February 3, 2014

Turf Wars: Territoriality and the Allocation of Sales and Use Taxes in California

Kevin Schmitt, None
Turf Wars
Territoriality and the Allocation of Sales and Use Taxes in California

Kevin J. Schmitt
# Table of Contents

**Abstract** 1  
**Introduction** 1  
**I. Sales and Use Taxes in California** 3  
  **A. Background** 3  
    1. **Federal Constitutional Nexus Requirements for State Sales and Use Taxes** 3  
    a. **Due Process Clause Nexus: Minimum Contacts** 4  
    b. **Commerce Clause Nexus: Physical Presence** 6  
  2. **Sales and Use Taxes** 11  
  **B. The Bradley-Burns Uniform Local Sales and Use Tax Law** 17  
**II. Problems with the Situs-Based System** 20  
  **A. The Fiscalization Land Use and the Attendant Side Effects** 20  
    1. **Fiscalized Land Use Planning** 20  
    2. **Disparities in Local Revenues** 22  
    3. **Nonproductive Inter-Governmental Competition** 24  
  **B. Fiscalized Land Use in Practice** 25  
    1. **Incentive Payments: Ventura and Oxnard Battle for Retail Business** 26  
    2. **Buying Companies: Oakland and United Airlines Make a Deal** 28  
    3. **Sales Office Consolidation: Fillmore Hires Outside Help** 30  
**III. Possibilities for Reform** 31  
  **A. Structural Reform** 32  
    1. **Population-Based Allocation** 32  
    2. **Tax Base Revision** 34  
    3. **Local Partnerships and Revenue Sharing** 35  
  **B. Incremental Reform** 38  
**Conclusion** 44  
**Appendix A** 46  
**Appendix B** 48
Abstract

Sales and use tax revenue provides an important source of funding for California’s local governments, particularly its cities. Under the Bradley-Burns Uniform Local Sales and Use Tax Law, local governments may enact sales and use tax ordinances and contract with the state to manage collection and distribution. The current allocation system, known as the situs-based system, provides for distribution to local government based on the physical location of the retailer. Although such a system has logical appeal, in practice it has proven highly problematic, promoting unproductive competition among local governments for scarce revenue.

Reform of the situs-based allocation process has drawn attention from primarily political and policy-focused sources, but there has been little in the way of legal scholarship addressing these problems. This article aims to fill this gap by analyzing the situs-based system from a legal standpoint, as a complement to existing policy analysis of the issue, emphasizing the central role of territoriality in state and local taxation. First, it provides a background to sales and use taxes in California, with emphasis on federal constitutional limits, theoretical issues with sales and use taxes, and an overview of the Bradley-Burns law. Second, it highlights the range of problems associated with the situs rule. Finally, it examines a range of possible reforms of the system to combat some of these problems.

Introduction

Sales and use taxes\(^1\) constitute a significant source of local government revenues. Between fiscal years 1996-97 and 2010-11,\(^2\) the State Controller reported that these taxes accounted for an average of a little less than 25\% of city general fund revenue and over 8\% of total revenue.\(^3\) If anything, amounts reported for city governments probably tend to understate the importance of these taxes. As part of the debt financing bonds approved in 2004, when voters adopted Proposition 57, the local sales tax rate was reduced and the lost funds replaced by

\(^1\) As used in this article, “sales tax” refers to the retail sales tax. While other forms of sales taxes exist – such as the general sales tax, gross receipts tax, or gross income tax – the retail sales tax is the dominant form of sales taxation and the form used in California. WALTER HELLERSTEIN ET AL., STATE AND LOCAL TAXATION: CASES AND MATERIALS, 605 (9th ed. 2009) (“The most significant form of sales taxation in this country . . . is the retail sales tax.”); ALAN J. AUERBACH, CONSUMPTION TAX OPTIONS FOR CALIFORNIA, 8-10 (June 2011), available at http://www.ppic.org/content/pubs/report/R_611AAR.pdf at 8-10 (overview of state and local sales tax in California, including criticisms of the current system).


\(^3\) See Appendix A.
transfers of property taxes from school districts. The state then reimbursed the school districts, in a process known as the “triple flip.” Thus, for the seven years of data available after this shift, the transfer of taxes under the state’s debt-financing bonds have led to a nominal decline in sales and use tax revenue for local governments that likely would not have occurred otherwise. In a 2007 report on local financing, for example, the Legislative Analyst’s Office noted that, for fiscal year 2006-07, “local governments still receive[d] the equivalent of a 1.25 percent rate on taxable sales – or about $7 billion.” Prior to the “triple flip” associated with the Proposition 57 bonds, sales tax revenue had risen to account for just below 30% of city general fund, making it an extraordinarily important source of discretionary funds. This significantly outpaced the growth of property tax revenue, the traditional source of most local government funding. These taxes have proven far less important for counties, where they have accounted for an average of only 1.27% over the same time period, but sales and use taxes overall clearly provide an important supplement to the property tax and other sources of revenue for all local governments.

Local sales taxes in California are imposed on the retailer and collected by the state. The state then allocates the revenue to the corresponding jurisdiction based on the location of the seller. Because this system depends on the physical site of the retailer, observers and analysts refer to it as a “situs-based” system. In principle, such an allocation system reflects common sense and aligns with analogous federal constitutional doctrine regarding interstate taxation. After all, it seems only fair that the particular local entity hosting the retailer and providing support services benefit from the tax on that retailer’s activities. In practice, however, this has led to a variety of negative outcomes as local governments engage in unproductive competition amongst each other. While many of these problems are inherent to the situs-based system, the overall California tax regime tends to exacerbate them. With other revenue sources constrained by the use of special funds and the limitations on property taxes and general tax increases under Proposition 13, sales tax revenue has become an especially valuable revenue source for local governments.

---

5 CAL. STATE CONTROLLER’S OFFICE, CITIES ANNUAL REPORT, FISCAL YEAR 2010-11, v (Sept. 11, 2012), available at http://www.sco.ca.gov/Files-ARD-Local/LocRep/1011cities.pdf at p. v (“This is the seventh year for the shift of 0.25% Bradley-Burns sales and use tax from the cities to the State to repay Economic Recovery Bonds.”).
6 HILL, ISSUES AND OPTIONS, supra note 4 at 4.
7 See Appendices A.
8 See Appendix B.
10 For a fuller overview of the local sales tax allocation system, see, infra, Part I.B.
governments. The pressure to attract lucrative businesses from other local jurisdictions has therefore led to a wide array of problems in terms of land use planning, local finance, and general principles of economics.

This article surveys the issues related to the situs-based sales tax allocation structure in California, a topic which has previously drawn some concern from policy analysts but has received relatively little attention in legal scholarship. Part I provides a conceptual background for state and local sales taxation, including an overview of California’s Bradley-Burns Uniform Local Sales and Use Tax Law. Part II describes many of the problems associated with the situs-based allocation system, particularly with reference to events occurring in the last decade that will inform new approaches to this issue. Finally, Part III outlines some of the contemplated solutions presented up to this point, which include both structural changes to the sales tax as well as minor, incremental reforms.

I. Sales and Use Taxes in California

A. Background

1. Federal Constitutional Nexus Requirements For State Sales and Use Taxes

Federal courts have long recognized that the Constitution limits the ability of states to enact regulations that affect commercial activity across state lines. In the realm of taxation, the longstanding doctrine of the post-New Deal era has been, in the words of Justice Harlan Stone, to balance “the double standard that interstate business shall pay its way, and at the same shall not

\[\text{footnote text}\]

\[\text{footnote text}\]

\[\text{footnote text}\]

\[\text{footnote text}\]
be burdened with cumulative exactions which are not similarly laid on local business.”\footnote{Western Live Stock et al. v. Bureau of Revenue et al., 303 U.S. 250, 258 (1938).} Thus, while recognizing the need for state and local jurisdictions to recoup the costs of providing a marketplace for out-of-state businesses, the courts have primarily sought to avoid multiple taxation of business activity.

In enforcing this principle, courts have relied on two key constitutional provisions: first, the Fourteenth Amendment’s protection against “depriv[ations] . . . of life, liberty, or property, without due process of law”\footnote{U.S. Const. amend XIV, § 1.}; second, the power of Congress “[t]o regulate commerce . . . among the several states.”\footnote{Id. at art. I, § 8, cl. 3.} Together, these provisions have led the federal courts to focus their state tax analyses on the level of intrastate activities in assessing state taxation. As discussed below, the Commerce Clause has proven far more important in recent decades, making that provision the central issue in many state tax controversies under the federal Constitution. In both contexts, though, the Supreme Court has typically viewed taxing limitations in terms of a state’s territorial political boundaries.

a. Due Process Clause Nexus: Minimum Contacts

Application of the Due Process Clause to state taxation focuses on questions of fundamental fairness.\footnote{See Quill Corp. v. North Dakota By and Through Heitkamp, 504 U.S. 298, 312 (1992) (“Due process centrally concerns the fundamental fairness of governmental activity.”).} In the much-noted \textit{International Shoe} opinion, for example, the Supreme Court upheld a state tax levied against an out-of-state corporation where the company’s in-state activities were “systematic and continuous” resulting in “a large volume of interstate business, in the course of which [the corporation] received the benefits and protection of the laws of the state.”\footnote{International Shoe Co. v. Washington, 326 U.S. 310, 320 (1945).} As a result, the Court concluded that “these operations establish sufficient contacts or ties with the state of the forum to make it reasonable and just according to our traditional conception of fair play and substantial justice to permit the state to enforce the obligations” of the tax.\footnote{Id.} A decade later, the Court articulated the basic principle for assessing state taxes under the Due Process Clause in even clearer terms. In \textit{Miller Bros. Co. v. Maryland}, the Court surveyed its opinions on the subject, noting that these cases had not established a clear line of
authority and had instead approached the matter rather haphazardly.\textsuperscript{22} Out of the apparent chaos, however, the Court identified “consistent adherence to one time-honored concept: that due process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.”\textsuperscript{23}

This “minimum connections” principle focuses due process controversies of this kind on the nature and extent of in-state activities. In part, this is due to the fact that the “power to tax ‘is an incident of sovereignty’” and courts recognize that “‘[a]ll subjects over which the sovereign power of a State extends, are objects of taxation.’”\textsuperscript{24} In other words, limits on a state’s sovereignty beyond its political boundaries necessarily mean territorial limits on that state’s tax jurisdiction. This led to significant initial overlap with the Commerce Clause, with the Court construing both clauses to “forbid the States to tax ‘“extraterritorial values.”’”\textsuperscript{25} Indeed, it used to analyze both concepts together. In \textit{National Bellas Hess, Inc. v. Illinois Department of Revenue}, the Court explicitly stated that “[t]he two claims are closely related” and that the tests for each “are similar.”\textsuperscript{26} \textit{Bellas Hess} involved a dispute as to whether the State of Illinois could compel collection of the use tax by a mail order business whose only in-state activity involved transportation of goods by the postal service or other common carrier.\textsuperscript{27} In an opinion that intertwined Due Process and Commerce Clause concerns, the Court ultimately held that the state’s attempt to force the retailer to collect the use tax violated the Constitution.\textsuperscript{28}

Later, however, the Court began to differentiate between the two clauses in the area of state taxation. Contrary to the \textit{Bellas Hess} assertion that such challenges are “closely related,” the Court’s doctrine has evolved to recognize that “while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause” and that “the Due Process Clause and the Commerce Clause reflect different constitutional concerns.”\textsuperscript{29} Thus, the Court in \textit{Quill Corp.}, which also involved an out-of-state mail order company, overruled \textit{Bellas Hess} to the extent that that case required a taxpayer’s physical presence within the state for Due Process purposes based on

\begin{itemize}
\item \textsuperscript{22} 347 U.S. 340, 344.
\item \textsuperscript{23} Id. at 344-45.
\item \textsuperscript{25} MeadWestvaco Corp. ex rel. Mead Corp. v. Illinois Dept. of Revenue, 553 U.S. 16, 19 (2008) (citations omitted).
\item \textsuperscript{26} 386 U.S. 753, 756 (1967).
\item \textsuperscript{27} Id. at 754.
\item \textsuperscript{28} Id. at 760.
\item \textsuperscript{29} Quill Corp., supra note 19 at 305.
\end{itemize}
intervening case law. Following *Quill Corp.*, the touchstone of Due Process nexus analysis is whether “income attributed to the State for tax purposes [is] rationally related to ‘values connected with the taxing State.’”

Despite this departure from *Bellas Hess* and other earlier cases conflating Due Process and interstate commerce concerns, however, the principal question remains whether the taxpayer has some connection within the taxing state’s territorial jurisdiction.

b. Commerce Clause Nexus: Physical Presence

The Commerce Clause confers on the federal government the power to regulate interstate commerce. Courts have held that this grant of power to the federal government carries with it a restriction of state power. The constitutional grant of authority to Congress to regulate interstate commerce implies, according to the Supreme Court, that states have limited authority to do so. “The very purpose of the Commerce Clause,” wrote Justice Stewart in *Bellas Hess*, “was to ensure a national economy free from . . . unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control.”

While the Court in *Quill Corp.* saw fit to overrule *Bellas Hess* on Due Process grounds, it agreed with that earlier case’s holding regarding the Commerce Clause. Part of this decision rested on the Court’s conclusion that the two provisions represent different constitutional values. Due Process, the Court in *Quill Corp.* held, concerns “fundamental fairness” and “‘notice’ or ‘fair warning’ [is] the analytic touchstone.” By comparison:

. . . the Commerce Clause and its nexus requirements are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills. In this light, we have interpreted the negative implication of the Commerce Clause.  

---

30 Id. at 308.
31 Id. at 306 (citations omitted).
32 *Bellas Hess*, supra note 26 at 760.
33 *Quill Corp.*, supra note 19 at 312.
Historical scholarship has called into question this notion of hyper-competitive states threatening the free movement of goods as the impetus for the Commerce Clause.\(^{34}\) On the other hand, it was given as justification for federalization at the time of the founding. Hamilton in particular warned of the “competitions of commerce”\(^{35}\) and emphasized the advantages of “unrestrained intercourse between the States.”\(^{36}\) Regardless, this view has dominated the Court’s approach to interstate commerce issues and has had a profound impact on the development of the Dormant Commerce Clause.

Compared to the evolution of the Due Process standard for state taxation outlined above, which although uneven at times remained consistent in its purpose, the Court’s Dormant Commerce Clause doctrine has undergone substantial change since its inception. Early cases interpreted the Commerce Clause as a strict, absolute ban on state taxes that burdened interstate commerce. The Court’s reading of the Commerce Clause during this time led it to conclude:

\[\ldots\text{ that no state has the right to lay a tax on interstate commerce in any form whether by way of duties laid on the transportation of the subjects of that commerce, or on the receipts derived from that transportation, or on the occupation or business of carrying it on, and the reason is that such taxation is a burden on that commerce, and amounts to a regulation of it, which belongs solely to congress [sic].}\(^{37}\)

During the *Lochner* era, the Court looked to whether state taxes directly or indirectly affected interstate commerce. The Court invalidated direct taxes as unconstitutional, but upheld indirect ones.\(^{38}\) The Court eventually abandoned this standard in favor of the Justice Stone’s philosophy of preventing multiplicity of taxation.\(^{39}\) This remains the Court’s primary objective in interstate taxation cases and has shaped the subsequent case law on this issue.

\(^{34}\) See HELLESTEIN ET AL., STATE AND LOCAL TAXATION, *supra* note 1 at 105 (indicating that “historians have begun to question the extent of actual ‘interstate commercial warfare’ among the states in the 1780s” and summarizing research on the matter).

\(^{35}\) THE FEDERALIST NO. 7, at 111 (Alexander Hamilton) (Kramnick ed. 1987)

\(^{36}\) THE FEDERALIST NO. 11, at 132 (Alexander Hamilton) (Kramnick ed. 1987)


\(^{38}\) See, e.g., Brennan v. City of Titusville, 153 U.S. 289, 302 (1894) (“\ldots\text{ nothing which is a direct burden upon interstate commerce can be imposed by the state without the assent of congress [sic]’ and “the silence of congress [sic] in respect to any matter of interstate commerce is equivalent to a declaration on its part that it should be absolutely free.”); Adams Express Company v. Ohio State Auditor, 165 U.S. 305, 311 (concluding that tax only “indirectly” burdened interstate business because it was “essentially a property tax, and, as such, not an interference with interstate commerce”).

\(^{39}\) *Supra*, note 16.
The current standard for Dormant Commerce Clause tax issues derives from the Court’s opinion in *Complete Auto Transit, Inc. v. Brady.* In ruling on an out-of-state corporation’s challenge to state tax statutes, the Court noted that the corporation “did not allege that its [in-state] activity . . . does not have sufficient nexus with the State; or that the tax discriminates against interstate commerce; or that the tax is unfairly apportioned; or that it is unrelated to services provided by the State.” This was not a new standard but a distillation of existing Commerce Clause doctrine. In fact, the Court cited to a long string of cases raising these specific issues in support of this list of criteria. Nevertheless, numerous opinions from an array of jurisdictions have drawn on this list of factors, leading to the gradual development of the *Complete Auto* test for state taxes. This test emphasizes the territorial limits on taxing authority: “Two of *Complete Auto*’s factors – substantial nexus and apportionment – directly addressed concerns about extraterritorial exercises of taxing jurisdiction and the dangers of multiple taxation.” This article focuses on the substantial nexus prong, as it is the most significant in terms of sales and use tax jurisdiction.

Commerce Clause nexus represents a much more stringent standard than its Due Process counterpart. As discussed previously, both clauses limit extraterritorial taxation, but, as *Quill Corp.* recognized, based on different principles. *Quill Corp.* also held that a taxpayer “may have the ‘minimum contacts’ with a taxing State as required by the Due Process Clause, and yet lack the ‘substantial nexus’ with that State as required by the Commerce Clause.”

---

41 Id. at 277-78.
42 Id. at 278, fn. 6.
45 See In re Laptops Etc. Corp., 164 B.R. 506, 520 (Bankr. D. Md. 1993) (analyzing *Quill Corp.* to hold that Commerce Clause nexus “require[s] something more than ‘minimum contacts’” and that “unlike the due process ‘minimum contacts’ nexus analysis, the ‘substantial nexus’ requirement for Commerce Clause purposes is not ‘a proxy for notice,’ but instead a means of limiting the burdens which a sovereign may impose upon interstate commerce”).
46 See, supra, note 25.
47 See, supra, notes 32 to 36 and accompanying text.
48 *Quill Corp.* supra note 19 at 313.
concluded that, although the Due Process ruling of *Bellas Hess* had outlived its utility, the Commerce Clause analysis of that case remained viable and thus should be upheld.\(^{49}\) The Court appeared particularly concerned with the problem of “6,000-plus taxing jurisdictions,” noting that sales and use taxes in particular highlight the dangers of multiple taxation.\(^{50}\) This in turn has spawned disagreement over whether the Court intended to limit this holding to sales and use taxes.\(^{51}\) Despite this, *Quill Corp.* clearly does restrict a state’s sales tax nexus based on the physical location of the retailer.\(^{52}\)

*Quill Corp.* thus strictly adhered to the physical presence test for sales and use taxes, but Commerce Clause nexus could still loosen in the near future. The flip side of any Dormant Commerce Clause issue is, of course, Congress’s affirmative power under the constitutional text. As Justice Stevens stressed in *Quill Corp.* itself, the Commerce Clause grants authority to Congress, as compared to the Due Process Clause which restricts government action. He reminded Congress that, while it lacks the power to “authorize violations of the Due Process Clause,” it does have “plenary power to regulate commerce among the states and thus may authorize actions that burden interstate commerce.”\(^{53}\) Justice Stevens also found it “easier” to uphold the Commerce Clause ruling of *Bellas Hess* because of “the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve.”\(^{54}\) Justice Scalia, in his concurrence, put it more bluntly: “Congress has the final say over regulation of interstate commerce, and it can change the rule of *Bellas Hess* by simply saying so.”\(^{55}\) In his view, the Court was right to overrule the *Bellas Hess* Due Process rule while affirming its Commerce Clause holding, though he thought it should have done so simply based on *stare decisis* rather than re-visiting that case’s logic.\(^{56}\) Both

---


\(^{50}\) *Id.* at 313, fn. 6.

\(^{51}\) See, e.g., Tax Com’r of West Virginia v. MBNA America Bank, N.A., 220 W.Va. 163 (2006), *cert. denied*, 551 U.S. 1141 (2007) (concluding that the Court in *Quill Corp.* intended to limit the physical presence requirement to sales and use taxes).

\(^{52}\) See 56 Cal. Jur. 3d Sales and Use Taxes § 38.

\(^{53}\) *Quill Corp.*, supra note 19 at 305 (citations omitted.)

\(^{54}\) *Id.* at 318.

\(^{55}\) *Id.* at 334 (Scalia, J., concurring in part and concurring in the judgment).

\(^{56}\) *Id.* (“We have long recognized that the doctrine of *stare decisis* has ‘special force’ where ‘Congress remains free to alter what we have done.’”) (citations omitted).
opinions, as well as Justice White’s partial dissent, all-but openly invited Congress to overturn the physical presence test by statute.

Since Quill Corp., taxation of internet commerce has become perhaps the most pressing Dormant Commerce Clause issue. In disputes with one of the country’s biggest online retailers, Amazon.com, some states, including California and New York, have scored major victories. A national solution, however, remains elusive. Although Congress has yet to act to resolve these difficulties, there has been increasing momentum behind the most recent iteration of the Marketplace Fairness Act. This bill would permit states to require internet retailers to collect sales and use taxes on sales to in-state residents in two alternative situations. First, all states that are members of the Streamlined Sales and Use Tax Agreement (SSUTA) could begin collection within 90 days of providing notice of the state’s intent to use its authority. Second, states that are not SSUTA members may collect these taxes provided that they adopt certain measures, such as providing retailers with free software to calculate the amount of tax owed on each sale, which would help bring uniformity to the nation’s patchwork sales and use tax system. If enacted, the

57 Id. at 333 (White, J., concurring in part and dissenting in part) (“Although Congress can and should address itself to this area of law, we should not adhere to a decision, however right it was at the time, that by reason of later cases and economic reality can no longer be rationally justified. The Commerce Clause aspect of Bellas Hess, along with its due process holding, should be overruled.”)
60 S. 743, 113th Cong. (2013).
61 Id. at § 2(a).
62 Id. at § 2(b).
law could perhaps finally bring closure to one of the most contentious and vexing questions in constitutional law.

Whatever the eventual outcome, however, the saga of e-commerce under the Dormant Commerce Clause illustrates one of the key restrictions on state taxation. Moreover, the continued prominence of the physical presence test reveals that, just as with the Due Process Clause, territoriality is a primary concern under the Commerce Clause. This recognition helps frame the issues surrounding the principles of sales tax allocation to local governments in California.

2. Sales and Use Taxes

Sales and use taxes are alternative forms of taxation on the sale of tangible personal property within the taxing jurisdiction’s boundaries. Sales are subject to either tax, but not both, based on origin. If the sale occurs within the jurisdiction’s boundaries, then the sales tax applies; if the sale occurs outside the jurisdiction’s boundaries but the property is then shipped for consumption within its boundaries, then the use tax applies. As the Supreme Court has observed: “A sales tax is a tax on the freedom of purchase. . . . A use tax is a tax on the enjoyment of that which was purchased.” California follows this basic formulation, applying its sales tax to “the sale of all tangible personal property sold at retail in this state” and its use tax on “the storage, use, or other consumption of tangible personal property purchases from any retailer . . . for storage, use, or consumption in this state.” The state exempts sales subject to the sales tax from the use tax.

California, like most states, imposes the same rate under both types of taxes. The need for the use tax as a supplement to the sales tax arises from the constitutional issues described previously. As noted, both the Due Process Clause and the Commerce Clause limit a state’s

---

65 Cal. Rev. & Tax Code § 6051.
66 Id. at § 6201. Note that a use tax is also conceptually distinguishable from a property tax, meaning that provisions of the California Constitution relating to property taxes do not apply. 56 Cal.Jur.3d Sales and Use Taxes § 35; see also Douglas Aircraft Co. v. Johnson, 132 Cal.2d 545, 550 (1939).
67 Id. at § 6401.
68 See Cal. Rev. & Tax Code §§ 6051 et seq. (sales taxes), 6201 et seq. (use taxes).
ability to levy a tax on an out-of-state entity, thus focusing the jurisdictional question on the extent of the entity’s in-state activities. A sales tax is therefore inherently limited in the kinds of commercial activities it can reach – for example, a sale occurring outside of the state would always escape taxation, or at least would invite substantial litigation over the extent of the nexus involved. Use taxes provide an easy way to apply a similar tax to transactions not occurring within the taxing jurisdiction but nevertheless enjoying the benefits afforded by that jurisdiction’s services, such as police protection or transportation infrastructure, as well as preventing retailers from avoiding the sales tax by simply relocating out-of-state. In light of this, courts, including those of California, interpret the sales and use tax statutes “as an integrated whole,” reflecting the complementary nature of the two taxes. In fact, the sales and use tax dichotomy reflects one of the few accepted applications of the complementary tax doctrine, since the application of the sales tax to domestic sales offsets the otherwise discriminatory effects of the use tax. The legal incidence of the tax may fall either on the seller, who may pass it on to the consumer in the form of higher prices, or on the consumer directly, with the retailer merely acting as tax collector. In California, the sales tax is levied on the seller “[f]or the privilege of selling tangible property at retail” while the use tax imposes a duty to collect on the seller.

Sales tax practice often diverges from the theoretical ideal. Perhaps the most critical departure from the ideal involves exemptions of certain purchases, notably intangible goods and services. From an economic perspective, there is no reason to exempt any form of consumption from taxation. In other words, the sales tax should apply to all sales, including sales typically excluded:

69 See generally supra Part I.A.1.; Quill Corp, supra note 19 at 312-13 (describing the nexus tests under both due process and interstate commerce principles).
70 See Union Oil Co. of Cal. v. State Board of Equalization, 60 Cal.2d 441, 449 (1963) (“If the California businessman, intending to buy property for use in California, could avoid the sales tax merely by purchasing the product outside the state, the local retailer would suffer a severe commercial disadvantage. Hence, California imposes an excise tax upon the purchaser of tangible personal property in the event that, having paid no sales tax to California on the purchase, he proposes to and actually does store, or otherwise consume such property in this state.”); 67B Am.Jur.2d Sales and Use Taxes § 135 (“The use tax is correlative of and is complementary and supplemental to the sales tax, one of its principal purposes being to prevent the evasion of the sales tax.”).
71 Union Oil Co., supra note 70 at 449-50.
72 See Henneford v. Silas Mason Co., 300 U.S. 577, 584 (1937) (“When the account is made up, the stranger from afar is subject to no greater burdens as a consequence of ownership than the dweller within the gates.”)
73 Cal. Rev. & Tax Code § 6051.
74 Id. at §§ 6201, 6203(a).
75 DAVID BRUNORI, STATE TAX POLICY: A POLITICAL PERSPECTIVE, 67 (3d ed. 2011) (“In its purest form, the sales tax would apply to all final consumption. In economic terms, no real rationale exists for excluding some types of consumption and taxing other types.”).
A retail sales tax is generally considered a consumption tax, because its base includes household retail consumption expenditures. However, in California and elsewhere, there are two key differences between consumption and the basics of the sales tax. First, the tax base excludes many elements of household consumption. In some cases, these exclusions are aimed at encouraging the exempt activity (such as education) or at lessening expenses for lower-income individuals or those facing large medical purchases (e.g., prescription drugs). In other cases, including Internet and mail-order sales by out-of-state vendors without sufficient nexus, legal or administrative barriers make it difficult to collect sales taxes. In still other cases, the traditionally limited application of the sales tax to purchases of tangible goods has hindered the extension of the tax to cover services.\textsuperscript{76}

This has resulted in extensive litigation, leading to inconsistent approaches among legislatures, courts, and regulators as to the reach of sales and use taxes.

In one notable case concerning a services exemption, for instance, the D.C. Circuit held that the D.C. Tax Court had erred in applying the District’s use tax to the sale of mats used in printing comic strips for newspapers.\textsuperscript{77} According to the Circuit Court, the fact that the value of the mats was “less than ten per cent the amount charged” for the work of the cartoonists “was a sufficient basis for reaching the opposite conclusion” from that of the Tax Court.\textsuperscript{78} The court concluded that “[t]he price was paid for the artists’ work, i.e., for the right to reproduce the impressions on the mats, – not for the mats themselves.”\textsuperscript{79} For this reason, court held that the sale was excluded under the District’s use tax ordinance, which exempted personal service transactions involving “sales as an inconsequential element.”\textsuperscript{80} In a Georgia case decided around the same time, the state’s Court of Appeals based its interpretation of a sales tax statute on “the purpose of the customer” rather than the cost of the goods.\textsuperscript{81} Thus, the court found that the sale of materials used in repairing shoes were “incidental” to the object of the purchaser, “who primarily wishes to buy the skilled services of the shoe repairman.”\textsuperscript{82} Over time, the consensus has been to adopt the “true object” standard exemplified in the Georgia case, with states differentiating between taxable and non-taxable sales on the basis of the buyer’s intention in

\textsuperscript{76} Auerbach, Consumption Tax Options for California, supra note 1 at 8.
\textsuperscript{78} Id. at 24.
\textsuperscript{79} Id.
\textsuperscript{80} Id.
\textsuperscript{81} Craig-Tourial Leather Co. v. Reynolds, 87 Ga.App.360, 365 (1952).
\textsuperscript{82} Id.
seeking the transaction. Still, reaching this consensus has required a great deal of energy and effort that would not have otherwise been necessary absent the services exception.

Exempting intangible property has proven problematic as well. In recent decades, this has become particularly pronounced in the area of software sales. In the first high-court case on the subject, the Tennessee Supreme Court held that software sales were for intangible property and that the use of discs, punch cards, magnetic tapes, and other physical media were incidental to the actual purpose of the transaction. In other words, the court held that sale of software involves primarily the transfer of intangible information:

When the information is transferred from the tape to the computer, the tape is no longer of any value to the user; and it is not retained in the possession of the user. The information on the tape, unlike the phonograph record, is not complete and ready to be used at the time of purchase. It must be translated into a language understood by the computer. Once this information has been translated and introduced into the computer and the tapes returned or the punch cards destroyed, what actually remains in the computer is intangible knowledge; this is what was purchased, not the magnetic tapes or the punch cards.

Later cases confronted the difference between canned and custom software, with courts generally applying the sales tax to the former but not the latter. In the mid-1990s, however, the Louisiana Supreme Court issued a decision holding that software represents “knowledge recorded in a physical form” and that “[t]he purchaser of software neither desires nor receives mere knowledge, but rather receives a certain arrangement of matter that will make his or her computer perform a desired function.” This conclusion failed to gain traction in other

83 See Cal. Rev. & Tax Code § 6006 (defining “sale”); Cal. Code Regs. tit. 18, § 1501 (“The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true objects of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service. If the true object of the contract is the service per se, the transaction is not subject to tax even though some tangible personal property is transferred.”); City of Boulder v. Leanin’ Tree, Inc., 72 P.3d 361, 363 (Colo. 2003) (citing virtually identical Colorado regulation); WTAR Radio-TV Corp. v. Commonwealth, 217 Va. 877., (1977) (“The test applied by a preponderance of the authorities from other jurisdictions with sales tax statutes similar to our Virginia statutes is: if the ‘true object’ sought by the buyer is the services per se, the exemption is available, but if the true object of the buyer is to obtain the property produced by the service, the exemption is not available.”); In re Los Angeles Intern. Airport Hotel Associates, 196 B.R. 134, 139 (B.A.P. 9th Cir. 1996) aff’d, 106 F.3d 1479 (9th Cir. 1997) (“. . . the true object test should be used where the services and the property are inseparable and is inapplicable where these two elements are distinct.”) (quoting In re Advance Schools, Inc. 2 B.R. 231, 236).

84 Commerce Union Bank v. Tidwell, 538 S.W.2d 405, 408 (Tenn. 1976).


86 South Cent. Bell Telephone Co. v. Bartheley, 643 So.2d 1240, 1246 (La. 1994).
jurisdictions, with courts usually distinguishing that case insofar as it relied on Louisiana’s civil law tradition rather than the predominant common law system of the other states.87 States now generally deal with software sales by statute. In California, for instance, the definition of “sale” for the purposes of sales and use taxes does not apply to “the design, development, writing, translation, fabrication, lease, or transfer” of custom software.88 Again, however, these developments represent a prolonged process of adjustment brought on by the states’ policy decision to narrow the scope of the sales tax.

A further problem arises from how the states treat business purchases. Theoretically, sales and use taxes should exempt all business consumption, based on the principle that the tax is actually on the ultimate consumer rather than businesses along the supply chain.89 This avoids imposing the sales tax multiple times on a single item, a problem known as pyramiding.90 Instead, most states, including California, employ a “sale for resale” exemption that allows a seller to obtain a certificate exempting a sale from the tax.91 While this system exempts many business sales, it is far from perfect: an estimated 41% of business sales are still subject to the sales tax.92 As with the services and intangible property exemptions, this system has led to the need for extensive interpretation concerning the scope of the exemption. Thus, courts and administrative bodies have had to confront with the question of whether the sale-for-resale exemption applies to toys included in children’s fast food meals,93 travel agency brochures,94 carnival prizes,95 promotional items given out at sporting events,96 and disposable cups and other

---

87 See Gilreath v. General Elec. Co., 751 So.2d 705, 709 (Fla.App. 2009) ("... the view of the Louisiana court was that under its civil law system software consisted of knowledge recorded in a physical form. ... . [The court disagrees, and concludes that the views expressed in the other cited cases are more persuasive."]
89 BRUNORI, STATE TAX POLICY, supra note 75 at 73 (“Ideally, the sales and use tax should not be levied on consumption of business inputs.”).
90 Id. at 74 (“When business inputs are subject to the tax, the ultimate product price will contain the tax. Thus, consumers are taxed on the tax itself, an effect known as pyramiding. This outcome was probably unintended by policymakers.”).
91 See Cal. Rev. & Tax Code §§ 6007 (“retail sale” and “sale at retail” defined to exclude sales for “resale in the regular course of business”), 6091 et seq. (governing sale-for-resale certificates); Cal. Code Regs. tit. 18, § 1668(a) (sale-for-resale certificates “relieve the seller from liability for the sales tax and the duty of collecting the use tax”).
92 BRUNORI, STATE TAX POLICY, supra note 75 at 74.
94 Clark Franklin Press Corp. v. State Tax Commission, 364 Mass. 598 (1974) (resale exemption did not extend to brochures purchases by travel agency because the business’s primary purpose was to sell travel services, not brochures).
95 Prince v. State Tax Commission, 366 Mass. 470 (1974) (sale for resale exemption did not apply because prizes were inducements to play rather than intended for resale).
utensils used by restaurants. Additional difficulties arise in applying the resale exemption to businesses that primarily provide services, such as hotels and practicing professionals. This list is not exhaustive. Rather, it illustrates the range of problems states face in administering a needlessly complex sales and use tax systems.

Aside from these points where sales and use taxes stray from the theoretical ideal, the very concept of sales and use taxes raises a number of problems. Many critics contend that these taxes are regressive and fall disproportionately on low-income individuals. Because they tend to spend a greater portion of their pay than do wealthier persons, so the argument goes, the poor pay a greater share of their overall income. In an effort to combat this perceived regressivity, many sales taxes exempt purchases of essential items such as food and medicine, though this leads back to the problem with exemptions already discussed. Additionally, sales and use taxes, like income taxes, fluctuate substantially based on economic conditions, largely due to the myriad of exemptions applicable. In California in particular, where Proposition 13 severely

---

97 Wisconsin Dep’t of Revenue v. Milwaukee Brewers Baseball Club, 111 Wis.2d 571 (1983) (baseball bats and jackets given out to fans did not qualify for exemption because they were given away rather than sold); Minnesota Twins Partnership v. Commissioner of Revenue, 587 N.W.2d 287 (Minn. 1998) (same); Kansas City Royals v. Director of Revenue, 32 S.W.2d 560 (Mo. Banc. 2000) (exemption applied because cost of promotional items was factored into the price of admission).

98 Jan Co. Central, Inc. v. Commissioner of Revenue, 405 Mass. 686 (1989) (paper and plastic containers purchased by fast food company were inducements to attract sales, not part of the restaurant’s regular business); Sta-Ru Corp. v. Mahin, 64 Ill.2d 330 (1976) (disposable items purchases by Dairy Queen franchisee were not for resale because the franchisee was in the business of selling food rather than the containers); Burger King v. State Tax Commission, 51 N.Y.2d 614 (1980) (packaging a “critical element” of the final product and thus qualified for the exemption).

99 See Adamar of New Jersey v. Director, Division of Taxation, 17 N.J.Tax 80 (1997) (purchase of complimentary items provided to hotel guests not exempt); Helmsley Enterprises, Inc. v. Tax Appeals Tribunal, 187 A.D.2d 64 (N.Y. 1993) (same); Kansas City Power and Light Co. v. Director of Revenue, 83 S.W.2d 548 (Mo. Banc. 2002) (purchase of electricity for guest spaces was an exempt sale for resale); Nashville Clubhouse Inn v. Johnson, 27 S.W.3d 542 (Tenn. App. 2000) (hotel’s purchase of complimentary beverages and food for guests was an exempt sale for resale).

100 See Killbane v. Director, Department of Revenue, 544 S.W.2d 9 (Mo. 1976) (sale of crown and bridgework materials to dentists not exempt from collecting sales tax because dentists were engaged in providing a service rather than re-selling materials).

101 Brunori, STATE TAX POLICY, supra note 75 at 70-72 (overview of this criticism).

102 Id. at 71 (“In most states, food, utilities, medicine, and, in some cases, clothing are exempt from sales tax to some extent. . . . The exemption for necessities, however, does not necessarily reduce the regressivity of the tax” because they “apply to the wealthy as well as to the poor.”). See Cal. Code Regs. tit. 18, §§ 1591 (medicine and medical device exemptions), 1602 (food exemptions).

103 See, e.g., Brunori, STATE TAX POLICY, supra note 75 at 67 (“. . . the stability of the tax, one of its primary virtues, depends on a broad base. Only if the tax applies to all, or most, personal consumption can states maintain steady revenue levels through economic downturns. For various reasons, however, barely half of all personal consumption is subject to tax in the United States.”); Donald J. Boyd & Robert B. Ward, How To Address Rising Volatility in State Tax Systems, THE NELSON A. ROCKEFELLER INSTITUTE OF GOVERNMENT, April 2011, http://www.rockinst.org/observations/boydd/2011-04-how_to_address_volatility_in_taxes.aspx (last visited Dec. 4, 2013) (“If, for example, policymakers wish to exempt food from sales tax – as most states do in an effort to
limits the much more stable property tax, reliance on these volatile taxes led to a severe budget crunch following the collapse of the housing bubble and the ensuing recession in the late 2000’s. As one scholar observed, “When the economy is weak, tax collections of [sales and income] taxes shrivel, even as the demand for many government services increase.” The result is large deficits during bad economic times that add substantially to government debt.

Despite these problems, however, 45 states have a statewide sales tax. Additionally, as noted in the introduction to this article, these taxes provide an extremely important source of revenue for local governments, especially in a state such as California that strictly limits more traditional local revenue sources such as the property tax. As a result, California administers an extensive system of local sales and use tax collection and allocation.

B. The Bradley-Burns Uniform Local Sales and Use Tax Law

California law provides a mechanism by which local governments can levy their own sales and use taxes in conformity with state administration. That portion of the Revenue and Taxation Code devoted to this subject is commonly referred to as the Bradley-Burns Uniform Local Sales and Use Tax Law, or the Bradley-Burns Act, which the Legislature first enacted in 1955. The California Supreme Court, in interpreting this then-new law in 1957, held that Bradley-Burns “contemplates an integrated uniform system of city and county sales and use taxation” whereby “[t]he counties are given authority to impose sales and use taxes . . . , and the

counteract the regressive nature of the sales tax – there should be an understanding that narrowing the base of the tax in this way may make revenue declines during recessions somewhat sharper than they otherwise would be.

Understanding that can lead to other policy alternatives – for example, including food in the sales tax base, but enacting an income tax credit designed to offset its regressive effects.”; AUERBACH, CONSUMPTION TAX OPTIONS FOR CALIFORNIA, supra note 1 at 5 (highlighting volatility in California’s tax collection).

See Darien Shanske, What Would the Delegates Talk About? A Rough Agenda for a Constitutional Convention, 37 Hastings Const. L.Q. 641, 643-44 (2010) (highlighting common criticisms that California over-taxes and over-spends, but arguing that a more nuanced view is that “California’s fiscal base is too narrow and too unstable”).


Cal. Rev. & Tax. Code § 7200 et seq.

1955 Cal. Stats. 1311.
cities are furnished with a plan of state administration which will relieve them from operating collection systems of their own.”

The Legislature lacks the authority to impose local taxes, but may permit local governments to levy taxes. Bradley-Burns confers on counties the authority to levy sales and use taxes and recognizes the ability of cities to enact sales tax ordinances. This is a critical point, as local governments must rely on a grant of taxing power from the state, whether through the Constitution or by enactment of the Legislature. Charter cities have a bit more leeway. Specifically, courts have recognized that taxation constitutes a “municipal affair” under California’s home rule amendment to the Constitution. Even here, however, the power to tax derives from the general grant of charter authority by the Constitution.

Under Bradley-Burns, local entities establish their own sales and use tax ordinances and then contract with the State Board of Equalization to administer these taxes. The Board allocates revenues accordingly and receives compensation for providing this service. Allocation occurs in accordance with on the “situs-based” system, also referred to as the “situs rule.” This method allocates revenues to the appropriate jurisdiction on the basis of the actual, physical location where the sale occurred. It treats retail sales as “consummated at the place of business of the retailer,” and the Board distributes local sales and use taxes collected under contract to the individual local entity holding the contract. The one major exception involves the allocation of revenues from sales of jet fuel that are “consummated at the point of delivery of

108 Geiger v. Board of Sup’rs of Butte County, 48 Cal.2d 832, 837 (1957).
109 Cal. Const. art. XIII, § 24(a); see also County of Los Angeles v. Sasaki, 23 Cal.App.4th 1442, 1454 (“... the power of a local government to tax is not inherent” but is “derived from the Constitution upon authorization by the Legislature.”) (citations omitted).
110 Cal. Rev. & Tax Code § 7201.
111 Id. at 7202(h).
114 Cal. Rev. & Tax Code §§ 7201, 7202(a), 7303(a).
115 Id. at § 7202(d), (h)(4)
116 Id. at §§ 7204, 7204.3.
117 See HILL, ISSUES AND OPTIONS, supra note 4 at 4 (Bradley-Burns revenues “are predominantly allocated to specific cities or counties based on the site of the seller (sometimes called a situs-based system).”) (emphasis in original) LEWIS & BARBOUR, CALIFORNIA CITIES AND THE LOCAL SALES TAX, supra note 11 at 1 (referencing “California’s so-called situs rule, which returns local sales tax revenue – although collected by the state – to the jurisdiction in which the sale occurred”).
118 Cal. Rev. & Tax Code § 7205(a).
119 Id. at § 7204.
that jet fuel to an aircraft at a multijurisdictional airport.”

In such a case, the Board follows a specific set of rules for splitting revenues among the various jurisdictions at issue. Even here, however, the Board determines the location of the transaction and allocates tax money accordingly.

In adopting regulations governing its administration of the local sales tax, the Board has explicitly provided that “[l]ocal sales tax [be] allocated to the place where the sale is deemed to take place,” as determined in accordance with the statute and its regulatory guidelines, and that “[t]he local use tax ordinance of the jurisdiction where the property at issue is put to its first functional use applies to such use.” As a result, the Board must determine the actual, physical location where the sale occurred. When a retailer has only one place of business, for example, then “all California retail sales of that retailer in which that place of business participates occur at that place of business” unless the property is shipped out-of-state. Where a retailer has multiple places of business but only one California location participates in the sale, the sale occurs at that place of business. Finally, where a retailer has multiple places of business that participate in the sale, the sale occurs “where the principal negotiations are carried on.”

This system of allocation comports with what seems like a common sense assumption and an intuitive notion of fairness – namely, the idea that whichever jurisdiction hosts a retail transaction should receive the benefit of any tax on that transaction. Furthermore, the situs rule tracks the general theory of allocation in state taxation under the constitutional nexus theories discussed above, which tend to emphasize territorial limitations on state taxing regimes, not to mention similar state constitutional considerations of territoriality and local tax protections. A situs rule helps ensure that local government taxes reach activities within their jurisdiction and only those activities. It is therefore easy to understand why California has adopted such a system. While conceptually very simple, however, this allocation system has proven particularly troublesome under California’s current taxing regime.

120 Id. at § 7204.03(a).
121 Id. at § 7204.03(b); Cal Code Regs., tit. 18, § 1802(b)(6).
122 Cal. Code Regs., tit. 18, § 1802(d).
123 Id. at § 1802(a)(1).
124 Id. at § 1802(a)(2)(A).
125 Id. at § 1802(a)(2)(B).
126 See, supra, Part I.A.1.
127 See, infra, notes 229 to 236 and accompanying text.
II. Problems With the Situs-Based System

Situs-based allocation has a number of inherent problems, many of which are amplified under California’s tax rules. In a taxing system that narrows potential revenue and forces reliance on inherently unstable taxes, the situs rule has tended to encourage unproductive and shortsighted policy. The result is a kind of amplifying reciprocal effect: California’s tax limitations bring out the worst in the situs-based system, which in turn magnifies the problems of these tax limitations. The main issue has been in the so-called “fiscalization” of land use decisions and the negative consequences of that phenomenon:

The location-based system for distributing sales tax revenues under the Bradley-Burns Act causes cities and counties to compete against each other in promoting land uses that increase tax revenues while refraining from land uses that increase costs. This “fiscalization of land use” has an adverse effect on the local officials’ land use decisions by shifting their focus from public services to increasing their tax revenues.

Moreover, many retailers abuse fiscalization of land use and exacerbate the destructive competition among cities and counties by demanding additional subsidies from local officials for relocation and transfer. This practice increases the “receiving” community’s revenue, but deprives the “sending” community of much-needed funds. The receiving community, however, has to use some of its new revenue to provide services for the relocated retailer, while the retailer reduces its costs by using the subsidy it obtained from the receiving community. Ultimately, it seems that the relocated retailer is the real winner.\footnote{Bahara Hosseini, Chapter 4 to the Rescue: California Attempts to Prevent the Unjust Reallocation of Local Sales and Use Taxes, 41 McGeorge L. Rev. 600, 604-05 (2010).}

This article explores the problems of fiscalized land use, particularly as it relates to the situs rule, and its negative effects below.

A. The Fiscalization Land Use and the Attendant Side Effects

1. Fiscalized Land Use Planning

One of the most recognized side effects of a situs-based system, fiscalized land use is a phenomenon whereby local governments tend “to establish land uses based on the net tax
revenues they will generate for the city.” One could also understand it, as with other economic trade-offs, in terms of lost opportunity: “fiscalization of land use results when local officials approve projects because of their effects on local revenues, not because of the costs and benefits to economic development, environmental quality, or social equity.” In practice, this typically means that local governments favor retail development at the expense of other uses, notably housing and industrial. This seems to be a particular effect of the situs-based system under a Proposition 13 regime: “Because Proposition 13 reduced the revenues that would be received from property taxes from any particular development (industrial, commercial, or residential), local jurisdictions began to pay even more attention to the fiscal outcomes of land use decisions.” This not only reduces the supply of housing, driving up prices, it also restricts demand for high-wage jobs while boosting creation of a low-wage service sector. In particular, local governments seeking maximum sales tax revenue have tended to favor “big-box” retail and car dealerships, as these have a demonstrated potential of “generating a large amount of sales tax from a small area.”

Fiscalized land use does not appear to be a unique feature of a situs rule. The Public Policy Institute of California (PPIC) has previously found that “[i]n some states with no local sales tax whatsoever, . . . it is well known that municipalities are picky about the types of development they allow because of the amount of property taxes and services needs different land uses generate.” However, given that per capita sales tax revenue growth have stagnated (a

---

130 ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT, COMMITTEE ANALYSIS OF SB 114, at 2 (July 18, 2003).
131 JEFFREY I. CHAPMAN, PROPOSITION 13: SOME UNINTENDED CONSEQUENCES, 11 (Sept. 1998), available at http://www.ppic.org/content/pubs/OP_99JOP.pdf. See also MAX NEIMAN & DANIEL KRIMM, ECONOMIC DEVELOPMENT: THE LOCAL PERSPECTIVE, 12-13 (May 2009), available at http://www.ppic.org/content/pubs/report/R_509MNR.pdf (“That there is a general local preoccupation with enhancing the retail and tax base is borne out by the data in this study. The perceived result of state policy particularly since the passage of Proposition 13 has been to reinforce and amplify the fixation many cities have concerning revenue-creating development.”) (emphasis in original) (citations omitted).
132 Schwartz, Note, Prisoners of Proposition 13, supra note 14, at 203 (1997) (“As such, the system encourages land use decisions that create lower paying retail and service jobs instead of higher paying manufacturing positions; in the words of one official, ‘All we’re doing is sitting on a tax system the last few years that creates $5-an-hour jobs and not $15-an-hour jobs.’”) (citation omitted).
133 CHAPMAN, PROPOSITION 13: SOME UNINTENDED CONSEQUENCES, supra note 131 at 12. Chapman also notes that shopping malls are popular, but take up more space. Id. at fn. 16. Also note that early legislative efforts at combating fiscalized land use targeted incentives paid to big box retail stores and auto dealerships. See, infra, notes 237 to 241 and accompanying text.
134 LEWIS & BABBAGE, CALIFORNIA CITIES AND THE LOCAL SALES TAX, supra note 11 at 78 (emphasis in original).
conclusion that remains consistent with the updated empirical data\textsuperscript{135)}, the PPIC noted that local governments “are fighting over a largely fixed pie.”\textsuperscript{136} Based on its findings that retail business decisions are largely unaffected by inducements and that sales tax revenues represent a “fixed pie,” the PPIC concluded that “the main effect of fiscalized land-use decisionmaking in California is probably to shift resources from the public sector to retailers, their developers, and landowners.”\textsuperscript{137} Furthermore, based on extensive analysis, the PPIC found that, with the exception of some San Francisco Bay Area cities that “place certain quality of life considerations above maximizing sales tax revenue” and the “varied motives” among some of the state’s central cities,” favoritism toward retail development “is so common that it can be called ubiquitous.”\textsuperscript{138} Thus, the evidence suggests that fiscalized land use, while not linked exclusively to the situs rule, has combined with an overreliance on the sales tax in general and the stunted potential of other taxes to promote land use decisions favoring large retailers that will maximize revenue.

2. Disparities in Local Revenues

Related to fiscalized land use decisions, but posing a distinct problem, the effort at maximizing tax revenue has also led to significant revenue discrepancies among communities. While such disparities are inevitable to some degree, competition under situs-based allocation has exacerbated many of the negative effects associated with this inequality. Not only do local governments engage in fiscalized land use planning as discussed previously, with the goal being the maximization of tax revenue rather than sound community development, but cities that manage to attract the most lucrative businesses develop structural advantages favoring their own growth at the expense of their neighbors:

Interlocal competition can be seen as creating substantial and increasing disparities in quality of life for regional residents, disparities determined by residence in a particular community. Cities that are able to attract coveted types of economic development reap many benefits, including the important ability to lower overall tax rates to reflect the influx of revenue from commercial and industrial development. These lower tax rates become a self-fulfilling prophecy: businesses and affluent individuals looking for a home will prefer those

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{135} See, supra, notes 1 to 7 and accompanying text.
\item \textsuperscript{136} LEWIS & BARBOUR, CALIFORNIA CITIES AND THE LOCAL SALES TAX, supra note 11 at 79.
\item \textsuperscript{137} Id.
\item \textsuperscript{138} Id. at 107-08.
\end{itemize}
\end{footnotesize}
communities with lower tax rates, and those communities that attract businesses may be able to bring their tax rates lower still.

By contrast, cities that have trouble attracting business tend to find themselves perpetual losers in this competition, and the losses, too, become a self-fulfilling prophecy. If the local population tends to be low-income and high-need, tax rates will naturally rise higher to meet the higher needs and insufficient tax base. Either of these conditions can create a development deficit that heightens unemployment, and brings tax rates even higher, further overburdening the population, and driving out remaining businesses. The history of racial segregation and discrimination in the U.S. ensures that these prophecies have strong racial dimensions. There is thus a certain tautological character in the polar situation of “winning” and “losing” cities. Which came first, the economic development chicken or the regulatory egg?

There are complicated regional consequences to these intercity disparities. In the poorest cities, even when tax rates are raised significantly to overcome the effects of low overall incomes and lack of business tax base, the revenue raised is not sufficient to provide a basic level of many services.  

In short, the system tends to favor municipalities that have built up a strong retail base early on and makes it exceedingly difficult for their neighbors to catch up. As a result, many communities, particularly those with growing populations or special needs, find themselves unable to scrape together sufficient funding necessary for development.

In California, this has had real consequences in terms of sales tax revenue. In 1999, the PPIC made the following finding:

In fiscal year 1995-96, per capita sales tax revenues received by California cities ranged from $2.25 to $56,892. A city’s success in gaining these revenues can be partly predicted by certain market characteristics. Cities with higher populations, lower densities, fewer people per household, and freeway access tend to have higher per capita sales tax revenues. Cities devoting more of their land to redevelopment projects also do better.  

Admittedly, the brief concludes that the distribution “is not necessarily biased in favor of high-status communities,” because cities with low per capita sales tax revenue tend to either have low-income populations or are primarily suburban communities with little commercial

---

139 Keith Aoki, *All the King’s Horses and All the King’s Men: Hurdles to Putting the Fragmented Metropolis Back Together Again? Statewide Land Use Planning, Portland Metro and Oregon’s Measure 37, 21 J.L. & Pol.397, 399-400 (2005) (footnotes omitted).

development. In some ways, however, this confirms the nature of the problem. The latter class of “sales tax losers” has chosen to avoid retail development and may be perfectly satisfied with current taxing and spending levels, whereas the former may have failed in their efforts to build up a sales tax base. Moreover, subsequent research has turned up similar findings, albeit on a (somewhat) more modest regional scale. For example, in fiscal years 2005-06 and 2006-07, Alameda County saw a range of per capita sales tax revenue from $800 to $900 (Emeryville) to less than $20 (Piedmont). Because sales tax revenue under the situs rule depends on the amount of in-city retail activity, the range of per capita revenues does not necessarily reflect a local entity’s needs, but rather its success at promoting a very particular kind of business activity.

3. Nonproductive Inter-Governmental Competition

Finally, fiscalized land use encourages competition among local governments that generates little to no benefits to the governments themselves or to the regional or state economy as a whole. Interlocal competition does not pose a particular problem in itself. The Tiebout model posits that local jurisdictions can use taxes the same way that private market actors use prices, adjusting the cost and provision of government services to meet the preferences of “consumer-voters.” In this view, competition incentivizes local governments to provide efficient, cost-effective services adjusted to meet their residents’ preferences. However, Proposition 13 and its progeny have undermined the ability of California’s local governments to effectively “price” these services. By removing local governments’ power to set varying property taxes as a way to encourage development and community participation, Proposition 13 has narrowed the base of available revenue and prompted a mad scramble for those funds that remain available. Rather than spurring genuine, healthy competition that produces growth and efficient government, the specter of Proposition 13 and the appeal of building up sales tax revenue have led local governments and private retailers to come up with unproductive schemes that create only illusory economic development. While one local community builds up its sales

---

141 Id.
144 Aoki, All the King’s Horses, supra note 139 at 399 (“In states like California, limitations on local government property taxing powers emphasize interlocal competition for the remaining available tax revenue: income and sales tax.”).
tax base, it does so at the expense of another. On a statewide level, or even a regional one, the outcome is the same as if no relocation had occurred:

There is a finite market for retail spending within an economic region. Thus, the main result of the various incentives offered to business is simply a relocation of the retail activity from one community to another— with no net gain in economic output or efficiency to the region or state as a whole.\(^{145}\)

Additionally, the fact that these relocations typically result from a local government’s offer of a tax rebate or other payment, the activity actually drains the total resources available to local governments.\(^{146}\) Thus, fiscalized land use incentivizes competition among local governments that does nothing to add to overall economic productivity. This article explores some specific examples of how this has played out in practice below.

**B. Fiscalized Land Use in Practice**

Fiscalized land use planning among California’s local governments arguably traces its origins to Proposition 13’s tax restrictions. Local governments have turned to sales taxes to “replace lost property tax revenues,” which in turn has “motivated planning and economic development decisions that sacrifice long-term fiscal and environmental health of communities for short-term gains in sales tax producing land uses.”\(^{147}\) In the years since, the range of available revenue options has diminished even further. In 1986, Proposition 62 distinguished between general and special taxes and imposed majority and supermajority vote requirements respectively for these taxes,\(^{148}\) though the effect was limited to general law cities and counties.\(^{149}\) In 1996, voters added a new article to the Constitution via Proposition 218, which imposed similar terms

\(^{145}\) HILL, ISSUES AND OPTIONS, supra note 4 at 8.
\(^{146}\) Id.
\(^{147}\) Schwartz, Note, Prisoners of Proposition 13, supra note 14, at 184.
\(^{149}\) By its terms, Proposition 62 also applied to charter cities. Cal. Gov. Code § 53720(a). However, Proposition 62 effected a statutory, rather than constitutional, change, meaning that charter cities enjoy home rule protection for “municipal affairs,” which includes taxation and public finance. See, supra, notes 112 to 113 and accompanying text. The fact that Proposition 62 enacted code amendments means that the state’s constitutional provisions on home rule trump statutory tax limits on charter cities. To understand the significance of this distinction, consider the Supreme Court’s different treatment of a constitutional ban on same-sex marriage following a case overturning a statutory ban. Strauss v. Horton, 46 Cal.4th 364, 395 (2009) (distinguishing previous holding overturning the prior ban by noting that the new initiative measure “add[ed] this language as a provision of the California Constitution” while the previous initiative did so “as a statutory provision”) (emphasis in original).
on all local government taxes. Finally, in 2010, in response to the perceived growth of “hidden taxes” and the courts’ apparent approval of the practice, Proposition 26 redefined “taxes” to include a whole range of regulatory fees which governments had turned to in order to make up for revenue losses under earlier enactments. As a result of the combined effects of these initiatives, local governments face substantial obstacles to raising tax rates or levying new ones. However, the rate of taxation is only part of the revenue equation, and no initiative measure has yet barred efforts to increase the tax base for existing taxes. Thus, California’s local governments have increasingly relied on fiscalized land use planning to increase their revenues. In recent decades, such attempts have led to escalating levels of conflict among local governments.

1. Incentive Payments: Ventura and Oxnard Battle for Retail Business

The conflict between the cities of Oxnard and Ventura offers one of the earliest prominent illustrations of the effects of Proposition 13 and other finance limitations on land use decisions, particularly in light of the shared competitive history of these cities. The two communities have been rivals since the late 1800s, when what would become the City of Oxnard sprang up as an immigrant boom town supporting a large sugar factory that drew away businesses from Ventura. Following incorporation in 1903, Oxnard attempted to shift the county seat away from Ventura, marking the beginning of a century-long enmity. With the property tax no longer a strong source of local revenue following Proposition 13, and the rivalry between the cities intensified as they began to compete for retail business. Oxnard was more successful than Ventura in this respect, developing a stretch of sales tax-rich retail center that one urban planner dubbed “Sales Tax Canyon.” However, Oxnard’s plans have not always gone smoothly. In particular, a high-profile proposal for a $500 million complex dubbed Oxnard

---

150 Cal. Const. art. XIIIC, § 1 et seq.
151 See Sinclair Paint Co. v. State Bd. of Equalization, 15 Cal.4th 866 (1997); LEAGUE OF CALIFORNIA CITIES, PROPOSITION 26 IMPLEMENTATION GUIDE, 2-3 (April 2011), available at http://www.cacities.org/UploadedFiles/LeagueInternet/el/e195192d-9641-4edeb-834c-1be10da30270.pdf (citing displeasure with Sinclair Paint and other similar cases as the primary motivation behind Proposition 26).
152 Art. XIIIC, § 1(e).
154 Id.
155 Id.
156 Id.
Town Center imploded after the developer went bankrupt. Although economic conditions were the proximate cause, Oxnard city leaders at the time blamed a lawsuit by Ventura, which alleged that the development would have led to severe traffic problems, for delaying development and contributing to the project’s demise. According to one Oxnard mayor, the Ventura lawsuit “ruined everything.”

The economic battle took on new dimensions when Ventura began offering incentive payments to retailers who relocated from Oxnard. In the mid-1990’s, Ventura considered an expansion plan for a shopping center within its boundaries whereby the owner would advance the cost of street improvements and the city would repay that amount over 20 years with interest out of the city’s increased sales tax revenue – a total estimated at the time to be a $32.3 million payment for $12.5 million worth of initial work. This amounted to an incentive payment from the city to retailers totaling 80% of expected sales tax revenue. At first, Oxnard proposed developing a joint shopping mall complex to prevent both cities from “being taken advantage of by the retailers.” Tom Holden, who served on Oxnard’s City Council, complained, “This is a classic case of retailers pitting one city against the other, and the residents are the losers. When you take away the battle between the two cities, you have retailers extorting money.”

The joint mall effort failed, and Oxnard and private parties that stood to lose the most from Ventura’s proposal turned to other avenues, notably the ballot box and the courts. Initially, the state did not intervene to address the situation. As State Senator Jack O’Connel said, “My hope is that local communities will work together to end this fiscalization of land use, these bidding wars to attract businesses, which have stretched cities’ abilities to provide basic services.” Ultimately, however, the state did enact legislation restricting the use of such incentive payments, with the chief proponent citing Ventura’s practices as the rationale.

---

157 Id.
160 Bustillo & Wilson, Oxnard Offers Joint Mall Plan, supra note 158.
161 Id.
163 Kelley, Measure Highlights Cities’ Hunger for Sales Tax Dollars, supra note 159.
164 See, infra, notes 237 to 241 and accompanying text.
2. Buying Companies: Oakland and United Airlines Make a Deal

Under current Board of Equalization regulations, businesses may establish subsidiary “buying companies,” which the Board defines as “a legal entity that is separate from another legal entity that owns, controls, or is otherwise related to, the buying company and which has been created for the purpose of performing administrative functions, including acquiring goods and services, for the other entity.”165 Valid buying companies are treated as “a separate legal entity . . . for purposes of issuing it a seller’s permit” and “shall be regarded as the seller of tangible personal property it sells or leases.”166 Because the situs rule allocates sales tax revenue to the location where the sale is transacted,167 buying companies can effectively direct their sales tax payments to a jurisdiction of their choosing based on where they decide to locate. For this reason, the Board provides that buying companies established for the sole purpose of re-directing sales tax allocations “shall not be recognized as a separate legal entity from the related company on whose behalf it acts for purposes of issuing a seller’s permit.”168

Establishing that a business has created a buying company solely to re-direct sales tax payments, however, poses a particularly troublesome challenge, as the Board affords great deference to a purported buying company. For one thing, the Board “presume[s] that the buying company is formed for the operational reasons of the entity which owns or controls it or to which it is otherwise related.”169 In the event of controversy over a purported buying company’s operations, the Board will conclude that “[a] buying company is not formed for the sole purpose of re-directing local sales tax” if it either “[a]dds a markup to its cost of goods sold in an amount sufficient to cover its operating and overhead expenses” or “[i]ssues an invoice or otherwise accounts for the transaction.”170 Finally, “[t]he absence of any of these elements is not indicative of a sole purpose to redirect local sales tax.”171 Practically speaking, these regulatory standards mean that the Board will almost always accept the validity of a supposed buying company. Indeed, in 2007 the Legislative Analyst’s Office criticized this rule as “minimal,” and stated that

---

165 Cal. Code Regs. tit. 18 § 1699(h)(1).
166 Id.
167 See, supra, notes 114 to 125 and accompanying text.
169 Id.
170 Id. at § 1699(h)(2).
171 Id.
Board staff “cannot point to a single instance where a seller’s permit has been denied to a buying company because it failed to meet the qualifications of Regulation 1699(h).”

United Airlines, like other airline industry giants, engages in the practice of locating the sales offices of its jet fuel subsidiary, United Aviation Fuels Corp., in jurisdictions that provide the best sales tax benefits. In the early 2000s, United and Oakland entered into an agreement in which United would locate the sole office for United Aviation Fuels at Oakland International Airport, thus allocating all sales of jet fuel in California to that office. In return, Oakland agreed to provide a rebate to United worth 65% of all sales tax revenue realized from sales through the subsidiary. The Legislative Analyst’s Office found that, for each year of the deal, United saved $6 million in savings and Oakland saw a net gain of $3 million in extra sales tax revenue. Meanwhile, other jurisdictions with airports operating within their boundaries lost a corresponding total of $9 million per year, half of which accounted for losses to San Mateo and San Francisco, which share sales taxes from San Francisco International Airport. As such, the Oakland-United deal did not result in any net economic gain but rather merely shifted sales tax money from a range of local entities across the state to Oakland and United.

The Legislature amended the Bradley-Burns statute so that sales of jet fuel would be allocated to the point of delivery in all situations. This amendment effectively nullified the Oakland-United deal as of its effective date in 2008. However, Board has not acted to address the overall problems associated with its buying company rules. Although San Francisco and San Mateo petitioned the Board to change or repeal Regulation 1699(h), the Board ultimately denied the petition, leaving the rule untouched.
3. Sales Office Consolidation: Fillmore Hires Outside Help

In 2000, a prominent Southern California cement manufacturer, Robertson’s Ready Mix, sought to decrease its tax burden. At the time, the manufacturer operated under the purview of twenty local taxing jurisdictions – sixteen cities and four counties. Robertson’s managed to negotiate a deal with the City of Corona under which it would consolidate its sales activities into a single, Corona-based office in exchange for half of the city’s new sales tax money. The agreement terminated a year later, after the Superior Court denied Corona’s motion for summary judgment in its validation action. One of the chief criticisms of the deal “was that communities where the batch plants resided lost sales taxes and thus were no longer being compensated for the environmental, infrastructure, and public service burdens being placed on them by the concrete manufacturing and delivery operations.” The Legislature considered a variety of bills responding to the Robertson’s Ready Mix arrangement, though it ultimately did not enact any of the proposed changes. These proposals raised concerns about creating special rules regarding sales tax allocation for the cement mixing industry and thus proved politically infeasible.

Sales office consolidation, however, remains one of the key problems associated with the situs rule, and one that local governments and retailers are more than willing to exploit. So it was in the late 2000s, when the City of Fillmore hired a private consulting firm to persuade out-of-town retailers to relocate their sales activities. Retailers would maintain their business presence in other cities, but all of their sales would be attributed to Fillmore for sales tax

179 ASSEMBLY COMMITTEE ON REVENUE AND TAXATION, COMMITTEE ANALYSIS OF AB 553, at 3. (April 7, 2003).
180 Id.
181 Id. at 3-4.
182 HILL, ISSUES AND OPTIONS, supra note 4 at 11. See also ASSEMBLY COMMITTEE ON REVENUE AND TAXATION, COMMITTEE ANALYSIS OF AB 553, at 4 (April 7, 2003) (primary argument in support of AB 553 was “that the local jurisdictions which bear the burden of product delivery . . . deserve the local sales tax revenue generated by sales of the taxable product”).
184 HILL, ISSUES AND OPTIONS, supra note 4 at 11; ASSEMBLY COMMITTEE ON REVENUE AND TAXATION, COMMITTEE ANALYSIS OF AB 553, at 4 (April 7, 2003) (“Prior opposition to this bill has been based in part on concern that the bill create special local sales tax allocation provisions for one industry. The bill’s author responds to that concern by noting the study required by this bill. . . . Pending completion of that report, Assemblyman Chavez wishes to help the 20 local jurisdictions currently receiving inequitable treatment under the Bradley-Burns Local Sales and Use Tax Law.”).
pursues because they would be formally directed through the sales office there. Fillmore paid the consultant 85% of the new sales tax revenue attributed to businesses that consolidated their sales offices under this scheme, the majority of which was in turn paid to the retailers themselves as a rebate. The City of Livermore alone stood to lose up to $6 million in sales tax money, though the deal affected other large cities including Industry and San Diego. Senator Loni Hancock, who authored legislation designed to prohibit this practice, decried “[t]his outrageous scam [which] would have deprived both Livermore and Fillmore of needed revenue for vital police, fire and other public services.”

Unconstrained by the political concerns that killed the Robertson’s Ready Mix bills, the Legislature finally intervened to halt this practice. Under the new legislation, cities and counties may not offer sales tax rebates if there is an agreement which would result in another jurisdiction losing sales tax revenue and the retailer will maintain its business presence in that other jurisdiction. However, the law only narrowly targets this specific kind of sales office consolidation, which led to criticism that it fails to go far enough to achieve its purpose.

III. Possibilities for Reform

To the extent that the situs rule requires reform, policy makers have a strong menu of options available. In most instances, policy analysts have thoroughly studied these proposals or else the Legislature has taken some action towards implementation. These options range from a radical change to the local revenue structure, essentially abolishing the local sales tax and replacing it with other revenue sources, to leaving the core system untouched while enacting legislation designed to combat the effects of fiscalized land use planning.

This article groups these proposals in two general categories. First, it looks at what may be called “structural” reforms, i.e. those proposals that substantially alter the current local government financing system. Replacement of the situs rule with an allocation system based on

---

186 SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS OF SB 27, at 2 (March 4, 2009).
187 Id.
188 Id.
189 Id.
190 Governor Signs Hancock Bill to Protect Cities From Sales Tax Scam, supra note 185.
191 See, infra, notes 256 to 261 and accompanying text.
193 See, infra, note 262 to 264 and accompanying text.
population has proven the most popular for study. The other major proposal in this category involves replacing the local sales tax with other revenues. Such a reform could take a variety of forms, including complete abolition of the local sales tax as well as partial replacement with other state funding. The last of these structural reforms would either mandate or incentivize regional revenue sharing as a counterweight to the pressures of fiscalized land use. Second, the article looks to past efforts at “incremental” reform. Under this approach, the Legislature has left the local sales tax, including the situs rule, intact and declined to address the fiscalized land use problem in a systemic way. Instead, lawmakers respond to particular calls to action with targeted legislation instead of a total overhaul.

A. Structural Reform

1. Population-Based Allocation

Recently, one of the most noted potential alternatives to the situs rule calls for distribution of sales tax revenue based on population size. Such a system would directly address most of the shortcomings associated with the situs rule. Although local entities may still engage in some degree of fiscalized land use planning, particularly in connection with growing property tax revenue, population-based allocation would remove a major incentive to engage in land use planning directed toward maximizing retail activity to bolster sales taxes. Retailers would still pay their local sales taxes, but the money would go into one large pot that the Board of Equalization would then distribute according to the size of each local entity. Since sales tax revenue would no longer depend on the number of retailers located within a given jurisdiction, local governments would face less pressure to attract retail business at the exclusion of residential and industrial development. Furthermore, population-based allocation would equalize per capita sales tax returns, allowing cities that have foregone retail development to finally catch up to their neighbors in terms of providing appropriate services to their residents.

The PPIC has highlighted a variety of advantages associated with a population rule. These are as follows:

194 HILL, ISSUES AND OPTIONS, supra note 4 at 15 (summarizing population-based allocation).
• Allocation based on population size reflects the needs of the community, as most services are expended on individuals rather than businesses, and would reduce per capita revenue disparity.
• By removing the territorial element of sales tax allocation, local governments might give more attention to residential land uses, which could increase the supply of affordable housing for low-income individuals and families.
• Local governments would have less pressure to seek retail development, which is a weak basis for overall economic growth and has proven to be something of a zero-sum game, and would be less likely to give incentive payments or other rebates to retail businesses.\textsuperscript{195}

The population-based method has also drawn some support from the Legislative Analyst’s Office\textsuperscript{196} as well as staff members in the Legislature.\textsuperscript{197}

However, population-based allocation would carry its own set of problems. Indeed, the PPIC listed a far longer set of arguments against a population-based system than in favor of it.\textsuperscript{198} The Legislative Analyst also noted that any alteration to the form of allocation “would require difficult tradeoffs across multiple worthy policy objectives, including state-local fiscal stability and revenue diversification.”\textsuperscript{199} Overall, “moving to redistribute the local sales tax . . . on a population basis might, in a narrow sense, work to the fiscal advantage of the majority of jurisdictions, covering the majority of the population of the state,” but it “not only would be politically unpopular among the numerous local governments that stand to lose but would also fail to address the wider problem of making nonretail forms of development more fiscally viable.”\textsuperscript{200} Reallocation of sales tax would serve to discourage retail development, but would not alter the perception that “other forms of development . . . simply [do] not pay their own way.”\textsuperscript{201}

\textsuperscript{195} \textsc{Lewis} \textsc{&} \textsc{Barbour}, \textit{California Cities and the Local Sales Tax}, supra note 11 at 113-14.
\textsuperscript{196} \textsc{Hill}, \textsc{Issues and Options}, supra note 4 at 15.
\textsuperscript{197} \textit{See}, e.g., \textsc{Senate Local Government Committee, Committee Analysis of SB 27}, at 3 (March 4, 2009);
\textsc{Hosseini, Chapter 4 to the Rescue}, supra note 128 at 605.
\textsuperscript{198} \textit{See}, infra, note 228 and accompanying text.
\textsuperscript{199} \textsc{Hill}, \textsc{Issues and Options}, supra note 4 at 15.
\textsuperscript{200} \textsc{Lewis} \textsc{&} \textsc{Barbour}, \textit{California Cities and the Local Sales Tax}, supra note 11 at 122.
\textsuperscript{201} \textit{Id.} The report cites complaints by the city manager of Long Beach that “a typical owner-occupied home produces only $210 per year in property tax revenue, but it costs the city $350 per year in services.” \textit{Id.} at 122-23.
Quite apart from any policy concerns, any effort to abolish the situs rule would run into severe legal problems. The California Constitution enshrines the situs-rule, prohibiting the Legislature from “chang[ing] the method of distributing revenues derived” from Bradley-Burns local sales taxes.\(^2\) As a result, the situs rule may only be changed if the voters amend Bradley-Burns to provide for population-based allocation themselves through a statutory initiative or if they approve a constitutional amendment permitting the Legislature to do so.\(^3\) Thus, any direct change to the allocation system depends exclusively on the attitudes of the electorate, giving legislators and regulators very little direct control over advancing such a reform.

2. Tax Base Revision

One of the earliest contemplated alternatives, revision of the local tax base encompasses a range of possible policies under which “[l]ocal government sales tax revenue could be swapped (in whole or in part) with another tax. For example, the state could transform the local sales tax into a state resource and provide local governments with (1) an increased share of the local property tax or (2) a per person allocation from the statewide personal income tax.”\(^4\) The idea traces back to an early 1990’s budget report from the Legislative Analyst’s Office which advocated “eliminate[ing] the existing Bradley-Burns 1 percent local sales tax, and replac[ing] it with a corresponding increase in the state sales tax” with “local property tax allocations . . . replac[ing] the revenues lost, on a statewide basis.”\(^5\) Following the Legislative Analyst’s initial proposal, others began considering similar ideas.\(^6\)

Revising the tax base in such a manner would address the problems of the situs rule and fiscalized land use while avoiding many of the criticisms of the population-based allocation

\(^2\) Cal. Const. art XIII, § 25.5(a)(2)(A). For further discussion, see, infra, notes 231 to 236 and accompanying text.
\(^3\) Cal. Const. art. XVIII, § 4 (constitutional amendments must receive voter approval).
\(^4\) HILL, ISSUES AND OPTIONS, supra note 4 at 15.
\(^6\) LEWIS & BARBOUR, CALIFORNIA CITIES AND THE LOCAL SALES TAX, supra note 11 at 124-25 (referencing a host of tax base revision proposals from the Legislative Analyst’s Office, the San Diego Association of Governments, and the California Governance Consensus Project); Schwartz, Note, Prisoners of Proposition 13, supra, note 14 at 215-16 (using the Legislative Analyst’s idea of replacing Bradley-Burns revenue with increased property tax allocation as a foundation for developing a reform proposal).
method.\textsuperscript{207} Again, however, this option entails significant political and legal barriers to overcome. For one thing, with any system designed to achieve broader economic growth, “those who gain from the status quo could stand to lose much if it were changed, whereas the potential gains are more broadly diffused and lack a highly organized and motivated constituency.”\textsuperscript{208} Furthermore, de-emphasizing the sales tax in favor of other local revenue sources would “run[] contrary to the expressed cognitive preferences of California voters, who have favored sales taxes to property taxes.”\textsuperscript{209} Legally speaking, revising the tax base still must contend with the constitutional protections afforded local sales taxes.\textsuperscript{210} Voters may perceive an attempt to replace Bradley-Burns money with other revenue sources as the very type of state tampering with local government funds that they have proscribed in the past.\textsuperscript{211} Insofar as a tax base revision would therefore also require an initiative for the same reason that a population-based method would, voters may withhold their approval based on this belief.

3. Local Partnerships and Revenue Sharing

The last of the big structural reforms is actually a comparatively modest one. Where the last two proposals contemplated fundamental changes to the local sales tax system, this one would leave the basic structure of local sales taxes in place while encouraging local communities to cooperate. In essence, the state would encourage or require local communities on a regional scale to enter agreements with one another to pool their sales tax revenue and divide it based on

\textsuperscript{207} See LEWIS & BARBOUR, CALIFORNIA CITIES AND THE LOCAL SALES TAX, supra note 11 at 126 (referencing “alternatives with the potential to broaden cities’ interest in pursuing balanced growth,” including “giving local policymakers control over a larger proportion of property tax revenues, in exchange for returning other, narrower revenue bases to the state”).
\textsuperscript{208} Id.
\textsuperscript{209} Schwartz, Note, Prisoners of Proposition 13, supra note 14 at 215.
\textsuperscript{210} Supra, notes 202 to 203 and accompanying text.
\textsuperscript{211} Most recently, Proposition 22 prohibited the Legislature from “reallocate[ing], transfer[ring], borrow[ing], appropriate[ing], restrict[ing] the use of, or otherwise us[ing] the proceeds of any tax imposed or levied by a local government solely for the local government’s purpose.” Cal. Const. art. XIII, § 24(b). Legislative findings included in Proposition 22 highlighted unhappiness with the state’s borrowing of local government funds, and the stated purpose of the measure was “to conclusively and completely prohibit state politicians in Sacramento from seizing, diverting, shifting, borrowing, transferring, suspending, or otherwise taking or interfering with revenues that are dedicated to funding services provided by local governments.” Prop. 22, §§ 2, 2.5, approved Nov. 2, 2010, eff. Nov. 3, 2010. Proponents characterized this state borrowing as raids on local government funds and presented Proposition 22 as a way to protect local services. LEGISLATIVE ANALYST’S OFFICE, CALIFORNIA GENERAL ELECTION TUESDAY, NOVEMBER 2, 2010, OFFICIAL VOTER INFORMATION GUIDE, 36 (2010), available at http://librarysource.uchastings.edu/ballot_pdf/2010g.pdf. Supporters of Proposition 1A earlier in the decade had made similar arguments. See, infra, note 235 and accompanying text.
relative need, effectively accomplishing population-based allocation on a smaller scale.\textsuperscript{212} The main advantage of this strategy is twofold. From a policy perspective, it encourages collaboration to counteract the drive toward competition under fiscalized land use planning, thus netting many of the same benefits as the other proposed reforms. From a legal perspective, it avoids the main obstacles that could stymie the other reform efforts.

Unlike the other proposals described, which must contend with constitutional protections for state and local taxes, revenue sharing agreements have constitutional recognition. The Legislature has long had the power to authorize sales tax revenue sharing contracts among cities and counties, provided that the electorate of each jurisdiction approves any resulting contract by a majority vote.\textsuperscript{213} This provision went unused for most of its early life,\textsuperscript{214} as the voter approval requirement made it overly burdensome to negotiate such contracts.\textsuperscript{215} As a result, state voters approved a subsequent legislative constitutional amendment, Proposition 11, which expanded this power in 1998 to allow local governments to enter contracts to share Bradley-Burns revenue on their own with a supermajority vote of each entity’s governing body.\textsuperscript{216} Supporters expressed specific concern about the intensity of competition resulting from fiscalized land use planning, arguing that Proposition 11 “provides a mechanism where local communities can cooperate, rather than engage in bidding wars, in order to attract new business and retain long-time business” and that “[b]y working together, rational land use planning and free market principles will determine where businesses locate.”\textsuperscript{217} “Appalled by how the fiscalization of land use promotes competition for shopping malls and care dealers,” many local governments which had opposed previous attempts to loosening restrictions on revenue sharing contracts came to support the idea.\textsuperscript{218}

\begin{footnotesize}
\textsuperscript{212} See \textsc{Lewis} \& \textsc{Barbour}, \textit{California Cities and the Local Sales Tax}, supra note 11 at 111-13 (discussing revenue sharing agreements and their limits).
\textsuperscript{213} Cal. Const. art. XIII, § 29(a).
\textsuperscript{214} \textsc{Legislative Analyst’s Office, Supplemental Ballot Pamphlet, General Election, November 3, 1998}, 9 (1998), available at \texttt{http://librarysource.uchastings.edu/ballot_pdf/1998gu.pdf} (“We are not aware of any local governments that have used this provision.”).
\textsuperscript{215} \textsc{See Senate Committee on Constitutional Amendments, Committee Analysis of ACA 10}, at 2 (Aug. 12, 1998) (“Although the California Constitution currently allows revenue sharing, apparently the voter approval requirement renders it impractical.”); \textsc{Assembly Committee on Appropriations, Committee Analysis of ACA 10}, at 1-2 (July 1, 1998) (“According to the author, sales tax sharing contracts authorized under current law are not widely utilized because of the cost-prohibitive elections required for voter approval of the contracts.”).
\textsuperscript{216} Cal. Const. art. XIII, § 29(b).
\textsuperscript{217} \textsc{Legislative Analyst’s Office, Supplemental Ballot Pamphlet, supra} note 214 at 10.
\textsuperscript{218} \textsc{Senate Local Government Committee, Committee Analysis of ACA 10}, at 2-3 (Aug. 5, 1998).
\end{footnotesize}
Despite these advantages, though, the potential for greater reliance on revenue sharing agreements at present seems limited. Evidence of such agreements remains elusive, although Proposition 11 did receive credit for accelerating a revenue sharing plan between the City of Modesto and Stanislaus County. This result was not unexpected. Even at the time of Proposition 11’s passage, “informed observers” predicted that “effects are likely to be modest,” since “[l]ocal governments that are ‘doing well’ in generating sales tax revenue will have little incentive to engage in such agreements.” To that end, one should note that Proposition 11 did not dissuade Corona, Oakland, or Fillmore from seeking to enhance their sales tax returns or encourage revenue sharing agreements to resolve those conflicts. Of course, the Legislature could act to further encourage these revenue sharing agreements either by mandating them in some way or by enhancing incentives. The state could, for example, offer incentive payments, perhaps out of the state’s own sales tax revenue, to local governments entering revenue sharing arrangements. Still, this illustrates one of the biggest detriments of reforms designed to promote revenue sharing, given that they offer little to communities with already highly developed retail activity. Revenue sharing also faces some political opposition, with many on the political right opposed to what they see as a move toward regionalism to undermine individual liberty and redistribute wealth from suburbs to cities.

219 City and County Encourage Good Land Use Planning Through Tax Sharing, ASSOCIATION OF BAY AREA GOVERNMENTS, http://www.abag.ca.gov/planning/theoryia/cmprmodesto.htm (last visited Dec. 3, 2013) (crediting the revenue sharing contract with prompting a “land use decision favor[ing] a business park development over a big box retailer” and leading to “[a] long-lasting partnership between the city and county”).

220 See supra Part II.B.2 and II.B.3.

221 See LEWIS & BARBOUR, CALIFORNIA CITIES AND THE LOCAL SALES TAX, supra note 11 at 14.

222 See LEWIS & BARBOUR, CALIFORNIA CITIES AND THE LOCAL SALES TAX, supra note 11 at 112 (opposition to a 1994 proposal to revise county sales tax allocation argued that the proposal “would lead to cities being disinterested in in recruiting new businesses, would reward anti-growth jurisdictions, and would lead to ill-considered residential sprawl (because counties, seeking capitated sales tax revenues, might seek population growth for unincorporated areas”).

223 This manifested itself particularly in the debate over Proposition 31 in 2012, which, although most closely associated with its proposal for a 2-year state budget cycle, would have permitted contracts to share property tax revenue. LEGISLATIVE ANALYST’S OFFICE, CALIFORNIA GENERAL ELECTION TUESDAY, NOVEMBER 6, 2012, OFFICIAL VOTER INFORMATION GUIDE, 91 (2012), available at http://vig.cdn.sos.ca.gov/2012/general/pdf/complete-vig-v2.pdf. While the Republican Party supported the measure, members of the conservative tea party movement criticized Proposition 31 as “an elitist, Eurocentric move aimed at undermining property rights and self-determination” that would “impos[e] regional government run by unelected bureaucrats following the dictates of that bogeyman of populist conservatives, the United Nations’ Agenda 21.” Robert Greene, Is Proposition 31 really a U.N. conspiracy?, L.A. TIMES, Sept. 14, 2012, available at http://articles.latimes.com/2012/sep/14/news/la-ol-agenda-21-20120913. One group warned that Proposition 31 would “authorize the state to withhold or divert taxes from local governments unless those governments adopted a ‘Strategic Action Plan’ to distribute the revenues from the suburbs to the large urban cities” and would make the governor an “emergency czar” with expanded power over local revenue. Wayne Lusvardi, Prop. 31 would regionalize state revenue sharing, CALWATCHDOG, Aug. 30, 2012,
Finally, while the Constitution explicitly allows revenue sharing, it remains unclear how these provisions would interact with those designed to protect the local sales tax from state interference.\textsuperscript{224} If a court confronting the question decided that these provisions conflict, it would have to determine how they should interact in practice. In general, courts work to harmonize conflicting statutes if possible,\textsuperscript{225} and even to the extent that there is conflict, subsequent constitutional amendments may carve out limited, narrow exceptions to broader principles.\textsuperscript{226} This makes it hard to predict how legislation designed to encourage revenue sharing would fare under current law, since the outcome would depend mostly on the actual bill itself. For example, legislation that merely provides incentives to enter regional revenue sharing agreements may have a better chance than a bill that requires such agreements or punishes local governments that do not enter such contracts. In the latter instance, the court could interpret the law as circumventing the voter-approved prohibition on altering the situs-based allocation rule to achieve a population-based system.\textsuperscript{227} Ultimately, political resistance combined with this legal uncertainty may prevent any real move toward this type of reform.

B. Incremental Reform

The other main approach would leave the situs-based system intact in favor of tinkering around the edges. In its 1999 report, the PPIC noted some of the arguments against population-based distribution, many of which centered on the advantages of the situs-based system. Some of these include: promoting competition among cities as a way to generate economic value; the special needs of retail-heavy cities in supporting large visitor-worker populations; and preventing a windfall for heavily suburban cities with wealthier populations that have avoided retail development.\textsuperscript{228} From a legal standpoint, one might also emphasize the role of California’s own

\textsuperscript{224} Cal. Const. art. XIII, § 25.5(a)(2)(A).
\textsuperscript{225} See, e.g., Baker v. Workers’ Comp. Appeals Bd., 52 Cal.4th 434, 446 (2011) (“The words of the statute must be construed in context, keeping in mind the statutory purpose, and statutes or statutory sections relating to the same subject must be harmonized, both internally and with each other, to the extent possible.”) (citations omitted).
\textsuperscript{226} See, e.g., Strauss, supra note 149 at 412 (holding that constitutional same-sex marriage ban “must be understood as creating a limited exception to the state equal protection clause”).
\textsuperscript{227} See, supra note 224.
\textsuperscript{228} LEWIS & BARBOUR, CALIFORNIA CITIES AND THE LOCAL SALES TAX, supra note 11 at 114-16.
informal “intra-state commerce clause” as a parallel to the federal Commerce Clause. This doctrine evolved from California case law, which has interpreted various provisions of the California Constitution to protect the free flow of commerce between the state’s political subdivisions from unduly burdensome taxation:

... it is clear that in spite of the absence of a specific “commerce clause” in our state Constitution, other provisions of that Constitution – notably those provisions forbidding extraterritorial application of laws and guaranteeing equal protection of the laws... – combine with the equal protection clause of the federal Constitution to proscribe taxes which operate to unfairly discriminate against intercity businesses by subjecting such businesses to a measure of taxation which is not fairly apportioned to the quantum of business actually done in the taxing jurisdiction.229

A situs-based allocation regime arguably fits well within this framework because it provides a clear delineation of where a tax is paid so as to avoid running afoul of intra-state commerce protections. Without an overhaul of the entire local sales tax system, merely shifting revenues could prove legally problematic insofar as high-population and low-sales jurisdictions (i.e. those with lower per capita revenue under the current system) benefit at the expense of low-population and high-sales jurisdictions (i.e. those with higher per capita revenue). It is not inconceivable that this may constitute extraterritorial taxation or that, assuming that Legislature has the ability similar to Congress’s power to authorize Commerce Clause violations,230 state lawmakers may choose not to do so in this instance for policy reasons based on this theory.


230 Note that, although the “intra-state commerce clause” remains somewhat undeveloped as its own concept, it is very likely that the Legislature could act in this manner. Constitutional theory generally regards the federal Constitution as granting authority, meaning that Congress cannot act absent some authorization based on the constitutional text, while construing state constitutions as limits on authority, meaning the Legislature can act however it sees fit provided that there are no constitutional limits barring its proposed action. See U.S. Const. amend. X (reserving powers not delegated to the federal government “to the states respectively”); 7 Witkin, Summary 10th (2005) Const. Law, § 1. p.68; 13 Cal. Jur. 3d Constitutional Law § 93 (“The American constitutional system is based on the idea that all inherent powers of government are divided between the nation and the states – in the one case delegated and in the other reserved. The national government is one of limited delegated powers; the state governments possess all the powers that are incidental to legitimate government not delegated to the United States.”); Nogues v. Douglass, 7 Cal. 65, 70 (1857) (“The Legislature has the actual power to pass any Act it pleases. . . .While that body confines its action within the limits of the Constitution, its acts are rightful and conclusive. . . .”)

39
Moreover, as previously noted, local sales taxes have enjoyed constitutional protection from state legislation since 2004, when voters approved Proposition 1A. This initiative “significantly reduce[d] the state’s authority over major local government revenue sources” and included a range of limitations on the Legislature’s power over local government revenue. Most importantly for the purposes of this article, Proposition 1A prohibited both the outright abolition of local sales and use taxes and alterations to the situs-based allocation method. Originally placed on the ballot by the Legislature itself, Proposition 1A effectively replaced a measure already under consideration, Proposition 65. Proponents (including Republican Governor Arnold Schwarzenegger and Democratic Senator Tom Torlakson, who served at the time as the chair of the Senate Local Government Committee and had authored the initiative) touted the measure as “a historic bipartisan agreement” designed to “prevent[] the State from taking and using funding that local governments need to provide services like fire and paramedic response, law enforcement, health care, parks, and libraries.” Proposition 1A thus locked significant portions of Bradley-Burns “as that law read on November 3, 2004.”

Within the confines of these political and legal restraints, incremental reform has more or less marked the Legislature’s efforts to date. Under this approach, the Legislature and Board of Equalization have confronted specific, contained issues in an ad hoc fashion. In particular, lawmakers have sought to curb the use of financial incentive agreements in the attempt to minimize fiscalized land use planning among local governments. This trend has manifested itself particularly in the last decade or so as a response to particular outbursts of hyper-competitiveness between cities. In 1999, then-Assembly Member Tom Torlakson introduced AB 178, intended to limit incentive payments by local government entities to “big box” retailers and auto

---

232 Cal. Const. art. XIII, § 25.5(a)(2)(A) (the Legislature may not “restrict the authority of a city, county, or city and county to impose a tax rate under, or change the method of distributing revenues derived under, the Bradley-Burns Uniform Local Sales and Use Tax Law,” except as provided).
233 2004 Cal. Stats. 133.
234 LEGISLATIVE ANALYST’S OFFICE, SUPPLEMENTAL BALLOT PAMPHLET, supra note 231 at 15 (“. . . in the time since Prop. 65 was submitted, a new and better measure – Prop. 1A – has been placed on the ballot to prevent state raids on local government funding. Prop 1A is supported by Governor Arnold Schwarzenegger, Democrats and Republicans, local government and public safety leaders because it is a better, more flexible approach to protect funding for vital local services.”).
235 Id. at 8.
dealerships. The analysis of the Assembly Committee on Housing and Community Development highlighted the “bidding wars between local governments” provoked by large retailers in order to identify those communities willing to “provide the greatest subsidy for the business’ location.” According to committee staff, “[t]hese bidding wars” had proven “particularly damaging when a business threatens to relocate to a nearby city if the current municipality fails to come up with an incentive package for it to stay.”

Assembly Member Torlakson cited a particular concern already discussed here – the practice of the City of Ventura to enter agreements to “give away all of the increases in sales tax revenue generated by shopping mall anchors lured from nearby Oxnard over a 15-year period” – as the catalyst for this legislation. A few years later, Torlakson, who had moved to the Senate, introduced SB 114, which expanded on AB 178 by outright prohibiting the practice of making incentive payments to big box retailers and car dealers, whereas the earlier bill had merely required sharing of sales tax revenues among local entities. While strengthening provisions of AB 178, however, the Legislature made no attempt to go farther.

In 2005, the Legislature enacted AB 451, a version of which had been vetoed in the prior session. Like Torlakson before him, the author, Assembly Member Leland Yee, intended to address a particular outcome of the situs-based allocation system rather than affect a total reform. This time, the objective was reform of the allocation method for jet fuel sales. From 1998 to the 2008, when AB 451 went into effect, Bradley-Burns attributed sales of jet fuel to the point of delivery if both: (1) principal negotiations for the sale were conducted in-state, and (2) the seller had multiple places of business in California. Based on the wording of the statute, Oakland and United Airlines entered into the economic development agreement

---

238 ASSEMBLY COMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT, COMMITTEE ANALYSIS OF AB 178, at 3 (May 12, 1999).
239 Id.
240 Id. at 3-4. Note the warnings of Senate Local Government Committee that “[l]egislators should resist the temptation to prescribe limited cures for the huge problems they’ve created.” SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS OF AB 178, at 3 (July 8, 1999).
242 2005 Cal.Stats 391.
243 AB 2466, 2003-2004 Reg. Sess. (Cal. 2004). Governor Schwarzenegger issued a veto message indicating his agreement with the general policy of the bill but disapproving of the use of the gut and amend process to enact the bill late in the session without the opportunity for public input. ASSEMBLY COMMITTEE ON REVENUE AND TAXATION, ASSEMBLY FLOOR ANALYSIS OF AB 2466: GOVERNOR’S VETO, 4-5 (Oct. 19, 2004); ASSEMBLY COMMITTEE ON REVENUE AND TAXATION, COMMITTEE ANALYSIS OF AB 451, at 5-6 (April 11, 2005).
244 2005 Cal. Stats. 391, § 3.
previously described, which took advantage of the requirement of multiple places of business and the Board of Equalization’s buying company regulations to channel all sales of jet fuel to United through the seller’s Oakland location.\(^{246}\) While San Mateo County and San Francisco led the effort to convince the Board to revise or repeal Regulation 1699(h),\(^{247}\) Assembly Member Yee sought to correct this “unintended result” of the original jet fuel allocation scheme.\(^{248}\) Specifically, AB 451 repealed the conditions for allocation to the point of delivery, providing instead that all jet fuel sales are consummated at wingtip regardless of the place of negotiation or the number of the retailer’s in-state places of business.\(^{249}\) Originally, the bill would have gone into effect in 2006,\(^{250}\) but Yee agreed to delay the effective date to 2008 in order to obtain approval from the Senate policy committee.\(^{251}\)

Meanwhile, the Board had agreed to consider changes to its buying company rules in Regulation 1699(h).\(^{252}\) As summarized by Board staff, a petition effort led by San Francisco and San Mateo County challenged the regulation, arguing that: (1) the rule as applied to jet fuel sales contradicts the Legislature’s intent to allocate these sales at wingtip; (2) the presumption that a buying company is a separate legal entity exceeds the Board’s statutory authority; (3) issuance of permits to subsidiaries that are not truly separate from the parent company contradicts case law; (4) the regulation does not offer real protection against schemes meant to re-direct sales tax revenue; and (5) the Federal Anti-Head Tax Act, which prohibits local governments from taxing airline flights or transactions relating to such flights that do not land or take off within their jurisdictional boundaries, preempts the regulation.\(^{253}\) Ultimately, the Board did not act to alter its buying company regulations,\(^{254}\) and the County of San Mateo sued, raising many of these claims in its complaint. The Court of Appeal affirmed a trial court order sustaining the Board’s

\(^{246}\) ASSEMBLY COMMITTEE ON REVENUE AND TAXATION, COMMITTEE ANALYSIS OF AB 451, at 4-5 (April 11, 2005).

\(^{247}\) See, infra, notes 252 to 255 and accompanying text.

\(^{248}\) SENATE REVENUE & TAXATION COMMITTEE, COMMITTEE ANALYSIS OF AB 451, at 5 (June 29, 2005).

\(^{249}\) 2005 Cal. Stats. 391, § 2; Cal. Rev. & Tax Code § 7205(b)(2).

\(^{250}\) Cal. Const. art. IV, § 8(c)(1) (“a statute enacted at a regular session shall go into effect on January 1 next following a 90-day period from the date of enactment of the statute”).

\(^{251}\) SENATE REVENUE & TAXATION COMMITTEE, COMMITTEE ANALYSIS OF AB 451, at 5 (June 29, 2005) (“This bill was amended on June 27, 2005 to reflect the policy goals of this committee; specifically, the bill was amended to delay the implementation of the proposal and study the broad issues of revenue sharing agreements.”).

\(^{252}\) Ogrod, Memorandum, supra note 174.

\(^{253}\) Id.

\(^{254}\) See HILL, ISSUES AND OPTIONS, supra note 4 at 14 (describing Board action on the petition to alter Regulation 1699(h)).
demurrer, agreeing with the lower court that the county had not exhausted its administrative remedies.\textsuperscript{255}

Finally, in 2009, the Legislature enacted SB 27, by Senator Loni Hancock, which further strengthened the restrictions of Torlakson’s AB 178 and SB 114.\textsuperscript{256} SB 27 responded to the situation of the cities of Livermore, Industry, and San Diego.\textsuperscript{257} These cities faced the prospect of losing millions of dollars in sales tax revenue due to Fillmore’s aforementioned deal with a private consultant, who would receive “85% of the Bradley-Burns revenues that are attributable to a retailer that worked with the firm to relocate the sales office to Fillmore,” with a large portion of that amount “rebated to the relocated retailer.”\textsuperscript{258} Fillmore and its partners took advantage of the Board’s practice of attributing sales to the jurisdiction hosting the taxpayer’s sales office when the seller has multiple in-state places of business.\textsuperscript{259} SB 27 was designed to “strengthen[] the existing law by putting an end to these sales consolidation scams.”\textsuperscript{260} It expanded restrictions on incentive payments by prohibiting cities and counties from providing this sort of sales tax rebate if: (1) the agreement reduces the amount of sales tax revenue available to another local government from a retailer located within that government’s boundaries, and (2) the retailer maintains its presence within the other government’s territory.\textsuperscript{261} Still, SB 27 represented another restrained response to the overall problem. The Assembly Committee on Local Government noted that SB 27 did not “limit other incentives that local governments may choose to use” as it proscribed only “those rebates that would negatively affect the sales tax received by other local governments because of the consolidation of a sales office into one location.”\textsuperscript{262} The Senate Local Government Committee analysis went farther, suggesting not only that SB 27 “[t]reat[s] the symptom, not the disease,” but also that it may “[l]eave

\begin{footnotesize}
\begin{itemize}
\item[256] 2009 Cal. Stats. 4.
\item[257] SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS OF SB 27, at 3 (March 4, 2009); ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT, COMMITTEE ANALYSIS OF SB 27, at 3 (May 13, 2009) (noting the City of Livermore as the bill’s sponsor). See also Hosseini, Chapter 4 to the Rescue, supra note 128 at 600-01 (describing the background behind SB 27); supra, notes 185 to 193 and accompanying text.
\item[258] ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT, COMMITTEE ANALYSIS OF SB 27, at 2 (May 13, 2009).
\item[259] Cal. Code Regs. tit. 18, § 1802(a)(2)(B); SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS OF SB 27, at 1 (March 4, 2009) (“. . . if a seller has more than one place of business and the sales and delivery of a product occur at separate locations, State Board of Equalization (BOE) regulations require that the sales be allocated to the site of the principal sales negotiation. This is usually the company’s sales office.”).
\item[260] Hosseini, Chapter 4 to the Rescue, supra note 128 at 606.
\item[261] Cal. Gov. Code § 53084.5.
\item[262] ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT, COMMITTEE ANALYSIS OF SB 27, at 2 (May 13, 2009).
\end{itemize}
\end{footnotesize}
symptoms untreated."\textsuperscript{263} Committee staff also referenced the Legislative Analyst’s Office recommendations for replacing the situs-based system with a population-based one or replacing local government sales tax revenue with other taxes.\textsuperscript{264}

The protestations of committee staff and recommendations by the Legislative Analyst’s Office notwithstanding, this sort of piece-by-piece reform represents the Legislature’s continued efforts to keep the situs-based system intact while smoothing down the wrinkles associated with fiscalized land use. Part of this may be due to the reluctance of term-limited lawmakers to devote their limited time in office to deep, far-reaching reform. As one Senate committee consultant has said, “There is absolutely less interest in the long-term, non-sexy issues. You don’t have members pushing legislation that will show its fruits ten years from now; it is of little value to them.”\textsuperscript{265} According to another, “Long term issues get ignored, and legislation is smaller and crappier. I’m not sure that they are capable of dealing with large policy issues. . . . Under term limits, you get people wanting to have something to put on their campaign brochure so that they can run for the next office.”\textsuperscript{266} In this context, it is hard to think of an issue that could have less public salience – an issue that is, in other words, less “sexy” – than the distribution of sales tax revenue to local governments. However, the Legislature’s tinkering around the edges when prompted to do so rather than tackling sweeping reform of sales tax allocation could also signal a general commitment to those values expressed by the situs-based system, such as promoting healthy economic competition among the state’s subunits. Whatever the reason, the kinds of deep reforms advanced by critics of situs-based allocation are unlikely to materialize soon.

Conclusion

\textsuperscript{263} \textsc{Senate Local Government Committee, Committee Analysis of SB 27}, at 2 (March 4, 2009) (suggesting that the Committee “consider whether, by leaving the situs-based sales tax allocation system for local governments unchanged, SB 27 adequately addresses the underlying problems associated with the fiscalization of land use” and that, “by narrowly prohibiting only one type of sales tax diversion scheme, and broadly excluding many types of local tax rebate agreements, SB 27 invites further misuse of Bradley-Burns tax rebates, which will require additional legislative remedies”).

\textsuperscript{264} Id.

\textsuperscript{265} \textsc{Bruce E. Cain & Thad Kousser, Adapting to Term Limits: Recent Experiences and New Directions}, 44 (2004), available at http://www.ppic.org/content/pubs/report/R_1104BCR.pdf.

\textsuperscript{266} Id. Note, however, that the PPIC report quoting both of these staff members ultimately concluded that legislation had actually gotten longer and more complex since the implementation term limits, although it acknowledged that this methodology for assessing the impact of term limits on policy content was far from perfect. Id. at 44-51.
Bradley-Burns sales tax allocation provides a useful framework for understanding the role of territorial limits in state and local taxation. In particular, the situs rule applicable to California’s local sales tax and the myriad of legal protections afforded to that system reflect the underlying goal of local taxes to attribute economic activity to the actual location where it takes place. This in turn traces federal constitutional principles governing the application of state taxes, which limit the reach of a state’s taxing power in the face of interstate commerce. However, the focus on territorial allocation under the Proposition 13 regime has prompted a variety of unhealthy practices, with local governments attempting to lure retail activity to their jurisdictions by any means necessary in order to increase their share of the tax revenue pie. As a result of this fiscalization of land use planning, local governments de-emphasize more beneficial economic activities and engage in destructive competition.

Despite these problems, the situs rule will likely remain a fixture of local sales taxes for the foreseeable future. Proposals that would address the underlying problem would in all probability fail to gain political traction, as revealed in the arguments levied against them as well as the array of state constitutional protections enacted by voters over the years. In this climate, the Legislature has turned instead to trying to negate the worst outcomes of the fiscalized land use problem. These efforts preserve the core of the situs rule and, with it, the focus on territoriality inherent in that allocation method. Whether these efforts will ultimately prove successful, and whether they will curtail the neverending turf wars for sales tax revenue between local governments, remains unclear.