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# ISSUE BACKGROUNDER

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# AURORA FOOD TAX CHANGES RESPECT TABOR RESTRICTION

**IB-2012-B • August 2012 • By Bob LeGare**

## EXECUTIVE SUMMARY

The City of Aurora amended its sales tax regulations related to candy and soft drinks, as a response to concerns raised by Aurora grocery retailers. The 2012 ordinance amendment has the appearance of a tax increase but further analysis concludes the tax policy change is likely to be "revenue neutral," And therefore does not require voter approval under TABOR.

In May 2012, the Aurora City Council adopted an ordinance[1] that amended the Aurora Sales Tax Code to provide for the taxation of candy and soft drinks sold at grocery and convenience stores. The City's actions in adopting this tax change conform to the letter and the spirit of the Taxpayer's Bill of Rights (TABOR).

Over the past two decades Colorado tax policy has been guided by TABOR.[2] The state constitutional provision lists governmental actions that trigger an election requirement, as follows:

> [D]istricts must have voter approval in advance for . . . any new tax, tax rate increase, mill levy above that for the prior year, valuation for assessment ratio increase for a property class, or extension of an expiring tax, or a tax policy change directly causing a net tax revenue gain to any district.[3] (Emphasis added.)

## BACKGROUND AND DEVELOPMENT OF THE MODIFICATION IN FISCAL POLICY

As a home rule city organized pursuant to the Colorado Constitution, Aurora has the power to adopt and enforce its own sales tax. This localized power has resulted in the City and the State taxing differently the sale of tangible personal property, such as food. The overriding purpose of the new ordinance is to simplify Aurora's tax structure to resemble that of the State, providing a uniform treatment of which grocery items are subject to taxation.

Since 2010, the State has taxed the sale of candy and soft drinks. Aurora long has had the authority to tax candy and soft drink sales but, starting in 1974, had exempted them as grocery items. On the other hand, for the past 25 years, Aurora's sales tax regulations have provided for the taxation of "food marketed for immediate consumption." In contrast, the State does not tax "food marketed for immediate consumption."

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In 2011, several grocery and convenience store operators brought to Aurora's attention the inconsistency that existed between Aurora's tax regulations and those of the State regarding the taxation of food. These businesses raised valid concerns over the difficulty in interpreting and consistently applying two very different sets of tax regulations. The City acknowledged their concerns, as well as its own difficulties in enforcing this particular regulation. For example, the sale of a four-ounce bag of chips located at the front of the store and marketed as a "grab and go" item would be taxed by Aurora. The same bag of chips located at the back of the store, however, would not be taxed. Moreover, neither item would be taxed by the State.

The difficulty in determining intent of the business in marketing an item and the intent of the consumer in purchasing the same item provided a good reason for the Aurora City Council to update its Sales Tax Code. One legitimate concern remained, as the Council sought how to preserve at least a part of what had become an important source of revenue to fund services to Aurora's citizens. The answer presented itself in the form of the State's tax on the sale of candy and soft drinks. When presented with the option of applying Aurora's tax to the sale of these items, local grocery and convenience store operators responded quite favorably. No longer would they be faced with the administrative burden of implementing two separate systems of taxation. Instead, the determination of which grocery items are subject to tax and which items are exempt would be made based upon a set of clearly defined guidelines that apply to both Aurora and the State.

## Considerations for strict adherence to TABOR

Before presenting the new ordinance to the City Council, Aurora's legal and finance staff worked closely together to make certain that the ordinance did not violate TABOR, if no citizen approval of the change were to take place. Two basic questions were asked and answered in the negative. First, does Aurora's tax on candy and soft drink sales constitute a "new tax?" If the alteration constituted a new tax, an election would have been required. Second, does the tax, when considered with the corresponding repeal of Aurora's tax on "food marketed for immediate consumption," constitute a "tax policy change directly causing a net tax revenue gain" to Aurora? Under TABOR, a change in fiscal policy is allowed without first obtaining taxpayer permission, so long as the change does not increase taxes.

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Since its reorganization as a home rule city in 1961, Aurora has continuously imposed a tax on the sale of tangible property. Since that time, Aurora has always taxed at least some sales of food (e.g., prepared food by restaurants and grocery stores, food sold through vending machines, etc.). Indeed, until the adoption of an exemption ordinance in 1974,[4] Aurora taxed the sale of all grocery items. Given this history, Aurora has determined that the tax on candy and soft drink sales constitutes a "tax policy change" rather than a "new tax."

Not every tax policy change, however, requires a vote of the people under TABOR. In 2009 the Colorado Supreme Court had its first opportunity to interpret the meaning of TABOR's requirement for voter approval of a "tax policy change directly causing a net tax revenue gain."[5] The Court found that, to understand the language in any real sense, it could not be applied to any policy modifications that have a minimal impact on a government's revenues. Otherwise, any legislative action in the revenue arena would become nearly impossible, thereby crippling the government's ability to function.

According to the Court, TABOR's election requirements must be read in conjunction with TABOR's other provisions—in particular, the revenue limits found in the Article. Reading these sections together, the Court concluded that a "tax policy change directly causing a net tax revenue gain" requires voter approval only when the gain exceeds one of TABOR's revenue limits.

***Aurora's City Council believes that, in order to comply with the spirit of TABOR, application of Aurora's sales tax to candy and soft drinks cannot be accomplished without a corresponding repeal of the tax on "food marketed for immediate consumption."***

Aurora has chosen to go one step further than the Colorado Supreme Court by requiring that its change in tax policy be revenue-neutral. Aurora's City Council believes that, in order to comply with the spirit of TABOR, application of Aurora's sales tax to candy and soft drinks cannot be accomplished without a corresponding repeal of the tax on "food marketed for immediate consumption." A memo from Aurora's Director of Finance explains that information from the actual business level audit process led to the conclusion of revenue neutrality for this tax policy change (see Appendix). Staff concluded that under the policy change,

convenience stores would likely collect fewer candy and soft drink tax revenues while grocery stores would likely offset that reduction with increased sales tax collections from such sales.

Todd Ely, Ph.D., from the Department of Public Affairs at the University of Colorado at Denver, conducted an independent review of the Aurora finance staff position of neutrality. Ely concluded, "Exact revenue neutrality is unlikely in either direction, but the claim of approximate revenue neutrality appears to be reasonable." Ely did not have access to Aurora's confidential audit data. However, he reviewed the revenue gains at the state level following the candy and soda tax policy change in 2010 and noted, "Although the Aurora tax base likely differs significantly from that of the State, and the City is more dependent on the sales tax, the State data are helpful in illustrating that the change is unlikely to have a significant impact on Aurora's overall tax revenues."

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By implementing this solution to a rather vexing problem, Aurora greatly eased the administrative burden of businesses charged with collecting sales tax by employing a single, uniform definition of the food that is taxable. Retailers naturally will benefit from lower costs of collecting taxes and improved bottom lines. By balancing one charge with the other, the change was done without increasing the overall financial burden on its taxpayers—just as the drafters of TABOR intended.

Optimally, an audit should be performed in future years to confirm the revenue neutral status. However, tax receipts from grocery retailers do not include any breakout of which specific items generated the tax revenue. Therefore, it will be incumbent upon the Aurora City Council to request investigation of any spike in grocery tax revenue that occurs as a result of this tax policy change.

The Council affirms that Aurora's new ordinance is not a backdoor tax increase. Rather, the effort reflected true collaboration between local government and the private sector to resolve conflicting state and local tax codes. Aurora recognizes that its private sector retailers first collect all sales tax revenue on behalf of the city. Citizen approval will not be needed because the TABOR prescriptions have been obeyed and the net result is a change in fiscal policy that will lead to no increased tax burden.

## Endnotes

[1] Ordinance No. 2012-20 found at http://tax.i2i.org/files/2012/08/Aurora-2012-food-tax-Ordinanace.pdf
[2] Article X, Section 20 of the Colorado Constitution
[3] Ibid, paragraph (4)(a).
[4] City of Aurora Ordinance No. 74-188
[5] Mesa County Board of County Commissioners v. State, 203 P.3d 519 (Colo. 2009)



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BOB LEGARE was elected to the Aurora City Council At-Large from 1995 through 2003 and was re-elected in 2011. Between his elected terms LeGare served on the Arapahoe County Open Space & Trails Advisory Board and was Co-Chair of the Aurora Chamber of Commerce Governmental Affairs & Education Committee. LeGare earned a BSBA degree from the University of Phoenix in 1997 and is employed as a commercial property manager. He holds the Certified Property Manager designation from the Institute of Real Estate Management.

The Independence Institute gratefully acknowledges the peer review conducted by Sam Mamet, Executive Director of the Colorado Municipal League, and of Todd Ely, Ph.D., Department of

Public Affairs at the University of Colorado at Denver.

ADDITIONAL RESOURCES can be found at: http://www.i2i.org/.

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## APPENDIX A

**City of Aurora** **MEMORANDUM**

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To: Council Member LeGare
Through: Michelle Wolfe, Deputy City Manager MW
From: Jason Batchelor, Finance Director JPB
Date: June 25, 2012
Subject: **Analysis of Revenue Impacts of Tax Code Changes**

This memorandum provides information for your request on staff's analysis for the revenue impacts of the recently enacted change in the city tax code and regulations related to sales tax on soft drinks, candy, and food marketed for immediate consumption.

Over the past year, the Finance Department was in the process of performing several compliance audits on businesses that typically sold food marketed for immediate consumption as well as candy and soft drinks. It was during those audits that the businesses expressed concerns over the city's tax treatment of food marketed for immediate consumption. Staff attempted to determine the revenue impacts of the potential changes that came from the tax code and regulation updates that addressed the city's treatment of food marketed for immediate consumption and soft drinks and candy.

When remitting sales tax collections to the city, businesses do not break out the sales tax by individual items or even by product types. As such staff cannot definitively state how much revenue had been remitted by businesses for food marketed for immediate consumption. Similarly staff would not be able to definitely state how much revenue will be remitted for sales tax collections on soft drinks and candy once the tax code and regulations are in effect.

However, staff did make an effort to use some anecdotal analysis to estimate the impacts of the tax code and regulation changes. While businesses do not break out sales tax collections by product type when remitting sales tax collections, businesses do provide access to more detailed listings of their sales figures as part of the city's tax audit processes. By law, the city is required to keep the information obtained from the audits of taxpaying businesses confidential, and as such that information cannot be publicly disclosed.

Those detailed sales figures that are reviewed as part of city's tax audit process provided the basis for staff's determination that the change would likely be revenue neutral. The data from tax audits of convenience stores indicated lower sales of candy and soft drinks than the sales of food for immediate consumption. Staff determined that it was likely that grocery store sales of candy and soft drink sales would be more than the sales of food for immediate consumption resulting in an overall revenue neutral position.

c: Mayor and City Council