



ADMINISTRATIVE SERVICES DEPARTMENT

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CITY COUNCIL STAFF REPORT

Meeting: October 10, 2023

Subject

Establish a General Fund Sales Tax Repayment Reserve

Recommended Action

- A. Approve an amendment to the City’s Committed, Unassigned Fund Balance, and Use of One Time Funds Policy to:
- i. Create a General Fund Sales Tax Repayment Reserve with an initial allocation of \$56.5 million
 - ii. Authorize staff to increase the Sales Tax Repayment Reserve when the City receives additional sales tax revenue in dispute
 - iii. Decrease the General Fund Capital Projects Reserve by \$10.0 million
 - iv. Decrease the General Fund Economic Uncertainty Reserve by \$6.0 million

Reasons for Recommendation

The anticipated outcome of the CDTFA audit of a City taxpayer is expected to have significant financial implications for the City’s operations.

Background

The California Department of Tax and Fee Administration (CDTFA) is responsible for administering the distribution of sales and use tax in California. Businesses in California must register for a sales tax permit, collect taxes from customers, and report their sales taxes accurately and timely. These taxes, along with information about their allocation to jurisdictions, are then forwarded to the CDTFA, which distributes them to the appropriate jurisdictions. Additionally, the CDTFA conducts audits on businesses to ensure compliance with tax laws and regulations.

The City receives a share of the sales tax revenue generated within its boundaries, which funds a wide range of City services and programs.

CDTFA Audit

In May 2022, the City received a letter from the CDTFA regarding an ongoing review of the allocation of sales and use tax revenue from one of the City's taxpayers. Although this audit has not concluded, the City anticipates a final decision from the CDTFA that will significantly reduce the City's sales and use tax revenue.

The CDTFA's eventual audit decision may require a one-time repayment of sales tax revenue collected since April 2021, estimated at \$56.5 million as of June 2023. Additionally, as outlined in the FY 2023-24 Adopted Budget, ongoing sales tax revenue is projected to drop by approximately \$30 million, a 73% reduction from initial forecasts.

Creation of a Sales Tax Repayment Reserve

To prepare for a potential adverse CDTFA decision and the uncertain outcome of the anticipated legal challenge, City staff recommends establishing a committed General Fund Sales Tax Repayment Reserve. Committed fund balance, as described on page 165 of the FY 2023-24 Adopted Budget, "includes amounts that can only be used for the specific purposes determined by formal action of the City's highest level of decision-making authority, the City Council. Commitments may be changed or lifted only by the City taking the same formal action (resolution) that imposed the constraint originally."

The purpose of this reserve is to set aside funds for potential sales tax repayments to the CDTFA. Staff proposes an initial allocation of \$56.5 million, corresponding to sales tax revenue received between April 2021 and June 2023 that the City may need to repay to the CDTFA. Additional sales tax revenue received by the City may increase the amount owed. To address this, staff recommends that the City Council grant staff the authority to augment this reserve as needed when additional disputed sales tax revenue is received.

The reserve is proposed to be funded as follows:

- \$40.5 million from General Fund Unassigned fund balance.
- \$10.0 million from the General Fund Capital Projects Reserve.
- \$6.0 million from the General Fund Economic Uncertainty Reserve.

The following table illustrates the impact of creating the new reserve on fund balance:

	FY 2023-24 Adopted	FY 2023-24 Amended	Change
General Fund			
Unassigned	44.1	3.6	(40.5)
Capital Projects Reserve	10.0	-	(10.0)
Economic Uncertainty Reserve	24.0	18.0	(6.0)
Sales Tax Repayment Reserve	-	56.5	56.5

If the reserve is established, the City Council retains the authority to approve the use of committed funds. If an adverse CDTFA decision becomes final, the City Council can authorize the use of funds for repayment. Conversely, if repayment isn't necessary, the City Council has the discretion to release the commitment and use the funds for alternative purposes.

Next Steps

Regular and routine reports on the reserve will be provided to the City Council. Council check-in points in January and April, along with the existing first-quarter budget update in November and mid-year budget update in February, will provide opportunities to communicate progress on the CDTFA audit and budget-balancing strategy.

Sustainability Impact

No sustainability impact.

Fiscal Impact

Allocating \$56.5 million to the Sales Tax Repayment Reserve sets aside funds for potential sales tax repayments to the CDTFA. Funding will come from Unassigned fund balance, the Capital Projects Reserve, and the Economic Uncertainty Reserve.

California Environmental Quality Act

Not applicable.

Prepared by: Thomas Leung, Budget Manager

Reviewed by: Kristina Alfaro, Director of Administrative Services

Approved for Submission by: Matt Morley, Assistant City Manager

Attachments:

A – Committed, Unassigned Fund Balance, and Use of One Time Funds Policy Clean

B – Committed, Unassigned Fund Balance, and Use of One Time Funds Policy Redline