



REPORT TO COUNCIL

City of Sacramento

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Staff Report
June 22, 2010

**Honorable Mayor and
Members of the City Council**

Title: Proposed November 2010 Revenue Measure

Location/Council District: Citywide

Recommendation: 1) Discuss a proposed tax measure for placement on the November 2010 ballot to update and modernize the business operations tax and to tax marijuana businesses; and 2) Direct the City Attorney to prepare an ordinance and resolution for the proposed tax measure for City Council consideration on July 13, 2010

Contact: Patti Bisharat, Assistant City Manager, (916) 808-8197

Presenter: Patti Bisharat, Assistant City Manager, (916) 808-8197

Department: City Manager's Office

Division: Not applicable

Organization No: 02001011

Description/Analysis

Issue: The deep national recession has significantly reduced the City's available revenue to fund essential local services. Today, the City faces a \$43 million budget gap in Fiscal Year 2010/11 and substantial challenges in returning to a long-term structurally balanced general fund budget. In February, the Council directed staff to pursue several budget development strategies including consideration of revenue improvements. Staff evaluated a number of revenue enhancement opportunities and recommends updating and modernizing the City's business operations tax (BOT) and taxing marijuana businesses and placing a measure on the November 2010 ballot.

Policy Considerations: The City's BOT has not been updated since 1991. Updating the BOT requires majority voter approval. Staff estimates updating the BOT and phasing in a five percent tax on marijuana will generate approximately \$4.5 million in year one and approximately \$8.8 million per year by the end of a three-year phase in period. The general fund revenues derived from an updated BOT will be used to fund essential City services like police, fire protection, park maintenance and recreation programs.

Environmental Considerations: The recommendation does not constitute a

"project" and therefore is exempt from the California Environmental Quality Act (CEQA) according to Section 15061(b)(1) and 15378(b)(3) of the CEQA guidelines.

Commission/Committee Action: None

Sustainability Considerations: Not applicable

Rationale for Recommendation: The proposed BOT modernization measure will result in a tax that is less regressive and generates needed revenue for the City's general fund (see Financial Considerations below). After implementation, larger businesses will pay a more proportionate share of the City's BOT revenue (see Attachment 4). The measure's incentive for new clean-tech companies and grace period for delinquent accounts will serve as added economic development strategies.

Financial Considerations: Today, the City faces a \$43 million budget gap in Fiscal Year 2010/11 and substantial challenges in returning to a long-term structurally balanced general fund budget. The FY 2011/12 projected deficit is \$25 million and assumes \$15 million in new revenue to balance the budget. Staff estimates updating the BOT and phasing in a five percent tax on marijuana businesses will generate an additional \$4.5 million in year one and approximately \$8.8 million per year by the end of a three-year phase in period. As noted on Attachment 3, the annual financial impact of this measure on a business generating \$100,000 in gross receipts (subject to the 0.07% rate structure) will be an additional \$27. A business generating \$10 million in annual gross receipts (that is subject to the 0.07% rate structure) will pay an increase of approximately \$3,000.

Emerging Small Business Development (ESBD): Not applicable

Respectfully Submitted by: 
Patti Bisharat, Assistant City Manager

Recommendation Approved:

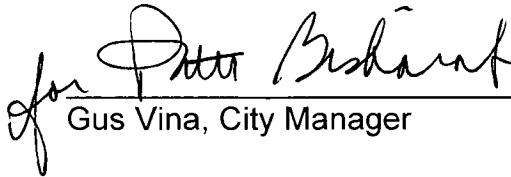

for 
Gus Vina, City Manager

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Background

The deep national recession has significantly reduced the City's available revenue to fund essential local services. Today, the City faces a \$43 million budget gap in Fiscal Year (FY) 2010/11 and substantial challenges in returning to a long-term structurally balanced general fund budget. The FY 2011/12 projected deficit is \$25 million and assumes \$15 million in new revenue to balance the budget. The State of California's estimated \$20 billion budget deficit threatens to result in added state funding cuts to the City's budget.

In February, the Council directed staff to pursue several budget development strategies in preparing the FY 2010/11 budget including alternative service delivery, streamlining the organization, planned use of one-time reserves, and consideration of revenue improvements. Staff evaluated a number of revenue enhancement opportunities and recommends updating and modernizing the City's business operations tax (BOT) and taxing marijuana businesses.

Business Operations Tax (BOT)

A business operations tax is paid to the City of Sacramento in order to conduct business legally within the City limits. The tax provides general revenue that helps pay for essential City services like fire protection, police, park maintenance and recreation programs. Most cities in California levy a BOT.

The City's BOT was enacted by Ordinance No. 3508 on May 1, 1975 and its structure has remained largely unchanged since its inception. Last updated almost twenty years ago in 1991, Sacramento's per capita BOT revenue today ranks lowest among the State's ten largest cities (see table below). A 1984 Tax Force recommended the "[Business Operations Tax] base and revenue yield should be reviewed periodically."

City	Population ¹	BOT Revenue ²	Per Capita BOT Rev	Per Capita Rank
San Francisco ³	836,360	332,168,000	\$ 397.16	1
Oakland	419,189	53,119,065	\$ 126.72	2
Los Angeles	4,016,085	466,996,623	\$ 116.28	3
San Jose	985,047	41,323,025	\$ 41.95	4
Fresno	484,804	16,654,781	\$ 34.35	5
Long Beach	489,090	16,366,297	\$ 33.46	6
Santa Ana	351,161	10,444,074	\$ 29.74	7
San Diego	1,337,926	26,142,556	\$ 19.54	8
Anaheim	345,002	5,831,911	\$ 16.90	9
Sacramento	474,925	7,319,000	\$ 15.41	10

¹ 1/1/2008 – Source: California State Department of Finance

² FY08 State Controller's Office "Cities Annual Report"

³ San Francisco's BOT revenue is derived from a payroll tax and reflects the FY 06/07 budget estimate

Tax rates are determined by each city collecting the taxes. For the City of Sacramento, the BOT separates businesses into the following four rate structures:

- Professional Business Owners (Accountants, Architects, Attorneys, Doctors, Engineers, etc.). Tax is based on number of years a professional license is held plus an additional amount for each employee.
- Professional – Brokers (Real Estate Broker, Insurance Broker, or Stockbroker). Tax is based on a flat rate per broker plus an additional amount for each licensed employee.
- Housing & Shelter (Rental of Real Property, Hotels & Motels, and Rental of Non-Residential Property). Tax is based on a flat rate per property plus an additional amount for each room over four.
- All other business. Tax is based on a rate of 0.04% or \$0.40 for every \$1,000 in gross receipts or permit value.

While some cities do not cap their BOT, Sacramento's BOT includes a maximum cap of \$5,000 annually. Today, this cap is reached for businesses generating gross receipts of \$12.5 million or more. Therefore, a business generating \$100 million pays \$5,000 in BOT just as a \$12.5 million business pays \$5,000. To account for inflation, other cities tie their BOT to a Consumer Price Index (CPI).

The City exempts charitable and nonprofit organizations that are exempt under state or federal law from payment of the business operations tax.

Marijuana

Marijuana is currently taxed in two other California cities. In Oakland, Measure F was passed by 79.9% of voters in November 2009 to tax medical cannabis dispensaries at a rate of 1.8% or \$18 for every \$1,000 in gross receipts. Berkeley also taxes marijuana businesses.

Estimating the revenue associated with a marijuana tax measure is difficult. The difficulty is due in part to the uncertainty related to the number of dispensaries that might be permitted in the City in the future, the sales associated with such dispensaries and the potential market variability of the products. Staff has analyzed the revenue potential utilizing several different scenarios (different number of dispensaries and sales volumes) associated with the phasing in of a 5% tax rate and estimates tax revenues of approximately \$500,000 in year one and growing to approximately \$850,000 annually by year three when fully implemented.

Proposed Business Operations Tax Modernization Measure

Components of Existing Business Operations Tax

- Minimum tax of \$30 per year
- Maximum tax of \$5,000 per year
- BOT ordinance currently applies four different rate structures:
 - Professional Business Owners
 - Professional – Brokers
 - Housing & Shelter
 - All other business

Components of Proposed BOT Modernization Measure

- Adjusts maximum tax from \$5K to \$50K (for example, any business generating more than \$12.5 million in gross receipts/permit value pays no more than the \$5K maximum; when fully implemented, businesses generating less than \$72 million will pay according to the rate up to a new maximum of \$50K)
- Phases in adjustment of 0.01% (\$0.10/\$1,000) over three years for most businesses from 0.04% to 0.07% (\$0.40 to \$0.70/\$1,000)
- Creates new BOT category for marijuana and phases in a tax of a 5% tax on gross receipts over three years (e.g. 3% in year 1, 4% in year 2, 5% in year 3)
- Applies CPI adjustment to minimum tax and maximum tax after implementation of phasing
- Creates an incentive for new “clean tech” companies with temporary waiver of BOT
- Includes grace period that waives past taxes due and penalties if delinquent businesses begin paying within the grace period
- Implementation July 2011

Additional Background

- City’s BOT has not been updated in nearly 20 years (1991)
- Sacramento’s per capita BOT revenue ranks lowest among the State’s 10 largest cities
- Proposed measure is sensitive to impacts on small business and includes economic development incentives
- Changing the maximum tax results in a less regressive BOT
- Because the rate structures are unique to their industries (e.g. number of employees, years a license has been held, amount per room), measure does not adjust rates for the BOT categories of Professional Business Owners, Professional – Brokers, and Housing & Shelter

Revenue Projections

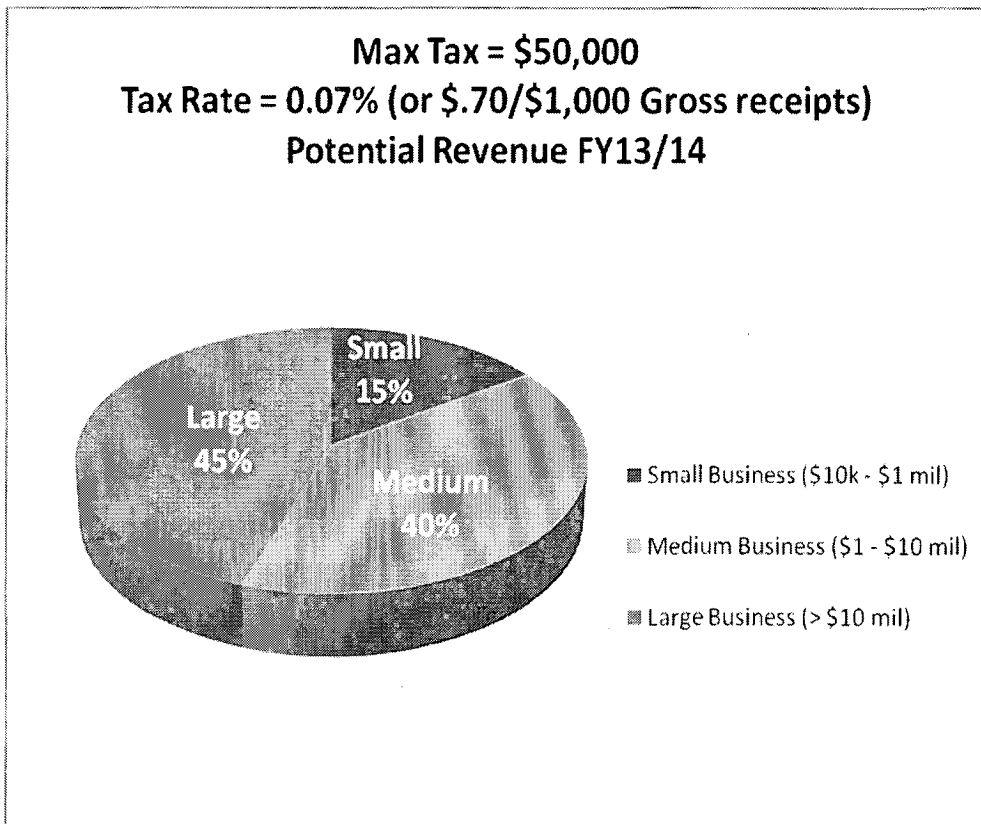
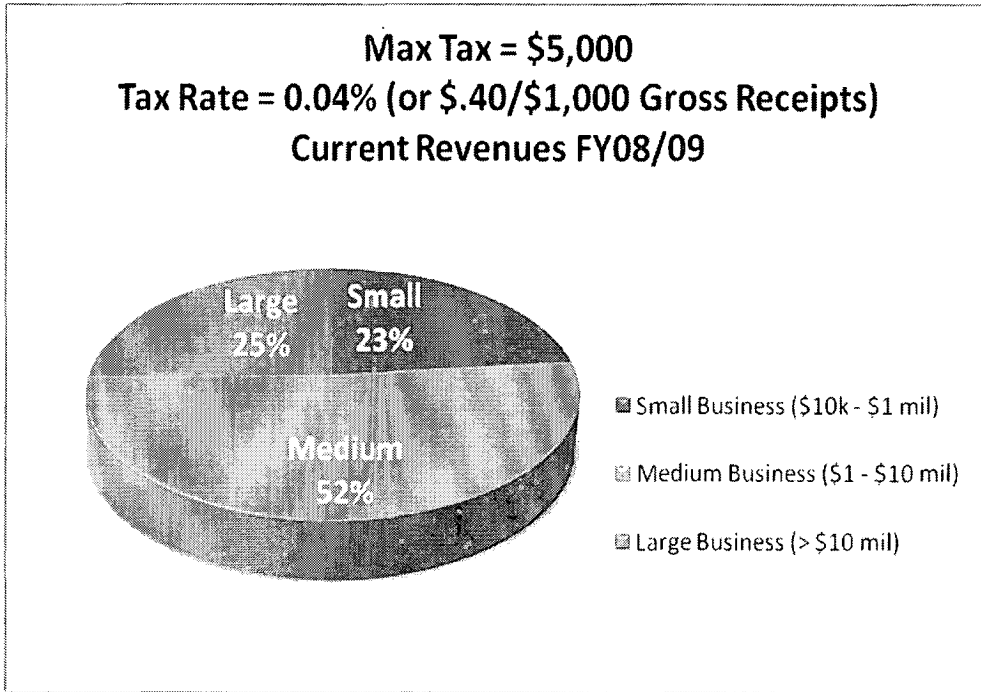
- New revenue of approximately \$4.5 million in year one increasing to \$8.8 million per year in year three

**Example of Proposed BOT on Different Businesses
(For Illustration Purposes Only)**

Business Size	Gross Receipts/ Permit Value	Max Tax \$5K	Max Tax \$50K	Max Tax \$50K	Max Tax \$50K
		Current 0.0004	Year 1 0.0005	Year 2 0.0006	Year 3 0.0007
Small Business	<\$ 10,000	\$ 30	\$ 30	\$ 30	\$ 30
	100,000	66	75	84	93
	500,000	226	275	324	373
Medium Business	1,000,000	426	525	624	723
	5,000,000	2,026	2,525	3,024	3,523
Large Business	12,500,000	<u>5,000</u>	6,275	7,524	8,773
	25,000,000	5,000	12,525	15,024	17,523
	50,000,000	5,000	25,025	30,024	35,023
	75,000,000	5,000	37,525	45,024	<u>50,000</u>

Indicates the approximate dollar amount (rounded to closest \$5,000) where the Maximum Tax would be reached.

BOT Becomes Less Regressive After Implementation



Draft Ballot Question (75 words)

To help preserve essential local services like fire, police and 911 emergency response, shall City of Sacramento's 19-year old business operations tax be modernized by phasing in a 5.0% tax on marijuana businesses and increasing the rate for most other businesses to 0.07% over three years, creating a three-year tax exemption for clean-tech businesses, increasing the maximum tax paid by multi-million dollar businesses, providing inflationary adjustments beginning July 2014, and requiring independent audits?