

SPUR REPORT
ECONOMIC JUSTICE

 **SPUR**
REGIONAL
STRATEGY



Undue Burden

Reforming Bay Area sales taxes

NOVEMBER 2020



**This report is a component of the SPUR Regional Strategy,
a vision for the future of the San Francisco Bay Area**

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Executive Summary

Despite high income tax rates on wealthier households, California still depends on its regressive sales tax to deliver a significant share of state revenue. At 7.25%, the state sales tax is the highest in the country, and added local sales taxes in the Bay Area mean that Bay Area residents pay between 7.375% and 9.75% on taxable purchases, which are generally confined to tangible goods by state law. In practical terms, this means that the burden of sales tax falls more heavily on lower-income households and communities: As a share of income, people in the lowest income quintile in the Bay Area pay three times as much in sales tax than those in the top income tier. This inequity contributes to the systemic barriers to building financial security that lower-income households face and calls for our attention as the Bay Area works to build a more equitable place to live and work.

At the same time, both the economic picture in California and the constraints on legislative action complicate any efforts to eliminate sales tax or, conversely, to expand what is taxable to digital products and services and thereby spread the tax burden across a wider swath of households. Absent state-level action to reform the sales tax, counties and cities can look to policies pioneered in other states and counties, particularly sales tax credits and supplements provided to households below a certain income threshold.

Similar to federal and state earned income tax credits, a refundable sales tax credit can return the money paid in sales tax to low-income people, offering greater financial stability to households that have been disproportionately impacted by the sales tax burden. As outlined in this paper, a Sales Tax Fairness Credit in the Bay Area would meet the four goals SPUR outlines for tax reform: to close disparity gaps for those who have been most impacted by structural inequity, to preserve as much government revenue as possible, to provide a simple and automatic process for the taxpayer and to offer straightforward, efficient implementation for government agencies.

Instituting a tax credit or supplement could take three different forms, depending on the desired scope of impact and amount of funding available. This paper explores three options:

1. Create a Sales Tax Fairness Credit for the region.
2. Create a local sales tax supplement at the county or sub-county level.
3. Create a local sales tax cash benefit at the county or sub-county level.

The first option, a regionwide approach, would have the largest impact but faces greater challenges in funding and implementation. We suggest a partnership between the state Franchise Tax Board and a regional entity or county governments (as has been done elsewhere) to make the administration easier and scalable. Sales tax supplements and benefits at the county level could also be tied into existing programs to reach low-income families who are already utilizing social services or state income tax credits.

All of these approaches could offer greater financial security for low-income households in Bay Area counties today and generate momentum toward the larger goal of a statewide tax credit and more widespread equity in the future.



Introduction

Sales tax is a familiar feature on purchase receipts in the Bay Area and across California. At 7.25%, California has the highest state sales tax rate in the country, and local taxes can add up to 2% (or more, if the state legislature allows) to the state's base rate, making sales taxes a significant source of funding for state and local governments. But their burden is disproportionately felt. This paper explores the mechanics of sales taxes and their impacts on low-income Bay Area households. Recognizing that many other pieces of federal, state and local tax codes contribute to inequality, we offer policy and implementation options for one category for reform: creating a sales tax credit or supplement for low-income Bay Area households. Tax credits and cash benefits provide both immediate and long-term opportunities to create more equity in the tax code. These are straightforward, targeted and effective policies to provide relief from the region's high sales taxes and advance a more just tax code.

Chapter 1

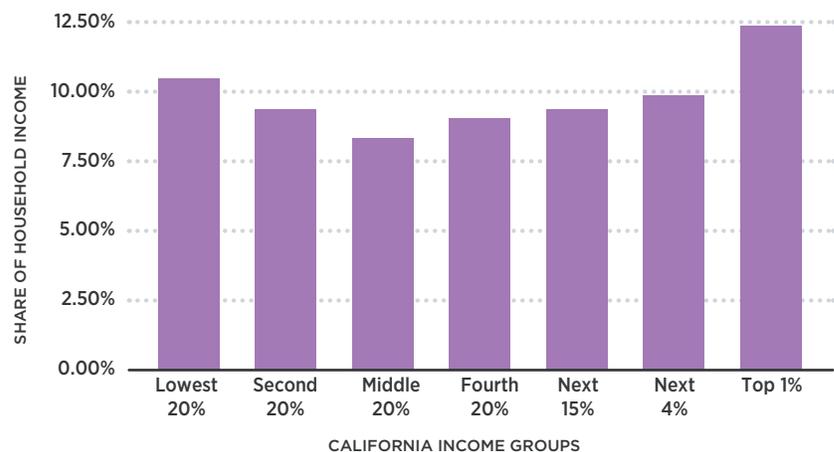
The Disproportionate Impact of Sales Taxes

In the midst of the COVID-19 pandemic, many Bay Area cities and counties are turning to increased or new sales taxes to address historic budget shortfalls. But as rates approach 10% in some communities, sales taxes continue to play a significant role in reinforcing structural inequity in the region and across the state. Despite high income tax rates on the wealthiest, California's state tax code is disproportionately burdening low-income households. Low-income Californians pay over 10% of their income in total taxes — a higher share than their low-income counterparts in 28 other states.¹ Sales and excise taxes are driving this trend. California's 7.25% state sales tax rate is the highest in the nation and accounts for far more of the overall tax burden on low-income households than income or property taxes.

FIGURE 1

California's Tax Code Has Uneven Impacts

Californians in the lowest income groups pay a higher share of their income in taxes than all but the very wealthiest households (top 1%) in the state. For the lowest-income households, this tax burden is primarily driven by sales taxes.



Bay Area households in the lowest income quintile pay more than triple the percentage of their income in sales taxes than those in the top income quintile (see Chapter 3). The burden of sales taxes is disproportionately felt by low-income people and those who have been most impacted by structural inequity. Why? Sales taxes are considered “regressive” because of the way the tax burden is distributed — even though each consumer pays the same tax rate at the register, low-income households actually pay a higher percentage of their income in sales taxes because their income is lower than that of their wealthier counterparts (see Figure 2).

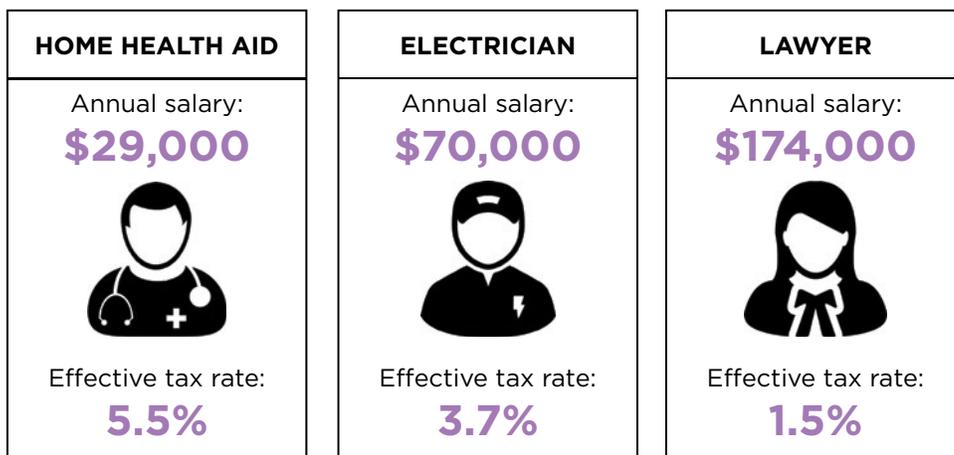
Sales taxes reduce every household's income. But for the poorest households, the added burden makes it harder to rise out of poverty and to build financial security over time to save for retirement, invest in education or start a business. Nearly 40% of Americans do not have enough savings to pay for an unexpected \$400 expense. In California, an estimated 3.3 million households struggle to meet basic monthly needs (such as housing, healthcare and child care).²

¹ SPUR analysis of data from Institute on Taxation and Economic Policy, “Who Pays: 6th Edition,” 2018, <https://itep.org/whopays-map/>

² Jhumpa Bhattacharya and Anne Price, The Cost of Being Californian: A Look at the Economic Health of California Families, Insight Center, April 2018, https://insightcced.org/wp-content/uploads/2018/04/Cost_of_Being_Californian_April_2018_final.pdf

FIGURE 2
Financial Impact of Sales Tax Varies by Income

The sales tax rate in a typical Bay Area city, Dublin, California, is the same for everyone, but the effective tax rate — the tax paid as a share of income — varies widely. Each of these workers pays 9.5% sales tax on the goods they buy, but the burden falls most heavily on the one with the lowest income.



*Dublin, CA Sales Tax: 9.5%

For families living paycheck to paycheck, sales taxes contribute to financial insecurity.

Sales tax burden (and financial insecurity more broadly) is also fundamentally racialized: In California, like most of the United States, poor households are more likely to be Black or Latino than white. Black and Latino people are twice as likely to struggle (or delay) paying monthly bills than their white counterparts, at every level of educational attainment.³ In California, some estimates indicate that roughly 75% of households of color have difficulty meeting basic monthly needs.⁴ The disproportionate impact of sales taxes on communities of color only exacerbates the structural barriers that people of color face every day. People of color are disproportionately denied access to stable housing, adequate health care, career advancement, education and more, and in the Bay Area the high cost of housing often compels lower-income people to live far from their jobs. For example, a Black woman living in Solano County likely spends over 50% of her income on housing and commutes more than 90 minutes to work, and on top of those inequities she shoulders a disproportionate sales tax burden.⁵

3 U.S. Federal Reserve, "Dealing With Unexpected Expenses," Report on the Economic Well-Being of U.S. Households in 2019 - May 2020, <https://www.federalreserve.gov/publications/2020-economic-well-being-of-us-households-in-2019-dealing-with-unexpected-expenses.htm>

4 See note 2.

5 "Indicators," Bay Area Equity Atlas, <https://bayareaequityatlas.org/indicators>



A New Approach: Creating a More Equitable Tax Code

How could the Bay Area reform sales taxes to eliminate their disproportionate impacts and move toward a more just and equitable tax code? Choosing a policy reform inevitably involves trade-offs around implementation, raising revenue and determining who benefits from the change. In thinking about reforming sales taxes in the Bay Area, SPUR considered the following principles:

1. Rather than exacerbate negative consequences, tax policies should be designed to close disparity gaps for those who have been most impacted by structural inequity.
2. Under our current tax structure, local governments rely on sales tax for significant revenue that funds a variety of public services. Tax reform should aim to preserve as much government revenue as possible.
3. Tax policies should be as simple and automatic as possible for the taxpayer.
4. Tax policies should be straightforward and efficient to implement for government agencies.

SPUR has long advocated for and supported sales taxes to fund public services, particularly transportation. We acknowledge that in doing so, we have helped perpetuate their inequitable impacts. Accordingly, we consider it our responsibility to help remedy the burden of sales tax on low-income residents of the Bay Area. In Chapter 4, we outline several possible strategies for policy reform, and the result of our analysis points us to a sales tax credit or supplement for low-income households as a solution that can best address the goals enumerated above. Chapter 5 dives deeper into this strategy, presenting three variations on what such a credit could look like.

Chapter 2

Sales Taxes in California

Beginning in 1933, California state and local governments have levied a tax on the retail sale of certain “tangible personal property.”⁶ Generally, the state applies the tax to material products that businesses purchase for resale and to personal property (which is defined as “movable” as opposed to real property like land and buildings). The tax applies to the sale of most household goods, such as furniture, appliances and toilet paper. Restaurant food and takeout food is taxed, as well as clothing and gasoline. However, a number of other categories of household spending are either not taxed or only partially taxed under a complex system of exemption rules. Housing and groceries, for example, are not taxed. Other categories defined as services rather than goods, such as health care and vehicle maintenance, are exempt. Still other items are defined as digital rather than tangible goods and are exempt, such as digital media subscriptions. In total, the state maintains over 100 exemptions to the sales tax.⁷

Understanding Consumption Taxes

Sales taxes are a form of consumption tax, a class of tax levied on the consumption of products and services. Sales taxes are considered indirect because they are charged to retailers, who pass on the added charge to consumers at the point of sale. The amount of tax is applied as a percentage to the taxable price of the product. (Related to this are use taxes, which are paid directly by the consumer to the government.) Sales taxes are designed to be broad and applicable to a wide range of goods, which means that they are typically high revenue-raising tools. Their flat rate, however, makes this type of tax regressive because everyone pays the same rate regardless of their differences in income. Other types of consumption taxes include:

Excise tax: This tax applies to certain types of products such as alcohol, cigarettes, soda or gasoline. Excise taxes are levied on the manufacturer or producer as opposed to the consumer; the increase is sometimes passed on to consumers in the form of higher prices.

Value-added tax (VAT): This tax applies to the increment of value added to a product at each stage of its production, distribution and sale. Producers and retailers pay a flat tax amount at each stage. A VAT system can include exemptions similar to those used for sales taxes; it is common in European Union countries and also exists in Canada.

Direct expenditure tax: This type of consumption tax is directly applied to consumers’ income after deducting their annual savings and investments. Tax rates can be designed progressively; some economists have called for changing California’s sales tax to a similar form of direct consumption tax to eliminate the regressive impacts of the sales tax.⁸

⁶ California’s sales and use tax consists of two parts: a tax on retailers of certain tangible goods (like toilet paper) and a use tax on consumers of other tangible goods (including some goods purchased out of state). This paper focuses on the tax on retailers only, and the term “sales tax” used throughout refers to this piece of the sales and use tax.

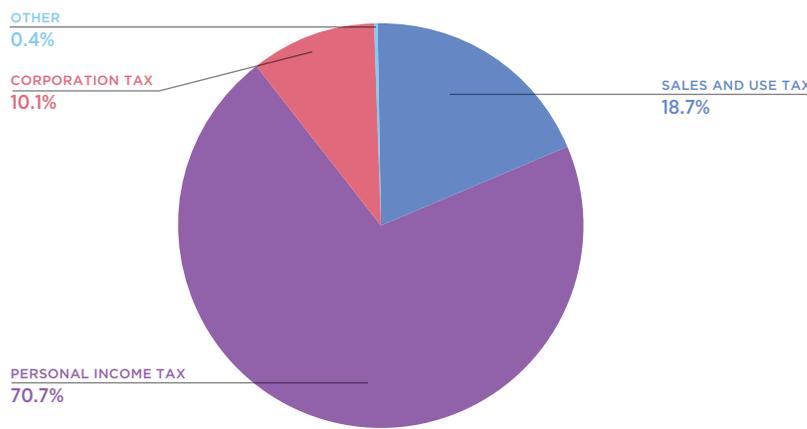
⁷ California Department of Tax and Fee Administration, Sales and Use Taxes: Exemptions and Exclusions, <https://www.cdtfa.ca.gov/formspubs/pub61.pdf>

⁸ Fred Foldvary, Colleen Haight and Annette Nellen, An Analysis of a Consumption Tax for California, Center for California Studies, 2016, https://sor.senate.ca.gov/sites/sor.senate.ca.gov/files/Final%20Consumption%20Tax_12-3-16.pdf

California’s 7.25% sales tax is the highest state rate in the nation. Beginning in 1969, the state allowed local governments to levy additional local rates, called Transactions and Use Taxes (TUTs), which must be approved by the voters. State law restricts the total TUT rates to 2%, although some local governments have received special permission from the legislature to levy higher rates. These jurisdictions, such as the City of Santa Fe Springs (10.5%), have the highest sales tax rates in the state.

Sales tax revenue is a significant source of funding for the state’s General Fund, second only to income tax. In fiscal year 2018–19, California raised \$26.1 billion in sales and use tax revenue. The largest categories of purchases driving sales tax revenue are motor vehicles and parts dealers (12.9%), bars and restaurants (12.3%), wholesalers (11.5%), general merchandise stores (7.3%), gas stations (7.1%) and manufacturers (6.7%).⁹

FIGURE 3
Sources of Revenue in California’s General Fund
 Sales and use tax revenue is the second-largest driver of state revenue after the personal income tax.



The largest share of sales tax revenue, accounting for over 4% of the total state rate, goes to the state General Fund to flexibly fund a range of programs. Another 1% goes back to city and county general funds for flexible spending, and 0.25% directly funds local transportation programs (collectively known as the “Bradley-Burns local rate”). The remainder is allocated to a number of county and city programs, including public safety, criminal justice, mental health and transportation.

FIGURE 4
Allocating California Sales Tax Revenues
 California’s state sales tax revenues are allocated to a range of state and local purposes, including public safety, social services and transportation.¹⁰

3.69%	- State General Fund
0.25%	- State General Fund
0.50%	- City and county public safety programs
0.50%	- County health and social services programs
1.06%	- County criminal justice, mental health and social services programs
1.00%	- City and county general purposes (Bradley-Burns local rate)
0.25%	- County transportation programs (Bradley-Burns transportation rate)
<hr/>	
7.25%	Sales and use tax rate

Several factors can affect sales tax revenue from year to year. Revenue tracks economic activity, decreasing during downturns and increasing when the economy is humming. Some of the decrease is buffered by purchases of essentials like home goods. Individual household spending also tends to vary widely from year to year, driven by purchases of big ticket but durable goods such as furniture, appliances and cars. Overall, consumers have been spending less on taxable goods in California since the 1980s. This shift in spending has been driven by a

⁹ Email correspondence with Seth Kerstein, Legislative Analyst’s Office, March 2020.

¹⁰ The 0.25% state General Fund allocation amount is separated from the larger 3.68% amount because this allocation is sometimes restricted based on certain state budget conditions.

movement of tangible goods to digital products (which are not taxed) and a rise in the price of services (which are not taxed). In fact, sales tax revenues have been declining slightly over time, when adjusted for inflation, rising tax rates and overall population growth.¹¹

A number of state laws restrict how the sales tax can change in the future. For example, Proposition 13 requires that any increase to the rate be approved by a majority vote at the ballot (for taxes that are raised for specific purposes, the threshold is even higher, at two-thirds). Proposition 163 constrains the legislature's ability to apply sales tax to food. Finally, while the legislature can narrow the types of taxable purchases with a simple majority vote, lawmakers need a two-thirds majority to expand what is taxed.

Sales Taxes in Context: The State Tax Code

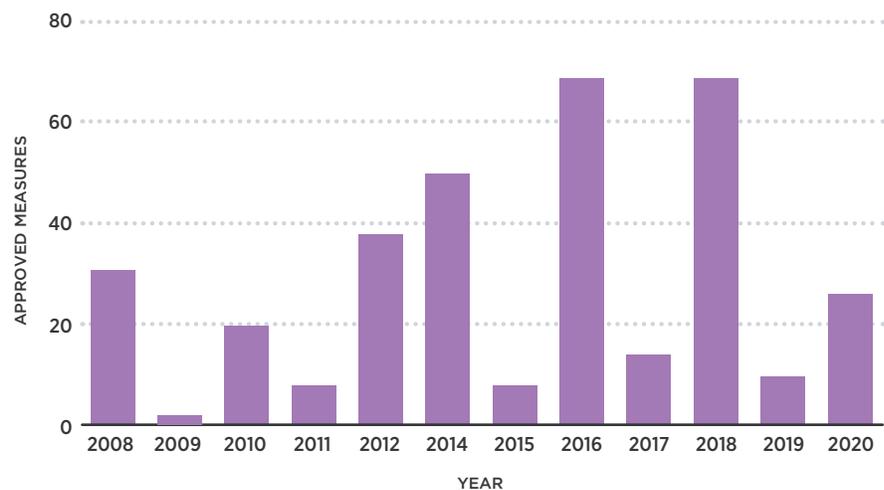
Several elements of the state tax code have contributed to the prevalence of sales taxes today and their disproportionate impacts.

First, Prop. 13 shifted revenue sources away from property tax and constrained local governments' control over their finances. The 1978 law capped property tax rates and restricted the amount they could grow to 2% per year or inflation (whichever is lower). Prop. 13 also gave the state authority to reroute property tax revenues and created the requirement that special taxes be approved by a two-thirds majority vote. Local governments immediately lost a significant source of revenue, and many shifted their focus to sales taxes.

FIGURE 5

Approved California Sales Tax Measures (2008–2020)

The number of new and increased sales taxes has grown over time, as local governments look to make up for declining sales tax revenues due to changes in what people buy.



Second, California's sales tax is increasingly disconnected from the growth of the economy. As noted, state law restricts the sales tax to tangible products and does not tax services or intangible goods. This omission means that sales tax revenues have not grown with the economy: Since the 1980s, consumers have spent more of their income on services (for example, car repairs or massages), and many products that used to be tangible and taxed have become digital (such as music and TV subscriptions).¹²

The upshot of these factors is that California's under-reliance on property tax revenues has led to an over-reliance on sales taxes. At the same time, changes in what consumers buy has led local governments to continually raise rates over an increasingly narrow base of taxable products, further burdening the poorest Californians.

11 Legislative Analyst's Office, "Understanding California's Sales Tax," 2015, <https://lao.ca.gov/reports/2015/finance/sales-tax/understanding-sales-tax-050615.aspx>

12 Sarah Jo Szambelan, Egon Terplan and Bob Brownstein, "Back in the Black: A Fiscal Strategy for Investing in San Jose's Future," SPUR, 2016, www.spur.org/sifiscalstrategy

Chapter 3

Sales Taxes in the Bay Area

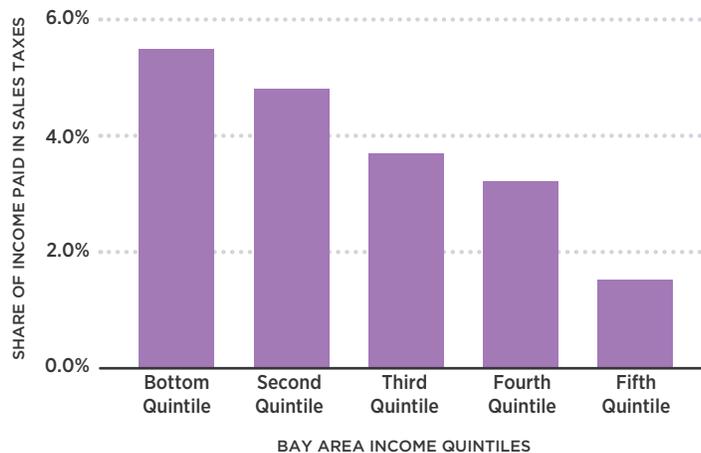
In the Bay Area, over 80 counties and cities have levied additional taxes (TUTs) above the state rate. A number of special districts also levy sales taxes, including the Bay Area Rapid Transit District and Valley Transportation Authority. Solano County has the lowest rate, at 7.375%, while a number of cities, including East Palo Alto, Rohnert Park and Union City, levy the highest rate, 9.75%.

FIGURE 6
Sales Tax Rates in the Bay Area (by County)
 All of the Bay Area counties have added a local increment to the state's base sales tax rate. This does not include additional rates levied by cities and special districts.

Alameda	9.25%
Contra Costa	8.25%
Marin	8.25%
Napa	7.75%
San Francisco	8.50%
San Mateo	9.25%
Santa Clara	9.00%
Solano	7.375%
Sonoma	8.25%

Sales tax revenue is a significant source of funding at the local level for many cities and counties. For East Palo Alto, one of the Bay Area cities with the highest sales tax rate, this revenue accounts for about 20% of the annual budget.¹³ A significant use of sales tax revenue in the Bay Area (and elsewhere in the state) is in funding transportation agencies. The Valley Transportation Authority, for example, derives 52% of its budget from the Santa Clara County sales tax; the Bay Area Rapid Transit District relies on sales tax revenue across three counties to fund about 30% of its operating budget.¹⁴

FIGURE 7
Total Sales Tax Burden by Bay Area Income Group (% of income)
 Low-income households in the Bay Area pay more than three times as much in sales taxes as their high-income counterparts, as a share of income.



¹³ City of East Palo Alto, Fiscal Year 2019-20 Operating Budget, <https://www.cityofepa.org/finance/page/proposedadopted-budgets>

¹⁴ SPUR, "The Pandemic's Disastrous Impact on Transportation Funding," 2020, https://www.spur.org/sites/default/files/events_pdfs/04.02.2020_the_pandemics_impact_on_transit_funding.pdf

Modeling the impact of sales taxes shows how these taxes affect households with different incomes in the region. The cumulative impact of sales taxes at the state, municipal, county and special district levels is significant: The lowest-income households pay roughly three times more than those at the top on sales tax, as a percentage of income. Those making less than \$30,000 per year face an average annual tax burden of \$1,026 from sales tax alone, or 5.5% of their annual income.

For a housecleaner or other low-wage worker, \$1,000 represents an extra two weeks' worth of wages and, with it, the opportunity to take extra trips to the grocery store, pay past-due bills or get ahead on a big expense. Since traffic citations in California now average over \$500, an extra \$1,000 could prevent a low-wage worker from having their license suspended and then losing a job due to lack of transportation.¹⁵ The Bay Area's historic growth has brought skyrocketing costs of living. By some measures, the cost of living in the Bay Area rose by 46% from 2014 to 2018, compared to 9% in other urban areas in the state.¹⁶ Today, an additional \$1,000 would be a significant benefit for households living on the margins.

Figure 8
Impact of All State and Local
Sales Taxes on Bay Area
Households (2017 incomes)

While lower-income people spend less on sales tax in absolute dollars, a larger share of their income goes to pay state and local sales taxes in the Bay Area.

	LOWEST QUINTILE OF HOUSEHOLDS \$0 to \$30,000	SECOND-LOWEST QUINTILE OF HOUSEHOLDS \$30,000 to \$53,000	MIDDLE QUINTILE OF HOUSEHOLDS \$53,000 to \$91,000	SECOND-HIGHEST QUINTILE OF HOUSEHOLDS \$91,000 to \$163,000	HIGHEST QUINTILE OF HOUSEHOLDS \$163,000 and up
Tax as Percentage of Income	5.5%	4.8%	3.7%	3.2%	1.5%
Average Combined State and Local Sales Tax per Year	\$1,026	\$1,967	\$2,613	\$3,854	\$7,240

* "Local taxes" includes the Bradley-Burns 1% rate for general local purposes and the Bradley-Burns 0.25% rate for local transportation uses, as well as additional rates levied by cities and counties.

A racial breakdown of the data confirm that the sales tax burden is falling disproportionately on non-white households. White households are fairly evenly distributed among the income quintiles. Black households, however, make up 31% of the lowest-income households while only accounting for 6% of the Bay Area population.¹⁷ The households paying the greatest share of income on sales tax are more likely to be people of color. These taxes are one barrier to financial security and thus part of a system that perpetuates structural inequality in the Bay Area.

¹⁵ Lawyers' Committee for Civil Rights of the San Francisco Bay Area, Not Just a Ferguson Problem: How Traffic Courts Drive Inequality in California, April 2015, <https://lccrsf.org/wp-content/uploads/Not-Just-a-Ferguson-Problem-How-Traffic-Courts-Drive-Inequality-in-California-4.2015.pdf>

¹⁶ See note 2.

¹⁷ "Race/Ethnicity," Bay Area Equity Atlas, 2020, <https://bayareaequityatlas.org/indicators/race-ethnicity/#/?breakdown=2&year=2020>

FIGURE 9
Impact of Local Sales Taxes
on Bay Area Households
(2017 incomes)

Separate from state taxes, local taxes alone also cost lower-income people a larger percentage of income than wealthier people pay in the Bay Area.

	LOWEST QUINTILE OF HOUSEHOLDS \$0 to \$30,000	SECOND-LOWEST QUINTILE OF HOUSEHOLDS \$30,000 to \$53,000	MIDDLE QUINTILE OF HOUSEHOLDS \$53,000 to \$91,000	SECOND-HIGHEST QUINTILE OF HOUSEHOLDS \$91,000 to \$163,000	HIGHEST QUINTILE OF HOUSEHOLDS \$163,000 and up
Tax as Percentage of Income	1.5%	1.4%	1.0%	0.9%	0.4%
Average Local Sales Tax per Year	\$286	\$561	\$725	\$1,057	\$1,982

FIGURE 10
Racial Representation by
Income Group (2017 incomes)

People of color, particularly Black households, are disproportionately represented in the lowest income quintiles in the Bay Area. Because the lowest-income households pay the highest share of their income on sales taxes, this results in a racial disparity in the tax burden throughout the region.

	LOWEST QUINTILE OF HOUSEHOLDS	SECOND-LOWEST QUINTILE OF HOUSEHOLDS	MIDDLE QUINTILE OF HOUSEHOLDS	SECOND-HIGHEST QUINTILE OF HOUSEHOLDS	HIGHEST QUINTILE OF HOUSEHOLDS
White alone (not Hispanic)	17.2%	19.8%	22.6%	20.5%	19.9%
Black or African American (not Hispanic)	30.8%	23.5%	18.8%	13.7%	13.2%
Asian alone (not Hispanic)	19.8%	17.7%	19.3%	21.4%	21.7%
Other single race (not Hispanic)	23.8%	19.0%	18.3%	19.2%	19.7%
Hispanic	24.6%	23.1%	16.6%	17.5%	18.2%
Multiple races and/or ethnicities (not Hispanic)	18.5%	14.5%	14.4%	25.2%	27.5%
All	20.0%	19.9%	20.1%	20.0%	20.0%

Chapter 4

Remedying Inequity: Sales Tax Credits

For many years, economists and policymakers have been calling for reform to the sales tax to make it more equitable, to increase revenue and to modernize rules around its administration (for examples of strategies, see sidebar below).¹⁸ While other methods of reform are worth further study, SPUR prefers tax credits because they offer an actionable, targeted, straightforward and cost-effective approach. Credits are most commonly issued as part of a household's annual income tax return and are applied toward the amount of tax a household owes to the government. Refundable credits allow a household to keep whatever remains after applying the credit to their tax liability. These programs are based on household income and are designed to benefit those who most need relief.

Sales Tax Reform Strategies

Reform of the sales tax could achieve a number of policy goals, including increasing revenue, modernizing the tax base and reducing its disproportionate impacts. Some ideas worth more study include:

Structural reform: Most structural reform ideas have centered around broadening the base of products subject to the tax to include digital items (like subscriptions) and services (like haircuts or lawyer's services), combined with lowering the overall rate. Taking this approach would better align revenues with consumer spending over time. It would also better spread the tax burden across taxpayers while also relieving some tax burden, and it could raise new revenue to direct at programs that reduce the inequities inherent in the sales tax. However, structural reform has been proposed in the legislature consistently with little success; to enact these kinds of changes, proponents would need to overcome significant political opposition from businesses whose services are currently exempt from sales taxes.

Product exemptions: Many state governments either partially or fully exempt certain products from the sales tax. As discussed in Chapter 2, California provides over 100 individual exemptions across manufacturing, agriculture and transportation in addition to exempting certain purchases deemed "essential to life" (including groceries, vending machine food, prescription drugs and utilities). Exemptions are applied at the point of sale, so taxpayers immediately benefit. The state could reform exemptions such that they cover more essential purchases of low-income households (such

¹⁸ Recent examples include: Think Long Committee for California, *A Blueprint to Renew California*, 2009, https://36z59wrviv543qd814533ma8z-wpengine.netdna-ssl.com/wp-content/uploads/2018/10/Blueprint_to_Renew_ca.pdf; Public Policy Institute of California, *Consumption Tax Options for California*, 2010, https://www.ppic.org/content/pubs/report/R_611AAR.pdf; and California Office of the Controller, *Comprehensive Tax Reform in California: A Contextual Framework*, June 2016, https://www.sco.ca.gov/Files-EO/Comprehensive_Tax_Reform_in_California_A_Contextual_Framework_06_16.pdf

as clothing). The legislature could also eliminate old exemptions that don't align with state priorities (such as the exemption on international passenger airline fuel, which conflicts with the state's climate change goals).

However, exemptions present a number of policy and administrative challenges. They narrow the base of what is taxed, reducing revenue overall and making it more vulnerable to economic downturns.¹⁹ Exemptions require a significant amount of coordination between retailers and administrators at multiple levels of government to determine what is taxable and what is exempt. Finally, exemptions are a blunt method of providing relief from the regressive impacts of sales taxes, because they provide blanket benefit to taxpayers regardless of their income. Exempting groceries, for example, benefits all consumers instead of just low-income households. In fact, higher-income households stand to benefit more from an exemption on groceries because their total grocery spending is higher and because they tend to purchase more expensive items.²⁰ The idea of income-based exemptions, however, could be worthy of further research. This kind of exemption would immediately benefit low-income households and could be tied to electronic benefit cards (EBT) that people can swipe at the register.

Administrative reforms: All sales tax revenue is collected by the state, and the 1% Bradley-Burns rate for general local use is allocated back to cities based on the “place of sale,” the retailer’s location. This type of “situs-based” allocation gives cities a strong financial incentive to zone for retail uses or warehouses, often at the expense of housing. Some have argued for transitioning to an allocation system that is based on the “destination” of the purchased good, which might dampen cities’ preference for retail uses and encourage the production of more market-rate and affordable housing.²¹ This change, however could bring its own new set of incentives and unintended consequences and is worth further study.

Tax credits are also considered one of the most highly effective tools for building financial security for low-income working households. The federal earned income tax credit (EITC) is the most well-known tax credit for low-income households in the United States. The EITC provides certain low-wage households with a credit toward their annual tax liability that can be claimed by filing a federal tax return. Any remaining balance after the tax bill is paid is transferred directly to the household as supplemental income. Created in 1975, it is considered to be one of the federal government’s most successful anti-poverty programs. In 2018, over 22 million working families and individuals received an EITC benefit, and it lifted 5.6 million people above the federal government’s poverty threshold.²²

Twenty-nine states, including California, have created their own credits to supplement the federal EITC.

¹⁹ Institute on Taxation and Economic Policy, *Options for a Less Regressive Sales Tax in 2019*, September 26, 2019, <https://itep.org/options-for-a-less-regressive-sales-tax-2019/>

²⁰ Nicole Kaeding, *Sales Tax Base Broadening: Right-Sizing a State Sales Tax*, Tax Foundation, October 24, 2017, <https://taxfoundation.org/sales-tax-base-broadening/>

²¹ League of California Cities, *Evaluating Some Options for Sales Tax Reform*, CaliforniaCityFinance.com, April 6, 2015, <http://www.californiacityfinance.com/SalesTaxReformOptions150406.pdf>

²² Center on Budget and Policy Priorities, “Policy Basics: The Earned Income Tax Credit,” December 10, 2019, <https://www.cbpp.org/research/federal-tax/policy-basics-the-earned-income-tax-credit>

The California EITC (CalEITC) was created in 2015 and was designed to expand the impact of the federal credit, targeting extremely low-income earners making less than \$15,000. Changes to the CalEITC that became effective in 2019 essentially doubled the credit amount and increased the income threshold under which a tax filer could qualify to \$30,000.²³ The credit amount doesn't vary based on marital status, and it also applies to filers who don't have children, to those over age 64 and to those between ages 18 and 24 (all of whom are not eligible for the federal credit). In the 2017 tax year, over \$351 million in CalEITC benefits went to an estimated 1.5 million households.²⁴

Tax credits can be structured in a number of ways based on several important levers:

- **Credit amount:** Many credits are designed as a base dollar amount that increases with income and/or family size up to a certain point. When establishing a base credit amount, policymakers can decide how much of a particular burden (income tax burden or sales tax burden, for example) should be offset.
- **Income eligibility:** Policymakers can decide whom to target the credit toward based on household income and, in doing so, broaden or narrow its impact and affect its total cost.
- **Refundability:** Some tax credits simply offset a household's tax liability. Credits that are structured to be refundable, however, have particular power. After the credit has covered a household's tax liability, any leftover goes directly to the household as supplemental income.
- **Household size:** Tax credits can be designed to increase by the number of children (often referred to as "dependents" for tax purposes) in a household. This provides added benefit for working families.
- **Phase-out:** Credits can be more finely tuned by adjusting how credit amounts grow with income (under the assigned eligibility criteria) and then decrease as household income approaches the upper income limit. These kinds of details allow policymakers to make changes that impact how much the credit program will cost.

Building off the EITC and other models, a number of states currently provide an annual sales tax credit. Most do so to offset the burden of including groceries or other essentials in the tax base.

²³ Charles Davis and Evan White, Who Receives the Earned Income Tax Credit in California?, California Policy Lab, October 2019, <https://www.capolicylab.org/wp-content/uploads/2019/10/Who-receives-the-EITC-in-California-Oct-2019.pdf>

²⁴ Ibid.

FIGURE 11
Existing Sales Tax Credit Programs in the United States

CAPTION: A number of states have already created sales tax credit programs with varying income eligibility requirements and credit amounts, most of them designed to serve lower-income residents.

	CREDIT ELIGIBILITY CUTOFF (BY INCOME)		MAXIMUM CREDIT VALUE		CREDIT PHASE-OUT	REFUNDABILITY
Arizona	\$12,500	Single	\$25	per exemption	No phase-out; flat dollar amount	Refundable
	\$25,000	Married				
Hawaii	\$30,000	Single	\$110		Credit phases out as income rises	Refundable
	\$50,000	Married				
Idaho	Universal		\$100	Non-seniors with dependents <21	No phase-out; flat dollar amount	Refundable
			\$120	Seniors (>55)		
Kansas	\$30,615	All filer types	\$125	per exemption	No phase-out; flat dollar amount	Nonrefundable
Maine	\$26,000	Single	\$125	if one exemption	Credit phases out as income rises	Refundable
	\$41,000	Head of household	\$175	if two exemptions		
	\$51,000	Married filing jointly	\$200	if three exemptions		
			\$225	if four or more exemptions		
New Mexico	\$22,000	All filer types	\$135	Single, no kids	Credit phases out as income rises	Refundable
			\$195	Married, no kids		
			\$450	Married, with kids		
Oklahoma	\$20,000	Filers without dependents	\$40	per exemption	No phase-out; flat dollar amount	Refundable
	\$30,000	Filers with dependents				
	\$50,000	Seniors				

Maine’s Sales Tax Fairness Credit was created in 2015 and is considered a national model. The credit is refundable, meaning that the taxpayer uses the credit to pay for any taxes owed to the government and can keep the remainder (taxpayers who owe no money receive the full value of the credit). The value of the credit is based on income, filing status (for example, single or married filing jointly) and family size and caps out at \$225 per year. It is indexed to inflation, so the benefit grows with the cost of living over time. Finally, the credit is designed to phase out over a certain income threshold. This design means that a taxpayer’s credit will gradually decrease as their income rises, as opposed to the “cliffing out” effect, where the taxpayer suddenly gets nothing when their income pushes them past the eligibility range. Those who earn no income are still eligible for

the credit. The total cost of the credit is approximately \$25 million per year, and it affects 196,000 taxpayers.²⁵

However, any tax credit program presents its own challenges. Most credits are issued annually, so low-income households still bear the burden of the tax at the register. Tax credits place the burden on households to apply for them, and most are distributed as a single lump sum. Most credits are only available to taxpayers who earn income, which excludes the elderly and those who cannot work. Undocumented taxpayers are also generally left out of tax credits. Any sales tax credit program will need to address these challenges.

Related to tax credits, direct cash assistance provides supplemental income to households, often with no restrictions on how the money is spent. Most U.S. welfare programs have focused primarily on providing specific services, such as food or rental assistance, but the Temporary Assistance for Needy Families (TANF) program offers limited cash assistance to low-income families, with a number of restrictions. A growing body of research suggests that cash assistance has significant impact on financial security and on longer-term measures such as health and earnings.²⁶ Cash assistance also functions as a local stimulus, injecting money into communities and magnifying the benefits of this cash infusion. Narrowly focused programs can serve to stabilize extremely low-income households. The COVID-19 federal stimulus checks are an example of direct cash assistance as an emergency response. Finally, larger programs such as guaranteed income in Norway and Stockton, California, aim to provide the kind of long-term, substantial supplemental income that can help people permanently exit poverty.

25 Maine Revenue Services Office of Tax Policy, Maine State Tax Expenditure Report 2020-2021 & Maine Tax Incidence Study, p. 40, https://www.maine.gov/revenue/research/tax_expenditure_19.pdf

26 Economic Security Project, "Guaranteed Income," <https://www.economicsecurityproject.org/guaranteedincome/>; and Innovations for Poverty Action, "Enterprises for Ultra Poor Women After War: The WINGS Program in Northern Uganda," <https://www.poverty-action.org/study/enterprises-ultra-poor-women-after-war-wings-program-northern-uganda>

Chapter 5

From Idea to Implementation: Three Policy Options

Tax credit and cash benefit policies could be pursued in both the short and long term to provide relief from the burden of sales taxes in the Bay Area. Below are three possible policy options to consider.

OPTION 1:

Sales Tax Fairness Credit

Who's responsible: Franchise Tax Board, state legislature, county governments

A sales tax credit would offset the cumulative average sales tax burden for the region's lowest-income residents. Under our proposal, households with incomes under \$35,000 would be eligible to receive the credit. The tax credit value could start at \$1,000 per household and increase by \$50 per additional exemption²⁷ up to a maximum credit of \$1,150. The value of the credit could phase out between \$30,000 and \$35,000, meaning that the amount of credit would start to decline for each additional amount of income a tax filer has between these benchmarks. The credit values, income threshold and phase-out starting point should all be indexed to inflation. To maximize efficiency in administering the credit, SPUR suggests using the same inflation adjustment formula as the CalEITC policy. Finally, the credit should be refundable so that those who make too little to owe federal or state taxes would receive the full credit amount. The credit should be available to any filer with a Social Security number or individual taxpayer identification number, which would enable the program to include undocumented tax filers.

Modeling the impact of this kind of tax credit, as shown in Figure 12, indicates that this design would cover all Bay Area residents in the lowest-income quintile as well as some residents in the next quintile, providing an average annual credit of \$1,048. In total, 24.9% of Bay Area residents would be eligible to be fully reimbursed for the total Bay Area sales tax burden they pay each year. This Bay Area Sales Tax Fairness Credit would cost \$669 million in 2020 dollars.

Implementation

A regional entity and the Franchise Tax Board (FTB), which currently administers the CalEITC, could be given authority by state legislation to jointly administer the credit. However, absent a regional entity, FTB could build off the model in Montgomery County, Maryland (see sidebar on page 22), by establishing contracts with Bay Area county governments. The contracts would allow FTB to identify eligible households from their income tax return database and mail paper checks directly to recipients (or directly deposit the credit for those who have bank accounts on file). As in Maine's statewide sales tax credit program, those who don't file income taxes could fill out a simple application form — in this case, provided by counties in partnership with nonprofit tax preparers. Demonstrating the success of county-based programs could generate momentum to expand to a statewide credit.

²⁷ Dependent exemptions refer to a certain amount of money that can be deducted from a tax filer's gross income because of children or certain dependent relatives. Tax credits are often structured so that the credit amount you receive increases with the number of children or qualifying dependents you claim on your taxes.

FIGURE 12
Bay Area Sales Tax Fairness Credit

A sales tax credit would fully offset the average annual sales tax burden for households in the lowest-income quintile in the Bay Area.

	LOWEST QUINTILE OF HOUSEHOLDS	SECOND-LOWEST QUINTILE OF HOUSEHOLDS	MIDDLE QUINTILE OF HOUSEHOLDS	SECOND-HIGHEST QUINTILE OF HOUSEHOLDS	HIGHEST QUINTILE OF HOUSEHOLDS
	\$0 to \$30,000	\$30,000 to \$53,000	\$53,000 to \$91,000	\$91,000 to \$163,000	\$163,000 and up
Combined State and Local Sales Tax Burden (as a percentage of income)	5.5%	4.8%	3.7%	3.2%	1.5%
Average Annual Sales Tax Burden	\$1,026	\$1,967	\$2,613	\$3,854	\$7,240
Average Tax Credit	\$1,048	--	--	--	--

Considerations

In fully offsetting the total burden of sales taxes in the Bay Area, this option is arguably the most impactful; however, it faces two significant challenges: scale and funding. Without a dedicated regional funding source, it would be difficult to identify revenue to support a \$669 million program. State funding sources would be a better solution and could take the form of eliminating certain sales tax exemptions and redistributing the revenue back to counties.²⁸

Ultimately, Bay Area legislators should advocate over the long term for the creation of a California sales tax credit. This paper demonstrates the disproportionate burden that exists in our region, and we can infer similar or even greater burdens for low-income households elsewhere in the state. At the state level, policymakers have the infrastructure in place to administer a large-scale program, as well as greater funding resources and the ability to achieve broad impact in line with other state-level tax credits.

28 For example, the California Department of Taxes and Fee Administration estimates that the current exemption on fuel for international passenger flights costs the state \$190 million per year.

Montgomery County's Working Families Supplement

The Working Families Supplement in Montgomery County, Maryland, is a useful model for implementing a tax credit at a local scale. The countywide refundable earned income tax credit was developed in 1999. Households that are eligible to receive the State of Maryland's earned income tax credit are automatically eligible to receive this supplement, which is equal to 100% of the state credit amount. Administered through a partnership with the State of Maryland Comptroller, the credit requires no additional application from tax filers and utilizes existing tax data to proactively detect eligible households. The comptroller's office identifies which residents of Montgomery County claimed the state EITC, issues them separate paper checks and then bills the county for the cost of the credit plus an administrative fee. Checks are mailed beginning in July, after residents have filed their taxes.²⁹ Staff at the comptroller's office will search their database twice more over the course of the year to identify any late filers or other households that are eligible. In tax year 2015, the county paid out \$24.3 million for the credit to an estimated 41,000 recipients. It costs \$40,000 per year to administer.³⁰

OPTION 2:

Local Sales Tax Supplement

Who's responsible: County or city governments, special tax districts, Franchise Tax Board

Until a Sales Tax Fairness Credit could be implemented at the state or regional scale, local governments could take action themselves to address the regressive impacts of a sales tax. In this option, a taxing jurisdiction (like a county or city) could set aside a portion of revenue from any future new sales tax, tax increase or extension to fund a Sales Tax Fairness Supplement. At minimum, the supplement could be designed to offset the additional burden of the new or extended sales tax on low-income residents within that jurisdiction — and could cover the burden of previous sales taxes on low-income residents as well. To make administration easy, it could be structured as a flat amount per household, the income eligibility requirements could match that of the CalEITC (\$30,000 annual household income) and the supplement could be distributed as an automatic payment.

Implementation

In this option, jurisdictions seeking to establish new sales taxes or increase or extend existing taxes would include language in the ballot measure to set aside a percentage of revenue to a Sales Tax Fairness Fund. Similar to what's done in Montgomery County, Maryland, these jurisdictions would establish contracts with FTB to administer the supplement. FTB would identify eligible households (those who qualified for the CalEITC) from their income tax return database and distribute the supplement directly to recipients (by check or direct deposit). FTB would then bill the jurisdiction for the total cost of the program plus an administrative fee; the county would pay the costs out of its Sales Tax Fairness Fund.

29 Steven Holt, "Baltimore and Maryland CASH Campaigns EITC Periodic Payment Project," 2016, <https://drive.google.com/file/d/1OhZUTionFWztVMAliS0LPke3V-peCtGq/view?usp=sharing>

30 "Montgomery County at a Glance," https://www.richmondfed.org/-/media/richmondfedorg/conferences_and_events/community_development/2015/pdf/montgomery_md_20150331.pdf



As in Option 1, those who don't file income taxes could fill out a simple application form provided by the jurisdiction in partnership with nonprofit tax preparers.

Considerations

This option would have a narrower impact than a state or regionwide credit (benefitting low-income residents only in the geographic area that decided to create the program) and would cover only a portion of the sales tax burden for low-income households. However, it would secure a dedicated funding source and be more straightforward to implement than a regionwide credit.

Finally, as a flat supplement that is automatically distributed, it would have particular power. A significant barrier to households receiving tax credits is that the taxpayers must apply for them, so much work has been done to make credits as automatic as possible (see sidebar on page 24). But one obstacle to establishing automatic payments is the fact that many credits vary in amount based on family size. Family structures can change year to year, and who counts as a dependent for tax purposes can be complicated. Matching this supplement to the CalEITC and making it a flat amount regardless of family size would overcome these administrative challenges.

With these parameters, it would be straightforward to automatically distribute a local sales tax supplement to low-income households. In this way, it could function very much like a supplement to the CalEITC, magnifying those benefits. Jurisdictions could also use this option as a way to increase uptake of CalEITC by proactively sending out information for how to apply for the CalEITC when the supplement is distributed.

OPTION 3:

Local Sales Tax Benefit

Who's responsible: County or city governments, social service agencies

Another option for more immediate action is to create a locally funded and locally administered cash benefit. Structured as a flat cash benefit, this option could be designed to match eligibility requirements for other cash benefit programs implemented at the local level, such as supplemental food assistance (known as SNAP) or CalWorks (a state program that provides cash assistance to low-income families). The intention of this benefit would be to partially offset the total burden that low-income households in that jurisdiction face.

Implementation

Local governments could pass legislation to create the benefit and fund it from their general fund revenues, adjusting the total amount year to year. One option would be to administer the benefit through county social services agencies, which could utilize their existing infrastructure to identify eligible households, send out direct payments and create outreach campaigns. Clients who are already enrolled in other county-administered benefits programs would be automatically enrolled in the program; other eligible households would fill out a simple online or paper form to verify income and residency. The San Francisco Working Families Credit provides a possible model. This county-administered income supplement was piloted in 2005 as a 10% match of the federal EITC for San Francisco families, before it transitioned to a flat cash benefit. Families apply for the credit by submitting a separate application form outside of the traditional tax system. The San Francisco Human Services Agency manages eligibility approval by validating tax return information, and checks are processed by the Department of Finance. The county has funded marketing campaigns that encourage filing for the EITC as well.

Considerations

Like Option 2, this option has a narrower scope of impact than Option 1, benefitting only those low-income people who live in a jurisdiction that decided to create the program, and it would only relieve a portion of the sales tax burden for low-income residents. It would be dependent on general fund revenues, which can fluctuate year to year depending on the local government's financial health or political decisions. However, with this option, there would be more flexibility to set benefit amounts, distribute funds throughout the year and make adjustments to implementation over time. Many counties have the infrastructure in place to identify eligible households and distribute this kind of straightforward benefit, and we recommend they pursue programs that don't require additional applications for most households. This is an option that Bay Area cities or counties could pursue immediately, demonstrating its impact while building up the program over time.

Who's Missing Out on Tax Credits and Public Benefits?

An estimated 20% to 25% of households that are eligible for the EITC don't receive it, which has led to reforms in the last 20 years aimed at increasing the "uptake" of tax credits — and of public benefits more broadly. Below are some highlights of work at the federal and local levels:

Making credits easier to apply for: Research shows that outreach campaigns have limited impact and that many EITC households face barriers around affordable and trustworthy tax preparation assistance.³¹ Code for America's user research found that fear of making costly mistakes or reliving traumatic life events (e.g., divorce or death of a family member) often prevents people from filing in the first place. In response, Code for America partnered with Volunteer Income Tax Assistance (a program of the IRS) to create a website and mobile app dedicated to connecting low-income filers with tax preparers. The pilot was underway in 2020 when the COVID-19 pandemic hit and has rapidly scaled up to assist millions of taxpayers in receiving government stimulus funds in addition to their annual tax benefit.

Making credits automatic: In a number of European countries and Japan, taxpayers spend much less time filing their taxes than their U.S. counterparts. Governments prefill tax returns based on information collected from employers and financial institutions, and in some cases they only require the taxpayer to check a box on a government-issued postcard or respond to a text message to acknowledge that the pre-filled forms are correct. Similarly, a number of programs in the U.S have been created to facilitate automatic filing for low-income households, particularly to make tax credits easier to get. In the early 2000s, New York City partnered with the IRS to send out pre-filled tax forms to households they identified as eligible for the EITC, distributing millions of additional dollars. Researchers point out that this kind of simplified filing system and automatic tax benefits work best for those with simple filing statuses, such as single people with no dependents, which could cover the majority of low-income households (an estimated 13 million Californians or more). However, the question of family size (who qualifies and how to verify) can often make these automatic tax benefit payments more challenging.

³¹ Elizabeth Linos et al., *Increasing Take-Up of the Earned Income Tax Credit*, California Policy Lab, January 2020, <https://www.capolicylab.org/wp-content/uploads/2020/05/Increasing-TakeUp-of-the-Earned-Income-Tax-Credit.pdf>; and Code for America, "The Power of Cash: Closing the Participation Gap for the Earned Income Tax Credit Program," January 23, 2020, <https://www.codeforamerica.org/news/the-power-of-cash>



A few jurisdictions, such as Montgomery County, Maryland, have gone as far as distributing automatic benefits under certain circumstances — and a number of reforms were enacted earlier this year to make the COVID-19 federal stimulus checks an automatic payment for many households. Significant political opposition from the tax preparation industry, however, would need to be overcome to streamline tax filing and fully automate tax benefit payments.³²

Bundling public benefits: Public benefits like unemployment insurance, cash and nutrition assistance are notoriously difficult to get (often by design). Because many clients who are eligible for one benefit program are often eligible for others, efforts to coordinate among agencies and increase access to multiple government benefits have significant impacts. Programs that already exist and provide a one-stop shop for accessing government benefits can serve as a model. BenePhilly was started in 2008 as a partnership between the City of Philadelphia and a nonprofit that uses data matching technology to identify what other benefits a client may be eligible for. With one phone call or an in-person meeting, a client can be enrolled in several different benefit programs at once. BenePhilly has served over 110,000 people and distributed \$350 million in additional benefit dollars.

Innovations around automatic payments, easy filing and access to benefits could all be applied to increase the uptake of a new program like a Sales Tax Fairness Credit in the Bay Area.

³² Justin Elliott and Paul Kiel, "Inside Turbo Tax's 20-Year Fight to Stop Americans From Filing Their Taxes for Free, ProPublica, October 17, 2019, <https://www.propublica.org/article/inside-turbotax-20-year-fight-to-stop-americans-from-filing-their-taxes-for-free>

Conclusion

Sales taxes may seem like an afterthought or a necessary evil, but they play an outsized role in reinforcing structural inequity in the Bay Area. The burden of these taxes is disproportionately felt by the lowest-income households, which pay three times more than their wealthy counterparts as a share of their income. If taxes are more than revenue-raising tools, if they reflect our collective sense of fairness and shared values, then we must reimagine our approach to sales tax. A sales tax credit is one tool that Bay Area governments can use to address these impacts on low-income households. In an economy with such profound instability, a benefit like this can have a sizeable impact on financial security, advancing a more just tax code and a more equitable region.

Appendix A

Methodological Summary – Sales Tax Incidence Analysis for the Nine-County Bay Area

Introduction

The Institute on Taxation and Economic Policy (ITEP) was engaged by the San Francisco Bay Area Planning and Urban Research Association (SPUR) to assess the impact of state and local sales taxes on Bay Area residents at different income levels and to design some potential tax credits that would help offset the regressive nature of these taxes. A regressive tax is one in which the effective tax rate — tax paid as a share of income — increases as income decreases.

ITEP has produced sales tax incidence analyses at the state level for decades and welcomed the opportunity to work with SPUR to develop similar analyses at the regional level. What follows is a description of the methodology ITEP employed to produce the Bay Area sales tax incidence analysis.

Step 1. Estimate California state and local sales taxes by income quintile based on ITEP’s personal income tax microsimulation and consumption tax models.

ITEP began its analysis by first estimating state and local sales taxes as a share of income for all California residents in 2017 for each income quintileⁱ using its consumption tax model and personal income tax microsimulation model.ⁱⁱ The consumption tax model combines information on consumer spending from the Consumer Expenditure Survey with information about what items are subject to tax at what rate(s) in the state of California in order to generate estimates of total sales tax paid by income quintile. Combined with data on the number of tax unitsⁱⁱⁱ and their respective incomes from ITEP’s personal income tax model, we are able to generate estimates of total state and local taxes paid by all California residents; the amount of taxes exported out of state to visitors and businesses; the average effective tax rate for California residents within each income quintile; and the average tax paid in dollars by California residents within each income quintile.

Step 2. Adjust initial estimate from Step 1 to match Board of Equalization (BOE) sales tax collection data.

Secondly, ITEP calibrated its initial estimates of total sales taxes by comparing its estimates to the BOE’s statewide sales tax collection data for tax year 2017 and adjusting to hit those collection targets. (The ITEP model initially grows spending at a constant rate matching income growth but makes a standard adjustment to match collections to account for differential growth rates between spending and income.)

Step 3. Determine a Bay Area resident’s share of state and local sales taxes using ITEP’s personal income microsimulation model.

The next step was to determine what portion of total California sales taxes — state and local taxes — within each income group were paid by residents of the nine-county Bay Area region. Using zip code data from the DataSF open data portal^{iv} and IRS individual income tax return data^v for California (tax year 2016), ITEP was able to assign a Bay Area resident marker to a subset of the California tax records in its microsimulation tax model to represent the Bay Area population. After validating the model results against the IRS zip code data for the number of total returns, income, returns by income and nonfilers, along with general California Bay Area

population statistics, we were able to determine the distribution of Bay Area tax units within the statewide income distribution, their share of total returns and taxes within each income group, and thus an estimate of total California state and local sales taxes coming from sales within the Bay Area.

Step 4. Adjust Bay Area sales tax estimates to account for higher visitor and national business purchases as a share of total sales collections compared to the rest of the state.

From the initial estimate of total California state and local taxes coming from the Bay Area, we used California travel impacts data from 2010–2018^{vi} to adjust the percentage of total sales attributed to purchases from out-of-state visitors via tourism or business expenses from travel. Because travel-related sales as a percent of total sales are 7.7% in the Bay Area compared to 7% for the state overall, we increased the share of Bay Area taxes being exported by 10%.

Steps 5 and 6. Adjust Bay Area local taxes to account for higher Bay Area local effective tax rates and validate distribution of Bay Area sales taxes as a share of statewide sales taxes against regional tax collection estimates.

The next set of adjustments to the tax data for Bay Area residents was to account for the higher local tax rates levied in the region compared to the rest of the state. Using California Department of Tax and Fee Administration Tables 1–6, 2017^{vii} and Apr2020-City-Rates provided by SPUR, we were able to determine average local tax rates for the Bay Area (2.9%) compared to the average statewide (2.6%) and increase the allocation of total local taxes being paid by Bay Area residents by 13% to account for the differences in local levies statewide.

We then checked the Bay Area sales tax estimates against collection estimates computed from the CDFTA Tables 1–6 combined with Apr2020-City-Rates data to test our methodology so far and identify the need for any further adjustments.

Step 7. Adjust Bay Area state and local tax estimates to account for changes in consumption between 1997 and 2017 Consumer Expenditure Survey (CEX) data.

Our final adjustments were to address changes in underlying consumption patterns between the 1997 Consumer Expenditure Survey (data foundation for ITEP’s current consumption model) and the 2017 Consumer Expenditure Survey produced by the Bureau of Labor Statistics. We examined budget shares spent on a broad collection of spending categories^{viii} by income quintile between 1997 and 2017. While there were variations between spending as a share of income within categories, taken as a whole these changes amounted to a very small increase in spending for the top 20% and slight downward adjustments for the bottom 80% between 1997 and 2017. We adjusted the aggregate sales tax estimates assigned to each of these income groups accordingly to account for these subtle changes in consumption.

Consumption Factor Adjustments Between 1997 and 2017 CEX

	QUINTILES					
	ALL	0 TO 20	20 TO 40	40 TO 60	60 TO 80	> 80
Expenditures, Total	1.000	0.998	0.996	0.996	0.996	1.001

Step 8. Move Bay Area resident tax estimates from the statewide income distribution to the Bay Area income distribution for final calculation of incidence by income group.

Our final step in the analysis was to calculate the average state and local sales taxes paid as a share of income and average dollars paid for Bay Area residents. To compute these final statistics, we determined the income distribution for just Bay Area tax units (as opposed to all California residents) using ITEP’s personal income tax model and moved Bay Area tax units (and their associated sales taxes) from their respective locations in the statewide income distribution into the Bay Area income distribution. The resulting summary statistic of sales tax as a share of income was calculated by dividing aggregate sales taxes paid per income quintile by aggregate income held by that income quintile; average tax in dollars was calculated by dividing the aggregate sales taxes paid per income quintile by the aggregate number of tax units in each income quintile.

Endnotes

- I Each income quintile represents 20% of the population.
- II 2017 was used as the base year for this analysis because it is the year for which we had core IRS data for California by zip code as well as the most recent Consumer Expenditure Survey data.
- III “Tax units” for the purposes of this analysis means economic units that for personal income tax purposes would constitute all primary filers and dependents.
- IV DataSF, <https://data.sfgov.org/Geographic-Locations-and-Boundaries/Bay-Area-ZIP-Codes/u5j3-svi6>
- V The IRS data indicated selected income and tax items by state, zip code and size of adjusted gross income.
- VI Dean Runyan Associates for Visit California, April 2019.
- VII Tables included statewide taxable sales by type of business, taxable sales by county, taxable sales in California counties by type of business, taxable sales in California cities by type of business, taxable sales in unincorporated areas by type of business, and taxable sales allocated countywide by type of business.
- VIII Categories of spending examined included food, alcoholic beverages, housing, apparel and services, transportation, health care, entertainment, personal care products and services, reading, education, tobacco products and smoking supplies, miscellaneous, cash contributions, and personal insurance and pensions.



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