

CITY INCORPORATIONS AND THE NEW PUBLIC FINANCE

How do the changes in VLF subventions and property tax allocations affect unincorporated communities that are considering incorporating?

The property tax exchange formula remains unchanged.

- The county auditor still determines the proportion that a county's property tax revenues bears to the county's total general purpose revenues. See Government Code §56810 (c)(1). [*Note that the property tax revenues come from Revenue and Taxation Code §93 which does not include the property tax revenues that a county receives to backfill its lost VLF revenues under Revenue and Taxation Code §97.7.*]
- The LAFCO still determines the county's total net cost of serving the unincorporated community. See Government Code §56810 (c)(2).
- The LAFCO still multiplies the total net service cost by the percentage of property tax revenues to determine the amount of property tax revenue that the county must transfer to the new city. See Government Code §56810 (c)(3).

The new city still inherits revenues from the county's situs-based taxes.

- The new city gets the sales tax revenues that used to go to the county.
- The new city gets the revenues from the county's other situs-based taxes, including any transient occupancy taxes, business license taxes, and utility user taxes.

New cities do not get property tax revenues to backfill VLF revenue losses.

- Unlike cities and counties that formerly received VLF revenues and VLF backfill payments from the State General Fund, new cities do not receive additional property tax revenues to backfill lost VLF revenues. See Revenue and Taxation Code §97.7.

Instead, new cities get a specially calculated share of residual VLF revenues.

- The VLF rate used to be 2% but now it's 0.65%. See Revenue and Taxation Code §10752.
- After paying for the DMV's costs, the county realignment program, and the special Orange County set-aside, there will be about \$200 million in VLF revenue to allocate.
- A new city that incorporates before July 1, 2009 receives a \$50 per capita allocation of VLF revenue that is adjusted over time to reflect changes in total VLF revenues relative to changes in the total population of all cities. See Revenue and Taxation Code §11005 (c).
- A new city's share of VLF funds and revenues from state fuel taxes are determined by a formula that increases the new city's actual population by 50% in its first year after incorporation and by 40%, 30%, 20%, and 10% in successive years. After five years, new cities receive VLF funding and fuel tax revenues in proportion to their actual populations. See Revenue and Taxation Code §11005.3 (c).
- Remaining VLF revenues, after allocations to new cities and recent city annexations, go to all cities on a per capita basis. See Revenue and Taxation Code §11005 (e).

The revenue neutrality law remains in effect.

- The LAFCO can't approve an incorporation if there's a negative fiscal effect on the county. See Government Code §56815 (b).
- But the LAFCO can impose revenue neutrality mitigation conditions, including tax-sharing agreements, lump-sum payments, or extended payments. See Government Code §56815 (c).