

REPORT TO COUNCIL

SUBJECT

Receive the Results of Public Outreach in Connection with the Study Issue to Evaluate Options for Revisions to the Sunnyvale Business License Tax (FIN 19-01); Discussion and Provide Direction Regarding a Potential Ballot Measure for the November 3, 2020 Election to Increase the Business License Tax by Removing the Employee and Rental Unit Caps on the Business License Tax

BACKGROUND

In March 2019, City Council sponsored a study issue to evaluate options to revise the City's Business License Tax (FIN 19-01). The Business License Tax was first established in 1968, and the last major update was approved by voters in 2005. The current structure is based on the number of employees (including the owner) operating in Sunnyvale. A business with one employee (meaning only the owner is operating the business, there are no other employees) is taxed at \$38.89 for the 2020 tax year. Businesses with two to five employees are taxed at \$66.52. The tax amount increases progressively every five employees thereafter, with a maximum tax of \$12,638.80 for businesses with 946 or more employees.

Additionally, businesses that provide three or more separate living or office units for rent pay the tax based on the number of rental units or the number of employees, whichever is greater. Rental properties with fewer than three units are not required to obtain a business license. The tax rates for rental properties are the same as for other businesses, but there is a lower maximum tax rate of \$5,654.20 for properties with 421 or more rental units. The tax rates for the businesses and rental offices adjust each year based on the San Jose/San Francisco/Oakland Consumer Price Index.

As part of a longer term look at revenues to the General Fund, which started with Utility Users Tax and more recently resulted in an increase to Transient Occupancy Tax, staff contracted with HdL Companies (HdL) to analyze Sunnyvale's business license tax and provide recommendations for potential modifications to the Municipal Code. HdL evaluated the business tax of 16 different communities in the Sunnyvale trade area and conducted a thorough review of Sunnyvale's Municipal Code (Attachment 1). Their analysis resulted in five potential options for a restructure of Sunnyvale's business license tax as follows:

- Model 1: Existing Categories with Simple Increases, remove the tax cap
- Model 2: Unified Employee and Unit Tax Rate
- Model 3: Classification based rates - per employee rates that are based on business types (e.g. General/Retail, Service, etc.)
- Model 4: Increasing rate based on business size, remove the tax cap, flat \$25 per unit for rental properties
- Gross Receipts Model: Bases the tax on gross receipts of the business or rental property.

Staff evaluated the options, simplified the consultant recommendations, and presented a refined list of four options to the City Council at the Council's February Strategic Session. They were:

- Make no change
- Model 1: Increase rates to market, remove the cap
- Model 2: Rate of \$20 per employee or rental unit, remove the cap
- Model 3: Rate of \$25 per employee or unit, remove the cap
- Model 4: Sliding scale based on business size
- Gross Receipts Model: Bases the tax on gross receipts of the business or rental property

Council refined the options to the first four models, eliminating the Gross Receipts Model and directed staff to begin outreach. After one outreach meeting was completed, the COVID-19 Shelter in Place orders were released. Staff returned to Council on April 14, 2020 and Council directed staff to move forward with a revised Model 1.

Revised Model 1: Remove only the cap.

Council's direction will result in the tax being paid on the total number of employees that an employer has in the City or rental units owned. The removal of the cap on the total number of employees will impact only large employers. Over the subsequent time period, staff completed direct outreach on removal of the cap from the Business License Tax.

EXISTING POLICY

Council Policy, Chapter 7, *Planning and Management*, Policy B.1.1 - The City will maintain a diversified and stable revenue base, not overly dependent on any land use or external funding source.

Council Policy, Chapter 7, *Planning and Management*, Policy B.1.4 - When considering a new tax or revenue source or an increase in an existing tax or revenue source, the following criteria should be considered:

- Community/Voter Acceptance
- Competitiveness with surrounding communities
- Efficiency of revenue collection and enforcement
- Effectiveness in generating sufficient revenues in the short and long-term to justify its establishment
- Enhancement of revenue diversity to promote stability and provide protection from downturns in business cycles
- Equity/Fairness in distribution of the revenue burden on various segments of the community

ENVIRONMENTAL REVIEW

This action is exempt from review under the California Environmental Act (CEQA) in that it involves fiscal and administrative activities that will not result in direct or indirect changes to the environment, and which do not commit the City to any specific project that may result in a potentially significant impact on the environment. (CEQA Guidelines, Section 15378(b)(4) and (b)(5).)

DISCUSSION

At Council's direction, staff conducted direct outreach to companies and owners of rental units on a single option to remove the tax cap. As this change would only affect a small number of taxpayers (fifteen businesses and nine multi-family businesses) staff conducted direct outreach. A call was held with all fifteen businesses and attempts were made to contact all apartments, with four out of nine responding.

The conversations were positive and almost all respondents appreciated the direct outreach to describe the impact. Feedback was neutral to negative, with all respondents indicating they were generally in opposition to anything that would increase the cost of doing business, especially in light of the unknown impacts that COVID19 will have on the business community. The representatives did state a general understanding of the issue of equity between large and small business. However, respondents did express that there are other ways in which larger business contribute to the community through increased economic activity positively impacting sales tax, and purchasing or improving properties, positively impacting property tax. Several businesses asked for clarification regarding whether remote workers are counted. The City's interpretation of how the tax is applied to the number of employees is to count the highest number of employees in the City in a single 24-hour period. Lastly, businesses expressed that with the current economic uncertainty and recession, now is not the time to be increasing taxes.

The rental properties that were engaged had similar responses, understood the equity issue between large and small properties, but expressed anything that puts potential upward pressure on rents or leases could impact Sunnyvale housing costs negatively. Also expressed was a concern that the properties are not receiving rent payments during the pandemic and are having difficulty finding tenants during this time as well.

After evaluation and consideration of the businesses' input, staff is recommending modifying the tax structure to remove the cap, resolving the inequality of the per employee/per unit tax between large and small business and rental properties. As this is a tax voter approval is required to increase the tax. Staff is recommending that Council direct staff to return in July with an action to place a measure on the November 2020 ballot to remove the cap. Staff is also proposing minor clean-up or clarification of language in the ordinance that will not affect the amount of the tax. The study also recommended some revisions to the City's ordinance. These proposed revisions will be evaluated no later than 2022 as they are not critical, and many may not require voter approval as they don't affect the amount of the tax.

Draft Ballot Questions

Staff has prepared a draft ballot question for consideration by Council. The language captures the removal of the cap for both employee count and rental unit count, as well as other clean up language. The proposed language is as follows:

Shall an ordinance be adopted amending Chapter 5.04 of the Municipal Code to eliminate the cap on the number of employees and rental units so the tax is paid on the total number of employees or rental units owned, generating approximately \$400,000 annually for unrestricted general revenue purposes such as libraries, street repair and other vital City services, until ended by voters; and changing the definitions of business, employee and person for administrative clarity?

Staff is seeking feedback or changes from Council should a decision be made to move forward per staff's recommendation.

A draft of proposed amendments to Sunnyvale Municipal Code Chapter 5.04 is attached (Attachment 2) for Council's review and discussion.

FISCAL IMPACT

Business License Tax revenue goes to the General Fund where it is used to fund all services in the General Fund. The impact of removing the cap on businesses and apartments is approximately \$400,000 per year, with approximately \$370,000 from businesses and \$30,000 from multi-family properties.

PUBLIC CONTACT

Public contact was made by posting the Council agenda on the City's official-notice bulletin board outside City Hall, Sunnyvale Public Library and Department of Public Safety; and by making the agenda and report available at the Office of the City Clerk and on the City's website.

ALTERNATIVES

1. Direct staff to return with a Resolution Calling an Election to place a ballot measure for the November 3, 2020 election to increase the Business License Tax by removing the employee and rental unit caps on the Business License Tax.
2. Take no action, leaving the ordinance as it stands and closing the Study Issue.

STAFF RECOMMENDATION

Alternative 1: Direct staff to Return with a Resolution Calling an Election to Place a Ballot Measure for the November 3, 2020 to Increase the Business License Tax by Removing the Employee and Rental Unit Caps on the Business License Tax.

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Reviewed by: Teri Silva, Assistant City Manager

Approved by: Kent Steffens, City Manager

ATTACHMENTS

1. HdL Companies Business Tax Analysis and Ordinance Review
2. Proposed Amendments to Sunnyvale Municipal Code Chapter 5.04