



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Julia H. Cooper

SUBJECT: SEE BELOW

DATE: September 17, 2020

Approved

Date

9/17/20

**SUBJECT: TEMPORARY EXPANSION OF BUSINESS TAX FINANCIAL
HARDSHIP EXEMPTIONS**

RECOMMENDATION

Approve an ordinance amending Chapter 4.76 of Title 4 of the San José Municipal Code to add a new Section 4.76.345.6 to temporarily expand, retroactive to October 1, 2020, eligibility for the existing financial hardship exemptions for low-revenue generating small businesses and small business owners with limited household incomes to include all persons engaged in business in the City who satisfy certain financial hardship requirements.

OUTCOME

The proposed ordinance would temporarily extend the eligibility for the existing business tax financial hardship exemptions to any business that meets certain income-based requirements.

BACKGROUND

There are over 95,000 active businesses registered to engage in business in San José. The City of San José (“City”) offers a variety of business tax exemptions, with most benefiting from the financial hardship exemptions. Of the 95,000 active businesses, over 21,000 are exempt from paying business tax, with nearly 15,000 qualifying for one of the financial hardship exemptions.

The COVID-19 pandemic has affected businesses differently with many experiencing reduced business activity due to the public health restrictions. The proposed recommendation expands the eligibility criteria for businesses to qualify for a financial hardship exemption and will provide financial relief for businesses affected by COVID-19. Due to the uncertainty of the COVID-19 pandemic, on March 24, 2020, staff recommended, and City Council approved, an extension of the Business Tax Amnesty Program (“Amnesty Program”) through June 30, 2020. On June 23,

2020, City Council approved the second extension of the Amnesty Program through September 30, 2020. By extending the Amnesty Program through September 30, 2020, businesses benefit from deferred payment of business tax, without penalty or interest applied. As the Amnesty Program is set to expire on September 30, 2020, the recommendation will provide financial hardship relief for an expanded number of businesses.

ANALYSIS

San José Municipal Code (“SJMC”) provides for two income-based exemptions that allow a business to obtain a business tax certificate without paying a business tax. The financial hardship exemption for low-revenue generating small businesses is available to small business owners where the gross receipts of the small business do not exceed two times the poverty level established by the United States Department of Health and Human Services. The financial hardship exemption for small business owners with limited household income is available to small business owners where the adjusted gross income of the small business owner and his or her spouse/domestic partner’s income do not exceed four times the poverty level. Each financial hardship exemption is available to small business owners that are owned by a single natural person or owned jointly by spouses or domestic partners, without other principals or employees.

The proposed recommendation would extend the eligibility for the existing financial hardship exemptions to any business, in addition to small business owners, that meets the income requirements. The temporary expansion of the financial hardship exemptions will be effective between October 1, 2020 through September 30, 2021. It is estimated up to 6,000 businesses and residential landlords may be eligible for the financial hardship based upon the expanded eligibility requirements. If all businesses apply and meet the income-based requirement, the 2020-2021 revenue estimate would be reduced by approximately \$1.0 million. Further, the Finance Department plans to modify its practices and policies for prequalifying financial hardship exemptions as well as extend repayment terms for payment plans.

Modifying exemption prequalification and approval practices

The normal process for prequalifying and approving a business for a financial hardship exemption is to review income reported on the most recently filed federal income tax return. Since the COVID-19 pandemic and ensuing public health orders have dramatically affected businesses in 2020, the normal process would disqualify many businesses based upon the income reported on their 2019 tax returns. In response, the Finance Department will allow businesses to apply for a financial hardship exemption based on their anticipated 2020 income. During the next year’s business tax renewal cycle, Finance staff will verify actual 2020 income against the filed federal income tax returns. In the event a business was granted a financial hardship exemption based on their anticipated 2020 income, but in fact earned more than the allowable income threshold, the business will be back-billed the business tax for the 2020 year. The business will have 30 days from the billing date to pay the back taxes before any penalties or interest are applied.

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Lengthening repayment terms

Businesses will continue to have the option of requesting a payment plan to make installment payments over time, rather than paying the full balance all at once. The Finance Department will extend the repayment terms from a maximum repayment period of three (3) months to up to twelve (12) months.

EVALUATION AND FOLLOW-UP

Business tax revenues will be reported to the Public Safety, Finance and Strategic Support Committee as part of the Bi-Monthly Financial Reports as well as the 2020-2021 Mid-Year Review, which will be brought forward for City Council consideration in February 2021. If continued relief is needed beyond September 30, 2021, the Finance Department may return to City Council with an extension of the temporary expansion of business tax financial hardship exemptions.

CLIMATE SMART SAN JOSE

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

PUBLIC OUTREACH

This memorandum will be posted to the City's website for the September 29, 2020 Council meeting. In addition, the business community will be informed about the temporary expansion of the financial hardship exemptions through messages on the Finance Department's website and phone systems. Lastly, the Finance Department will provide the Mayor's Office and City Council Offices a written summary of the actions that may be distributed through their networks.

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 RECOMMENDATION/INPUT

No commission recommendation or input is associated with this action.

COST SUMMARY/IMPLICATIONS

The 2020-2021 Adopted Budget included business tax revenues of \$25.7 million, representing a decrease by approximately 8% from the 2019-2020 estimate. This drop reflects a 10% anticipated reduction as a result of the COVID-19 pandemic's impact on local businesses, offset by an increase of 2% for the annual CPI adjustment. It is estimated that up to 6,000 businesses and residential landlords may be eligible for the expanded financial hardship eligibility criteria which would reduce the 2020-2021 revenue estimate by approximately \$1.0 million. The business tax revenue will continue to be monitored, and future budget adjustments may be brought forward for City Council consideration, as necessary.

POLICY ALTERNATIVES

The Finance Department analyzed several alternatives to provide financial relief for businesses affected by COVID-19.

Alternative #1: Temporary exemption for businesses with Employee Counts/ Rental Units under a certain number

Pros: This alternative would provide a broad exemption for any business with two or less employees and any residential landlord with one rental unit. It has the potential to assist approximately 28,000 businesses and landlords operating in San José.

Cons: This alternative would significantly impact the City's business tax revenue, with a projected reduction in the range of \$4.7 to \$8.8 million.

Reason for not recommending: While this alternative would provide business tax relief to many businesses and landlords, the revenue loss to the City would exacerbate the general fund budget challenges. Additionally, this broad exemption could benefit businesses and residential landlords that otherwise have not seen a business activity reduction due to COVID-19.

Alternative #2: Temporary exemption for businesses with Gross Receipts under a certain threshold

Pros: This alternative would provide an exemption for any business with gross receipts under \$50,000. It has the potential to assist approximately 15,000 businesses and landlords operating in San José.

Cons: This alternative would significantly impact the City's business tax revenue, with a projected reduction in the range of \$2.0 to \$3.2 million.

Reason for not recommending: While this alternative would provide business tax relief to many businesses and landlords, the revenue loss to the City would exacerbate the general fund budget challenges. Additionally, this increased income threshold would render most residential landlords with one or two units exempt and erase the progress made with Measure G (2016) to expand the tax base. This exemption could benefit businesses and residential landlords that otherwise have not seen a business activity reduction due to COVID-19.

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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.