



COUNCIL AGENDA: 08/13/2019
ITEM: 19-623
FILE: 3.4

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Julia H. Cooper

SUBJECT: SEE BELOW

DATE: July 22, 2019

Approved

D. D. Syl

Date

8/2/19

SUBJECT: AMNESTY PROGRAM FOR BUSINESS TAX AND BUSINESS IMPROVEMENT DISTRICT ASSESSMENTS AND APPROVAL OF AN ORDINANCE AMENDING CHAPTER 4.76 OF THE SAN JOSE MUNICIPAL CODE TO EXPAND THE ELIGIBILITY REQUIREMENTS FOR THE FINANCIAL HARDSHIP EXEMPTIONS TO INCLUDE TRUSTS UNDER CERTAIN CIRCUMSTANCES

RECOMMENDATION

- a) Approve an ordinance authorizing the Director of Finance to administer a Business Tax Amnesty Program which forgives taxpayers who pay certain past due business taxes from liability for the remaining past due business taxes, interest, and penalties;
- b) Approve an ordinance authorizing an Amnesty Program for the Downtown and Japantown Business Improvement District Assessments, to run concurrently with the Business Tax Amnesty Program; and
- c) Approve an ordinance amending Sections 4.76.115 and 4.76.120 of Chapter 4.76 of Title 4 of the San José Municipal Code to broaden the definitions of small business and small business owner in order to expand the eligibility requirements for the Business Tax Financial Hardship Exemptions to include trusts under certain circumstances.

OUTCOME

Approval of ordinances authorizing a Business Tax Amnesty Program and Business Improvement District ("BID") Assessment Amnesty Program (collectively, the "Amnesty Program") and approval of an ordinance expanding the definition of small business and small business owner for purposes of qualifying for a Business Tax Financial Hardship Exemption will: (1) encourage all persons engaged in business in San José to obtain a business tax certificate and comply with the requirements set forth in Chapter 4.76 of the San José Municipal Code ("SJMC"); (2) educate all persons subject to business tax and/or BID Assessments regarding the

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availability of exemptions; (3) allow businesses an opportunity to update their tax parameters (i.e. employee count, square footage, rental units, etc.); and (4) expand the eligibility requirements for the Business Tax Financial Hardship Exemptions to include trusts under certain circumstances.

BACKGROUND

An Amnesty Program is a limited-time opportunity for persons engaged in business in San José, as defined in Chapter 4.76, to pay a defined amount in exchange for forgiveness of a tax or assessment liability, including penalties and interest. The Finance Department has administered two Amnesty Programs since 2006, successfully increasing compliance and revenue.

In December 2012, the Finance Department administered a nine-month Amnesty Program, generating approximately \$2,100,000 in additional revenue from approximately 7,000 taxpayers. Outreach efforts included the mailing of approximately 81,000 direct mail letters to potential business tax payers and delinquent accounts as well as broadly advertising the Amnesty Program.

Similarly, the Finance Department administered a 60-day Amnesty Program in August 2006, generating approximately \$1,300,000 in additional revenue from approximately 5,300 taxpayers. Outreach efforts included the mailing of approximately 26,000 direct mail letters to potential business tax payers and delinquent accounts as well as broadly advertising the Amnesty Program. The accomplishments of the 2012 Amnesty Program were more notable than the 2006 Amnesty Program due to the duration of the amnesty application period and the expansion of outreach to potential potential business tax payers and delinquent accounts through direct mailings.

The proposed Amnesty Program was initiated to enhance business tax revenue and increase compliance with the requirements set forth in Chapter 4.76 of the SJMC. This is especially important given the changes to the business tax structure and rates as approved with Measure G. On November 8, 2016, voters approved Measure G, a ballot measure to increase the general business tax imposed on all persons (broadly defined) engaged in business in San José. The general business tax is an excise tax based on the number of persons employed or on the number of units, lots, or square feet leased in the City, as applicable. It is not a tax on gross receipts. Prior to Measure G, most businesses paid an annual base tax of \$150 for up to 8 employees with an additional \$18 for each employee thereafter, capped at \$25,000 annually. For landlords of residential real estate, mobile home parks, or commercial real estate, the tax was based on the number of units, lots, or square feet leased in San José, capped at \$5,000 annually.

Measure G enacted an ordinance, effective on July 1, 2017, that: (1) increased the minimum base tax from \$150 to \$195 and set graduated rates for businesses with more employees paying higher rates, increased rates for landlords who pay more per unit, lot, and/or square feet of leased space;

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(2) raised the annual cap on the maximum amount of tax payable to \$150,000; and (3) instituted an annual adjustment for inflation based on the consumer price index beginning on July 1, 2018, subject to certain limits. Measure G maintained various exemptions for nonprofits and a financial hardship exemption for small business owners, while adding a financial hardship exemption for certain small businesses with limited household income. Prior to Measure G going into effect, residential landlords leasing fewer than 3 units did not pay a business tax. However, with the adoption of Measure G, the business tax is now owed by residential landlords leasing 1 or 2 units.

ANALYSIS

The proposed Amnesty Program covers the amnesty period from October 1, 2016 through March 27, 2020, capping the maximum period of unpaid business tax and BID assessment liabilities at three prior tax years, plus the current tax year. The proposed application period during which a business may file a request for amnesty is projected to commence on October 1, 2019 and conclude on March 27, 2020. During the amnesty period, the Director of Finance will be authorized to waive all penalties and interest incurred during the affected tax periods (October 1, 2016 through March 27, 2020) for businesses that have never registered, are delinquent, or need to update their tax parameters (except for taxpayers against whom a civil or criminal action for business tax liability was commenced prior to October 1, 2019).

In addition to waived penalties and interest, businesses participating in the Amnesty Program may qualify and apply for one of several business tax exemptions. Of note, the financial hardship exemption for low revenue generating small businesses and the financial hardship exemption for small business owners with limited household income are the two income-based exemptions that allow a business to obtain a business tax certificate without paying a business tax. These financial hardship exemptions are available to sole proprietorships, partnerships, and corporations that are owned by a single natural person or owned jointly by spouses or domestic partners, without other principals or employees, whose gross receipts are at or below the poverty levels set forth in Chapter 4.76.

If approved, the proposed ordinance amending Chapter 4.76 will broaden the definition of small business to include a small business owned through a trust and, likewise, will expand the definition of small business owner to include a trustee; thereby making trusts and trustees eligible for the financial hardship exemptions described above, under certain circumstances. Currently, the definitions of small business and small business owner for purposes of qualifying for a financial hardship exemption for low revenue generating small businesses or small businesses owners with limited household incomes, do not include a trust or trustee. In order to allow residential landlords whose property is in trust to be eligible for a business tax hardship exemption based on either hardship exemption described above, the definition of small business which currently includes a business owned and operated by a single natural person or owned and operated jointly by married spouses or domestic partners, will be amended to include a trust.

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Similarly, small business owner which currently includes a single natural person who owns and operates a small business with his or her spouse or domestic partner, will be amended to include a single natural person acting as a trustee either alone or with his or her spouse or domestic partner. If approved, the ordinance amending Chapter 4.76 will be in effect as of October 1, 2019.

As described above, the business tax structure and rates changed with the passage of Measure G. Below are the business tax tables applicable to the covered tax periods.

Rates prior to July 1, 2017:

Type of Business	Annual Tax	Additional Tax Increments	Cap
Residential Landlords (3 or more units)	\$150.00 up to 30 units	\$5.00 per unit over 30	\$5,000
Commercial Landlords	\$150.00 up to 15,000 sq. ft	\$0.01 per sq. ft. over 15,000	\$5,000
Mobile Home Parks	\$150.00 up to 30 lots	\$5.00 per lot over 30	\$5,000
All other Businesses	\$150.00 up to 8 (owners + employees)	\$18.00 per person over 8 (owners + employees)	\$25,000

Rates effective July 1, 2017 and subsequent years:

Employee Count

Every person engaged in business in the City shall pay a business tax based on employee count, unless the basis of the tax is otherwise prescribed in the SJMC.

Businesses: Employee Count	July 2017- June 2018	July 2018- June 2019	Effective July 1, 2019
Base Tax: 1-2 employees	\$195.00	\$197.90	\$200.85
Incremental Tax: 3-35	\$30.00	\$30.90	\$31.80
Incremental Tax: 36-100	\$40.00	\$41.20	\$42.40
Incremental Tax: 101-500	\$50.00	\$51.50	\$53.00
Incremental Tax: 501+	\$60.00	\$61.80	\$63.65
Cap	\$150,000	\$154,500	\$159,135

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Residential Rental Property Units

Every person in the City engaged in the business of renting or leasing any residential real estate shall pay a business tax based on the number of rental units held for rental.

Residential Landlords: Rental Units	July 2017- June 2018	July 2018- June 2019	Effective July 1, 2019
Base Tax: 1-2 units	\$195.00	\$197.90	\$200.85
Incremental Tax: 3-35	\$10.00	\$10.30	\$10.60
Incremental Tax: 36-100	\$15.00	\$15.45	\$15.90
Incremental Tax: 101-500	\$20.00	\$20.60	\$21.20
Incremental Tax: 501+	\$25.00	\$25.75	\$26.50
Cap	\$150,000	\$154,500	\$159,135

Commercial (Non-Residential) Rental Property Units

Every person in the City engaged in the business of renting or leasing any non-residential real estate shall pay a business tax based on the square footage of space held for rental.

Commercial Landlords	July 2017- June 2018	July 2018- June 2019	Effective July 1, 2019
Base Tax	\$195.00	\$197.90	\$200.85
Flat Incremental Tax: Per Square Foot	\$0.02500	\$0.02575	\$0.02650
Cap	\$150,000	\$154,500	\$159,135

Mobile Home Parks Rental Units

Every person in the City engaged in the business of renting or leasing any mobile home parks shall pay a business tax based on the number of lots held for rental.

Mobile Home Parks – Rental Lots	July 2017- June 2018	July 2018- June 2019	Effective July 1, 2019
Base Tax: 1-2 lots	\$195.00	\$197.90	\$200.85
Incremental Tax: 3+ lots	\$10.00	\$10.30	\$10.60
Cap	\$150,000	\$154,500	\$159,135

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Below is an example of savings to a typical business, owning the base tax only, under the proposed Amnesty Program.

Typical Business Tax Owed

<u>Years Owed</u>	<u>Tax</u>	<u>ADA Fee</u>	<u>Penalties*</u>	<u>Interest**</u>	<u>Without Amnesty</u>	<u>With Amnesty</u>
3 Prior Years + Current Year	\$743.75	\$10.00	\$75.00	\$213.82	\$1,042.57	\$753.75
2 Prior Years + Current Year	\$593.75	\$9.00	\$97.50	\$123.37	\$823.62	\$602.75
1 Prior Year + Current Year	\$398.75	\$8.00	\$98.94	\$35.62	\$541.31	\$406.75
Current Year	\$200.85	\$4.00	\$0.00	\$0.00	\$204.85	\$204.85

*Penalties are calculated on the first two delinquent months at 25% of the business tax principal.

**Interest is calculated monthly at 1.5% of the outstanding business tax principal, penalties, and interest.

As displayed in the above chart, without the Amnesty Program, a typical business that failed to pay the business tax over the previous three years would owe a total of \$1,042.57. Conversely, the Amnesty Program reduces the amount a business owed to \$753.75, with the penalties and interest of \$288.82 waived.

The Finance Department will encourage payment-in-full of outstanding tax liabilities and assessments. However, installment payment plans will be available, on an as-requested basis, for businesses owing more than one year of outstanding business tax or BID assessments. Each installment payment plan will require that one-third of the outstanding tax or assessment be paid immediately. If a business does not comply with the terms of the payment plan, the unpaid tax or assessment, including penalties and interest, retroactive to the date the tax or assessment was originally owed, will become due and payable immediately.

EVALUATION AND FOLLOW-UP

Revenues recognized from the Amnesty Program will be reported to the Public Safety, Finance and Strategic Support Committee as part of the Finance Department's Quarterly Financial Reports.

After the conclusion of the Amnesty Program, the Finance Department will proactively pursue compliance from businesses and individuals who failed to take advantage of the Amnesty Program.

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PUBLIC OUTREACH

This memorandum will be posted to the City's website for the August 13, 2019 Council meeting. In addition, the business community will be informed about the upcoming Amnesty Program through a variety of mediums, including advertisements in print media, public service announcements through radio stations, and direct-mailing of approximately 60,000 notices informing potential businesses that have never registered and delinquent taxpayers of the requirements to register and comply with Chapter 4.76 of the SJMC. Staff will also complete additional outreach to organizations and associations, including, California Apartment Association (Tri-County Division), Greater San José Hispanic Chamber of Commerce, Hispanic Chamber of Commerce Silicon Valley, Santa Clara County Association of Realtors, Silicon Valley Black Chamber of Commerce, Silicon Valley Leadership Group, Silicon Valley SCORE, Silicon Valley Small Business Development Centers of Northern California, The Silicon Valley Organization, Vietnamese American Chamber of Commerce, neighborhood business associations, local CPA firms and title companies. Staff is exploring the feasibility to conduct several community meetings to educate businesses regarding the Amnesty Program as well as work with the businesses to determine if they qualify for any exemptions.

COORDINATION

This memorandum was coordinated with the City Manager's Budget Office, Office of Economic Development, Office of the City Attorney, and representatives of the Business Improvement Districts.

COMMISSION COORDINATION/INPUT

This item does not require any input from a board or commission.

COST SUMMARY/IMPLICATIONS

The 2019-2020 general business tax estimate includes revenue of \$1.0 million that is anticipated to be generated from the Amnesty Program. Amnesty Program revenue will be monitored and future budget adjustments may be recommended, as necessary. In addition, any ongoing impacts associated with the Amnesty Program will be evaluated and incorporated into the 2020-2021 budget process.

To administer the Amnesty Program, the Finance Department will hire temporary staff to assist with processing business tax registration forms, exemption forms, payments, and incur expenses for advertising and direct mailings at a total estimated cost of \$405,000 for the duration of the program, which was initiated in 2018-2019 and is continuing into 2019-2020. Of the \$405,000

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appropriated in 2018-2019 – \$305,000 for temporary staffing and \$100,000 for a business web portal and phone system add-on services to support the Business Tax Amnesty Program – approximately \$147,000 has been expended or encumbered. Manager's Budget Addendum #36, Recommended Adjustments to the 2019-2020 Proposed Operating and Capital Budgets, rebudgeted the balance of funding, \$258,000, to continue program implementation.

Fund #	Appn #	Appn. Name	Total Appn.*	2019-2020 Proposed Budget (Page)	Last Budget Action (Date, Ord. No.)
001	0492	NP/EQUIP - FINANCE DEPT	\$2,433,390	VIII-136	06/18/2019, 30286

* Reflects Adopted Budget, as approved by the City Council on June 18, 2019.

CEQA

Not a Project, File No. PP17-004, Government Funding Mechanism, or Fiscal Activity with no commitment to a specific project which may result in a potentially significant physical impact on the environment.

/s/

JULIA H. COOPER
Director of Finance

For questions, please contact Rick Bruneau, Deputy Director of Finance, at (408) 535-8310.