Agreement between the City of San Diego and Advanced Particle Therapy, LLC for a Tax Rebate

INTRODUCTION

According to a press release issued on August 5, 2010,¹ Scripps Health, Scripps Clinic Medical Group, and Advanced Particle Therapy (APT), LLC, have joined together to create the first facility in San Diego County to offer advanced proton therapy to cancer patients. Construction on the \$185 million Scripps Proton Therapy Center began in October 2010 in the Carroll Canyon area of Mira Mesa in the City of San Diego. The 102,000-square-foot center is expected to open for patient care in the spring of 2013.

The facility's centerpiece is a 90-ton cyclotron valued at \$90 million. The cyclotron accelerates protons to roughly 100,000 miles per second, creating a beam that can reach tumors up to 14 inches deep.

Scripps Health will provide clinical management services; Scripps Clinic Medical Group will oversee medical services; and APT is financing the construction and purchasing the cyclotron from Varian Medical Systems (Varian). Varian will construct the cyclotron in Germany and ship it directly to the San Diego construction site where it will be housed until it is used in 2013.

City of San Diego (City) staff has informed us that Varian has a "valid seller's permit with multiple locations" on file with the California State Board of Equalization (SBOE),² and that all sales negotiations have occurred between APT and Varian representatives through field offices outside of California.

¹ See http://www.scripps.org/news_items/3738-scripps-proton-therapy-center-breaks-ground.

² Varian has several manufacturing plants in California.

City staff has asked whether APT may qualify for a tax rebate under the "Business and Industry Incentive Program" created by City Council Policy (CP) 900-12.³ According to City staff, APT would take "whatever steps necessary and appropriate" to ensure the City receives all Bradley-Burns local tax associated with APT's purchase of the cyclotron. In exchange, the City would rebate 25% of the tax proceeds associated with the purchase of the cyclotron.

QUESTIONS PRESENTED

1. How is the 1% local use tax for individual sales and purchases of personal property allocated when the property is delivered from an out-of-state inventory?
2. Is it a gift of public funds if the City rebates 25% of the tax proceeds associated with the purchase of the cyclotron to APT?

SHORT ANSWERS

1. When property valued at \$500,000 or more is delivered to a California purchaser from out-of-state inventories, the local use tax proceeds are allocated to the city or unincorporated county area where the first functional use will occur. City staff can track proper allocation, and relief may be sought from the SBOE if funds are misallocated.
2. It would be a gift of public funds if the City rebates 25% of the tax proceeds associated with the purchase of the cyclotron to APT, because the City is entitled to the tax proceeds regardless of whether it enters into an agreement with APT.

ANALYSIS

A. WHEN PROPERTY VALUED AT \$500,000 OR MORE IS DELIVERED TO A CALIFORNIA PURCHASER FROM OUT-OF-STATE INVENTORIES, THE LOCAL USE TAX PROCEEDS ARE ALLOCATED TO THE CITY OR UNINCORPORATED COUNTY AREA WHERE THE FIRST FUNCTIONAL USE WILL OCCUR

The Bradley-Burns Uniform Local Sales and Use Tax Law allows counties to raise revenue by imposing up to a 1.25% sales tax on retail sales of "all tangible personal property" sold in the county, and a 1.25% use tax on "tangible personal property purchased from any retailer for storage, use or other consumption in the county." Cal. Rev. & Tax. Code §§ 7202-7203. The City has adopted a one percent (1%) sales and use tax that is administered and collected by the SBOE on its behalf. San Diego Municipal Code § 32.51.

³ CP 900-12 permits City staff to rebate up to 25% of sales or use taxes paid by a business if such sales or use tax constitute previously uncollectable revenue to the City, and the business pays its sales or use tax to the SBOE properly reporting San Diego as the situs of sale or use.

The issue at hand is the proper allocation of use tax generated by the purchase of the cyclotron, which is worth more than \$500,000, and will be manufactured and shipped directly from Germany to San Diego.

As mentioned, Varian has a “valid seller’s permit with multiple locations” on file with the SBOE. This means Varian collects use tax from the purchaser and pays the tax when it submits its sales and use tax return.⁴

The SBOE Tax Information Bulletin dated September 1999⁵ provides guidelines for allocating the 1% local use tax on individual sales, and purchases of \$500,000 or more when the property is delivered from out-of-state inventories. It states:

When your sales or purchases are subject to the 1% local use tax and are delivered from out-of state inventories, you are required to allocate the 1% local use tax to the *city or unincorporated county area where the first functional use will occur*. (Functional use means the use for which the subject property is designed or intended). Do not allocate the 1% local use tax based on a general countywide designation.⁶

Make your allocations for such sales or purchases on Schedule F, “Detailed Allocation of 1% Uniform Sales and Use Tax.” If you require a Schedule F and one is not provided with your return, please contact our Information Center.

For individual sales or purchases of less than \$500,000, you may continue to allocate the 1% local use tax as you have in the past.

Since Variant will deliver the cyclotron to San Diego from inventories located outside California, Variant is required to allocate the 1% local use tax to the City using Schedule F because the first functional use of the cyclotron will occur in the City.⁷

City staff’s concern about proper tax allocation is certainly warranted. Nevertheless, APT’s purchase of the cyclotron is widely publicized, and City staff can easily monitor the arrival of this equipment. Tax attaches when APT first uses, stores, or consumes the item in California. In this case, tax will attach when the cyclotron is delivered, as APT will not use the cyclotron until 2013, when construction is complete.

⁴ If Varian did not have a seller’s permit, it could voluntarily collect the tax and submit it to the SBOE. The purchaser is otherwise required to report and pay use tax.

⁵ See, www.boe.ca.gov/news/pdf/sep99fnl.pdf.

⁶ Tax allocation cannot be made using Schedule B.

⁷ We confirmed this information with Bonnie Bonnell from the State Board of Equalization on August 3, 2011. Her direct phone number is 760.213.9662.

If tax is not properly allocated to the City, the City may request an investigation of suspected misallocation of local tax by sending a petition to the SBOE's Allocation Group. Cal. Code Regs. tit. 18, § 1807. "The petition must contain sufficient factual data to support the probability that local tax has been erroneously allocated and distributed." *Id.* Sufficient factual data should include the taxpayer name, permit number, business address, a complete description of the taxpayer's business activity or activities, specific reasons and evidence why the taxpayer's allocation is questioned, the contact person's name, title, and telephone number, and the tax reporting periods involved. *Id.*

The SBOE's Allocation Group reviews the petition and issues a written decision to grant or deny the petition, including the basis for that decision. A reallocation is made if the preponderance of evidence, whether provided by petitioner or obtained by Board staff as part of its investigation of the petition, shows that there was a misallocation.

B. IT WOULD BE A GIFT OF PUBLIC FUNDS IF THE CITY REBATES 25% OF THE TAX PROCEEDS ASSOCIATED WITH THE PURCHASE OF THE CYCLOTRON TO APT

Article XVI, section 6 of the California Constitution, prohibits the legislature from "making of any gift, of any public money or thing of value to any individual, municipal or other corporation whatever. . . ." Cal. Const. art. XVI, § 6. Since the City is a charter city, it derives its powers from its own charter, rather than the legislature. *Los Angeles Gas & Electric Corp. v. City of Los Angeles*, 188 Cal. 307 (1922). The San Diego City Charter (Charter) likewise prohibits the gift of public funds. Charter section 93 states, in relevant part, that "[t]he credit of the City shall not be given or loaned to or in aid of any individual, association or corporation; except that suitable provision may be made for the aid and support of the poor." Cases interpreting the California Constitution prohibition are therefore instructive in interpreting Charter section 93.

An expenditure of public funds that benefits a private party constitutes an impermissible gift if the public agency does not receive adequate consideration in exchange or if the expenditure does not serve a public purpose. 2011 City Att'y Report 17 (11-17; April 7, 2011), referencing *People v. City of Long Beach*, 51 Cal. 2d 875, 881-83 (1959); *California School Employees Assn. v. Sunnyvale Elementary School District*, 36 Cal. App. 3d 46,59 (1973); *Allen v. Hussey*, 101 Cal. App. 2d 457,473-74 (1950). Consideration is "simply the conferring of a benefit upon the promisor or some other person or the suffering of a detriment by the promisee or some other person Consideration, if it consists of a benefit, must have some value." *California School Employees Assn.*, 36 Cal. App. 3d at 59. In *Orange County Foundation v. Irvine Co.*, 139 Cal. App. 3d 195 (1983), for instance, the court held that no public purpose was achieved where the public agency would expend funds under a settlement agreement in exchange for the plaintiff's agreement to relinquish a wholly invalid claim. Relinquishment of a colorable legal claim in exchange for a settlement, on the other hand, would be adequate consideration. *Id.* at 200.

The City's Business and Industry Incentive Program is intended to "attract and retain major revenue, job generating, and revitalization projects throughout the City," by authorizing City staff to offer incentives to businesses that bring their operations to the City. Available incentives include a rebate of "up to 25% of sales or use taxes paid by the business, if such sales or use taxes constitute previously uncollectable revenue to the City and the business pays its sales, or use taxes to the State Board of Equalization properly reporting San Diego as the situs of sale or use. . . ." A 25% tax rebate of "previously uncollectable" use tax is likely not a gift of public funds because the City would not receive the tax revenue absent a rebate agreement.

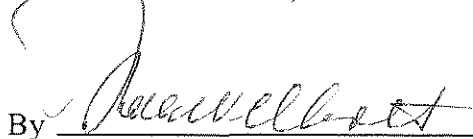
Here, the proposed agreement between the City and APT does not involve "previously uncollectable revenue." Scripps Health and Scripps Clinic Medical Group are already operating in the City, and likely would have purchased the cyclotron for delivery to San Diego regardless of whether the City offered business incentives.⁸ According to City staff, the proposed agreement is intended to ensure that local use tax to which the City is entitled is properly reported and allocated. We believe such an agreement would result in a prohibited gift of public funds because a public purpose is not achieved if the City rebates tax revenue to APT in exchange for APT's agreement to allocate tax as required by the SBOE.

CONCLUSION

Variant will deliver the cyclotron to APT at its California location from inventories located outside California. Accordingly, Variant is required under SBOE regulations to allocate the 1% local use tax to the City using Schedule F since this is where the first functional use will occur. No public purpose would be achieved if the City expends public funds for assurances from APT that it will properly allocate the local use tax to the City, as the City is entitled to this allocation even if it does not enter into a business cooperation agreement with APT. We therefore believe such an agreement would result in a prohibited gift of public funds.

We encourage City staff to monitor APT's purchase of the cyclotron which, thus far, has been well-publicized, in order to ensure use tax is properly allocated. This Office should be immediately notified if tax is not properly allocated so that we may file a petition for review with the SBOE's Allocation Group.

JAN I. GOLDSMITH, CITY ATTORNEY

By 

Mara W. Elliott
Deputy City Attorney

MWE:als
cc: David Graham, Office of the Mayor
ML-2011-12

⁸ A gift of funds analysis is very fact-specific. Additional or different facts may lead to a different legal conclusion.