



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Kim Welsh  
Julia H. Cooper

**SUBJECT: POTENTIAL BUSINESS TAX  
MODERNIZATION MEASURE**

**DATE:** July 20, 2016

Approved

*D. DSYL*

Date

*7/22/16*

**RECOMMENDATION**

- (a) Council discussion and consideration of City options for updating and modernizing the current Business Tax for the November 8, 2016, general election.
- (b) If Council wishes to proceed, adopt a resolution of the City Council calling and giving notice, on its own motion, for a Special Municipal Election to be held on November 8, 2016, to submit to the electors of the City of San José the following measure:

**San José Business Tax Modernization**

Shall an ordinance be adopted to modernize the 1986 San José business tax to fund essential city services such as police patrols, 911 emergency response, street repair, and parks maintenance by increasing tax rates, including base tax from \$150 to \$195, adding an inflation adjustment, raising caps, exempting certain small businesses, and expanding financial hardship exemption, providing approximately \$13 million added annual revenue, subject to existing independent financial audits?	YES	
	NO	

- (c) Council discussion and consideration of whether the full text of the proposed ordinance should be printed in the November 8, 2016, Voter's Sample Ballot, pursuant to Elections Code 12111, to be incorporated in the resolution calling the election;
- (d) Council discussion and consideration of whether to permit rebuttal arguments and authorize the City Council or any member or members of the City Council to submit a rebuttal argument in favor of the City measure in the November 8, 2016, Voter's Sample Ballot, pursuant to Elections Code Section 9285, to be incorporated in the resolution calling the election;

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- (e) Council discussion and consideration of whether to authorize the City Council or any member or members of the City Council to submit an argument in favor of the City measure on the November 8, 2016, Voter's Sample Ballot, pursuant to Elections Code Section 9282, to be incorporated in the resolution calling the election; and
- (f) Direct the City Clerk to take all actions necessary to place this measure for a November 8, 2016, Special Municipal Election, if needed.

### **OUTCOME**

Adoption of a resolution calling a Special Municipal Election would result in voter consideration of the recommended ballot measure at the November 8, 2016 General Election.

Staff has prepared the necessary materials including the ordinance, resolution and ballot language for Council to place the above measures on the November 8, 2016, ballot. The Santa Clara County Registrar of Voters must receive the resolution calling for the Special Municipal Election along with the final ballot question by Friday, August 12, 2016, in order to place the measure on the November ballot.

If the Business Tax Modernization Measure is approved by a majority of the voters, it will be effective July 1, 2017. Based on current projections, the Business Tax updates could result in additional annual revenues of approximately \$13 million. This would allow the City to enhance service levels consistent with spending priorities identified by the community and the City Council through the annual budget process.

### **BACKGROUND**

Although City finances have stabilized following several years of significant staff and service reductions, budget projections show that the City's financial position continues to remain fragile with limited ability to restore priority services to acceptable levels in areas identified by the public and Council. Pursuing additional revenue sources to address San José's structural deficit and underlying fiscal challenges was an important part of the General Fund Structural Deficit Elimination Plan (2008) and the Fiscal Reform Plan (2011). These Council-approved plans envisioned securing new revenue following the significant cost-cutting measures taken during the Great Recession, including the deep cuts in public services, layoffs of employees, and reductions in employee compensation that were necessary to close large budget shortfalls. The Deficit Elimination Plan identified the need to "restructure business tax rates to modernize and reflect current business profile."

On January 13, 2016, San José residents Steven Hunt, Kathleen Krenek, and Scott Myers-Lipton filed with the City Clerk a Notice of Intent to circulate a petition within the City of San José for the purpose of modernizing the business tax by replacing the current Business Tax with a tax

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based on gross receipts. The Notice of Intent to Circulate can be found here:

<http://www.sanjoseca.gov/DocumentCenter/View/53694>.

As required by California Elections Code Section 9203, on January 26, 2016 the City Attorney provided the residents with the ballot title and summary which can be found here:

<http://www.sanjoseca.gov/DocumentCenter/View/53694>.

The Potential Gross Receipts Tax Ballot Initiative memo dated January 21, 2016, and discussed by the Council on February 2, 2016 can be found here

[http://sanjose.granicus.com/MetaViewer.php?view\\_id=&event\\_id=2121&meta\\_id=554221](http://sanjose.granicus.com/MetaViewer.php?view_id=&event_id=2121&meta_id=554221).

On February 2, 2016 City Council took the following actions:

- Approved the recommendation to study the proposed Gross Receipts Tax Ballot Measure contained in the memo from Councilmembers Rocha and Peralez dated January 14, 2016.
- Directed staff to conduct a limited preliminary review of the City's options for updating the current Business Tax in Chapter 4.76 of the San José Municipal Code as contained in the Supplemental Memo from Councilmembers Rocha and Peralez dated January 29, 2016.

Council directed the City Manager to perform the analysis as expeditiously as possible, and with the use of consultant experts if required. The project was scoped, managed, and completed by a staff team (in conjunction with Keyser Marston) from the Finance Department, City Attorney's Office, Office of Economic Development, and City Manager's Office. The presentation to City Council on March 8, 2016, included information and analysis on the current Business Tax, the Gross Receipts Tax Citizen Ballot Measure, and options for updating the current Business Tax.

The Preliminary Analysis and Discussion of Citizen-Initiated Gross Receipts Tax Ballot Measure, and Options for Updating Current Business Tax memo, dated February 26, 2016 and discussed with the City Council on March 8, 2016 can be found here:

[http://sanjose.granicus.com/MetaViewer.php?view\\_id=&event\\_id=2126&meta\\_id=559674](http://sanjose.granicus.com/MetaViewer.php?view_id=&event_id=2126&meta_id=559674)

On March 8, 2016 City Council accepted Mayor Sam Liccardo's memorandum dated March 7, 2016, with direction to the City Manager to:

1. Draft revisions to the City's current Business License Tax (Municipal Code Section 4.76.300), for Council consideration, with the goal of modernizing the existing tax and meet the following objectives:
  - a. Protect smallest businesses:
    - i. Ensure that the increase in the base rate for the smallest businesses does not exceed the equivalent of a 1 percent annual increase since 1986<sup>1</sup> (the last year in which the tax was revised);

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<sup>1</sup> Current tax structure was approved in 1984 which included an increase in the tax rate in 1986.

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- ii. Make the existing tax structure more progressive, ensuring that larger businesses pay modestly more per employee than smaller ones
  - b. Double the annual revenues from the tax in a manner which does not unduly influence business location decisions
  - c. Expand the current maximum per-firm caps
  - d. Include a Cost-of-Living Adjustment (COLA) to prevent erosion of revenue and City services over time
  - e. Simplify compliance for taxpayers and administration for the City. Work with City Manager's Innovation Cabinet to create a system that ensures that businesses can obtain their licenses on-line
2. Engage the business community and other stakeholders in the process of reviewing the proposed revisions.

In addition, the City Council directed City staff to return to Council in June with a plan that reflects Council direction, as well as staff-proposed alternatives. In addition, direction was given to work with the Santa Clara County Cities Association to explore the issue of sole proprietorships engaged in business across multiple cities and counties in the Bay Area and the collection of the City's Business Tax.

On June 21, 2016 City Council accepted staff's memo dated June 9, 2016, with direction to staff to:

- Return to Council on August 2, 2016 with the structure and ballot language including the additional analysis as outlined by Mayor Liccardo, particularly looking at comparable taxes and fees for other cities.
- Include in the analysis contract employees and to expand exemptions by including a household adjusted gross income at four times the poverty level (\$47,520).

The Potential Business Tax Modernization Measure memo including staff analysis can be found here:

[http://sanjose.granicus.com/MetaViewer.php?view\\_id=&event\\_id=2141&meta\\_id=579538](http://sanjose.granicus.com/MetaViewer.php?view_id=&event_id=2141&meta_id=579538)

Based on Council direction on June 21, 2016 staff has prepared the necessary materials including the ordinance, resolution, and ballot language for Council consideration on August 2, 2016. The Santa Clara County Registrar of Voters deadline to submit the resolution and final ballot language to place a measure on the November 8, 2016 ballot is Friday, August 12, 2016. Arguments for and against the measure are due to the City Clerk by 12:00 noon, August 17, 2016. The City Attorney's impartial analysis is due to the City Clerk by 12:00 noon on August 23, 2016.

## ANALYSIS

The City's Business Tax was first adopted on July 15, 1963. The methodology used for calculating the City's current Business Tax (Chapter 4.76 of the San José Municipal Code and referred to herein as "Business Tax" or "Tax") was adopted in 1984 and the current rates have not been increased since 1986. In the intervening decades, the buying power associated with business tax revenue has eroded significantly. This Tax, which is charged to business owners, currently generates approximately \$12.7 million annually and the current Business Tax structure is summarized in the paragraph below.

The City's general Business Tax is based on the number of employees. For most businesses the annual tax is \$150 for up to eight employees. The additional tax increments are \$18 per person over eight employees with a maximum tax of \$25,000. For residential and mobile home parks, the Business Tax is based on dwelling units. Those businesses pay an annual tax of \$150 for up to 30 units/lots and \$5 per unit/lot over 30 units, not to exceed \$5,000. For commercial landlords, the Business Tax is based on square footage. Commercial landlords pay \$150 up to 15,000 square feet and \$0.01 per square foot over 15,000 square feet, not to exceed \$5,000. For water companies, the Business Tax is based on water metered connections not to exceed \$20,000. The current Business Tax structure does not have a Cost of Living Adjustment ("COLA") and rates have not been adjusted since 1986.

There are a number of options to modify the Business Tax and based on the direction of Council, staff has considered various levers to double the annual Business Tax revenue from \$12.7 million to approximately \$25.4 million in the first year of implementation of the new tax rate and structure. Staff recommends making July 1, 2017 the effective date of the changes to the San José Municipal Code, if approved by a majority of the voters. As stated in the "Background" section above, on June 21, 2016 City Council accepted staff's memo dated June 9, 2016, which included analysis on the levers to double the annual tax receipts. The levers include:

- Increasing the base tax
- Increasing the incremental tax and making it more progressive
- Increasing the cap
- Updating the application of the tax
- Placing into effect inflation-based adjustments over time (COLA)

Staff's recommendations in each of these five areas are summarized below. In addition, this section of the report includes a discussion of comparable taxes and fees for other cities, a discussion of contract employees and an addition of a new financial hardship exemption for small business owners that have a household adjusted gross income that does not exceed four times (4x) the poverty level as established by the U.S. Department of Health and Human Services ("HHS"). This new exemption is in addition to the current financial hardship exemption for low revenue generating small business owners that have a business income

threshold at two times (2x) the annual poverty level established by the HHS. The City's current financial hardship exemption threshold based on the poverty level is \$23,760.

### **Staff's Recommendations for Increasing the Business Tax**

Staff has evaluated options to achieve the goal of doubling the annual Business Tax revenue and making the tax more progressive. Staff is recommending to increase the base tax from \$150 to \$195, change the incremental tax rates for all types of businesses, increase the cap from the current levels of \$25,000/\$20,000/\$5,000 to \$150,000 for all types of businesses and add an annual COLA.

In order to prevent an erosion of revenue over time, staff recommends adding a Cost of Living Adjustment to become effective beginning July 1, 2018. In this model, the COLA would be set to the Consumer Price Index ("CPI") and capped at no more than 3 percent (3%) in one year. Incremental tax rates and the Cap are subject to the COLA; the base tax amount is subject to 50% of the maximum COLA of 3% (1.5%). The "CPI Index" refers to the Consumer Price Index, All Urban Consumers, published by the U.S. Department of Labor, Bureau of Labor Statistics for the San Francisco-Oakland-San José area, with all items included. Staff will use the February-to-February reporting period (similarly to what is currently being used for the Library Parcel Tax) to calculate the annual COLA percentage. COLA represents a future revenue stream; it will not increase the tax revenue in the first year of implementation. Starting in Fiscal Year 2018-2019, based on an average CPI increase of 2.5%, the COLA is expected to generate approximately \$500,000 annually. Over a 10 year period, an average COLA rate of 2.5% compounded, could generate approximately \$5.4 million in annual Business Tax revenue.

It should be noted that the proposed changes include the clarification that if such person is engaged in a single business operation involving a single business entity or name, owes a business tax calculated pursuant to both number of employees (SJMC Chapter 4.76, Part 3) and based on the number of rental units or commercial square feet (SJMC Chapter 4.76, Part 4), the amount of the Business Tax paid to the City shall be the greater of the two calculations, but not both.

The charts that follow present the current rates, proposed rates, and estimated amount of revenue raised by each change. Footnotes have been added to note where staff made modifications to the proposed changes presented in the original June 21, 2016 proposal.

### ***Employee Count***

Staff is recommending to:

- Change the per employee rate
- Commence the employee rate at the third employee rather than the ninth employee

- Scale the incremental employee rate thereby making it progressive based on the number of employees
- Continue to allow businesses to choose between calculating the number of employees based on Full-Time Equivalent (“FTE”) or based on the number employers report to the California Employment Development Department (“EDD”)<sup>2</sup>
- Increase the cap from the current level of \$25,000 to \$150,000
- Add an annual COLA not to exceed three percent (3.0%) per year for the incremental tax rates and the cap; add an annual COLA at 50% of the annual CPI and not to exceed one and one-half percent (1.5%) per year for the Base Tax.

Businesses	Current Structure	Staff Proposal	Estimated Additional Annual Revenue
Base Tax	\$150	\$195	<b>\$7.2 Million</b>
Employee Count	FTE or EDD	FTE or EDD	
Inc. Tax: 1-2	\$0	\$0	
Inc. Tax: 3-35	\$18 (9+)	\$25	
Inc. Tax: 36-100	\$18	\$35	
Inc. Tax: 101-500	\$18	\$45	
Inc. Tax: 501+	\$18	\$55	
Cap	\$25,000	\$150,000	

***Residential Rental Property Units***

Staff is recommending to:

- Change the per residential unit rate<sup>3</sup>
- Commence paying the base tax at the first rental unit rather than the third unit
- Commence the unit rate at the third unit rather than the 31<sup>st</sup> unit
- Scale the incremental unit rate thereby making it progressive based on the number of units
- Maintain the exemption for non-profit owned rental housing
- Assess rent controlled properties (i.e. apartments subject to SJMC Chapter 17.23) and covenant restricted affordable housing projects at 50% of the proposed new rate
- Increase the cap from the current level of \$5,000 to \$150,000
- Add an annual COLA not to exceed three percent (3.0%) per year for the incremental tax rates and the cap; add an annual COLA at 50% of the annual CPI and not to exceed one and one-half percent (1.5%) per year for the Base Tax.

<sup>2</sup> Original proposal was to eliminate the FTE option for calculating the number of employees. Based on testimony at the June 21 Council meeting and further analysis, staff is recommending maintaining the option for employers to use either FTE or EDD data in determining the number of employees.

<sup>3</sup> Original proposal was \$5 higher per unit rate in each incremental tax rate category.

Staff believes that the new rate structure places residential landlords at a more comparable basis to employee based businesses than the relatively low rates established in the original 1963 structure and enhances progressivity. If a landlord elected to pass the entire business tax directly to the renter rather than absorbing the cost, a full pass through by the largest residential landlords (501+), would amount to approximately \$4.17 per month in additional rent. Moreover, compared to other cities, residential real estate is a relatively larger component of the City's tax base and residential properties place a higher demand on the use of City services and infrastructure.

Residential Landlords	Current Structure	Staff Proposal	Estimated Additional Annual Revenue
Base Tax	\$150	\$195	<b>\$3.2 Million</b>
Inc. Tax: 1-2	N/A (Not Counted)	\$0 (Base Tax applied)	
Inc. Tax: 3-35	\$5 (31+)	\$20/\$10*	
Inc. Tax: 36-100	\$5	\$30/\$15*	
Inc. Tax: 101-500	\$5	\$40/\$20*	
Inc. Tax: 501+	\$5	\$50/\$25*	
Cap	\$5,000	\$150,000	

\*NOTE: Rent controlled properties/covenant restricted affordable housing projects assessed at 50% of the proposed incremental tax. Non-profit owned rental housing remains exempt.

***Non-Residential (Commercial) Rental Property Units***

Staff is recommending to:

- Change the square foot rate<sup>4</sup>
- Commence the square foot rate at the first square foot rather than the 15,001 square foot
- Increase the cap from the current level of \$5,000 to \$150,000
- Add an annual COLA not to exceed three percent (3.0%) per year for the tax per square foot rate and the cap; add an annual COLA at 50% of the annual CPI and not to exceed one and one-half percent (1.5%) per year for the Base Tax.

Staff believes that the new rate structure places commercial landlords at a more comparable basis to employee-based businesses than the relatively low rates established in the original 1963 structure, while maintaining competitiveness to attract jobs.

<sup>4</sup> Original proposal was a tax rate of \$0.022 per square foot. It has been increased to \$0.025 per square foot to in part address the decreased revenue from reducing the per unit residential rate.

<b>Commercial Landlords</b>	<b>Current Structure</b>	<b>Staff Proposal</b>	<b>Estimated Additional Annual Revenue</b>
Base Tax	\$150	\$195	<b>\$2.25 Million</b>
Tax per Square Foot	\$0.01 (15,000+)	\$0.025	
Cap	\$5,000	\$150,000	

***Mobile Home Property Units***

Staff is recommending to:

- Change the per residential unit rate
- Commence the unit rate at the third unit rather than the 31<sup>st</sup> unit
- Increase the cap from the current level of \$5,000 to \$150,000
- Add an annual COLA not to exceed three percent (3.0%) per year for the incremental tax rate and the cap; add an annual COLA at 50% of the annual CPI and not to exceed one and one-half percent (1.5%) per year for the Base Tax.

<b>Mobile Home Parks</b>	<b>Current Structure</b>	<b>Staff Proposal</b>	<b>Estimated Additional Annual Revenue</b>
Base Tax	\$150	\$195	<b>\$0.05 Million</b>
Flat Incremental Tax	\$5 (31+)	\$10	
Cap	\$5,000	\$150,000	

***Water Metered Connections***

Staff is recommending to:

- Apply the Base Tax
- Change the rate from a range of connections to a per connection rate
- Increase the cap from the current level of \$5,000 to \$150,000
- Add an annual COLA not to exceed three percent (3.0%) per year for the incremental tax rate and the cap; add an annual COLA at 50% of the annual CPI and not to exceed one and one-half percent (1.5%) per year for the Base Tax.

Water Companies	Current Structure	Staff Proposal	Estimated Additional Annual Revenue
Base Tax	n/a	\$195	<b>\$0.2 Million</b>
Flat Incremental Tax	\$0.10-0.30 per connection	\$1.00 per connection	
Cap	\$20,000	\$150,000	

**Comparison to Other Cities**

Below is a summary of information on the application of their business tax from nearby cities:

City	Tax Basis	Admin Fee	Annual Revenue Generated	Number of Businesses	Average Tax Revenue Per Business
San José	Unit	No	\$12.7 M	74,450	\$171
Campbell	Unit	No	\$0.7 M	5,000	\$133
Cupertino	Flat Rate	No	\$0.9 M	2,000	\$450
Fremont	Gross Receipts	\$30	\$8.6 M	19,000	\$453
Los Gatos	Unit	\$25	\$1.3 M	4,000	\$313
Milpitas	Unit	\$50	\$0.7 M	2,800	\$24
Morgan Hill	Unit	\$60	\$0.2 M	3,200	\$57
Mountain View	Flat Rate	No	\$0.2 M	6,500	\$31
Santa Clara	Unit	No	\$1.0 M	12,000	\$80
Sunnyvale	Unit	No	\$1.5 M	7,800	\$192

- Unit taxation is driven by number of employees, apartments, lots, square footage, etc. – or some combination thereof
- Flat Rate taxation is a single tax amount applied to all business regardless of size
- Gross Receipts taxation is driven by top line revenue of each business

Below is a summary of information from nearby cities on residential landlord tax structures:

Residential Landlords		
City	Base Tax	Incremental Tax
San José	\$195 – first unit	Progressive; \$20 to \$50 per unit to Cap of \$150,000
Campbell	\$65 – first unit	\$3 – each additional unit
Fremont	\$30 general fee	\$1.30 per \$1,000 gross rental receipts
Milpitas	\$30 – first four units	\$2 – each additional unit
Morgan Hill	\$15 – base	\$3 – per rental unit
Mountain View	\$12 – first five units	\$2 – each additional unit
Santa Clara	\$15 – first unit	Progressive; \$5 to \$12 per unit to Cap of \$500
Sunnyvale	\$35.14 – one unit	Roughly \$10 per unit to Cap of \$5,000

San José’s Business Tax for one residential unit would be \$195. It is important to note that if the business income generated by a residential landlord is less than two-times the poverty level (currently \$23,760), it may qualify for the financial hardship exemption for low revenue generating small business owners.

In summary, it appears that the proposed San José Business Tax structure for residential landlords is higher than smaller nearby cities. However, compared to other cities, residential real estate is a more significant business in San José, given San José’s small employment based businesses relative to its population. In addition, residential real estate is a relatively larger component of the tax base and places a higher demand on the use of City services and infrastructure.

It is also important to note, that like San José, other cities must seek voter approval to increase taxes and given the tax revenue generated by the other Santa Clara County cities and the costs of placing tax measures on the ballot, these cities may not have elected to pursue increases or changes in their business tax. Of the other Santa Clara County cities listed above, the last city that has sought voter approval to increase or modify their existing business tax structure was Campbell in 2010. Voters in Campbell approved the tax increase which increased the cost for most businesses by \$50 and included limiting the annual cost of living adjustment to 2%.

**Addition of a Financial Hardship Exemption for Small Business Owners with Limited Household Income**

In the current Business Tax, there are several exemptions provided by federal or state law as well as a number of exemptions specific to San José. The largest number of exemptions in San José is

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for businesses that qualify as a low-revenue generating small business (financial hardship). Currently, the financial hardship business income threshold is based on the poverty level guidelines established by the U.S. Department of Health and Human Services (“HHS”). The HHS poverty level is set at \$11,880 currently. Since the cost of living in the Bay Area is greater than the national average, the City Council approved an income threshold at two times (2x) the annual level established by the HHS. The City’s current financial hardship exemption threshold based on the poverty level established by the HHS is \$23,760. This hardship exemption is applied based on business income regardless of total household income.

As approved by Council on June 21, staff recommends adding an additional exemption category – financial hardship exemption for small business owners with limited household incomes. A small business shall be exempt where the adjusted gross income of the small business owner does not exceed four times (4x) the annual poverty level established by the HHS. Based on the current poverty level, the threshold would be based on income of \$47,520. This exemption based on household adjusted gross income will allow a more generous exemption for low income households and maintains the current financial hardship exemption program based on business income.

Staff estimates that approximately 3,000 additional businesses would fall under expanded “Hardship Exemption” with base tax revenue loss of \$195 each for a total revenue loss of \$585,000.

With the addition of this household adjusted income exemption, staff further reviewed the ordinance regarding exemption categories. In addition to removing the exemption for minors<sup>5</sup>, staff recommends removing the exemption for transient marketers (flea market-type vendors). Staff believes that these businesses should be treated like other small businesses, and that many transient marketers will be able to qualify for a tax exemption under the income thresholds. Overall, staff believes that income thresholds should be used to capture businesses that qualify for a tax exemption, rather than specific exemption categories.

### **Contract Employees**

Based on the data and information currently collected from individuals who pay a business tax based on their self-employment/1099 income, staff is unable to determine how many of the over 35,000 businesses that report only one employee/sole proprietorships are generating income from only one source, i.e. they only received one 1099 for tax reporting purposes. Of those 35,000 businesses, approximately 12,000 of them are currently exempt from the Business Tax. Given that staff is unable to quantify the potential revenue impact from creating an exemption for this large group of current business tax payers, staff is not recommending creating an additional

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<sup>5</sup> The June 2016 recommendation included eliminating the senior exemption, but based upon further review, staff is recommending maintaining this exemption which is based on the Social Security Administration income thresholds for seniors receiving social security income.

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exemption at this time. Staff will however, explore ways to capture this data after implementation of the new Business Tax Billing System and if approved by the voters, implementation of the new tax rate structure. The Council has the ability under the current Business Tax Ordinance and the Proposed New Business Tax Ordinance to create future exemptions.

**Revenue Impact Summary of Recommended Business Tax Changes**

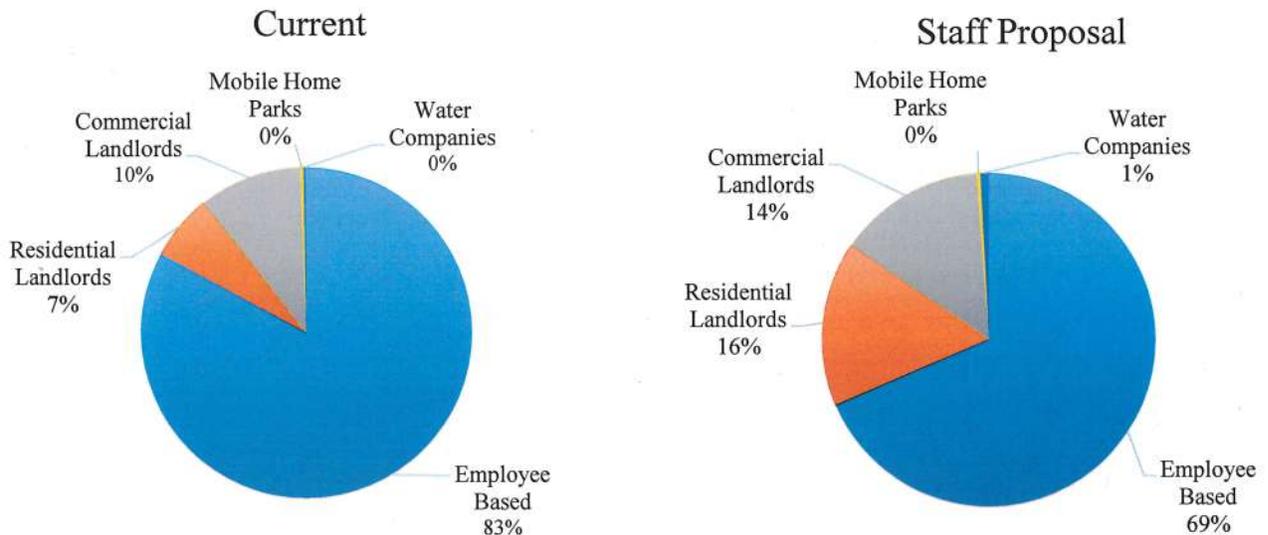
Currently, the City’s Business Tax generates approximately \$12.7 million in annual revenue. If the staff recommendations are approved by the City Council and the ballot measure approved by a majority of the San José voters, staff estimates an additional \$12.3 million will be generated in the first year of implementation as highlighted below:

<b>Business Tax Modernization Estimated Annual Revenue Increase</b>		
	<b>Current (in millions)</b>	<b>Proposed (in millions)</b>
<b>Tax Revenue</b> (target was to double the current revenue)	<b>\$12.70</b>	
<b>Staff Proposed Recommendations</b>		
Per Employee Rate		7.20
Per Residential Property Unit Rate*		3.20
Per Commercial Rental Property Unit Rate		2.25
Per Mobile Home Park Lot Rate		0.05
Per Water Metered Connection Rate		0.20
Expand hardship threshold (from 2X to 4X) for household adjusted gross income**		(0.60)
<b>Total Estimated Revenue Increase</b>		<b>\$12.30</b>

\*NOTE: Inclusion of single & double residential property rentals

\*\*NOTE: Estimate that 3,000 additional businesses would fall under expanded “Hardship Exemption” with base tax revenue loss of \$195 each. (3,000 businesses \* \$195 = \$585K revenue loss). “Low Revenue Generation/Micro-Enterprise” Exemption stays at 2X poverty threshold.

The pie charts below provide an illustration of the composition of Business Tax revenue from the various business sectors. Staff’s recommendation does result in an increase in the percentage of the tax paid by residential landlords. However, when evaluating the current tax rate structure which included a significantly lower per residential unit rate (\$5) as compared to employee based businesses rate (\$18) and significantly lower caps \$5,000 and \$25,000, residential and employee based, respectively, staff believes the recommendations are appropriate in creating a more equitable alignment in the distribution of tax among the various business activities.



### ***Stakeholder Outreach***

Since the Council meeting in March, City Staff conducted stakeholder outreach to share various ideas for how to fulfill the Council direction to double the amount of Business Tax revenue raised, while making the tax more progressive and protecting the smallest businesses. Outreach meetings were held with the San José/Silicon Valley Chamber of Commerce, the Silicon Valley Leadership Group, the San José Downtown Association, 6<sup>th</sup> Annual Summit on Entrepreneurship and Innovation (small business and small business organizations), National Association of Industrial and Office Properties (“NAIOP”), SPUR San José, and the Tri-County Apartment Association.

A variety of industries and company types participated in these meetings, and the input was very valuable to staff in iterating the proposal during the April through July time period.

### ***Ballot Measure Language***

The specific language that would be placed on the ballot is limited to no more than 75 words according to criteria set by state law. The recommended ballot language meets this requirement.

### ***Spending Priorities for Proposed General Purpose Measure***

The proposed Business Tax would generate an estimated \$25 million annually in San José (an increase of approximately \$12.3 million in the first year of implementation of the new tax rate

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and structure). All proceeds of a general purpose funding measure must be placed into the City's General Fund and available for general municipal purposes. None of the funds from this locally enacted measure can be seized by the state. If approved by the voters in November 2016, the new tax rate would be effective on July 1, 2017 and projected additional revenue generated by the tax would be included in the development of the FY 2017-18 Proposed Operating Budget.

### **EVALUATION AND FOLLOW-UP**

If Council adopts a resolution to submit a tax measure to the voters at the November 2016 election, the deadline to submit the resolution and final ballot language to the Registrar of Voters is Friday, August 12. Arguments for and against the measure are due to the City Clerk by 12:00 noon, August 17. The City Attorney's impartial analysis is due to the City Clerk by 12:00 noon on August 23.

### **POLICY ALTERNATIVES**

Staff has provided the following policy alternatives, and the likely impact of each on the total revenue raised.

#### **Employee Count**

Calculate employee count by EDD information solely instead of allowing businesses to choose between calculating the number of employees based on Full-Time Equivalent ("FTE") or based on the number employers report to the California Employment Development Department ("EDD"). Retail and food service companies have a higher employee count with this method due to factoring in part-time employees. **Potential revenue generation: \$150,000.**

#### **Residential Landlords**

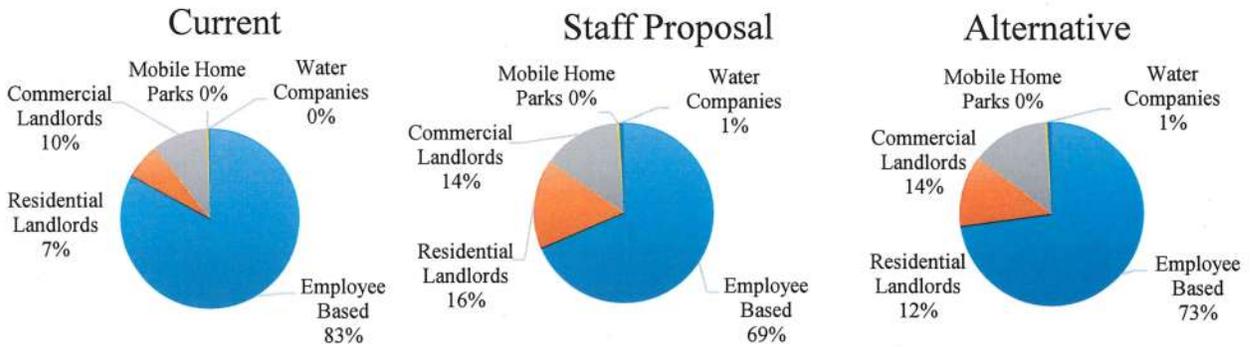
##### ***Decreased Per Residential Unit Tax Rate Offset by Increased Per Employee Rate Option:***

Tax residential units based on different rates than staff's recommendation and increase the per employee rates to offset the revenue loss. Included in calculating the revenue impact of this alternative is the direction to add a financial hardship exemption for small business owners with limited household income plus the recommendation to remove the mandatory EDD employee count, which results in this alternative to have a net zero impact on additional revenue generation. **Potential revenue generation: Net Zero (Increase in amount employee based businesses pay of \$1.8 million, offset by \$1.1 million residential property tax loss, and a reduction of approximately \$750,000 for the additional financial hardship exemption and allowing businesses to choose between calculating employees by FTE or EDD).**

Residential Rental Property Tax Rate			
	Current Rate	Staff Recommendation	Alternative Rate
Base Rate	\$150	\$195	\$195
Unit Rate (1-2)	\$0	\$0	\$0
Unit Rate (3-35)	\$5 (starts at 31)	\$20	\$10
Unit Rate (36-100)	\$5	\$30	\$15
Unit Rate (101-500)	\$5	\$40	\$20
Unit Rate (501+)	\$5	\$50	\$25

Business Tax Rate			
	Current Rate	Staff Recommendation	Alternative Rate
Base Rate	\$150	\$195	\$195
Employee Rate (1-2)	\$0	\$0	\$0
Employee Rate (3-35)	\$18 (starts at 9)	\$25	\$30
Employee Rate (36 – 100)	\$18	\$35	\$40
Employee Rate (101-500)	\$18	\$45	\$50
Employee Rate (501+)	\$18	\$55	\$60

The pie charts below provide an illustration of the composition of Business Tax revenue from the various business sectors comparing current tax receipts, staff's proposal and the policy alternatives. As discussed above, staff believes the recommended tax structure for residential landlords are appropriate in creating a more equitable alignment in the distribution of tax among the various business activities.



**Non-Residential (Commercial) Rental Property Unit Rate**

Assess the square foot rate at \$0.022 rather than at the staff proposed amount of \$0.025.  
**Potential revenue loss: \$344,000.**

<b>Non-Residential (Commercial) Rental Property Tax Rate</b>			
	<b>Current Rate</b>	<b>Staff Recommendation</b>	<b>Alternative Rate</b>
Base Rate	\$150	\$195	\$195
Per Square Foot Rate	\$0.01 over 15,000 sq. ft.	\$0.025	\$0.022

**PUBLIC INTEREST**

This memorandum will be posted on City’s website on or about July 22, 2016, for the August 2, 2016, City Council meeting.

It should be emphasized that the role of City staff, with respect to any ballot measures, is to provide information to the public. The City is prohibited from using City resources for campaigning or advocating for any measure that is placed on the ballot. The role of the City Attorney’s Office is to develop the ballot question that will be considered by Council. The City Attorney’s Office is also responsible for developing an impartial analysis of the ballot measure to provide factual information that is printed in the sample ballot along with arguments for and against the measure as well as rebuttals to the arguments for and against the measure, if submitted.

**COORDINATION**

The City Attorney’s Office, City Manager’s Budget Office, Environmental Services Department, Housing Department, and City Clerk’s Office have been involved in the coordination of this memo.

**COST SUMMARY/IMPLICATIONS**

The City Clerk will issue a separate memorandum which provides the ballot measure costs and the associated budget related to the placement of either recommended tax measure on the ballot, as well as the authorization for rebuttal arguments and the publication of the full text of the measure.

HONORABLE MAYOR AND CITY COUNCIL

July 20, 2016

**Subject: Potential Business Tax Modernization Ballot Measure**

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**CEQA**

Not a Project, CEQA Guidelines Section 15378(b)(4).

/s/  
KIM WALES  
Deputy City Manager  
Director of Economic Development

/s/  
JULIA H. COOPER  
Director of Finance

For questions, please contact Wendy Sollazzi, Revenue Management Division Manager, at (408) 535-7005.