



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Julia H. Cooper

**SUBJECT: TELECOMMUNICATIONS USERS
TAX CAP EXTENSION**

DATE: November 27, 2017

Approved

D. P. Syl

Date

12/8/17

RECOMMENDATION

Approve an ordinance amending Chapter 4.70 of Title 4 of the San José Municipal Code ("SJMC") to (1) extend the Cap Program ("Program") for the Telecommunications Users Tax ("TUT") three years through December 31, 2020; and (2) change the 2% annual increase increment to an annual increase of 3% to take effect retroactively on January 1, 2018.

OUTCOME

By amending Chapter 4.70 of the SJMC to extend the Program, participants will be provided ample time to fully prepare for the full implementation of the TUT which went into effect 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 communication 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), prepaid cards, 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 Federal, 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

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

The input received through outreach and educational efforts with large businesses helped establish a framework and criteria in developing the 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). Chapter 4.70 of Title 4 of the SJMC was amended again in 2012 to extend the Program through December 31, 2017 with updated threshold requirements (Ordinance 29151; September 25, 2012). The original 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. The threshold is approximately \$59,755 for calendar year 2017. Since the Program was extended there have been no other service users that have applied for the Program; however, in 2014-2015 one Program member split into two companies so the program now has four participants.

ANALYSIS

The Program was originally established to reduce TUT costs for the City's largest users of communications while preserving the City's TUT receipts. The 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 have experienced a significant increase in TUT without participation in the Program. The Program does include a tax receipt growth provision which automatically increases the payment obligations by 2% annually.

Staff requested data from the Program participants on November 2, 2016 to reevaluate the TUT receipts and compare the data against what the participants would be remitting should they be subject to the full extent of the TUT ordinance. The City requested gross charges for telecommunication services for the prior three years (2013, 2014, and 2015) for telecommunication services that originate or terminate in San Jose or are billed to San Jose billing addresses. An analysis was completed to determine foregone revenues associated with the Program and the impact it would have on Program participants. Collectively, the analysis resulted in estimated foregone revenue of approximately twice the total annual cap amounts paid by Program participants.

The original goal of the Program was to mitigate the tax burden of larger businesses as a direct result of the broadened coverage of the modernized TUT approved in 2008. Based on analysis conducted in 2009, it was projected that without the Program larger business could have experienced at least a doubling of their then current TUT payments. Analysis today indicates the

same holds true, that without the Program it is estimated that the four businesses currently participating in the Program would experience a doubling of their TUT obligation.

On October 25, 2017 the City's Finance Department sent out letters to all Program participants notifying them that the Program would be expiring on December 31, 2017 and that the City was open to engage in further discussion regarding the expiration of the Program. Upon discussion with City staff, all Program participants indicated that they need further time to transition into the full extent of the TUT and out of the Program.

Telecommunications Users Tax Cap Program Payment Summary

As shown in the chart below, the current participants in the 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 2017 was \$695,444. Program payments from all four companies from 2009 through 2017 totaled \$5,641,515.

<u>Calendar Year</u>	<u>TUT Cap Payments</u>
2009	\$445,166*
2010	605,426
2011	617,534
2012	629,885
2013	642,482
2014	655,332
2015	668,439
2016	681,807
2017	<u>695,444</u>
Total Paid to Date	\$5,641,515

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

TUT Revenue Summary

The City's TUT revenues remained above the base year despite the tax rate reduction from the Program's effective date of April 1, 2009 until 2014-2015 when TUT revenues ended flat when compared to the base year. City TUT revenues have ended below the base year in 2015-2016 and 2016-2017. The table below illustrates the actual revenues received for telecommunication services subject to the TUT for 2008-2009 through 2016-2017.

<u>Fiscal Year</u>	<u>TUT Revenue</u>
2008-2009	\$29.2 million*
2009-2010	32.5 million
2010-2011	30.8 million
2011-2012	31.3 million
2012-2013	32.3 million
2013-2014	32.5 million
2014-2015	29.2 million
2015-2016	27.8 million
2016-2017	<u>28.8 million</u>
Total	\$274.4 million

**TUT program implemented 4/1/09*

Should the Program sunset on December 31, 2017, the participating businesses would be subject to the broadened tax application and the City would likely receive approximately twice the amount of TUT revenue paid by the Program participants. If the Program is extended, the existing participating businesses would pay a combined total of \$716,307 in 2018 which would be subject to an increase in the annual growth rate from 2% to an annual increase of 3%.

The Program's 2009 implementation mitigated the impact of Measure K on the City's business partners and achieved its core purpose of maintaining a cooperative relationship with Program participants.

Staff recommends that the Program not be extended again and that it be discontinued on December 31, 2020.

EVALUATION AND FOLLOW-UP

A Program extension for three years will allow Program participants to adjust their business practices to prepare for the full extent of the City's TUT as expressed by Program participants in their meeting with City staff.

The program will not be renewed and will be discontinued December 31, 2020.

POLICY ALTERNATIVES

Alternative #1: Discontinue the Telecommunication Users Tax Cap Program

Pros: Generates additional General Fund revenue estimated at approximately \$716,000 per year.

Cons: Increases the TUT obligations of the four Program participants.

Reason for not recommending: 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 City's Finance Department mailed a letter on October 25, 2017 explaining the Program will not be renewed past the December 31, 2017 expiration date, but left the issue open for discussion should Program participants wish to request to further extend the Program. The four Program participants met with City senior staff and expressed that they needed additional time to adjust their business practices to absorb the full impact of the City's TUT.

PUBLIC OUTREACH

This memorandum will be posted on the City's website for the December 19, 2017 Council agenda.

COORDINATION

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

COMMISSION RECOMMENDATION/INPUT

This item does not have input from a board or commission.

COST SUMMARY/IMPLICATIONS

Based on the City staff estimates, it is anticipated that the City will forego additional TUT revenue of approximately \$716,000 annually if the Telecommunications Users Tax Cap Program is extended.

HONORABLE MAYOR AND CITY COUNCIL

November 27, 2017

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CEQA

Not a Project, File No. PP17-003, Agreements/Contracts (New or Amended) resulting in no physical changes to the environment.

/s/

JULIA H. COOPER

Director, Finance Department

For additional information, please contact Lisa Taitano, Assistant Director of Finance at (408)535-7041.