



FINANCE COMMITTEE

Special Meeting
June 15, 2009

Chair Burt called the meeting to order at 5:41 p.m. in the Council Chambers, 250 Hamilton Avenue, Palo Alto, California.

Present: Burt (chair), Klein, Morton arrived at 5:50p.m., Schmid

Absent: None

1. Oral Communications

None

2. Continuation of Recommendation to Approve Proposed Business License Tax Ordinance for November 2009 Ballot (Continued from the Finance committee Meeting of June 2, 2009).

City Manager James Keene clarified for the Committee and Public that the Finance Committee is meeting on this item and it is scheduled to go to Council on June 22, 2009. A story in the Daily Post was incorrect in stating that the City was taking action on the Budget tonight. Action will be taken by the Council on June 22, 2009, and potentially on July 20, 2009.

Director of Administrative Services Lalo Perez stated that he would present a background from the last meeting, methodologies and classifications from the Committees feedback at prior meetings, provide revenue estimates as requested, touch on the timeline, and then open for comments. The Committee recommended that Staff move forward with a Business License Tax (BLT) recommendation to the City Council, that would generate a net revenue amount of \$3 million, it would be implemented on July 1, 2010, with an option to delay, all businesses would be subject to the (BLT), except those with statutory exemptions, with a cap of \$30,000 annually for all businesses, except Retail, Personal services, hotel, and miscellaneous which would have a \$20,000 cap. The Committee made additional recommendations that were not recapped but are included in Attachment A. Staff did not receive direction regarding methodology as the Committee was split. Staff was guided to merge retail, personal services, expanded professional, and hotel to include other business services. Staff was also



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recommended to consider a wider tax rate distribution between the professional and retail classifications and to then take those changes and do provide revenue models for both Gross Receipts and Employee Count Methodologies. Staff then evaluated alternative taxing methodologies for multi-unit rentals and commercial properties using units for rentals and square footage for commercial properties. The last meeting focused on the Gross Receipts model, this is a self reporting methodology that does not require submittal of income taxes to the city. The Employee Count, or Per Capita methodology, would be based on full time equivalent number of employees.

Senior Financial Analyst, Tarun Narayan reviewed the presentation showing the difference between the previous classifications, and how they were consolidated. Staff is also recommending that all fixed amounts and tax rates tied to a fixed amount be subject to annual Consumer Price Index (CPI) adjustments. The presentation also demonstrated Gross Receipts revenue under the two models. The minimum tax is \$75 and the cap for all businesses except retail is \$30,000. The exemption of \$85,000 as a minimum gross income was eliminated. Per comments of the Finance Committee, all businesses except Federal and State Exempt businesses would be subject to the BLT. The tax rates are lower than the previous models, with the exception of the Professional Classification; which is higher due to the wider rate of distribution. The Commercial Property tax rate has been revised to a single blended rate for greater administrative ease. Non-Profits are exempt under the Gross Receipts Method, but not the Per Capita method. Stanford University Hospital and Palo Alto Medical Foundation are therefore not included in the Gross Receipts model.

Mr. Perez clarified that Staff changed the Commercial Tax rate from office space and R&D to one rate for simplicity. It would be appropriate for the Committee to give Staff direction if they wish to make changes in the tax structure for commercial property tonight. The Timeline is that Council will hear for the first time on June 22, 2009 giving Staff time to revisit the proposal with the business community. Also July 20, 2009 is tentatively schedule for Council to vote on whether or not the BLT should be added to the November Ballot. The County Election Code dictates that this must be decided by August 7, 2009.

Council Member Klein asked if the inflation rate would be rounded to the nearest dollar.



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Mr. Perez stated that it would and that verbiage would be included in the Ordinance.

Council Member Klein asked if the inflation rate would be based on the Bay Area rate or the National rate.

Mr. Perez state that it would be based on the San Francisco, Oakland, San Jose Bay Area Rate.

Vice Mayor Morton asked for a rough idea of what the differential would be if Stanford were included in the head count rate.

Mr. Perez said that from the data Staff has, it is difficult to categorize Stanford and would have to refine the definition of non-profits in general.

Vice Mayor Morton asked if they would meet the cap with a \$60,000 differential.

Mr. Narayan said that between the two, Stanford and Palo Alto Medical, there are about 2000 employees, which would meet the cap.

Chair Burt stated that the per employee format for Multi Unit Rentals and Commercial Properties have an alternative formula that isn't per employee, and asked if there is a reason that we couldn't have a similar structure under Gross Receipts for those entities.

Mr. Perez said that that would be appropriate if Staff was given direction by the Committee to do so.

Chair Burt stated that the issue of administrative costs was briefly discussed at the last meeting, and asked if the place holder dollar amount is the same for Gross Receipts Tax as it is for Per Employee Tax. He stated that he appreciates the blended costs of a business registry and a cost based on the type of tax. He then asked if Staff has had a chance to determine if there is a lower cost to administer the Per Employee Tax.

Mr. Perez said that Staff is working on providing a more detailed analysis on June 22, 2009 specifically regarding the number of transactions that would be processed. The key would be to go forward with the proposal that starts with temporary staffing and Council would have to approve of any change.



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Because it is self reporting the numbers that we would process would not be that different from Gross Receipts.

Mr. Keene said that we are dealing with estimates. If this passes and we implement we would track and manage the expenditures hopefully improving the net. We would not take some allocation and funding positions with that.

Chair Burt commented that one of the issues that came up when they were discussing the Document Transfer Tax was the amount it had fallen off from previous years where it had accelerated appreciably, and then dropped off during this fiscal year. He then asked if there were any updates over the last month or two on what appears to be the revenue rate

Mr. Perez said that we are seeing a slow increase on the number of properties changing hands, approximately 54 or 56 transactions in May for single residential homes, including about 8 condos. The numbers are still below May of last year when there were 70 plus properties that changed hands. He stated that he didn't have the commercial information at hand, for the month of May, but believes they are pretty much stagnant.

Mr. Narayan said the revenue rate of decline has slowed and is declining still comparing from year to year.

Chair Burt clarified that it's not on a declining trend, it's recently up, but year to year it is much lower.

Mr. Perez stated that April and May are showing month to month increases

Council Member Klein stated that they've talked about the triple net lease problem and said it still seems to be there under either model and asked if Staff has a solution yet.

Mr. Perez said the solution that Staff proposed was a lower rate to address the concerns as he understood them from the business community regarding the double taxation. Staff has shown the rates are now significantly different. Staff believes that the practice will be for the landlords to pass the tax onto their tenant.



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Council Member Klein stated that the rate on Commercial Real Estate is lower comparatively, but that Professional and Business Services would still be taxed at a higher rate.

Mr. Perez agreed and stated that the issue is open for further discussion perhaps with the attorney's office.

Council Member Klein asked if there is a chance that they can put in a provision so that the tax can not be passed through.

Senior Assistant City Attorney, Cara Silver said that it would not be effective. One of the things being considered is that the tenants will be aware of it and negotiate their leases. In the leases that Staff has reviewed, a few do not pass these types of taxes through, but the majority do.

Mr. Perez said that another point is that this is not an unusual tax in other communities with the difference being the methodology or rate.

Council Member Schmid stated that he would be in favor of setting a goal for the Business Community at perhaps \$3 million, and then including the City costs in accumulating that. That would mean the Council has an interest in getting as much of the \$3 million as possible and would then follow up with Staff regarding efficiency. If the goal is to be conscious of the incentives we're creating, and one incentive is to create a viable environment for neighborhood service, then the City should be sensitive about the share picked up by Retail and personal services. Under Gross Receipts that number is kept small, this increases the incentive for doing Retail Services. Under the Employee side the retail share jumps up, that may be a function of the nature of retail, as a low wage-labor intensive activity they are penalized under an economic thing. This figure shows an accurate way to measure that discrimination. If one looks at the wage occupation and industry the ratio of professional and business services to the retail and professional services it's a 2.5 to 1, which is close to what we see in the first diagram. The ratio between manufacturing and wholesale is 1.6 to 1 which is not the flat pace. He then asked if, in that diagram, the first two were more accurate in representing a city that wants to create incentives for neighborhood serving retail.

Mr. Perez said that Staff feels more comfortable with the data set for the Gross Receipts Model because Staff has more information on the retail sales activity based on the sales tax data. Staff is looking at what would be the



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Gross Receipts amount that would be generated to meet the minimum of the tax. For example, for the Gross Receipts Model a Professional Rate would be \$125,000, in Retail it would be \$108,000. In example B Gross Receipts is \$375 thousand.

Council Member Schmid said that we are measuring the median which is sensitive to those issues

Mr. Perez stated that the numbers are reflective of not having exemptions

Council Member Schmid said that the City was treating rentals and commercial properties with Gross Receipts or Employee Count and now square footage. We are already taxing renters or users of buildings with property tax and Document Transfer Taxes, and now another tax is being added. He thought the point was to tax the people collecting the rent. He questioned why it has changed from Gross Receipts or Head Count to square footage when the ratios are about 3000 to 1. He asked what the ratio was of people in a commercial office that deals with renters. And suggested Staff figure the Per Capita or Gross Receipts against that instead of introducing square footage which will be passed on to the same people who already paying tax.

Mr. Perez said that Staff was following what the Committee wanted and this data was provided per a discussion at the June 2, 2009 meeting. It was not intended to be a recommendation.

Council Member Schmid thought that from the perspective of equity we should tax those that will pay, not those that are already taxed.

Mr. Burt asked for clarification that if it were Gross Receipts a triple net lease the tax would be passed on.

Mr. Perez agreed that that's what their data shows and reiterated that this is not unique in other communities.

Chair Burt clarified that the only way to avoid this double taxation for commercial properties would be if the commercial properties had a per employee but they don't employ a lot of people, so the tax rate would have to be appropriate.

Mr. Perez agreed that they could have less employees.



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Susan Kaplan, 550 Hamilton Ave spoke in opposition of the Business License Tax stating that the business community does not support the Gross Receipts Model. A lawyer has advised her of the likelihood of increased City audits that would require her to illegally provide confidential client lists. She warned of increased ill will with the business community.

Beth Rosenthal, 550 Hamilton Ave spoke regarding her surprise at Staffs recommendations for increasing the tax on professionals with no explanation. She cited Los Angeles as an example of a city that used Gross Receipts and has suffered from audits.

Myrna Robinson, 550 Hamilton Ave, #240 spoke regarding her support of Dr's. Kaplan and Rosenthal's comments. She further stated that the Gross Receipts amount of revenue would be a smaller amount than in C&D.

Paula Sandas, CEO Chamber of Commerce spoke regarding the Chamber Government Action Committee(GAC) meeting last week. It was clear that many Chamber Members felt their interests were not taken into consideration. Chamber Members are interested in alternative options for a cost neutral business registry.

Council Member Klein stated that the GAC seems to have changed positions.

Ms. Sandas said that it is not a GAC change, but a change from the informal meetings hosted at the Chambers, due to the limited number of people.

Council Member Klein thought the participants were opposed to a Gross Receipts tax but were in support of a Head Count tax.

Ms. Sandas stated that the people that participated were in support of a Head Count Tax.

Council Member Klein stated he thought she said the GAC participants didn't support it.

Ms. Sandas said that not all of them do.

Council Member Klein asked if it is a divided position on the GAC.



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Ms. Sandas said that the Chamber is as she stated, they are interested in alternative options. The informational meetings were limited in number, but they tried to have even representation of the business community. The GAC is large and did not reflect every opinion. The board has not yet seen a position statement nor have they voted.

Council Member Klein stated that he felt misled.

Herb Borock, PO Box 632 spoke regarding his feelings that the structural deficit is because the City uses their tax base to support the school district which has its own tax base. Mr. Borock supports an Employee Based Tax without a cap as long as Staff uses accurate data. He stated that Stanford Clinic and Lucile Packard is a multi billion corporation which has excess of revenue over expenses, but they are income tax exempt. Stanford has over 5,000 employees, contrary to Staffs report.

John Hackmann spoke in opposition of the proposed business license tax. He saw it as an affront and imposition on freedoms. He felt it was unnecessary since it was not a huge percentage towards the budget total. He noted it produced negative feelings among the self-employed and small business community. He also spoke on the Children's Theater investigation fund. He suggested enhancing the revenue and taxation areas already in place to solve the City's budget problems.

Vice Mayor Morton clarified multiple aspects of the gross receipts methodology including the fact that confidentiality was not compromised. He noted there was not the threat of ongoing regular audits. He stated the Gross Receipt Tax adjusted automatically with inflation which was a positive for this methodology. He stressed businesses who had left the City in the past had done so for multiple reasons and not because of the proposed business license taxation. He was in full support of the Gross Receipt Tax for its simplified nature, because it taxes the type of wealth available the community and it adjusted automatically with inflation.

MOTION: Vice Mayor Morton moved, seconded by Council Member Schmid that the Finance Committee recommend to the City Council approval of the proposed Business License Tax Ordinance based on the Staff recommended Gross Receipt model for the November 2009 Ballot.

Council Member Schmid asked for clarification from Staff on the concerns raised over records auditing.



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Ms. Silver stated the City's proposed Ordinance does not include an actual audit provision. It included an inspection of records provision. Staff would administer this provision. She stated it was advisable to have this Ordinance include specific protections for confidential patient lists, attorney and client communications and other documentation typically not necessary for these types of inspections.

Mr. Keene reiterated the audits were rare, even in other jurisdictions. He stated the level of successful voluntary compliance was extremely high which made the audits unnecessary. He stated a huge expenditure on regular audits far out-spent what they would receive in return since most businesses voluntarily complied.

Council Member Schmid stated the Gross Receipts Tax was the best and most equitable way to proceed.

Council Member Klein reiterated he was in favor of a BLT, but not the Gross Receipt Tax methodology. His opposition was due to the fact the Gross Receipt Tax carried an administrative burden in enforcement. It was more equitable in where the tax burden fell. He stressed he did not want businesses to leave the City. However, he wished for the community businesses to begin thinking about what happened if there was no effective City government with the resources to repair and improve its infrastructure.

Chair Burt clarified that the per employee headcount had an inflationary adjuster as per Staff recommendations.

Mr. Perez stated they proposed a Customer Price Index (CPI) increase on the per employee tax adjusted to the nearest dollar.

Chair Burt stated he was troubled by the 10 percent administrative costs. He asked if the Document Transfer Tax by comparison had transfer costs.

Mr. Perez stated the transaction occurred during the escrow process with the title company and the submittal of the tax to the County. The County then gave the funding to the City. There was an administrative cost at that point. For staffing, the area of the most impact was in cases where a refund or exemption occurred.



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Chair Burt restated his position from the previous meeting. He was not in clear opposition of the Business License Tax and had made two recommendations: 1) A Document Transfer Tax, and 2) A Business License Tax based on the number of employees. Prior to going to Council, he wanted Staff to conduct a community survey for the comparative support of the alternative. He stated the revenue goal he saw at that time was comparable to either the business license taxes and based on the current revenue. He asked for an implementation date of July 1, 2010.

Mr. Perez stated they would make these changes and updates in the Staff report for his comments as well as those of Council Member Klein.

Chair Burt recalled the outreach meetings hosted by the Chamber of Commerce were not with the Government Action Committee. When the straw poll was taken, it was a question over which form of the business license taxing was supported. Out of fairness, he felt it was important to get this on the record. With regard to the Chamber of Commerce bringing up the possibility of a sales tax, he felt this option brought with it a great deal of outcry from the retail community. He suspected any sales taxation option was not likely to receive wide support. He again stressed the need for more information going forward to Council on the merits of the Document Transfer Tax as absolutely necessary. He noted the alternative to not having this information lent to a final decision being made based on the lack of information on where the tax community stood. A broad-based sampling was necessary to provide Council with clarity on the issue. Beyond his personal opinions and those of the Committee, he felt the sentiments of the community also needed to be heard. Finally, he noted economic times were difficult and business were suffering. Since he did not see an imminent full-scale recovery in the near future, he advised the need for some level of understanding for the public's support of the Document Transfer Tax.

MOTION FAILED: 2-2 Burt, Klein no

MOTION: Council Member Schmid moved, seconded by Vice Mayor Morton to recommend to the City Council to move forward with a Business License Tax on the November 2009 Ballot, and Staff to present both the Gross Receipts and the Employee Based methodologies to the Council.

Vice Mayor Morton concurred that it would go on to Council but wished to hear colleagues input prior to the final decision.

07/05/08

FIN:10



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Council Member Klein noted everything moved on to Council as so-noted in the Motion. He suggested the crafting of a reverse Motion regarding the Employee Based method of taxation.

SUBSTITUTE MOTION: Council Member Klein moved, seconded by Chair Burt to recommend to the City Council to move forward with a Business License Tax using the Employee Based method of taxation.

AMENDMENT: Chair Burt moved, seconded by Council Member XXX to request that Staff conduct a low cost survey to judge community support for the Business License Tax and alternately an increase in Documentation Transfer Tax.

AMENDMENT FAILED FOR LACK OF A SECOND

SUBSTITUTE MOTION FAILED: 2-2 Morton, Schmid no

MOTION FAILED: 2-2 Burt, Klein no

3. Discussion for Future Meeting Schedules and Agendas.

Next meeting scheduled for July 7, 2009.

ADJOURNED: The meeting was adjourned at 7:02 p.m.