COUNCIL AGENDA: 5-24-11
ITEM: 3.4

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: COUNCILMEMBER NANCY PYLE

SUBJECT: **CITY MANAGER'S FISCAL REFORM PLAN**

DATE: May 23, 2011

APPROVED: Nancy Pyle

DATE: 5/23/11

RECOMMENDATION:

If the Council decides to pursue a ballot measure in November 2011, I recommend that we also look at ways to quickly bring in more much needed revenue to the city. My recommendation is to modernize a small portion of the City's Business Tax structure to reflect the conversion of traditionally used retail space to space for businesses offering personal services which are not subject to sales tax.

Direct the City Manager to return to Council on June 21 with a further staff analysis on this proposal.

If Council decides consider this modification to the Business Tax, the City Manager should poll the public to gauge public support for changing the business tax structure for businesses offering personal services so that the business tax is based upon gross receipts instead of number of employees. The poll should also include questions gauging the level of support for a business tax of 1%, 1.5%, 2%.

As a point of reference, a 1% business tax is equivalent to the amount the City would have received if normal sales taxes were collected. A 1.5% tax would be 30 cents on a $20 haircut, and a 2% tax would be 40 cents on a $20 haircut.

The polling results should be presented to Council and included in any Council discussion regarding ballot measures for pension or fiscal reform in November 2011.

BACKGROUND:

There is no question that the sales tax structure has dramatically changed with the popularity of internet sales. Small businesses that used to occupy our neighborhood shopping centers are forced to compete with both the convenience and the ability of consumers to avoid paying sales tax on most internet based sales. As a result, many of these small retail businesses closed and created vacancies in our neighborhood shopping centers.

At the same time, businesses offering personal services have exploded in popularity and have quickly filled our neighborhood and regional shopping centers. Businesses offering personal services like manicures and pedicures, tattooing, hair styling, spa services (including massage,

tanning, facials and other beauty treatments), pet daycare, educational tutoring and education enrichment services (i.e. art, language and music) currently occupy space traditionally occupied

by retail establishments selling goods subject to sales tax, not space for businesses offering tax exempt personal services. While these are desirable services to our residents, they occupy space designed to be sales tax generating.

Instead of playing the waiting game and hoping that other government agencies will wrestle with the complicated tax issues regarding our change to a service based economy and tax free internet sales, we have the ability to ask our residents make changes to our business tax now. Structuring the business tax on personal service providers as a small percentage of gross receipts will provide these small businesses the ability to cover the tax in a way that everyone is familiar with. We all understand the concept of a sales tax which applies the same rate to all goods regardless of the cost. The proposed gross receipts tax would operate the same way and will apply to all personal service providers regardless of the amount of services they provide.

Other jurisdictions have adopted a similar process. Basing a Business Tax upon gross receipts is the current policy in the city of Los Angeles, Oakland, Pleasanton and Alameda County.

Given that these are personal services, and the value to the business is their location near their client base, any concern with these businesses relocating to another city should only be a mild consideration.