



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Scott P. Johnson

SUBJECT: BUSINESS TAX REVISIONS

DATE: April 15, 2004

Approved

Date

Council District: Citywide
SNI: N/A

RECOMMENDATION

It is recommended that the City Council direct the City Attorney to bring back to the Council by May 25, 2004 for approval an ordinance amending Chapter 4.76 of the San Jose Municipal Code implementing revisions to the Business Tax related to increasing exemptions, establishing a grace period for new businesses, increasing the amount of Business Tax the Director of Finance may compromise, and establishing a Director of Finance authority to compromise Business Tax penalties and interest.

BACKGROUND

The City of San Jose Business Tax Ordinance (ordinance) was first established on July 15, 1963. At times, changes to the Business Tax are necessary to assure adherence to current policies enacted by the City Council, maintain City business regulations consistent with state and local law, and to maintain a process that is least burdensome to the business owners required to pay the business tax.

The Treasury Division in the Finance Department administers the outreach, education and compliance of the City's Business Tax. The City collects approximately \$12 million annually in business tax revenues to support General Fund programs and activities. There are currently approximately 72,000 registered businesses in the City of San Jose.

Since June 2003, the Finance Department has led a proactive effort to follow up on more than 45,000 business leads identified by the City's Business Information Management System (BIMS) database (BIMS Project). Objectives of the BIMS Project include providing education and outreach to the City's business communities regarding the City's Business Tax, while assuring existing business owners are compliant with the requirements outlined in Chapter 4.76. The BIMS Project was made possible through the use of an informational database, which compares information from third-party sources with those businesses currently registered in the City's business tax database. Source listings include information the City receives from the State

of California Franchise Tax Board regarding income tax filings for business related income as well as other sources such as fictitious business listings, business white pages, etc.

From the implementation date of the BIMS Project in early June 2003 through mid-February 2004, approximately 34,000 potential businesses identified through the BIMS Project have received an initial notification letter from the Finance Department requesting information to determine whether a business exists pursuant to the definition in the City's Business Tax Ordinance and whether a business tax might be due. As a result of this outreach, more than 6,900 new business tax accounts have been registered with the City and subsequently reconciled to the City's Business Tax database, leading to an additional \$1.6 million in General Fund revenue to date.

While undertaking the BIMS Project effort, staff became aware of certain anomalies existing in the current application of the Business Tax Ordinance which appeared to be in direct conflict with the Council's priorities of Getting Families Back to Work and the Council's Economic Development Strategies. Therefore, to better align with the Council's direction to review and develop policies and Ordinances that facilitate a "seamless" experience to our residents and business operators, and to assist the City in becoming more business friendly, Finance staff took a "pause" in the BIMS Project in early February 2004 to review the City's Business Tax Ordinance provisions and develop recommendations to the City Council that would better align with the City's recently adopted Economic Development Strategies. Staff recommends that in the event that any of the recommended changes to the City's Business Tax Ordinance would result in a reduction or exemption to the City's business tax, that such change be retroactive to the implementation date of the BIMS Project (June 2003).

ANALYSIS

Staff recommends the following revisions be made to the City's Municipal Code as they relate to the City's Business Tax Ordinance, retroactive to June 1, 2003 (the commencement date of the BIMS Project):

Business Tax Hardship Exemption

The current Business Tax Hardship Program requires those businesses that qualify for this exemption to pay the City's business tax each year and subsequently, after demonstrating that the business' annual gross receipts were at or below a defined poverty level, apply for a refund of business tax paid for that particular year.

As a means to simplify the current Business Tax Hardship Program, staff proposes to replace the existing program with a Hardship Exemption process. Under the Hardship Exemption, business owners would declare, in lieu of and prior to paying a business tax, that annual business income will not exceed a defined threshold, and thereby be exempt from paying the business tax that year. Consistent with the process currently in place to verify businesses qualifying for other exemption types, an annual processing fee, as defined in the City's Fees and Charges Resolution, would be assessed (currently \$16).

To assure businesses declaring a hardship exemption did not exceed the defined annual gross receipts threshold, each year a business applies for the Hardship Exemption, the business owner(s) would still be required to submit documentation to the City demonstrating qualification for the exemption. If it is determined that the business did not qualify for the hardship in any particular year in which the business filed for the Hardship Exemption, the business tax would become due and payable, with no assessment of penalties and interest as long as the Business Tax due would be paid within thirty (30) days of notification.

Presently, the Hardship Program income threshold is based on poverty level guidelines established by the Federal Department of Health and Human Services (FDHHS). The current level is \$9,310 for calendar year 2004. Given that the cost of living in the Bay Area is greater than the national average, staff recognizes that this income level may be too low with respect to qualifying for a hardship exemption (particularly in Santa Clara County). Therefore, staff proposes establishing an income threshold at two-times (2x) the annual level established by the FDHHS (this would be \$18,620 based on the current level.)

Family Provided Caregiver Exemption

The City currently has a business tax exemption for certain relatives who provide child day care services. Many families are also facing challenges to provide care for family members who have long term illnesses and/or are aging as a result of the changing demographics of an aging population and the advancement of medicine. These families are faced with few options for care of the ill and elderly, especially given the rising costs of medical care and the high costs of adult residential care facilities. In order to provide care for these individuals, relatives must stay at home or have their relatives live with them as they provide care services to these individuals. Consistent with the City's business tax exemption for family provided child day care services, staff recommends adding a business tax exemption for persons receiving payment for providing care to ill and/or elderly family members. Family members providing such services recommended for eligibility of this exemption are as follows:

- parent
- aunt
- spouse
- legal guardian
- uncle
- domestic partner
- stepparent
- adult sibling
- grandparent
- child

Upon approval of the Family Provided Caregiver Business Tax Exemption, any individual meeting the family member criteria noted above who receives compensation for providing care services to ill and/or elderly family members will be exempt from paying the City's Business Tax. Consistent with all other Business Tax exemptions, qualifying individuals will be required to pay an exemption verification processing fee as defined annually in the Fees and Charges Resolution adopted by Council.

45-day Grace Period to Pay Business Tax

The current Business Tax Ordinance requires new businesses to pay a business tax prior to commencing, transacting or carrying on any business in the City not specifically excluded by the ordinance. Under the current regulations, businesses which pay the tax subsequent to commencing business are assessed late payment penalties and interest.

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Staff recommends establishing a 45-day grace period to pay the business tax for all new businesses from the date of commencing, transacting or carrying on any business. Given all the requirements of properly establishing a new business, a 45-day grace period provides business owners with additional time to pay the business tax before any penalties and interest are assessed.

Business Tax Compromise of Claims

Staff recommends simplifying the existing compromise of claims process as outlined in the Business Tax Ordinance. Presently, the Director of Finance is authorized to compromise claims for business taxes where the portion of the claim proposed to be compromised is \$500 or less; and with the written approval of the city attorney may compromise such a claim where the portion proposed to be released is \$3,000 or less. The Director may compromise such a claim where the portion of the claim is greater than \$3,000 with the approval of the City Council.

Staff recommends increasing the Director's authority to compromise claims related to Business Tax and associated penalties and interest up to \$5,000; and with the written approval of the city attorney, up to \$20,000. Staff further recommends that the Director may compromise such a claim where the portion of the claim is greater than \$20,000 with the approval of the City Council.

Appellants would be required to submit a written request to the Director of Finance for the compromise of business tax, penalties and/or interest.

PUBLIC OUTREACH

N/A

CONCLUSION

Staff recommends the above changes to the Municipal Code be made to streamline existing processes and assist in achieving the City Council's Economic Development Strategies and Getting Families Back to Work initiatives. The above recommendations provide greater flexibility in meeting the needs of the City's business community while providing increased efficiencies to the business tax process. Upon approval of the recommended changes, staff will resume the BIMS Project to achieve the objectives for further business tax outreach, education and compliance consistent with the recommended revisions to the City's Business Tax Ordinance. Upon conclusion of the BIMS Project, staff will compile any additional recommendations for Council's consideration to improve and streamline the application of the City's Business Tax Ordinance.

COST IMPLICATIONS

Staff estimates that implementation of the recommendations would have minimal impact on the City's business tax revenues. At the present time, business owners qualifying under the hardship guidelines are ultimately refunded the business tax. The recommended hardship exemption will eliminate the need to collect the tax prior to the commencement of business from qualifying business owners.

COORDINATION

This memorandum has been coordinated with the offices of the City Manager and City Attorney.

CEQA

Not a project.

SCOTT P. JOHNSON
Director, Department of Finance

