

**Office of
The City Attorney
City of San Diego**

**MEMORANDUM
MS 59**

(619) 533-5800

DATE: September 21, 2017

TO: Honorable Mayor and City Councilmembers

FROM: City Attorney

SUBJECT: Allocation of Use Tax Revenue to the City's Infrastructure Fund under San Diego Charter Section 77.1

INTRODUCTION

Local voters passed Proposition H on June 7, 2016, amending the San Diego Charter (Charter) to add section 77.1 (Section 77.1) entitled "Infrastructure Fund." Commencing with the City's Fiscal Year 2018 budget, Section 77.1 diverts to a new City-administered Infrastructure Fund: (a) 50 percent of the City's growth in property tax revenue and transient occupancy tax revenue over the amount of such revenue received in Fiscal Year 2016, and certain utility franchise fee revenue received by the City, for five years; and (b) 100 percent of the City's growth in sales and use tax revenue over the amount of such revenue received in Fiscal Year 2016 adjusted for the annual change in the statewide Consumer Price Index for California, and certain pension cost reduction amounts, for 25 years.

The City's Business Cooperation Program (BCP) allows the City to offer financial and other incentives to local businesses in an effort to retain well-paying jobs in the City and promote job growth. *See* San Diego Resolution R-288034 (Nov. 12, 1996); Council Policy 900-12. The City Auditor is conducting a performance review of the BCP and, in that context, has asked this Office whether Section 77.1 allocates growth in the City's use tax revenue to the Infrastructure Fund, preventing the City from making any new commitment of such revenue to provide certain incentives authorized in the BCP.

This Office issued a memorandum in 2016 analyzing the impact of Section 77.1 on certain City fiscal activities. City Att'y MS 2016-27 (Sept. 12, 2016). That memorandum addressed the

Section 77.1 definition of “Exempt Revenues,” which are revenues not required to be deposited in the Infrastructure Fund. As applied to the BCP, the conclusion of that memorandum means that Exempt Revenues include only City tax revenues contractually committed as a BCP incentive before July 1, 2017.

QUESTIONS PRESENTED

1. Does the allocation of 100 percent of specified sales tax revenue growth to the Infrastructure Fund under Section 77.1 include the allocation of the corresponding measure of use tax revenue growth?

2. If so, does Section 77.1 limit the funding sources available to the City to pay any new BCP incentives while Section 77.1 is operative?

SHORT ANSWERS

1. Yes. The most reasonable interpretation of Section 77.1 is that the allocation of specified sales tax revenue growth to the Infrastructure Fund includes the allocation of the corresponding measure of use tax revenue growth.

2. Yes. Section 77.1 limits the funding sources available to the City to pay any new BCP incentives, while it is operative, from July 1, 2017, through June 30, 2042.

ANALYSIS

I. SECTION 77.1 REQUIRES THE CITY TO ALLOCATE CERTAIN USE TAX REVENUE GROWTH TO THE INFRASTRUCTURE FUND

Section 77.1 expressly allocates Sales Tax Increment (as defined in Charter § 77.1(a)(11)) revenue to the Infrastructure Fund. Section 77.1 defines “Sales Tax Revenue” as “any unrestricted sales tax revenue received by the City. In the *Base Year* [Fiscal Year 2016], *Sales Tax Revenue* is the Bradley-Burns Sales Tax received by the City including the Triple Flip Property Tax reimbursement.” Charter § 77.1(a)(12). Section 77.1 defines “Sales Tax Increment” as the annual change (i.e., growth) in Sales Tax Revenue over the City’s Fiscal Year 2016 Sales Tax Revenue adjusted for the annual change in the statewide Consumer Price Index (CPI) for California. Charter § 77.1(a)(11).

“Use tax” is generally defined in California Revenue and Taxation Code section 7203 as a tax upon the storage, use, or other consumption in the City of tangible personal property purchased from any retailer, if such purchase was not subject to sales tax in California. *See also* San Diego Municipal Code (SDMC or Municipal Code) §§ 32.53-32.53.4. The California State Board of Equalization (BOE) explains that, “[g]enerally, if sales tax would apply when you buy physical merchandise in California, use tax applies when you make a similar purchase without tax from a

business located outside the state.”¹ The BOE also provides the following example of the application of use tax:

For instance, if you bought a computer for your business here in California, you would pay sales tax. The same holds true if you bought that same computer from a retailer in New York for your business here in California. If you did not pay any tax to the retailer, you owe the USE tax on the cost of the computer.²

Section 77.1 does not expressly mention, or require the City to allocate, use tax revenue growth (Use Tax Increment)³ to the Infrastructure Fund. The definition of Sales Tax Increment in Section 77.1, though, could be interpreted alternatively as follows: (1) Sales Tax Increment implicitly includes Use Tax Increment; or (2) Sales Tax Increment excludes Use Tax Increment because use tax revenue is not mentioned in the definition of Sales Tax Revenue. While this Office has not found any California case law directly on point, the most reasonable interpretation of Section 77.1 is that Sales Tax Increment implicitly includes Use Tax Increment for the purpose of allocating City revenue to the Infrastructure Fund.

A. Voter Intent Prevails in Interpreting Charter Provisions

The basic rule for interpreting a voter-approved amendment to a city charter is to effectuate the voters’ intent in approving the amendment. *People v. Jones*, 5 Cal. 4th 1142, 1146 (1993). It is unlikely that the electorate, in voting to approve Proposition H, discerned any distinction between allocating Sales Tax Increment and Use Tax Increment to the Infrastructure Fund. As explained below, the two sources of revenue are closely intertwined in multiple respects and are treated by the City as a single revenue source.

B. State Law and City Practice Effectively Treat Sales and Use Tax as a Single Revenue Source

Many factors support the treatment of use tax revenue as a component of Sales Tax Revenue for the purposes of Section 77.1. The City’s sales and use tax ordinance, Municipal Code sections 32.50-32.59, is subject to the “Bradley-Burns Uniform Local Sales and Use Tax Law,” Cal. Rev. & Tax. Code §§ 7200-26 (Bradley-Burns Law). *See* Cal. Rev. & Tax. Code § 7203.2; SDMC § 32.51(a). Use tax is described in the Bradley-Burns Law as a complementary tax to the sales tax and is imposed at exactly the same rate as the sales tax. Cal. Rev. & Tax. Code § 7203; *see also, Wallace Berrie & Co. v. State Bd. of Equalization*, 40 Cal. 3d 60, 66-67 (1985). The City’s sales and use tax ordinance is legally required by the Bradley-Burns Law to impose both a sales tax and a use tax. Cal. Rev. & Tax. Code § 7302.2. In other words, the City cannot impose a sales tax without also imposing a complementary use tax. Further, the City’s BCP incentives refer to sales tax and use tax as a single revenue source. *See* Resolution R-288034; Council

¹ BOE (Sept. 5, 2017), <https://www.boe.ca.gov/sutax/usetax.htm#Overview>.

² BOE (Sept. 5, 2017), http://www.boe.ca.gov/sutax/pdf/Basic_SUT_Seminar.pdf, page 15.

³ Use Tax Increment refers to any amount of unrestricted use tax revenue received by the City exceeding the amount of use tax revenue received by the City in Fiscal Year 2016 adjusted for the annual CPI increase.

Policy 900-12. The Office of the City Comptroller has confirmed that the City accounts for sales tax and use tax revenues as a single revenue source, rather than separate revenue sources.

II. SECTION 77.1 LIMITS THE FUNDING SOURCES AVAILABLE TO THE CITY TO PAY ANY NEW BCP INCENTIVES

As discussed in Section I above, the City must allocate all Sales Tax Increment and Use Tax Increment to the Infrastructure Fund during the 25-year operative time period of Section 77.1, from July 1, 2017, through June 30, 2042. Consequently, Sales Tax Increment and Use Tax Increment are not funding sources available to the City to pay any new BCP incentives authorized during this time period.

Before Section 77.1 became operative, the City provided BCP incentives in amounts measured by the sales and use tax revenue growth generated by the incentivized business. The City has not specifically committed sales and use tax revenue to payment of any BCP incentive. Instead, the City has measured the incentive amount as a specified portion of the sales and use tax revenue growth generated by the incentivized business. The City has paid the incentive amount from available funding sources (not necessarily limited to sales and use tax revenue), as determined in the City's discretion during the annual budget process.

During the operative time period of Section 77.1, all of the City's Sales Tax Increment and Use Tax Increment are required to be deposited in the Infrastructure Fund and are not available as a funding source for payment of new BCP incentive commitments. However, under Section 77.1, the "Sales Tax Baseline" amount of City sales and use tax revenue is not required to be deposited in the Infrastructure Fund. This amount is defined as the City's Fiscal Year 2016 Sales Tax Revenue (including use tax revenue) amount adjusted for the annual CPI change. Charter § 77.1(a)(10). In other words, the amount of the City's sales and use tax revenue in a given fiscal year that does not exceed the City's sales and use tax revenue in Fiscal Year 2016 adjusted by the annual CPI change is the only portion of sales and use tax revenue that may be available to the City as a funding source for payment of new BCP incentive commitments.⁴

The City may make new BCP incentive commitments measured by the sales and use tax revenue growth generated by the incentivized business during the operative period of Section 77.1. Payment of any such new BCP incentive amount must come from City funding sources then available for such purpose, which will typically include General Fund revenue, exclusive of Sales Tax Increment or Use Tax Increment required to be deposited in the Infrastructure Fund.⁵

⁴ Any new City commitment of this nature could give rise to additional legal issues that are outside the scope of this Memorandum. For instance, depending on the factual circumstances, providing a BCP incentive measured only by the Sales Tax Baseline amount of use tax revenue could constitute an improper gift of public funds.

⁵ Charter section 77.1(g) provides for suspending deposits into the Infrastructure Fund for all or part of a fiscal year upon request by the Mayor and approval by two-thirds of the City Council, following a public hearing on the request for suspension. The analysis in this Memorandum assumes that Section 77.1 is in effect and not suspended during all fiscal years in which Section 77.1 may be operative.

CONCLUSION

Section 77.1 requires the City to allocate both Sales Tax Increment and Use Tax Increment to the Infrastructure Fund for its 25-year operative time period commencing July 1, 2017. Consequently, Sales Tax Increment and Use Tax Increment are not funding sources available to the City to pay any new BCP incentives authorized during this time period. However, while Section 77.1 is operative, the City may authorize new BCP incentives measured by the sales and use tax revenue growth generated by the incentivized business that are payable from other City funding sources then available for such purpose.

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