



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Julia H. Cooper

SUBJECT: TELECOMMUNICATIONS USERS
TAX CAP EXTENSION

DATE: September 4, 2012

Approved

Date

9/11/12

RECOMMENDATION

Approve an ordinance amending Chapter 4.70 of Title 4 of the San José Municipal Code (SJMC) to (1) extend the Cap Program for the Telecommunications Users Tax (TUT) (commonly referred to as the Telephone Utility Tax) through December 31, 2017; and (2) direct staff to conduct an outreach program for other business to apply for participation in the program under the same criteria established in 2009 with the threshold for participation in the TUT Cap Program ("Cap Program") set at approximately \$54,000.

OUTCOME

By amending Chapter 4.70 of the SJMC to extend the TUT Cap Program, service users in the City who qualify for the Cap Program that pay at least \$54,000 in TUT annually will not be subject to financial impacts as a result of the implementation of the new TUT which became effective April 1, 2009.

BACKGROUND

On November 4, 2008, San José voters approved Measure K which reduced the TUT rate from 5% to 4.5% (10% reduction) and updated the tax application. The updated tax was broadened to include interstate and international communications services regardless of the type of technology used to provide such services. The current methods of providing this service include landline, wireless, Voice over Internet Protocol (VoIP), private communication services, voice mail, paging and text messaging. Additionally, the tax applies to bundled communication services including services where taxable and nontaxable services are bundled together. The utility companies collect the tax from consumers on a monthly basis and are required to remit the tax to the City. The tax is not applicable to State, County, or City agencies.

The rate reduction and broadened tax application had minimal impact on residential and small to medium sized businesses. Most residential service users likely experienced a reduction in the

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amount of TUT paid. However, due to the broadening of the tax base, some large businesses would have experienced a greater impact by paying a larger amount in TUT. In an effort to mitigate the possibility of large businesses paying a disproportionate amount of the tax, Council directed the Administration to initiate discussions with large San José businesses and develop a plan that would mitigate the potential impact.

The input received through outreach and educational efforts with large businesses helped establish a framework and criteria in developing the proposed Cap Program. As a result, Chapter 4.70 of Title 4 of the SJMC was amended to add a new section which applied a cap to the maximum amount of TUT payable by service users that meet certain threshold requirements (Ordinance 28498; February 24, 2009). The threshold requirements for participation in the program included demonstration of at least \$50,000 per year in TUT paid in the initial base year (calendar year 2008), increased by 2% per year, and estimated to be approximately \$54,000 for 2012.

The June 2012 Mayor's Budget Message directed staff to present the City Council with an amendment to the Telecommunications Users Tax Ordinance to continue the current tax cap.

ANALYSIS

The Cap Program was originally established to reduce TUT costs for the City's largest users of communications while preserving the City's TUT receipts. The Cap Program was offered to any business that exceeded an annual minimum base of \$50,000 in TUT (on a calendar year basis for the 2008 base year) prior to the broadening of the tax application. Large businesses consume high volumes of complex telecommunication services such as private lines. With the broadened tax application, these businesses would experience a significant increase in TUT without participation in the Cap Program. The Cap Program does include a tax receipt growth provision which automatically increases the payments by 2% annually.

The recommendation to extend the Cap Program for five years will provide the opportunity to allow other businesses that qualify for the program to apply and for a recertification of the businesses currently participating in the Cap Program. A reexamination of the Cap Program every five years allows for the City to more efficiently manage resources for administration of the Cap Program and to revalidate the original goal of the Cap Program to mitigate the tax burden of larger businesses. Based on analysis conducted in 2009, it was projected that without the Cap Program larger business could have experienced at least a doubling of their then current TUT payments. Staff believes this analysis holds true today. Without the Cap Program, it is estimated that the three businesses currently participating in the Cap Program would be responsible for over 4% of the total TUT collected by the City. In order to mitigate this tax burden and to encourage economic development, staff recommends the extension of the Cap Program.

Cap Program Payment Summary

As shown in the chart below, the current participants in the Cap Program paid a total base tax of \$445,166 in TUT in the first year of the program (the amount was prorated from \$593,555 due to the effective implementation date). For each subsequent year, the TUT cap base year is automatically increased by 2% and payments are made in advance on, or before, January 31 of the following year. The total due and paid for calendar year 2012 was \$629,885. Cap Program payments from all three companies for the period from 2009 through 2012 totaled \$2,298,011.

<u>Calendar Year</u>	<u>TUT Cap Payments</u>
2009	\$445,166*
2010	605,426
2011	617,534
2012	<u>629,885</u>
Total Paid to Date	\$2,298,011

*Payment was prorated based on program effective date of 4/1/09

TUT Revenue Summary

Since the effective date of April 1, 2009, the City's TUT revenues have remained above the base year despite the tax rate reduction. The broadening of the tax base offset the impact of a reduced tax rate. The table below illustrates the actual revenues received for telecommunication services subject to the TUT for 2008-2009 through 2011-2012.

<u>Fiscal Year</u>	<u>TUT Revenue</u>
2008-2009	\$29.2 million*
2009-2010	32.5 million
2010-2011	31.5 million
2011-2012	<u>31.3 million</u>
Total	\$124.5 million

*TUT program implemented 4/1/09

Should the Cap Program sunset on December 31, 2012, the participating businesses would be subject to the broadened tax application and would incur significant TUT liabilities. If the Cap Program is extended, the existing participating businesses would continue to pay a combined total of approximately \$630,000 per year in addition to the annual 2% growth rate.

Overall, the Cap Program is a success. Its implementation mitigated the impact of Measure K on the City's business partners and achieved its core purpose of maintaining a cooperative relationship with the City's business partners.

The Finance Department in coordination with the Office of Economic Development will conduct an outreach program to identify additional companies that could be eligible for participation in

the Cap Program based on the same criteria established in 2009 (adjusted for the 2% annual growth in the threshold).

EVALUATION AND FOLLOW-UP

The TUT Cap extension for five years will allow staff to work with the service users in the Cap Program to reevaluate the impacts of the TUT Cap at which time it will make recommendations to Council before December 31, 2017, taking into consideration the financial impact on the taxpayers relative to the City's financial condition.

POLICY ALTERNATIVES

Alternative #1: Discontinue the TUT Cap Program

Pros: Generates additional General Fund revenue

Cons: Disproportionate impact on these businesses relative to the intent of TUT revisions

Reason for not recommending: As stated previously, large businesses consume high volumes of complex telecommunication services such as private lines. With the broadened tax application, these businesses could experience a significant increase in TUT. The City of San José appreciates its relationship with the businesses that have chosen to establish their operations within the City's jurisdiction. The mutual benefits resulting from this relationship justifies the approval of a TUT Cap for businesses and other service users that qualify. In order to mitigate the tax burden and to encourage economic development, staff recommends the extension of the Cap Program.

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This memorandum will be posted on the City's website for the September 25, 2012 Council agenda.

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COORDINATION

This memorandum has been coordinated with the City Attorney's Office, the Office of Economic Development and the City Manager's Office.

COST SUMMARY/IMPLICATIONS

Based on the consultant's estimate that was developed at the time the TUT Cap Program was implemented, it is anticipated that additional TUT revenue in the amount of \$600,000 could be received by the City if the TUT Cap Program extension is removed.

CEQA

Not a Project; File No. PP10-068, Municipal Code or Policy.

/s/
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Acting Director, Finance Department

For additional information, please contact Wendy Sollazzi, Revenue Management Division Manager at 408-535-7005.