

**Council Meeting: October 21, 2008****SUBJECT: Clean-Air Vehicle Sales Tax Rebate (Study Issue)****REPORT IN BRIEF**

In December Council approved a study issue initiated by the Department of Public Works to investigate the possibility of providing a Sales Tax rebate for customers purchasing clean-air vehicles from automobile dealers in Sunnyvale.

Providing an incentive to consumers to purchase clean air vehicles would be in line with the City's policy to encourage improvements to regional air quality. Additionally, the City has an interest in the success of local automobile dealerships and approval of a Sales Tax rebate would provide Sunnyvale dealers with an edge over dealerships in other locations and would likely encourage consumers to make their automobile purchases in Sunnyvale.

On the other hand, the sale of hybrid vehicles over traditional vehicles is already brisk without the benefit of a Sales Tax rebate. The cost of fuel and other economic factors are encouraging consumers toward clean-air vehicles and other "greener" lifestyle choices. In fact, the allure of hybrid vehicles over traditional vehicles is significant enough to allow dealers to charge an additional mark-up for many hybrid models. Additionally, while the City has policy to encourage improvements to regional air quality, and the City has an interest in the success of local automobile dealerships, approval of a Sales Tax rebate program would provide tax incentives to only a small segment of Sunnyvale residents and may require a change in the City's established fiscal practice and policy regarding uniform and equitable tax application.

Loss of the Sales Tax revenue from the sale of clean air vehicles, while benefiting a few, would result in a significant impact on the City's General Fund Long Term Financial Plan and the funding necessary to provide basic services to the greater community.

Staff recommends that Council not pursue a Sales Tax rebate for clean air vehicles and direct staff to continue to look for and support larger regional efforts aimed at improving air quality and decreasing the dependence on fossil fuels.

## **BACKGROUND**

At the Council Study Session on September 25, 2007, the Department of Public Works staff identified the concept of a Sales Tax rebate to encourage the purchase of clean-air vehicles as a potential policy issue for Council consideration. The basis for the concept was a perceived opportunity to improve air quality and encourage shopping in Sunnyvale by providing an incentive for consumers to purchase clean-air vehicles from Sunnyvale automobile dealerships.

## **EXISTING POLICY**

- Goal 3.7C            Make a contribution towards improving regional air quality.
- Policy 5.1B.3        Monitor the effect of City policies on business development and consider the effects on the overall health of business within the City.
- Policy 5.1B.4        Participate in regional efforts to respond to transportation and housing problems caused by economic growth in order to improve the quality of life and create a better environment for business to flourish.
- Fiscal 7.1B.1.2     Taxes levied by the City will be used for the purpose of financing services performed for the common benefit.

## **DISCUSSION**

The concept of providing an incentive to consumers to purchase clean air vehicles has certain merits. Sales Tax on the purchase of a car is a significant amount of money and receiving even a small portion of that back would be attractive to consumers. It might make the difference in the decision as to what kind of car to purchase or where to conduct the transaction. As a City, to provide a tax rebate incentive to automobile consumers to choose clean air vehicles would be a statement in support of the movement toward sustainability and a “greener” lifestyle. Sunnyvale could add to the growing movement to improve air quality, decrease dependence on fossil fuels and foreign oil, and slow global warming. As an added bonus, such a move would also provide support and additional sales to Sunnyvale automobile dealers.

However, in deciding whether to adopt a Sales Tax rebate for clean air vehicles, Council must also consider a number of other factors. The first is the loss of Sales Tax revenue and the resultant reduction in the basic services the City would be able to provide to the entire population. Another factor to consider is the City’s current fiscal policy as adopted in the Fiscal Sub-element of the General Plan. Finally, the complexity and cost of administration of a Sales Tax rebate program needs to be considered.

### Impact on Sales Tax Revenue

The City of Sunnyvale has been home to over a dozen automobile dealerships, many of whom offer clean-air vehicles or plan to in the future. Currently the City of Sunnyvale receives 1% of the 8.25% Sales Tax applied to the purchase of every automobile. Over the past three years, the amount of Sales Tax remitted to the City from automobile dealerships has amounted to between \$4 and \$5 million annually. This is approximately 15% of the City's total Sales Tax revenue. With the current economic downturn, it is clear that automobile sales in general are suffering. In fact, two dealerships in the City have recently closed their doors; the impact of these closures based on historical Sales Tax receipts is estimated to be a loss of about \$650,000 per year. Nationally, automakers are reporting declines in sales of 16% – 37% for September 2008. Should this trend hold for 2009, conservatively the City could see a decline in Sales Tax revenue from automobile sales of as much as \$700,000, not including the impact of the dealership closures.

The decline in automobile sales will directly affect the General Fund Long Term Financial Plan and the City's ability to maintain current service levels. In addition to projections for new sales to be lower for the coming future, it should also be noted that dealers are expecting to see a continued shift away from traditional vehicle toward clean-air options. This means that any Sales Tax rebate for clean-air vehicles will only further deplete what is already anticipated to be a hard hit revenue source.

Sunnyvale Toyota and Sunnyvale Ford are two of the largest clean-air dealerships of their brands nationwide. Sunnyvale Honda and Nissan also have a growing clean-air sales record.

It is estimated that approximately \$500,000 of Sales Tax revenue will be received in Calendar Year 2008 from the sale of clean air vehicles. Some estimates are that up to 50% of all new car sales will be clean air vehicles within the immediate future. If Council were to decide to go ahead with a Sales Tax rebate program, a decision would need to be made as to the amount of the Sales Tax that would be rebated. If the entire 1% of Sales Tax received by the City from the sale of the clean air vehicle were rebated, it would result in a revenue reduction of \$500,000 the first year with the expectation that this number will continue to rapidly increase in future years. Council could also choose to rebate a portion of the Sales Tax as part of the program. For example, if one half of the Sales Tax received were rebated, the impact on the City's revenue in the first year would be an estimated \$250,000 with the expectation that this number will continue to climb.

Currently the dealerships are projecting increases in the sale of clean air vehicles in 2009 and 2010. However, as this increase is likely at the expense of traditional

vehicles rather than from additional sales it is not expected that Sales Tax revenues will increase overall enough to offset the loss from the rebate program.

#### Current City Fiscal Policy

In addition to the fiscal concerns noted above, one factor to consider is the City's current fiscal policy. The Fiscal Sub-element states: "Taxes levied by the City will be used for the purpose of financing services performed for the common benefit." Use of tax funds for the purpose of a Sales Tax rebate to a small number of consumers would not support this policy. The question of whether to provide the rebate only to Sunnyvale citizens or to all purchasers would have to be addressed, and if the decision was made to provide it to all customers it would have the effect of rebating Sunnyvale revenue to residents of other jurisdictions. Especially in light of the current economic climate and already anticipated budget constraints, to further reduce the City's revenue would likely lead to deeper service cuts thereby affecting a greater population than might benefit from a Sales Tax rebate.

#### Variables to a Sales Tax Rebate Program

A final concern would be the complexity and cost of administration of a Sales Tax rebate program and how such a program would be implemented. As mentioned, one issue would be to determine which consumers might receive a rebate. Would the program rebate the Sales Tax for all purchases or only those made by Sunnyvale residents? If the goal is to improve air quality, would the residence or work location of each consumer need to be examined to see if the purchase might affect the air quality in Sunnyvale? Would the purchase qualify if the owner worked in Sunnyvale? Would the program only apply to new vehicles, or to used vehicles as well? How these questions are answered would directly impact the amount of Sales Tax revenue that would be rebated, but might also result in other costs.

The City would also need to clearly identify what would be included in the definition of a clean air vehicle. Currently, the discussion of clean air vehicles is primarily centered around the hybrid or the electric vehicle. However, compressed natural gas (CNG) vehicles are becoming more common and the more recent addition to the market is the partial zero emissions vehicles (PZEV), which are clean burning gasoline cars. With the rapid pace that technology is changing in this arena, without a clear definition of what would qualify as a clean air vehicle and therefore be eligible to receive a rebate, the potential number of rebate-eligible vehicles could skyrocket and would likely at some point completely eclipse the sale of traditional vehicles.

In addition to the loss of revenues, if the program requires a consumer to apply and meet certain criteria, there would be paperwork involved. This would require staff time to handle as well as the staff time needed to produce the rebate check once the application is approved. To pursue a Sales Tax rebate for clean-air vehicles, the City would not only be accepting a loss of revenue, but would also be increasing staff costs to allow for administration of the program.

### **FISCAL IMPACT**

Council's approval of a Sales Tax rebate program will reduce revenues to the General Fund. If the full 1% that the City receives from each car sale is rebated, the current loss is estimated to be about \$500,000. Because clean air vehicles are increasing rapidly as a percent of vehicles sold, it is expected that the annual loss could be approximately \$1 million in the near future.

If Council chooses to rebate an amount of Sales Tax less than the 1%, the revenue loss will be reduced accordingly.

Administration of a Sales Tax rebate program will also add costs to the Department of Finance for verification and processing of the rebate paperwork. These costs are unknown at this time because the parameters of the program have not been defined as to which purchasers would be included in the program.

The General Fund Long Term Financial Plan is fully balanced to the twentieth year, so any reduction in revenues or increase in cost as a result of implementing a Sales Tax rebate program will require a corresponding reduction in current services or an increase in other taxes.

### **PUBLIC CONTACT**

Public contact was made by posting the Council agenda on the City's official-notice bulletin board outside City Hall, in the Council Chambers lobby, in the Office of the City Clerk, at the Library, Senior Center, Community Center and Department of Public Safety; posting the agenda and report on the City's Web site; and making the report available at the Library and the Office of the City Clerk.

### **ALTERNATIVES**

1. Council approves the concept of a Sales Tax rebate for clean air vehicles and directs staff to design a program proposal for Council review with the full 1% City share of the Sales Tax being rebated. Council reviews the current priority ranking of services provided by the General Fund and identifies reductions in the amount of approximately \$500,000 per year.
2. Council approves the concept of a Sales Tax rebate for clean air vehicles and directs staff to design a program proposal for Council review with a portion of the Sales Tax received by the City being rebated. Council reviews the current priority ranking of services provided by the General Fund and identifies reductions in the amount of the rebate program.
3. Council rejects the concept of a Sales Tax rebate for clean air vehicles.

**RECOMMENDATION**

Staff recommends that Council adopt Alternative 3, to reject the concept of a Sales Tax rebate for the purchase of clean air vehicles in the City of Sunnyvale.

The current financial instability impacting the country will also be felt in Sunnyvale over the next few years. A decision to further reduce already dwindling resources from the City's budget is one which should be weighed carefully and balanced against tangible benefits. In light of the current economic crisis, the fiscal impact of substantially reduced Sales Tax revenue on our ability to provide basic services outweighs the potential benefits to a portion of the community.

The issues at stake, namely improvement of air quality and decreased dependence on fossil fuels, are much larger than the City of Sunnyvale and to have a real impact change is required at the state and national level. For this reason, and the fact that other economic factors are encouraging citizens toward clean-air vehicles and other "greener" lifestyle choices, staff does not believe that the benefits gained from a tax rebate program would be worth the cost to the City's revenue stream.

Reviewed by:

Mary J. Bradley, Director of Finance  
Prepared by: Karen Miller, Finance Department

Approved by:

Amy Chan  
City Manager

**Attachment**

A. Study Issue Paper

### Proposed New Council Study Issue

Number FIN-3  
 Status Pending  
 Calendar Year 2008  
 New or Previous New  
 Title Clean Air Vehicle Sale Tax Rebate Study  
 Lead Department Finance  
 Element or SubElement Air Quality Sub Element

**1. What are the key elements of the issue? What precipitated it?**

Hybrid vehicle technology has tremendous marketability to the general public and therefore is a powerful tool for improving air quality. One possible incentive that has economic development implications as well is a City Clean Air Vehicle Sales Tax Rebate. This program would allow the purchasers of hybrid vehicles from Sunnyvale dealers to apply to the City for a rebate of the sales tax revenue that the City realizes from the sale of these vehicles. This would incentivize both the purchase of clean air vehicles as well as shopping in Sunnyvale. Because the City has policy to encourage clean air actions rather than actual regulatory objectives to reach with regards to clean air, and the City has an interest in the success of local auto dealers, this local incentive program may fit within City policy well while accomplishing at a micro level the goals of greater regional and global climate change efforts.

**2. How does this relate to the General Plan or existing City Policy?**

Air Quality 3.7C, Make a contribution towards improving regional air quality.

Socioeconomic 5.1B, Maintain and establish policies that promote a strong economy which provides economic opportunities for all Sunnyvale residents within existing environmental, social, fiscal, and land use constraints.

**3. Origin of issue**

Council Member(s)  
 General Plan  
 City Staff                   XX  
 Public  
 Board or Commission none

**4. Multiple Year Project? No   Planned Completion Year 2008**

**5. Expected participation involved in the study issue process?**

Does Council need to approve a work plan?	No
Does this issue require review by a Board/Commission?	No
If so, which?	
Is a Council Study Session anticipated?	Yes

What is the public participation process?  
Outreach to auto dealers.

6. Cost of Study

Operating Budget Program covering costs  
Project Budget covering costs  
Budget modification \$ amount needed for study  
Explain below what the additional funding will be used for

7. Potential fiscal impact to implement recommendations in the Study approved by Council

Capital expenditure range None  
Operating expenditure range \$51K - \$100K  
New revenues/savings range None  
Explain impact briefly

8. Staff Recommendation

Staff Recommendation For Study

If 'For Study' or 'Against Study', explain  
Study may result in a decision to rebate sales tax revenue. Depending upon the level of sales of clean air vehicles, the level of the rebate, and the number of rebate claims, there would be a positive or a negative impact to sales tax revenues.

9. Estimated consultant hours for completion of the study issue

Managers		Role	Manager	Hours	
Lead	Gonda, Pete	Mgr CY1:	0	Mgr CY2:	0
		Staff CY1:	0	Staff CY2:	0
		Total Hours CY1: 0			
Total Hours CY2: 0					

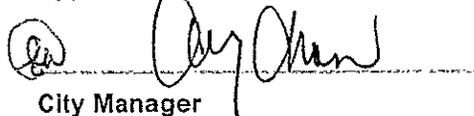
Note: If staff's recommendation is 'For Study' or 'Against Study', the Director should note the relative importance of this Study to other major projects that the Department is currently working on or that are soon to begin, and the impact on existing services/priorities.

Reviewed by

  
Department Director

11/6/07  
Date

Approved by

  
City Manager

11/13/07  
Date

### Addendum

**A. Board / Commission Recommendation**

Issue Created Too Late for B/C Ranking

Board or Commission	Rank	Rank
	1 year ago	2 years ago
Arts Commission		
Bicycle and Pedestrian Advisory Committee		
Board of Building Code Appeals		
Board of Library Trustees		
Child Care Advisory Board		
Heritage Preservation Commission		
Housing and Human Services Commission		
Parks and Recreation Commission		
Personnel Board		
Planning Commission		
Board or Commission ranking comments		

**B. Council**

Council Rank (no rank yet)  
 Work Plan Review Date (blank)  
 Study Session Date (blank)  
 RTC Date (blank)  
 Actual Complete Date (blank)  
 Staff Contact