



## CITY MANAGER'S OFFICE

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### CITY COUNCIL INFORMATIONAL MEMORANDUM

Date: October 10, 2024

To: Cupertino City Council

From: Pamela Wu, City Manager

Re: Update on the California Department of Tax and Fee Administration (CDTFA) Audit and Settlement

#### Purpose:

The City recently resolved the dispute with CDTFA regarding the distribution of disputed sales and use tax revenues. This informational memorandum aims to provide a background on the sales and use tax redistribution and the resulting impacts, City Council actions, the City's efforts to adapt to financial challenges, and the next steps. Details regarding CDTFA administrative proceedings are confidential and are not discussed in this memorandum.

#### Background:

In December 2021, the City received a notice from CDTFA informing the City of an audit of one of its taxpayers. In October 2023, CDTFA notified the City of a proposed reallocation of sales and use tax revenues previously allocated to Cupertino. The proposed allocation sought to require repayment of significant sales and use tax revenues previously disbursed to the City and would have an ongoing impact on the allocation of sales and use tax revenues in the future. CDTFA's determination was subject to review through a confidential administrative process, as discussed below.

#### *Council Action*

In response to the review of sales and use tax distributions to the City, the City Council preemptively reduced the City's annual budget by \$17.9 million for FY 2023-24 and further by \$8.7 million in FY 2024-25 through service level reductions focused on operations and maintenance infrastructure, fiscal accountability, and community benefits. The City Council also set aside a sales tax repayment reserve that is presently estimated at \$74.5 million as of June 30, 2024. These actions and adjustments have resulted in the City adopting a balanced budget in June.

### Budget Balancing Strategies

Several strategies were implemented to help balance the budget in FY 2023-24 and FY 2024-25, which are shown by fiscal year below.

FY 2023-24:

#### Vacant Position Reductions

Position	Department	Description	FTE
<b>FY 2022-23 Adopted Budget</b>			<b>225.00</b>
<b>FY 2022-23 Amended Budget</b>			
Special Project Executive (Limited-Term)	Administration	Adding New Position	1.00
<b>FY 2022-23 Amended Budget</b>			<b>226.00</b>
<b>FY 2023-24 Adopted Budget</b>			
Assistant City Manager	Administration	Eliminating Position	-1.00
Communications Analyst (Limited-Term)	Administration	Eliminating Position	-1.00
Administrative Assistant	Administrative Services	Eliminating Position	-1.00
Office Assistant	Community Development	Eliminating Position	-1.00
Housing Senior Planner	Community Development	Eliminating Position	-1.00
Permit Center Manager	Community Development	Eliminating Position	-1.00
Recreation Manager	Parks and Recreation	Eliminating Position	-1.00
Community Outreach Specialist	Parks and Recreation	Eliminating Position	-1.00
Maintenance Worker	Public Works	Eliminating Position	-3.00
Project Manager	Public Works	Eliminating Position	-1.00
Project Manager (Limited-Term)	Public Works	Eliminating Position	-1.00
Assistant Director of Public Works	Public Works	Eliminating Position	-1.00
<b>FY 2023-24 Adopted Budget</b>			<b>212.00</b>

#### Summary of Reductions

Expense Category	Reduction	Service Impact
Contract Services	\$2,700,000	Reduce expert technical training; less outside technical support, and reduced LaserFiche document scanning. Reduced maintenance of equipment. Reduced citywide trainings, reduced executive recruitments and reduced consultant costs. Reduced expansion of current or new offerings for contracted programs, camps, and classes. Reduction of free events offered and removed budget to cover fees for festivals. Termination of on-call contracts and negotiation of new contracts will reduce service level and response time.
Materials	\$1,800,000	This reduction is primarily related to savings in supplies, meeting expenses, and conference, travel and food and drink for city council meetings. Reduced applications utilized by staff, residents, and customers. Commissioners and part time staff limited to E-mail; Prolonged tech refresh cycles and significant reduction in replacement parts and supplies. Drone program and training reduced, and eliminate Wi-Fi in parks. Reduced Employee events and small tool and equipment.
Staffing	\$6,200,000	Elimination of 14 vacant full time positions and reduced PT Staff budgets to minimum levels necessary to operate currently open Recreational facilities and ongoing programs.
Special Projects	\$1,400,000	Delayed or deferred sidewalk repairs and pavement maintenance.
Transfers Out	\$5,800,000	Reduce General Fund subsidies for other funds
<b>TOTAL \$</b>		<b>17,900,000</b>

In addition to these reductions in FY 2023-24, Council authorized the use of \$6 million in one-time unassigned fund balance and utilizing the City's Section 115 Trusts to fund pension and OPEB (Other Post-Employment Benefits) costs.

FY 2024-25:

#### Vacant Position Reductions

Position	Department	Description	FTE
<b>FY 2023-24 Amended Budget</b>			<b>212.00</b>
<b>FY 2024-25 Adopted Budget</b>			
Special Project Executive Limited-Term	Administration	Eliminating Position	-1.00
Public Works Project Manager	Public Works	Eliminating Position	-1.00
Public Works Project Manager	Public Works	Eliminating Position	-1.00
Maintenance Worker I/II	Public Works	Eliminating Position	-1.00
Innovation & Technology Manager	Innovation & Technology	Eliminating Position	-1.00
<b>FY 2024-25 Adopted Budget</b>			<b>207.00</b>

#### Service Level Reductions

Grouping	Reductions
<b>Operations and Maintenance</b> Reduce sidewalk, curb, and gutter. Move some Public Works contract services in-house, extending maintenance timelines. Reduce Public Works PT staffing. Shift credit card fees to customers. Remove library extra hours from the base due to available State funding to cover these costs. Various other reductions.	(2,903,446)
<b>Infrastructure</b> Reduce funding to CIP of \$2M annually for the first 5 years of the forecast. Will utilize the existing fund balance to cover these costs. Lengthen tree trimming cycle, reduce frequency of median maintenance, shift focus of sidewalk maintenance	(2,947,764)
<b>Fiscal Accountability</b> Align law enforcement costs with prior year actual hours. Reduce applications used in the City, extend tech refresh cycles, and remove the new Enterprise Resource Planning (ERP) software from the budget.	(2,750,544)
<b>Community Benefit</b> Per Council direction, community benefit items have been retained in the budget. Staff is working with non-profit organizations to secure funding for them, but nothing has been finalized.	(123,344)
<b>Total</b>	<b>\$(8,725,098)</b>

#### *Continuing City Operations*

Despite fiscal challenges, the City has shown remarkable resilience and adaptability. Since receiving the state audit notification, the City has provided important services to residents while balancing its budget through mitigation measures taken by the Council as mentioned above. The City also adopted innovative approaches such as strategic partnerships, sponsorships, and exploring more efficient service delivery methods. This has led to the City maintaining critical operations and serving our residents without significant disruption. It is important to highlight the role of our community and partners in these efforts to navigate the financial shortfall and, at the same time, identify long-term opportunities for growth and sustainability.

#### *CDTFA Appeal and Settlement*

In November 2023, , the City filed an administrative appeal of CDTFA's proposed reallocation. As part of the appeals process, the City entered into settlement negotiations with CDTFA.

On October 2, 2024, the City and CDTFA finalized a settlement agreement resolving the dispute regarding the proposed reallocation of sales and use tax. While the terms of the settlement agreement are confidential, the agreement will have a significant net positive fiscal impact on the City. Specifically, the repayment reserve that was set aside will now be available for other uses. Staff will seek Council direction on the use of those funds.

Note, however, that certain future sales and use tax revenues will remain unavailable to the City. Beginning in 2025, the City will no longer receive the sales tax distributions that CDTFA determined should be reallocated to other jurisdictions, resulting in an estimated ongoing structural deficit estimated in FY 2028-29 of \$0.3 million and increasing to \$7 million annually beginning in FY 2033-34. The growth in the structural deficit is driven by increased funds for capital projects and the sunset of the Utility Users Tax in FY 2030-2031. Thus, it is best to view the settlement agreement as providing a one-time event that does not address the City's ongoing structural deficit, even though it provides significant short-term financial relief. The City will need to identify other revenue sources or expenditure reductions to balance its budget over the long term.

#### *Next Steps*

In addition to the information being provided in this memorandum, staff will bring back a plan for the strategic use of one-time repayment dollars as part of the First Quarter Financial Report in November for Council consideration and further direction.

#### Sustainability Impact

No sustainability impact.

#### Fiscal Impact

No fiscal impact.

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Prepared by: Tina Kapoor, Interim Assistant City Manager

Reviewed by: Chris Jensen, City Attorney

Approved by: Pamela Wu, City Manager