

Memorandum



Financial Services

Date: January 19, 2010

To: Mayor and Council

From: Jerry Hart, Financial Services Manager (8505)

Subject: Sales Tax Rate Information

At the January 7th Issue Review Session, the Council asked staff to conduct research and provide answers to a number of questions surrounding a proposed .2% (two-tenths) increase to the current sales tax rate from 1.8% to 2.0%. Attached are the results of the research presented in "question and answer" format for your review. Staff will present these findings at the January 21st Issue Review Session and answer any questions that you may have.

Sales Tax Research

1. What impact would the sales tax increase have on taxable sales, like automobile and durable goods?

The impact on automotive and durable goods sales resulting from a 0.2% sales tax rate change, if any, cannot be precisely determined. Tempe's sales tax rate has changed 3 times since the early 90's, as follows:

FY 1994: 1.0% to 1.2%
 FY 1997: 1.2% to 1.7%
 FY 2001: 1.7% to 1.8%

To analyze the impact of these rate changes, we first applied a regression of annual changes in taxable sales against disposable personal income and sales tax rate changes during the period from FY 1990 to FY 2009. The analysis did not reveal a statistically significant negative impact on taxable sales as a result of the rate changes.

A second approach to this question involved a review of published literature on the topic. A list of these articles appears in the reference section at the end of this report. This issue has received attention for decades and has been the subject of numerous published research studies. It is worth noting that these studies were conducted using a number of different methods in a variety of geographical areas and in some cases occurred several decades in the past. None of the studies were specific to Tempe or the Phoenix metro area.

With that caveat in mind, these studies generally show that a **full 1%** change in the sales tax rate can result in a taxable sales reduction of 3 to 7% (Mikesell 2009). Applying this proportionally to a 0.2% rate change would equate to a 0.6% to 1.4% taxable sales loss. Using this range would translate to a \$450,000 to \$1,000,000 downward adjustment to any new General Fund revenues that would normally accrue as a result of a rate change of this size.

It is unclear how applicable these past studies are to the current economy. The growth in internet sales, as well as increased traffic congestion and higher transportation costs, may play a role in consumer purchasing decisions.

2. How much will the 0.2% sales tax increase generate?

In light of the information presented above, a 0.2% tax increase could be expected to generate approximately \$8.9 to \$10 million for FY 2010/11 above the amount projected in the long range forecast. This estimate assumes that food for home consumption is not excluded from the marginal tax rate increase and that contracting sales are excluded pursuant to Laws 2009, 3rd Special Session, Chapter 7. The range of estimates also reflects varying assumptions about the extent of lost sales tax base resulting from an increase, ranging from "no loss" scenario as found in staff's internal review of historical rate change impacts up to a maximum of -1.4%, the top end of the range from the literature review referenced above.

3. What are proposals to increase sales tax in other cities?

City	Status of Discussions on a Sales Tax Increase
Gilbert	Planning a special budget meeting in January to discuss a sales tax increase of one quarter of one percent (1.50% to 1.75%) for the May ballot.
Chandler	No current plans to increase the sales tax rate.
Scottsdale	No plans for an increase in the overall sales tax rate. A proposed bed tax increase of two percent (3% to 5%) has been placed on the March 2010 ballot.
Mesa	No current plans to increase the sales tax rate.
Peoria	No current plans to increase the sales tax rate.
Phoenix	Considering taxing food for home consumption. Currently exempt from sales tax.
Glendale	No current plans to increase the sales tax rate.

4. What impact will the sales tax increase have on food?

Fiscal Year	Estimated Tax Revenues Food for Home Consumption at 1.8%	Estimated Impact of 0.2% Rate Increase	Estimated Total Tax Revenues Food for Home Consumption at 2.0%
FY 2006/07	\$7,840,000	\$880,000	\$8,720,000
FY 2007/08	\$7,370,000	\$820,000	\$8,190,000
FY 2008/09	\$6,410,000	\$720,000	\$7,130,000
FY 2009/10	\$6,060,000	\$680,000	\$6,740,000
FY 2010/11	\$5,690,000	\$640,000	\$6,330,000

5. What is the definition of “Food for Home Consumption”?

Food for Home Consumption is all food sold by a grocery store, or other store that packages and displays similarly to a grocery store, except food for consumption on the premises.

6. What are the comparative tax rates for other cities?

Sales Tax Rates				
City	Overall	Retail	Food Home Consumption	Restaurants and Bars
Gilbert	1.50%	1.50%	1.50%	1.50%
Chandler	1.50%	1.50%	1.50%	1.80%
Scottsdale	1.65%	1.65%	1.65%	1.65%
Mesa	1.75%	1.75%	0.00%	1.75%
Tempe	1.80%	1.80%	1.80%	1.80%
Peoria	1.80%	1.80%	1.80%	2.80%
Phoenix	2.00%	2.00%	0.00%	2.00%
Glendale	2.20%	2.20%	1.80%	3.20%

The cities of Chandler, Peoria and Glendale currently tax the restaurant and bar business activity at a higher sales tax rate than the retail business activity. It is estimated that every **one-tenth** increase in the City’s sales tax rate on only the Restaurant and Bars business activity would generate an additional \$450,000 in sales tax revenue. Also, please find a listing of the state, county and city retail sales tax rates for Arizona cities and towns with populations over 10,000 (Attachment A).

7. What are the costs associated with a Special Election?

Expense	Qty	Cost	Estimated Election Costs May 2010	Totals
Tempe School District Facility Use Fee	3	465	\$1,395	\$1,395
Pamphlet Printing				
Translation			1,050	
Print, Fold, Mail Prep	9,500		22,000	
Postage			13,546	
Tax		0.081	1,782	
Total Pamphlet				\$38,378
Advertising			1,250	\$1,250
Maricopa County Election Costs				
Registered Voters*	86,000	0.73	62,780	
Early Voting Requests*	30,000	1.72	51,600	
Total MCED Costs				\$114,380
Early Voting Temporary Staffing		4,782	4,782	\$4,782
Misc. Translation Services			650	\$650
Miscellaneous Supplies			1,500	\$1,500
Estimated Election Costs			\$162,335	\$162,335

References:

Fisher, Ronald C. "Local Sales Taxes: Tax Rate Differentials, Sales Loss, and Revenue Estimation," *Public Finance Quarterly*, Vol. 8 No. 2 (April 1980): 171-188

Hamovitch, William. "Sales Taxation: An Analysis of the Effects of Rates Increases in Two Contrasting Cases," *National Tax Journal*, Vol. 19 (December 1966): 411-420

Mikesell, John L. "Central Cities and Sales Tax Rate Differentials," *National Tax Journal*, Vol. 23 (June 1970): 206-213

Mikesell, John L. "The Changing Landscape of Local Public Revenues," *Lincoln Institute of Land Policy* (June 2009)

Mikesell, John L. "Sales Taxation and the Border County Problem," *Quarterly Review of Economics and Business* Vol.11 (Spring 1971): 23-29

Mikesell, John L. and Zorn, C. Kurt "Impact of the Sales Tax Rate on its Base: Evidence from a Small Town," *Public Finance Quarterly*, Vol. 14, No 3. (July 1986): 329-338

Walsh, Michael J. and Jones, Jonathon D. "More Evidence on the Border Tax Effect: the Case of West Virginia, 1979-84," *National Tax Journal*, Vol. 41, No. 2 (June 1988): 261-65

Laws 2009, 3rd Special Session, Chapter 7:

Sec. 42. Construction contracting tax rate increase; municipalities; moratorium; retroactivity

- A. Notwithstanding any other law, beginning June 30, 2009 through June 30, 2011, a city or town shall not impose an increased tax rate that is levied on construction contracting by submitting the issue to the qualified electors of the city or town at an election or by action of the city or town council.
- B. This section does not apply to any transaction privilege tax rate that is adopted before June 1, 2009.
- C. This section is effective retroactively to from and after June 29, 2009.

Attachment A

State, County and City Retail Sales Tax Rates Cities or Towns with Populations Greater than 10,000				
City	State	County	City	Total
Apache Junction	5.60%	0.70%	2.20%	8.50%
Avondale	5.60%	0.70%	2.50%	8.80%
Buckeye	5.60%	0.70%	2.00%	8.30%
Bullhead City	5.60%	0.25%	2.00%	7.85%
Camp Verde	5.60%	0.75%	2.00%	8.35%
Casa Grande	5.60%	1.10%	2.00%	8.70%
Chandler	5.60%	0.70%	1.50%	7.80%
Chino Valley	5.60%	0.75%	3.00%	9.35%
Coolidge	5.60%	1.10%	3.00%	9.70%
Cottonwood	5.60%	0.75%	3.00%	9.35%
Douglas	5.60%	0.50%	2.80%	8.90%
El Mirage	5.60%	0.70%	3.00%	9.30%
Eloy	5.60%	1.10%	3.00%	9.70%
Flagstaff	5.60%	1.125%	1.721%	8.446%
Florence	5.60%	1.10%	2.00%	8.70%
Fountain Hills	5.60%	0.70%	2.60%	8.90%
Gilbert	5.60%	0.70%	1.50%	7.80%
Glendale	5.60%	0.70%	2.20%	8.50%
Goodyear	5.60%	0.70%	2.50%	8.80%
Kingman	5.60%	0.25%	2.00%	7.85%
Lake Havasu City	5.60%	0.25%	2.00%	7.85%
Marana	5.60%	1.10%	2.00%	8.70%
Maricopa City	5.60%	1.10%	2.00%	8.70%
Mesa	5.60%	0.70%	1.75%	8.05%
Nogales	5.60%	1.00%	2.00%	8.60%
Oro Valley	5.60%	0.50%	2.00%	8.10%
Paradise Valley	5.60%	0.70%	1.65%	7.95%
Payson	5.60%	1.00%	2.12%	8.72%
Peoria	5.60%	0.70%	1.80%	8.10%
Phoenix	5.60%	0.70%	2.00%	8.30%
Prescott	5.60%	0.75%	2.00%	8.35%
Prescott Valley	5.60%	0.75%	2.33%	8.68%
Queen Creek	5.60%	0.70%	2.25%	8.55%
Safford	5.60%	0.50%	2.50%	8.60%
Sahuarita	5.60%	0.50%	2.00%	8.10%
San Luis	5.60%	1.10%	4.00%	10.70%
Scottsdale	5.60%	0.70%	1.65%	7.95%
Sedona	5.60%	0.75%	3.00%	9.35%
Show Low	5.60%	0.50%	2.00%	8.10%
Sierra Vista	5.60%	0.50%	1.75%	7.85%
Somerton	5.60%	1.10%	2.50%	9.20%
Surprise	5.60%	0.70%	2.20%	8.50%
Tempe	5.60%	0.70%	1.80%	8.10%
Tucson	5.60%	0.50%	2.00%	8.10%
Winslow	5.60%	0.50%	3.00%	9.10%
Yuma	5.60%	1.10%	1.70%	8.40%

Source: Arizona Department of Revenue, Arizona Department of Commerce
Model City Tax Code