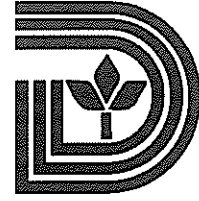


Memorandum



CITY OF DALLAS

DATE November 4, 2010

TO Members of the Budget, Finance & Audit Committee:
Chair Jerry Allen, Vice-Chair Ann Margolin, Vonciel Jones Hill, Angela Hunt, Delia D. Jasso, Ron Natinsky, David A. Neumann

SUBJECT Sales Tax Overview

The November 8, 2010 Budget, Finance & Audit Committee meeting agenda includes the Sales Tax Overview briefing.

Please let me know if you need additional information.

A handwritten signature in cursive script that reads "Jeanne Chipperfield".

Jeanne Chipperfield
Chief Financial Officer

Attachment

c: Honorable Mayor & Members of the City Council
Mary K. Suhm, City Manager
Deborah A. Watkins, City Secretary
Tom P. Perkins, City Attorney
Craig D. Kinton, City Auditor
Ryan S. Evans, First Assistant City Manager
A.C. Gonzalez, Assistant City Manager
Jill A. Jordan, P.E., Assistant City Manager
Forest E. Turner, Assistant City Manager
Frank Libro, Public Information Office
Helena Stevens-Thompson, Assistant to the City Manager

Sales Tax Overview

Budget, Finance and Audit Committee

November 8, 2010



Purpose and Outline

- Overview of sales tax is provided for informational purposes
 - No action is required
- Outline
 - State Law – tax rate and taxable items
 - Taxable vs. non-taxable sales
 - Historical Trends
 - Forecasting model
 - Geographic and demographics
 - Internet sales
 - Summary

Tax Rate

- Sales tax is governed by and capped by State law
- Dallas is at maximum sales tax permitted under State law which is 8.25%
 - State levies 6.25% tax
 - Local jurisdictions are allowed to levy up to 2% tax
 - Cities
 - Counties
 - Transit authorities
 - Special purpose districts created to generate revenue for a specific reason such as for crime control, libraries, emergency services
- In Dallas, sales tax includes
 - 6.25% - State
 - 1.0% - City's general fund
 - 1.0% - Dallas Area Rapid Transit

Taxable Items

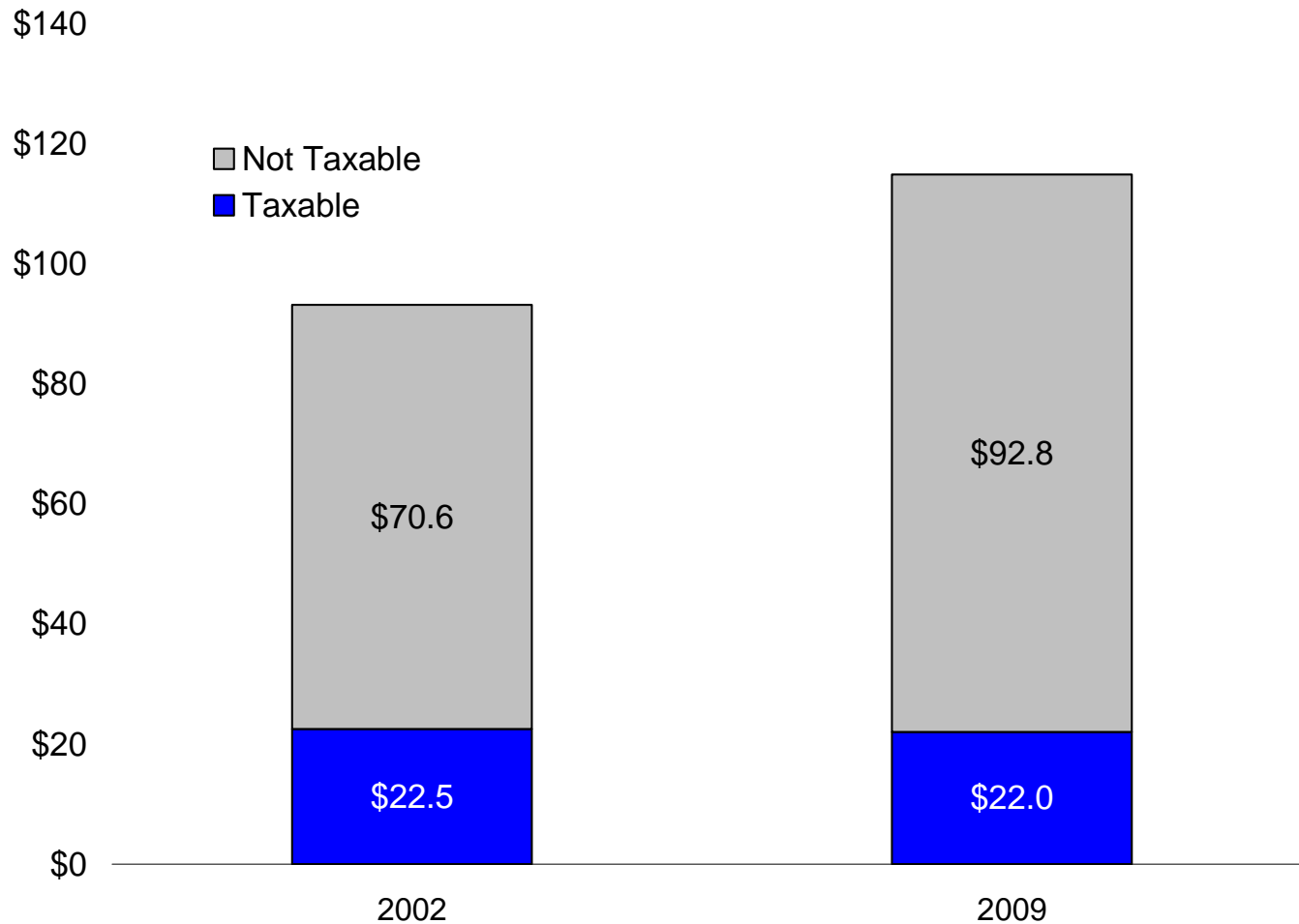
- Only the sell or lease of tangible personal property or the sell of taxable services as defined by State are subject to sales tax
- Not all sales are taxable - taxable sales are a subset of gross sales
- Sales tax revenue comes from much more than retail activity, because most industries (categorized below; examples in appendix) have at least some portion of their sales that are subject to sales tax
- Retail and wholesale trade accounts for about 34% of Dallas' sales tax revenue

Retail Trade	Admin Support, /Waste, Remediation	Transportation & Warehousing
Wholesale Trade	Professional, Scientific, Technical Services	Health Care & Social Services
Information	Other Services (Except Public Administration)	Public Administration
Utilities	Arts, Entertainment, Recreation	Educational Services
Accommodations & Food Service	Real Estate, Rental, Leasing	Agriculture, Forestry, Fishing, Hunting
Manufacturing	Mining-Quarrying, Oil & Gas Extraction	Mgmt of Companies & Enterprises
Construction	Finance & Insurance	Other and Nonclassifiable

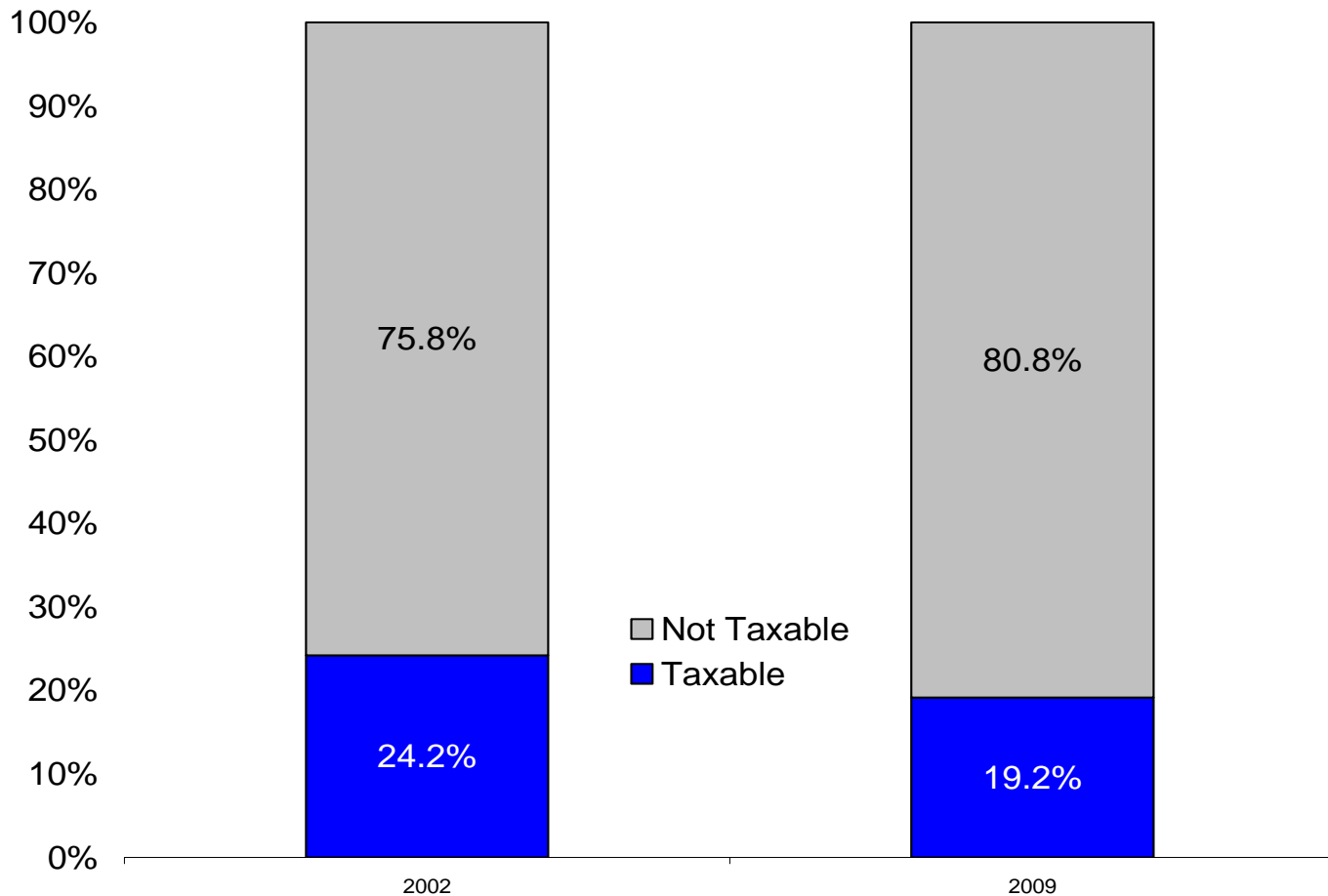
Taxable Sales

- Economic growth does not always translate into sales tax revenue growth
- For example, between 2002 and 2009, fastest growing gross sales in City were in industries that only account for 7.3% of sales tax revenue in City
 - Real estate, rentals and leasing industry – 833%
 - Finance and insurance – 608%
 - Health care and social services – 519%
 - Educational services – 123%
- The fastest-growing industries in terms of taxable sales from 2002 to 2009 account for only 3.6% of Dallas' sales tax revenue and were
 - Mining-quarrying-oil & gas extraction – 71%
 - Agriculture-forestry-fishing-hunting – 54%
 - Finance and insurance – 51%
 - Arts-entertainment-recreation – 38%

Taxable and Non-Taxable Sales (\$ Billion)



Taxable and Non-Taxable Sales (% of Gross Sales)

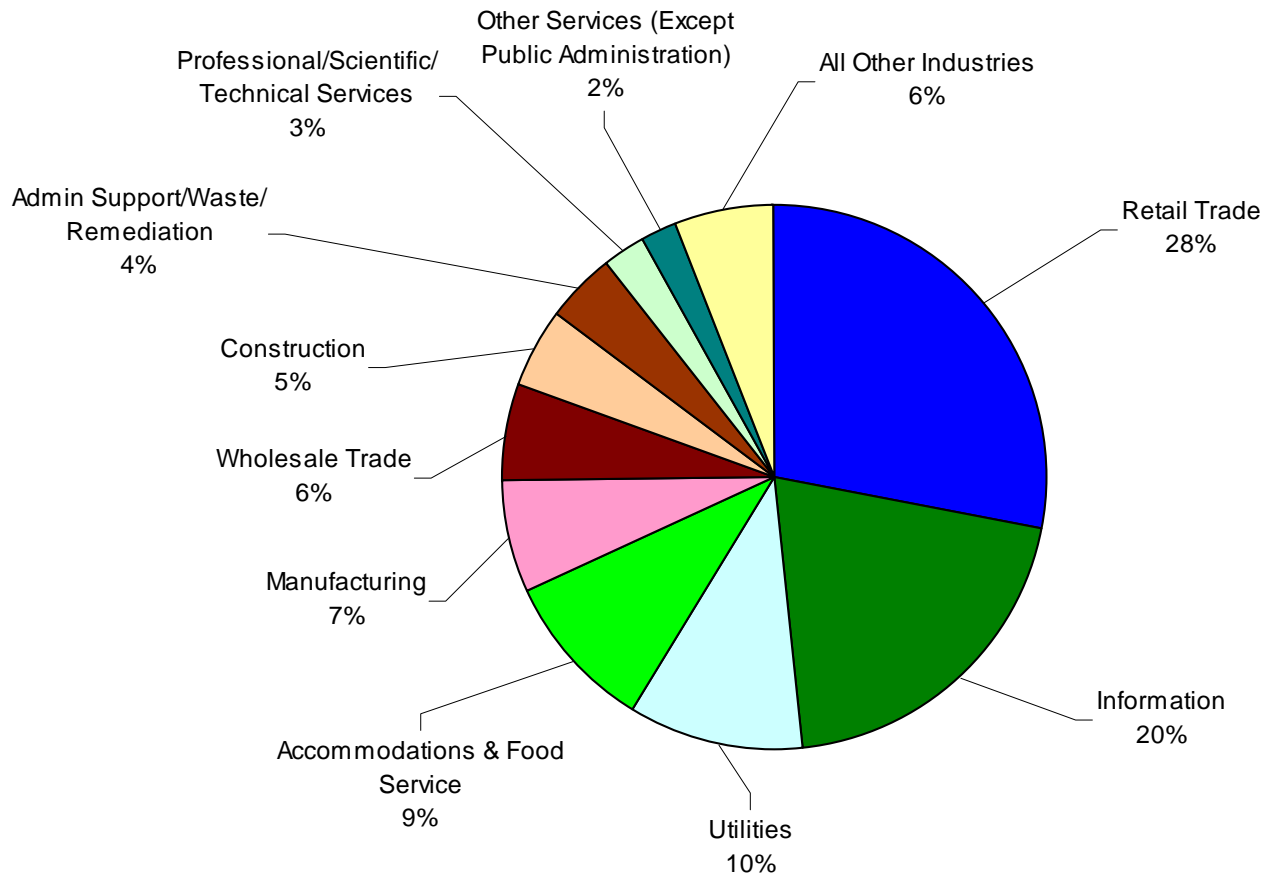


Taxable Sales by Industry

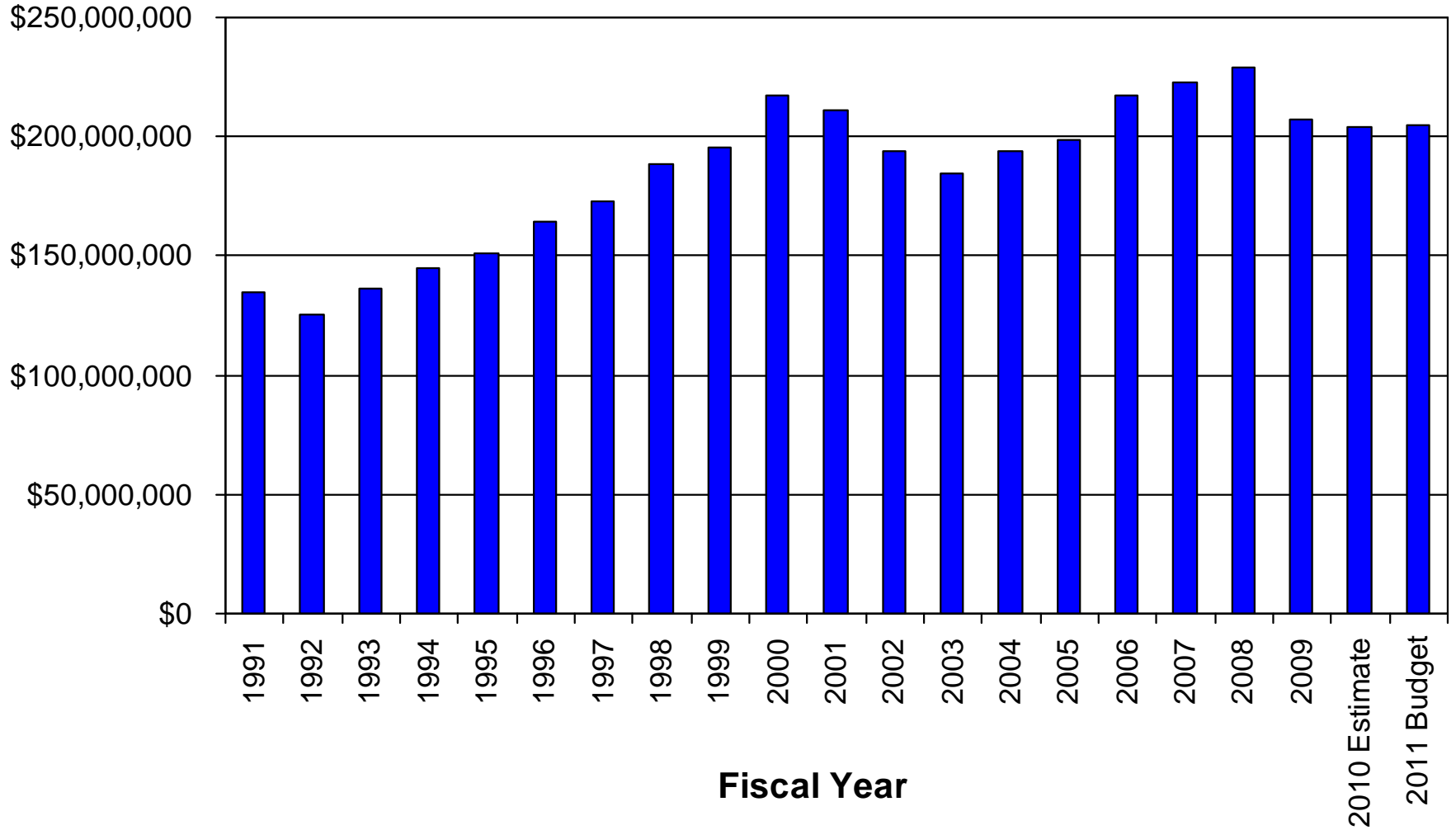
Type of Industry	2002		2009		Change
Retail Trade	6,070,459,589	27.0%	6,194,075,334	28.2%	+2%
Information	5,326,175,189	23.7%	4,428,644,112	20.1%	-17%
Utilities	2,383,700,880	10.6%	2,298,120,036	10.4%	-4%
Accommodations & Food Service	1,774,202,402	7.9%	2,061,842,057	9.4%	+16%
Manufacturing	1,775,366,831	7.9%	1,463,735,789	6.7%	-18%
Wholesale Trade	1,243,047,608	5.5%	1,291,224,030	5.9%	+4%
Construction	768,858,409	3.4%	1,012,378,818	4.6%	+32%
Admin Support, Waste, Remediation	943,755,461	4.2%	914,985,054	4.2%	-3%
Professional, Scientific, Technical Service	637,162,028	2.8%	584,710,641	2.7%	-8%
Other Services (except Public Admin)	418,635,630	1.9%	437,839,790	2.0%	+5%
All Other Industries	1,177,396,793	5.2%	1,309,856,931	6.0%	+11%
	22,518,760,820	100.0%	21,997,412,592	100.0%	-2%

Taxable Sales by Industry

Calendar 2009



Sales Tax Revenue Historical Trend for City of Dallas



Historical Trend – Recession Dates

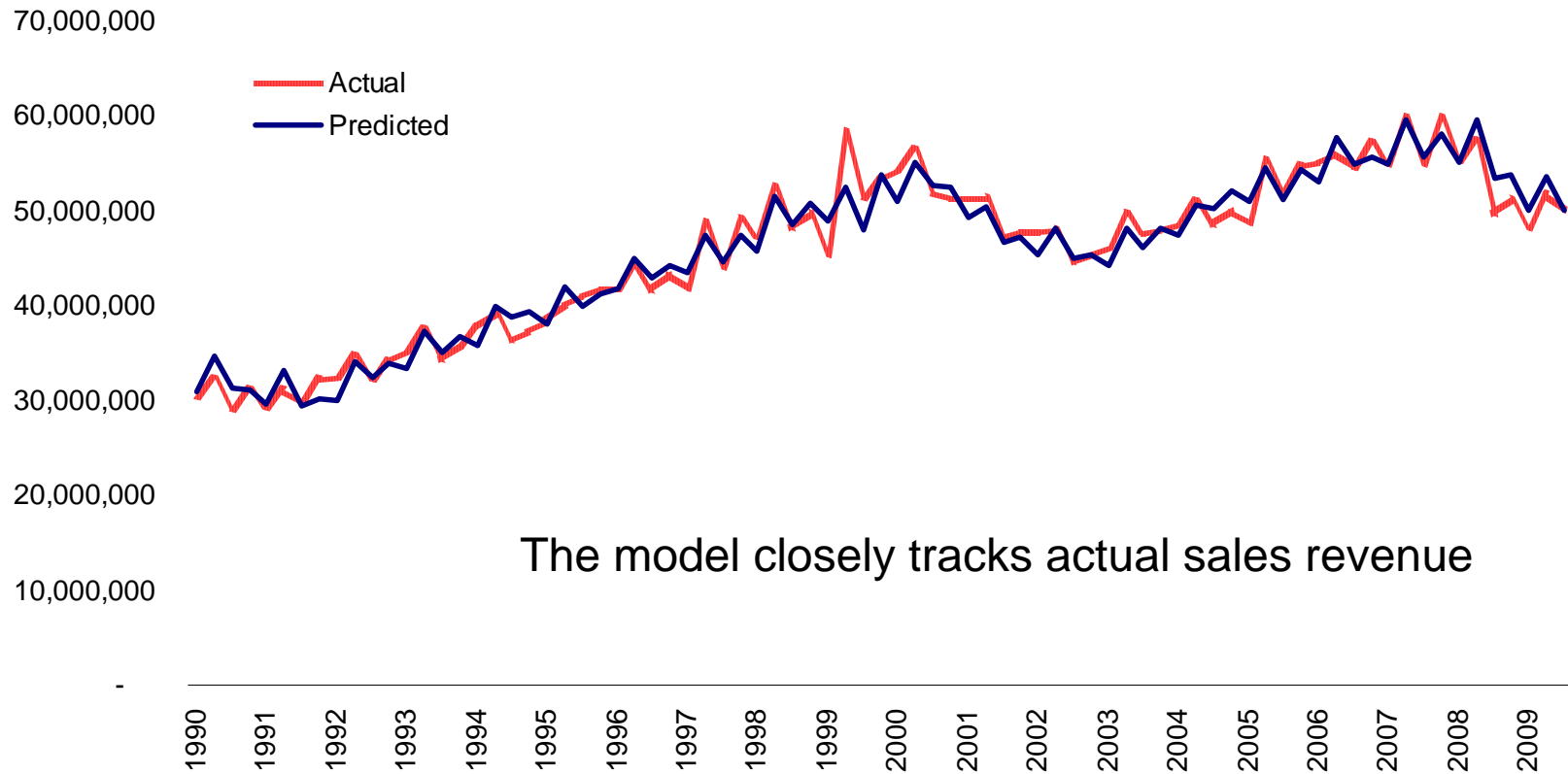
- Gross sales and taxable sales are affected by national and international economics
- National Bureau of Economic Research, a private organization maintains the following dates for the three recent national recessions
 - July 1990 to March 1991
 - March 2001 to November 2001
 - December 2007 to June 2009
- End of a recession does not necessarily mean the economy is growing strongly, rather that most major indicators are no longer falling

Forecasting Model

- Forecasting of sales tax is difficult due to volatile nature and numerous variables involved
- Office of Economic Development developed a sales tax forecast model that generates short and medium-term forecasts
- Model uses quarterly historic data from 1990
- A large selection of statistics were evaluated to include in the model
- The final model includes four variables that together provide the best predictive ability
 - City of Dallas unemployment rate (source: U.S. BLS)
 - Occupied retail space in the city (source: Costar)
 - Actual sales tax revenue from two quarters prior (source: TX Comptroller)
 - Special seasonal variable – accounts for fourth quarter holiday shopping season
- Model explains 95.9% of historic sales tax revenue behavior in Dallas

Forecasting Model Performance

(Quarterly Sales Tax Allocation)



Forecasting Model

- Model variables have the following effect on quarterly revenue
 - Dallas unemployment rate – every percentage point change in city's unemployment rate changes quarterly revenue by \$1.2m
 - Occupied retail space – every 1,000,000 square foot change of occupied space changes revenue by \$0.8m
 - Past sales revenue – each \$1m change in revenue two quarters prior changes current quarter revenue by \$0.4m
 - Fourth quarter (Oct-Dec) seasonal variable – revenue will be \$2.5m higher in fourth quarters

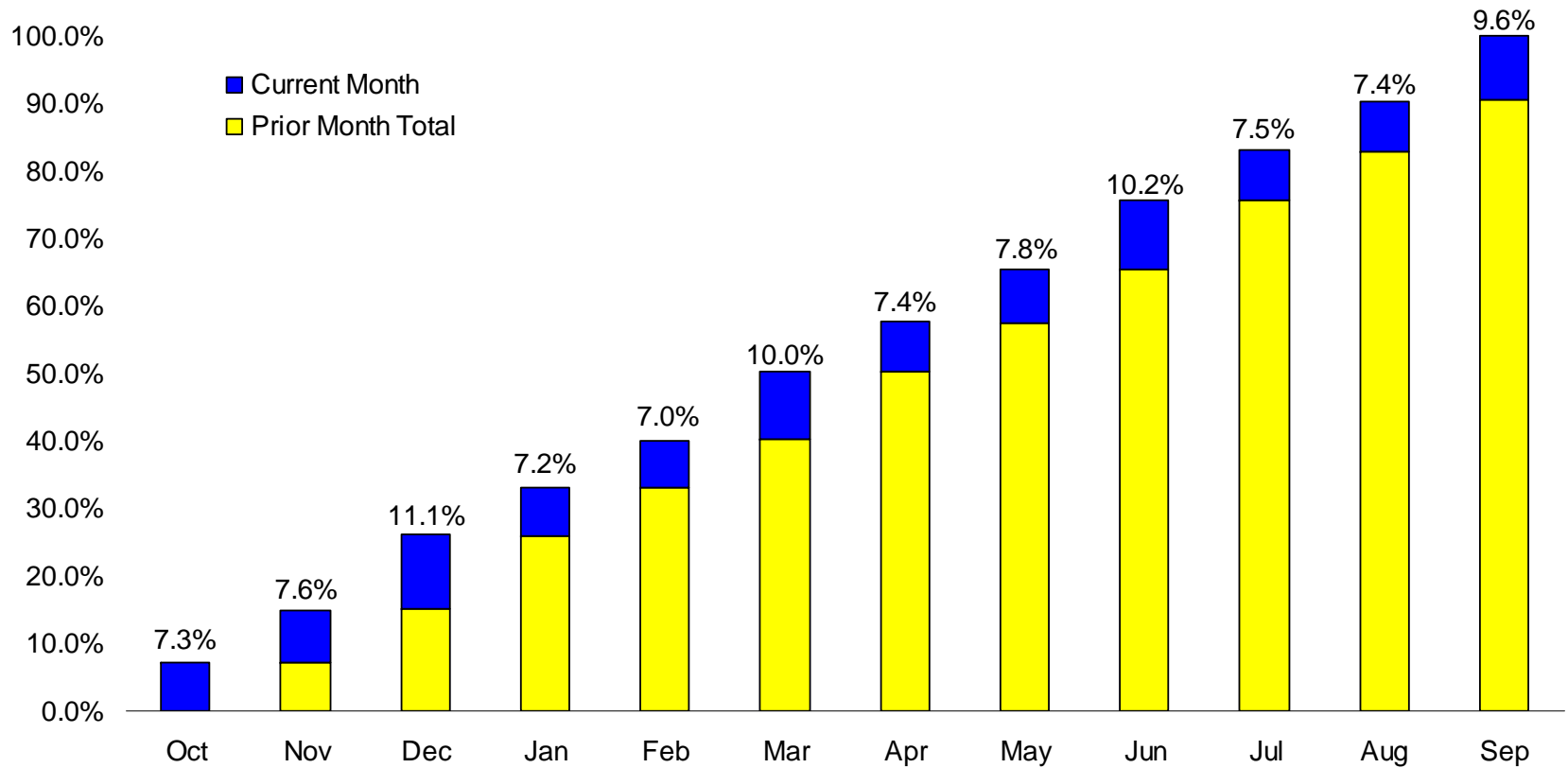
Forecasting Methodology

- Fiscal year budget is based on a ratio forecast methodology and confirmed through the model developed by Office of Economic Development
- Forecast of year-end sales tax revenue uses year-to-date actual receipts
 - Each calendar month account for approximately the same share of annual revenue from year to year
 - Uses averages from the last five years
 - Assumes current year revenue pattern will follow the historic trend
- Annually City Auditor reviews upcoming fiscal year revenue projection and methodology

Forecasting Methodology

Monthly Sales Tax Receipts

(2005-2009)



Forecasting Methodology

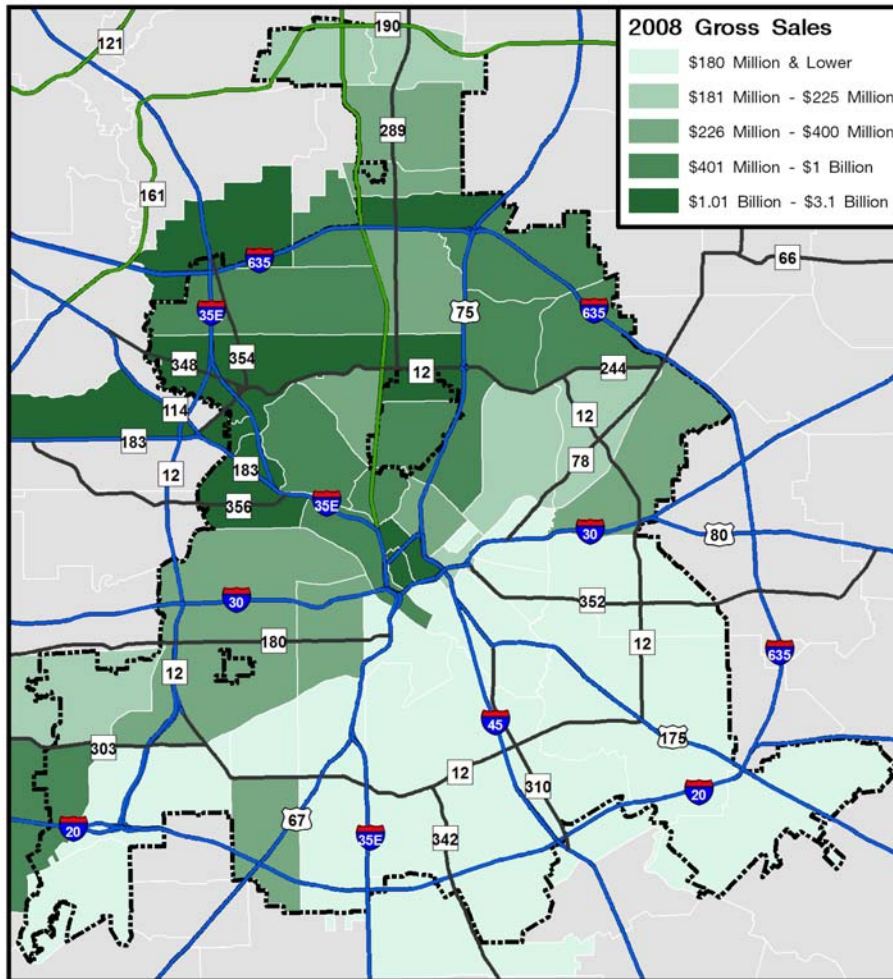
FY11 Budget

- For FY11 Budget, sales tax revenue is forecast at \$204.8m
 - Second largest revenue source for the general fund
 - Accounts for about 20.5% of revenue for general fund

FY08 Actual	\$228.8m
FY09 Actual	\$206.9m
FY10 Budget	\$206.6m
FY10 Estimate	\$203.8m
FY11 Budget	\$204.8m

Geographic Pattern of Sales

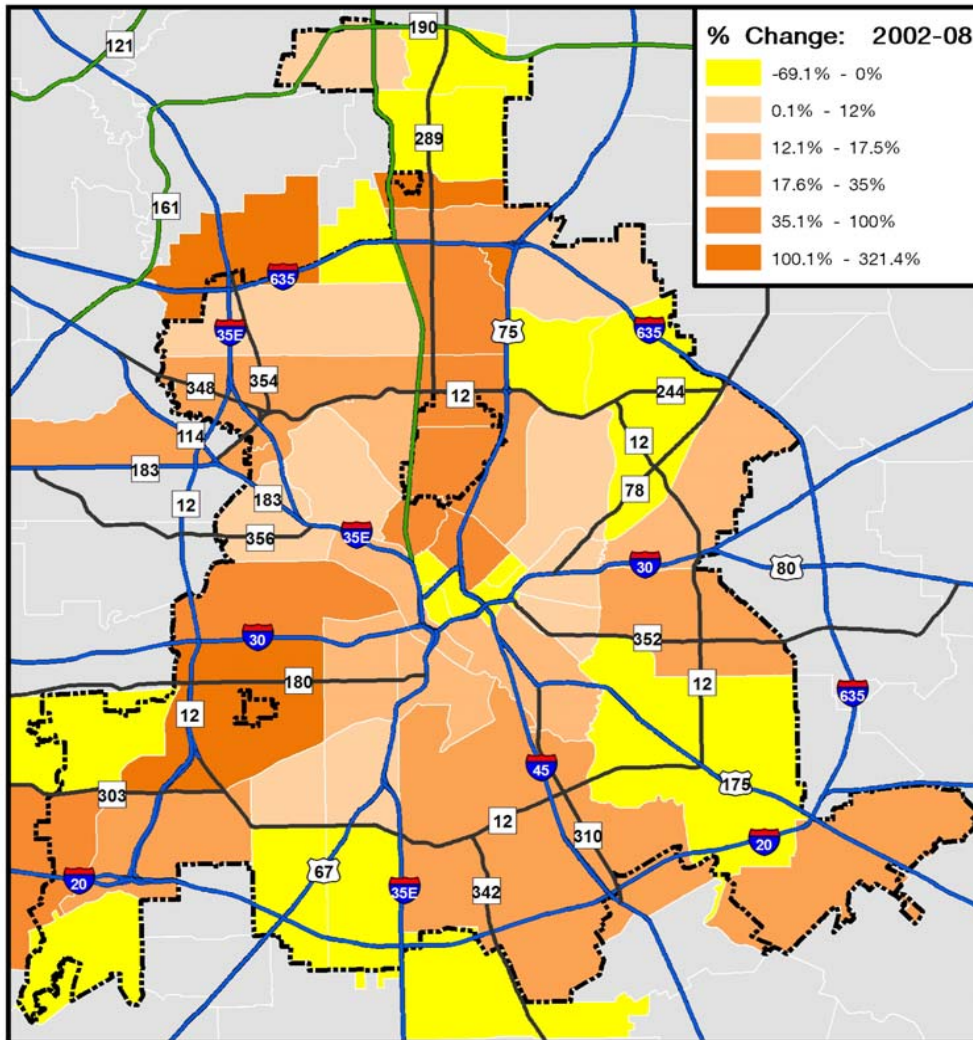
(Based on Point of Sale)



- Total sales in Dallas reflects the concentration of commercial activity
- Northern and western Dallas' retail and industrial corridors are the areas generating most of the city's sales
- This pattern does not reflect the source of the income that generates the sales
- These sales are to all individuals, including customers that may reside in other parts of the city, outside the city or even outside the state

% Change in Sales Activity

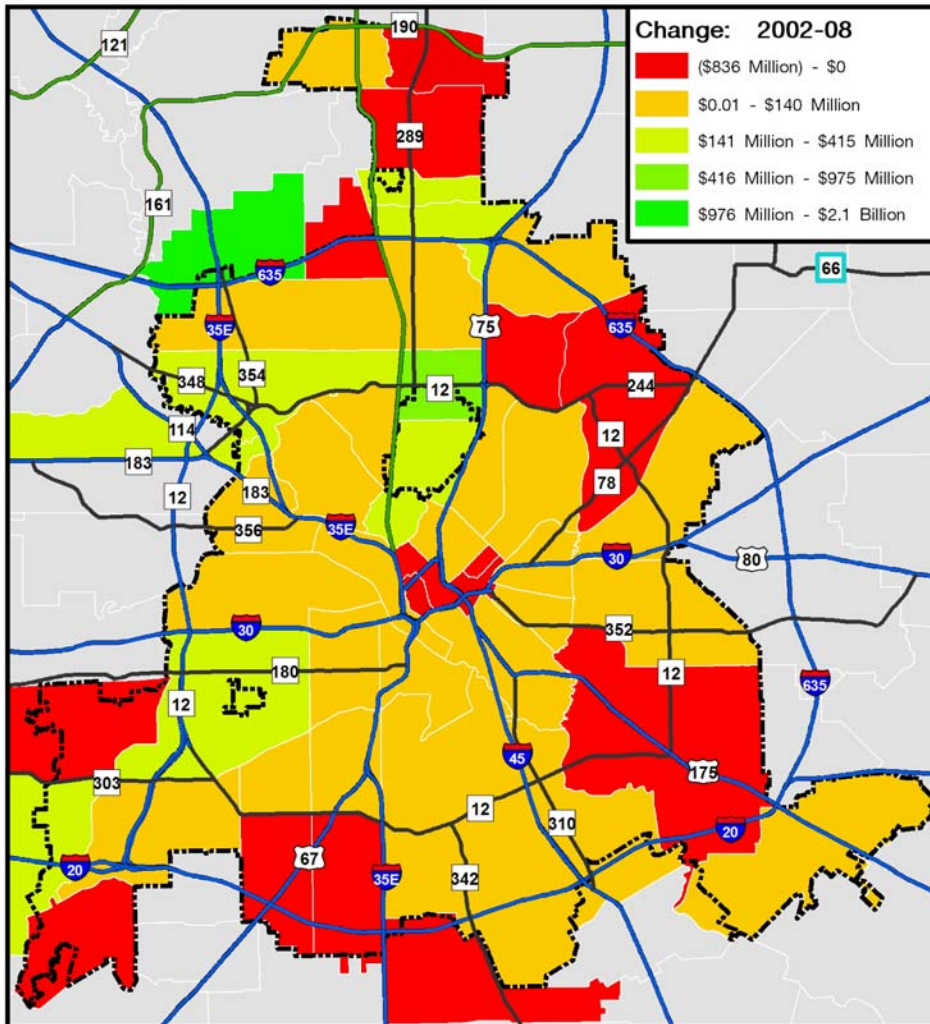
(Based on Point of Sale)



- Total sales activity has changed in the city
- Increases are likely due to increased commercial and retail activity
- Decreases may be due to loss of local customers or the removal of large tax payers (through closure or relocation)

\$ Change in Sales Activity

(Based on Point of Sale)



- The dollar change in sales activity matches the percent change pattern with scattered pockets of increasing and decreasing sales by ZIP code

Dallas ZIP Demographics

- Dallas ZIP codes present a range of socioeconomic characteristics
- Many of these factors drive retail and other spending behavior
- Non-Dallas residents also contribute to sales tax revenue and Dallas residents spend some income in other jurisdictions

	Average of all Zips	Min of all Zips	Max of all Zips
Total Household Expenditure	\$55,264	\$23,868	\$137,771
Retail Expenditure	\$23,487	\$10,472	\$57,783
Median Age	34.5	27.5	44.7
Owner Occupied Housing Units	41.8%	5.6%	77.1%
Median Household Income	46,041	16,922	126,828
Average Vehicles Per Household	1.6	1.1	2.4
Per Capita Income	31,132	8,500	94,338
Average Household Size	2.7	1.5	3.8
Education Total (Bachelors or higher)	2.8	3.8	7.31
Total Population	29,457	267	75,022

Socioeconomic Factors Driving Household Spending

- Household spending is an important determinant of sales activity in Dallas
- Dallas households, however, spend income inside and outside their neighborhoods and inside and outside the city overall
- At the ZIP code level, there is very little correlation between where spending power is concentrated and where actual sales take place (correlation = 0.26)
- A statistical analysis of the relationship between spending and socioeconomic variables by Dallas ZIP codes revealed the following:
 - Median household income and per capita income positively correlate to an increase in spending
 - Average household size correlates to a lesser degree, given that a family's budget can only expand so much as the family grows
 - Educational attainment tends to contribute to additional spending, but the results vary with different statistical models (limitations in the available data may explain this inconsistency)
 - Ethnicity and home ownership were not statistically associated with household spending

Internet Sales

- In early 2010, the Texas Comptroller estimated that the state is losing almost \$600m a year in state and local sales taxes from online purchases which translates to about \$4.6m per year for the City of Dallas
- Rules related to internet sales
 - Texas sales tax, including local tax, is due on purchases made on the internet for delivery in Texas
 - If the seller has a Texas location, Texas sales tax is due on the purchase
 - If a Texas buyer purchases merchandise through the Internet from a seller located outside of Texas and uses the taxable item in Texas, then the Texas use tax on the purchase is due from the customer
 - An out-of-state seller is not required to collect the Texas tax if the seller only conducts business in Texas from out-of-state by mail, telephone, or the Internet, but this seller can voluntarily collect the Texas tax from its Texas customers
 - If the seller has Texas outlets, Texas salespersons, or otherwise comes into Texas to conduct business, such as soliciting sales, performing services, or making deliveries, an out-of-state seller must get a Texas permit and collect the Texas tax.
 - The Comptroller's office monitors out-of-state sellers to make sure they properly report and remit the tax they collect

Summary

- Sales tax revenue is a significant revenue for the City's general fund
- Sales tax is volatile and affected by the economy and numerous variables
- Staff will continue to monitor and report on sales tax on a monthly basis

Appendix

Appendix: Example Taxable Items

- The sales tax code and the administrative rules crafted by the State Comptroller are lengthy and complex. There are hundreds of clauses, exemptions and findings that affect the taxability of goods and services
- Examples of taxable items in select industries
 - Information – Newsletters, data retrieval, or mailing lists
 - Utilities – Residential consumption of electricity when the municipality has removed its default exempt status
 - Manufacturing – Hand tools, maintenance and janitorial supplies and equipment, or machinery or equipment used to maintain or store products
 - Construction – Maintenance on non-residential property, labor to repair, remodel or restore residential real property, and labor for new construction

Appendix: Example Non-Taxable

- Examples of non-taxable items in select industries
 - Administration Support/Waste Services/Remediation – Use of pesticides or regulated herbicides for mainly agricultural purposes, and the services of full-time peace officers privately employed as guards
 - Professional/Scientific/Technical Services – Copyrights on photographs (in some instances), and the professional services of landscape designers and architects
 - Arts/Entertainment/Recreation – Skydiving training for a person intending to be a skydiving instructor, and consignment sale by an exempt museum of artwork of less than \$5,000 on one of the two days an exempt museum is allowed to make exempt sales
 - Retail Trade: Items used by the disabled, such as walkers, bedside rails or talking clocks, and items sold during the sales tax holiday
 - Mining/Quarrying/Oil & Gas Extraction - Labor to start or stimulate production or the labor to work on the formation outside a well
 - Transportation & Warehousing – Charges by colleges, universities, and public schools for parking permits and decals for students
 - Other Services (Except Public Administration) – Labor for motor vehicle repair, and qualifying sales made by groups such as PTAs
 - Public Administration – Amusement services provided exclusively by a governmental entity
 - Accommodation and Food Service – Baby food, fruit and vegetable juice made with more than 50% fruit and vegetable juice, or bakery goods not sold with utensils