



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kim Walesh
Julia H. Cooper

SUBJECT: SEE BELOW

DATE: February 26, 2016

Approved

Date

2/26/16

SUBJECT: PRELIMINARY ANALYSIS AND DISCUSSION OF CITIZEN-INITIATED GROSS RECEIPTS TAX BALLOT MEASURE, AND OPTIONS FOR UPDATING CURRENT BUSINESS TAX

RECOMMENDATION

Consideration of the preliminary analysis of the citizen-initiated Gross Receipts Tax Ballot Measure and preliminary review and discussion of City options for updating the current Business Tax.

BACKGROUND

On January 13, San Jose residents Steven Hunt, Kathleen Krenek, and Scott Myers-Lipton filed with the City Clerk a Notice of Intent to circulate a petition within the City of San José for the purpose of modernizing the business tax. The Notice of Intent to Circulate can be found here <http://www.sanjoseca.gov/DocumentCenter/View/53694>.

As required by California Elections Code Section 9203, on January 26 the City Attorney provided the residents with the ballot title and summary which can be found here <http://www.sanjoseca.gov/DocumentCenter/View/53694>

On February 2, City Council took the following actions:

- Approved the recommendation to study the proposed Gross Receipts Tax Ballot Measure contained in the Memo from Councilmembers Rocha and Peralez dated January 14, 2016.
- Directed staff to conduct a limited preliminary review of the City's options for updating the current Business Tax in Chapter 4.76 of the San Jose Municipal Code as contained in

the Supplemental Memo from Councilmembers Rocha and Peralez dated January 29, 2016.

The City Manager was directed to perform the analysis as expeditiously as possible, and with the use of consultant experts if required.

ANALYSIS

This analytic project was scoped, managed, and completed by a staff team (in conjunction with Keyser Marston as discussed below) from the Finance Department, City Attorney's Office, Office of Economic Development, and City Manager's Office.

Keyser Marston, a firm with experience in a range of services to local agencies including real estate advisory services, fiscal analysis and municipal services financing was hired to conduct the impact assessment of the proposed Gross Receipts Tax Measure, including the revenue estimate, the impact by sector and size of firm, and the specific impact on eight prototype examples. Keyser Marston also reviewed the analysis prepared by staff. The cost of Keyser Marston's assistance was \$24,000.

The attached presentation includes the following three sections:

- I. Current Business Tax - describes San Jose's current employment-based business tax, its history, and comparisons with other Bay Area and Santa Clara County cities.
- II. Gross Receipts Tax Citizen Ballot Measure - describes the proposed ballot measure, revenue projection, financial impact projection on various types of businesses, and identifies implementation, administrative, and other considerations.
- III. Options for Updating Current Business Tax - identifies options for changing San Jose's current employment-based Business Tax.

This material will be presented at the March 8, 2016 Council meeting by Keyser Marston and City staff.

EVALUATION AND FOLLOW-UP

Additional follow-up will be based on the direction from the City Council.

HONORABLE MAYOR AND CITY COUNCIL

February 26, 2016

Subject: Preliminary Analysis and Discussion of Gross Receipts Tax Ballot Measure

Page 3

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the March 8, 2016 Council Meeting.

COORDINATION

This report has been coordinated with the City Attorney's Office and the City Clerk's Office.

CEQA

Not a Project, File No. PP10-069(a), Staff Reports that involve no approvals of any City Actions.

/s/

KIM WALES
Deputy City Manager
Director of Economic Development

/s/

JULIA H. COOPER
Director of Finance

For questions, please contact Wendy Sollazzi, Division Manager, Department of Finance, at (408) 535-7005.

San José's Business Tax:

Preliminary Analysis of Gross Receipts Tax Ballot Measure, Options for Updating Current Business Tax

February 26, 2016



City Council Direction (2/2/16)

Conduct:

- **Preliminary analysis of citizen-initiated Gross Receipts Tax Ballot Measure**
- **Preliminary review of options for updating the City's current employment-based Business Tax**

Background:

On January 13, San José residents Steven Hunt, Kathleen Krenek, and Scott Myers-Lipton filed with the City Clerk a Notice of Intent to circulate a petition within the City to place a proposed gross receipts tax on a future ballot. If the measure qualifies for the November 8, 2016 ballot and is approved by a majority of voters, it will take effect January 1, 2018.

I. Current Business Tax

Structure History Comparisons

3

Current Business Tax Structure & Rate

Employment Based Model

Types of Business	Annual Tax	Additional Tax Increments	Not to Exceed	Number of Registered Businesses	Annual Tax Revenue
Most Businesses	\$150 up to 8 employees	\$18 per employee over 8	\$25,000 ⁽¹⁾	67,000	\$10.5 M
Commercial Landlords	\$150 up to 15,000 sq. ft.	\$.01 per sq. ft. over 15,000	\$5,000 ⁽²⁾	3,600	\$1.3 M
Residential Landlords	\$150 up to 30 units	\$5 per unit over 30	\$5,000 ⁽²⁾	3,800	\$0.8 M
Mobile Home Parks	\$150 up to 30 units	\$5 per lot over 30	\$5,000	50	\$0.05 M
Totals				74,450⁽³⁾	\$12.7 M

⁽¹⁾ 12 registered businesses are at the \$25,000 cap

⁽²⁾ 24 registered landlords are at the \$5,000 cap

⁽³⁾ Total count includes approximately 13,000 exempt businesses, but does not include approximately 11,000 branch locations

4

History of San José Business Tax

- **Adopted in 1964**
- **Council last modified 30 years ago**
 - **1984-Base rate increased from \$30 to \$75**
 - **1986-Base rate increased from \$75 to \$150**
- **Voters rejected an inflationary adjustment in 1998**

5

Recent History

- **Recommendation of General Fund Structural Deficit Elimination Plan Stakeholder Group (2008):**
 - **“Restructure Business Tax rates to modernize and reflect current business profile”**
 - **Revenue estimate: +\$1 million-\$7 million annually**
- **Recommendation of Fiscal Reform Plan (2011) as one of four Revenue Strategies to pursue after implementation of other fiscal reforms**
 - **Revenue estimate: at least +\$5 million annually**
- **Tested high-level concept in Community Budget Priorities Surveys 2008 to 2012; results varied**

6

Recent History

February 13, 2012 City Council Budget Planning Study Session

- **Shared benchmark data: San José in mid-range of Santa Clara County cities**
- **Provided two options for modernization: (1) change current employment-based tax or (2) change to gross receipts**
- **Did not recommend gross receipts option: “very significant effort to change tax base; is more intrusive and less competitive model”**
- **Directed to conduct initial outreach to stakeholders**

7

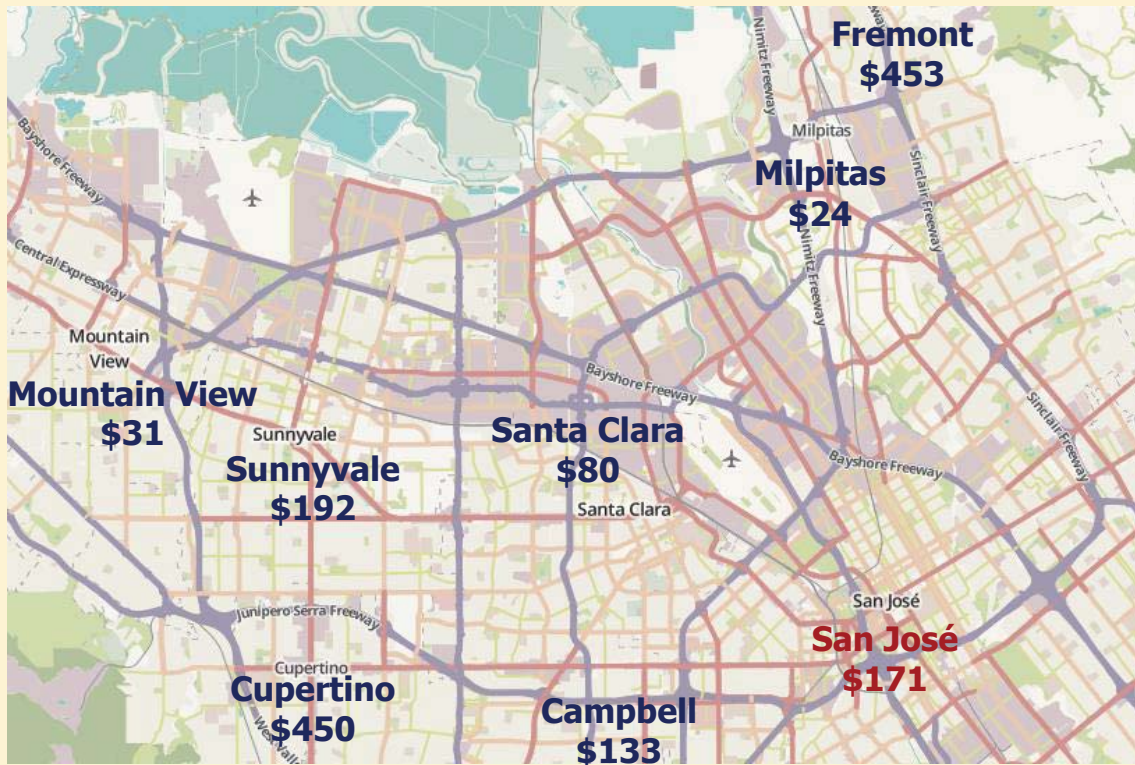
Comparative Analysis

San José’s business tax revenue per firm is:

- **In the mid-range of South Bay cities**
- **Far below San Francisco and Oakland**

8

South Bay Region Comparison: Average Business Tax Per Business



9

South Bay Region Comparison

City	Tax Basis	Admin Fee	Annual Revenue Generated	Number of Businesses	Average Tax Revenue Per Business
San José	Unit	No	\$12.7 M	74,450	\$171
Campbell	Unit	No	\$0.7 M	5,000	\$133
Cupertino	Flat Rate	No	\$0.9 M	2,000	\$450
Fremont	Gross Receipts	\$30	\$8.6 M	19,000	\$453
Los Gatos	Unit	\$25	\$1.3 M	4,000	\$313
Milpitas	Unit	\$50	\$0.7 M	2,800	\$24
Morgan Hill	Unit	\$60	\$0.2 M	3,200	\$57
Mountain View	Flat Rate	No	\$0.2 M	6,500	\$31
Santa Clara	Unit	No	\$1.0 M	12,000	\$80
Sunnyvale	Unit	No	\$1.5 M	7,800	\$192

Notes

- (1) Unit taxation is driven by number of employees, apartments, lots, square footage, etc. – or some combination thereof
- (2) Flat Rate taxation is a single tax amount applied to all business regardless of size
- (3) Gross Receipts taxation is driven by top line revenue of each business

10

Bay Area Large City Comparison

	San José	San Francisco	Oakland
Tax Basis	Unit	Gross Receipts	Gross Receipts
Tax Revenue Generated	\$12.7 M	\$600 M	\$70M
Average Tax Revenue Per Business	\$171	\$6,000	\$1,077

Notes

- (1) Unit taxation is driven by number of employees, apartments, lots, square footage, etc. – or, some combination thereof
- (2) Gross Receipts taxation is driven by top line revenue of each business

11

II. Gross Receipts Tax Ballot Measure

Description
Revenue Projection (Keyser Marston)
Impact (Keyser Marston)
Other Analysis

12

Gross Receipts Tax Ballot Measure

- **Tax on annual gross receipts from activities in San José**
- **Tax rate differs by industry classification**
 - **\$0.60, \$0.90, or \$1.20 per \$1,000 in gross receipts**
- **Businesses with gross receipts of \$1M or less (adjusted annually for inflation) are exempt**
- **No Cap**

13

Impacts on Existing Business Tax

- **Base tax of \$150 remains for businesses and landlords**
- **Businesses exempt under current business tax remain exempt from base business tax of \$150**
- **Incremental increases are suspended (e.g. \$18 per employee over 8 employees)**
- **No inflation index on \$150 base tax**

14

Two Options for Administrative Offices

- **Businesses that have administrative offices (HQ) in San José can elect either gross payroll tax or gross receipts tax**
- **Administrative office tax rate: 0.26% of gross payroll attributable to San José**

15

Other GRT Provisions

- **Tax revenue goes to General Fund**
- **Effective Date: January 1, 2018 (subject to majority voter approval)**
- **City Council prohibited from making amendments to provide any new exemptions, exclusions, suspensions, etc.**
 - **One exception: may exempt new businesses for up to 24 months or make necessary clarifications or corrections for effective implementation**

16

ANALYSIS OF THE “MODERNIZATION OF THE BUSINESS TAX ORDINANCE”

PREPARED FOR: CITY OF SAN JOSE
PREPARED BY: KEYSER MARSTON ASSOCIATES
FEBRUARY 24, 2016



17

PRESENTATION OVERVIEW

- I. Gross Receipts Projection
- II. Business Prototypes
- III. Questions and Comments

Note:

Nothing in this presentation should be construed as providing specific advice to any taxpayer regarding the potential impact of the Gross Receipts Tax (GRT) on their business in San Jose. The information contained herein is provided for discussion purposes only. Taxpayers are encouraged to seek advice of their own accountants and legal advisors on the impact of the GRT on their respective businesses.

BUSINESS TAX COMPARISON

	Chapter 4.76 Business Tax	"Modernization of the Business Tax Ordinance"
Businesses Subject To Tax	BUS: Businesses located in or conducting businesses in City (>5 days) RES & COMM: Lessors of property in City	BUS: Businesses located in or conducting business in City (7+ days) RES & COMM: Lessors of property in city
Base Tax	\$150 per entity	\$150 per entity (upholds Chap. 4.76 base tax)
Incremental Tax	BUS: \$18/ employee after 8 employees (FTEs) RES: \$5 / unit after 30 units COMM: \$.01 PSF after 15,000 square feet	.06% - .12% of gross revenues derived from City. Payroll tax option for corporate headquarters. Deductions apply.
Tax Cap	BUS: \$25,000 RES & COMM: \$5,000	None
Exemptions To Incremental Tax Based on Size	BUS: 8 or fewer employees RES: 30 or fewer units. COMM: 15,000 SF and under.	BUS & COMM: < \$1M in eligible GR RES: < 4 units
Combined Reporting	BUS: Yes, for operations falling under a single entity with combined bank accounts/ records. RES & COMM: Yes.	BUS & COMM: Yes, if permitted to file a combined return under State tax law. RES: No. By building.
Other Exemptions	Non-Profits, Others Exempt Per State Law.	Non-Profits, Others Exempt Per State Law.
KEY	BUS: Businesses. RES = Residential Landlords	COMM = Commercial Landlords.

I. GROSS RECEIPTS (GR) TAX PROJECTION

Objective:

Estimate gross receipts tax impact by industry and business size

PROJECTION APPROACH

- Determine industry classification and size of businesses currently active in City using online Business Tax Directory (BTD)¹
- Where necessary, combine records of multiple establishments with a common owner (“related entities”)
- For each business:
 - Determine corresponding tax rate and gross receipts formula
 - Use IMPLAN to estimate GR based on industry-specific factors
 - Apply exemptions and deductions stipulated in the ordinance
 - Calculate tax due on eligible GR
 - Compare to existing business tax bill
- Aggregate results by industry and business size

¹ Available at: <http://www3.csjfinance.org/bizlic/bizlicForm.asp>

TAX RATES AND GR FORMULAS (1/2)

NAICS	Industry	Tax Rate	GR Calculation
11-21	Agriculture/Natural Resources*	0.12%	Apportionment
22	Utilities	0.09%	Allocation + Apportionment
23	Construction	0.09%	Allocation + Apportionment
31-33	Manufacturing	0.06%	Allocation + Apportionment
42	Wholesale Trade	0.06%	Allocation + Apportionment
44-45	Retail Trade	0.06%	Allocation + Apportionment
48-49	Transportation & WH	0.06%	Allocation + Apportionment
51	Information	0.06%	Allocation + Apportionment
53	Real Estate and Leasing	0.09%	Local Properties
54-56	Prof., Mgmt., & Admin. Services	0.12%	Apportionment
61-62	Education and Health Services	0.12%	Apportionment
71	Arts, Entertainment, and Recreation	0.09%	Apportionment
52	Finance and Insurance	0.12%	Apportionment
721	Accommodation	0.09%	Local Properties
722	Food Services and Drinking Places	0.06%	Allocation + Apportionment

TAX RATES AND GR FORMULAS (2/2)

NAICS	Industry	Tax Rate	GR Calculation
811-814	Other Services	0.06%	Apportionment
Various	Biotechnology	0.06%	Allocation + Apportionment
Various	Renewable Energy	0.06%	Allocation + Apportionment
Various	Unclassified*	0.12%	Apportionment
99	Exempt Industries	n/a	n/a
	Administrative Offices (Option)	.26%	Local Payroll

Source: Modernization of Business Tax Ordinance

* Not specifically identified in ordinance. KMA assumption.

SUMMARY OF GR TAX IMPACT

	Current Tax*	Proposed Tax**	Net Change	Multiplier
Businesses	\$10.6 M	\$48.9 M	\$38.4 M	4.6X
Commercial Landlords	\$1.3 M	\$2.3 M	\$1.0 M	1.8X
Residential Landlords	\$0.8 M	\$1.2 M	\$0.3 M	1.5X
Total	\$12.7 M	\$52.4 M	\$39.7 M	4.1X

* Current tax by category varies slightly from estimate prepared by City of San Jose due to differences in the grouping of certain businesses (hotels, for example). Estimate of total current tax is the same.

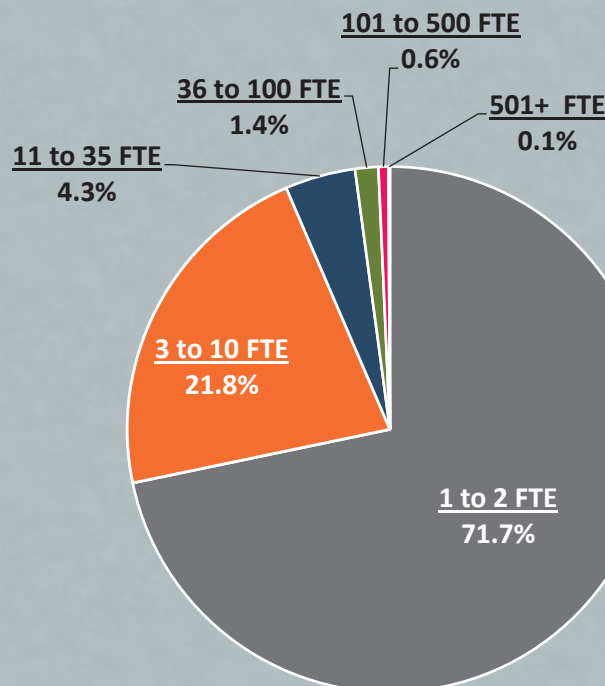
**Includes \$150 base tax which is preserved under proposed ordinance.

KEY FINDINGS

- Fourfold increase in business tax revenues projected, from approximately \$13 million to \$52 million
- Businesses (as opposed to property landlords) would be responsible for vast majority of increase
 - 88% of businesses would pay the same or less
 - 12% would pay more
 - Average increase = ~\$6,000/firm (for impacted firms)
- Largest tax increases would be experienced by firms with 501+ employees, particularly in manufacturing and retail sectors
 - Aggregate tax paid by firms with 501+ FTEs to increase from <\$1M to >\$14M; share of total City business tax revenues would increase from 8% to 29%
 - Share of business tax revenues paid by manufacturing and retail firms would increase from 22% to 41%

COMPOSITION OF BUSINESS TAXPAYERS

DISTRIBUTION OF BUSINESS TAXPAYERS BY SIZE



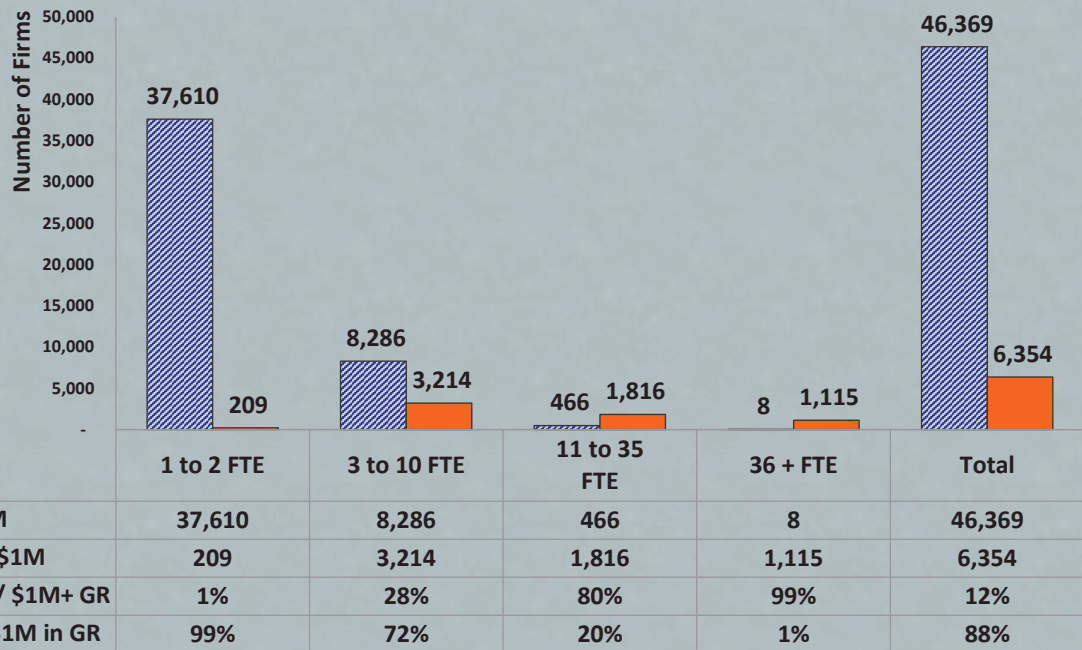
Number of Business Taxpayers:
52,724*

* Businesses currently subject to business tax. Excludes ~13,000 businesses exempt from base tax, as well as residential and commercial landlords (presented separately).

COMPOSITION OF BUSINESS TAXPAYERS

FIRMS ABOVE AND BELOW \$1M IN ELIGIBLE GROSS RECEIPTS* (ESTIMATED)

* Among businesses subject to base tax. Excludes residential and commercial landlords and ~13,000 exempt businesses.



PREPARED FOR THE CITY SAN JOSE BY KEYSER MARSTON ASSOCIATES FEBRUARY 25, 2016

27

BUSINESS TAX IMPACT BY FIRM SIZE

Firm Size	Existing Tax (\$000s)	Proposed Tax (\$000s)*	Net Change (\$000s)	Factor Change
1 to 2 Employees	\$5,321	\$5,542	\$221	1.0X
3 to 10 Employees	\$1,735	\$6,563	\$4,829	3.8X
11 to 35 Employees	\$774	\$6,264	\$5,490	8.1X
36 to 100 Employees	\$772	\$6,168	\$5,396	8.0X
101 to 500 Employees	\$1,118	\$9,998	\$8,880	8.9X
501+ Employees	\$839	\$14,380	\$13,541	17.1X
Total**	\$10,559	\$48,915	\$38,356	4.6X

* Includes \$150 base tax.

** Among businesses subject to base tax. Excludes residential and commercial landlords and ~13,000 exempt businesses.

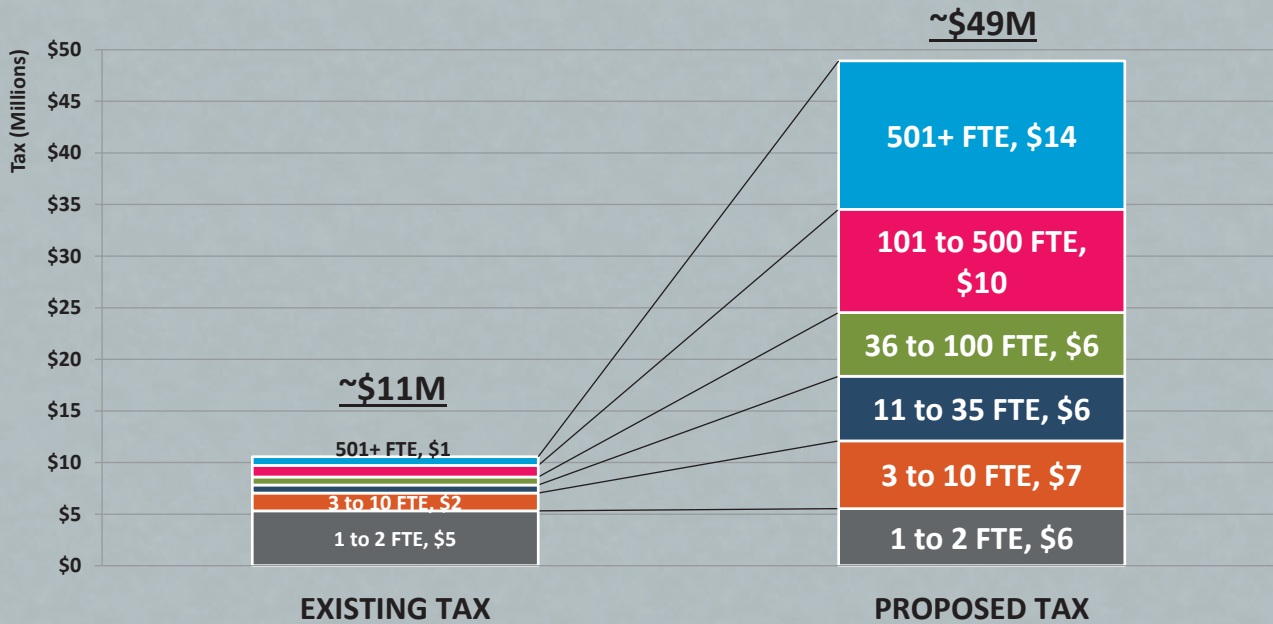
PREPARED FOR THE CITY SAN JOSE BY KEYSER MARSTON ASSOCIATES FEBRUARY 25, 2016

28

TOTAL TAX BY FIRM SIZE

EXISTING VS. PROPOSED TAX BY FIRM SIZE (\$ MILLIONS)*

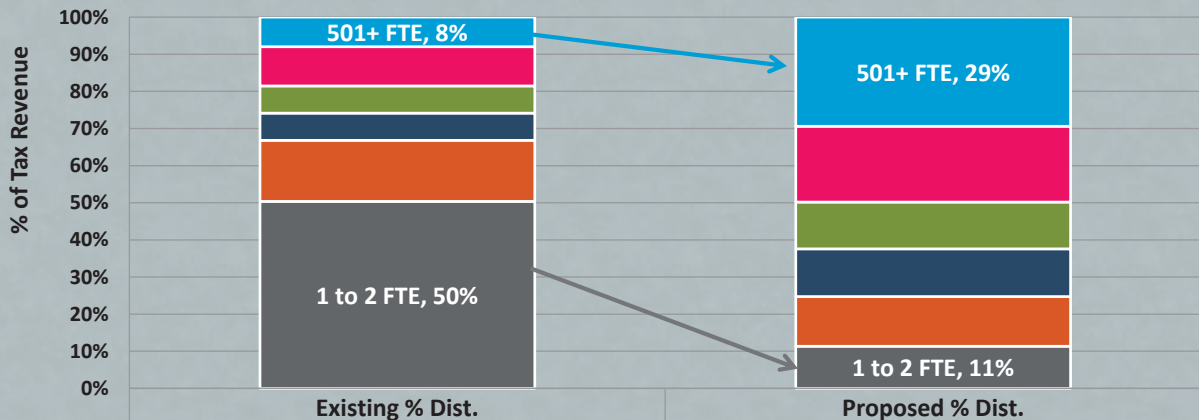
* Among businesses subject to base tax. Excludes residential and commercial landlords and ~13,000 exempt businesses.



TAX DISTRIBUTION BY FIRM SIZE

EXISTING VS. PROPOSED TAX DISTRIBUTION BY FIRM SIZE* (% OF TAX REVENUE)

* Among businesses subject to base tax. Excludes residential and commercial landlords and ~13,000 exempt businesses.

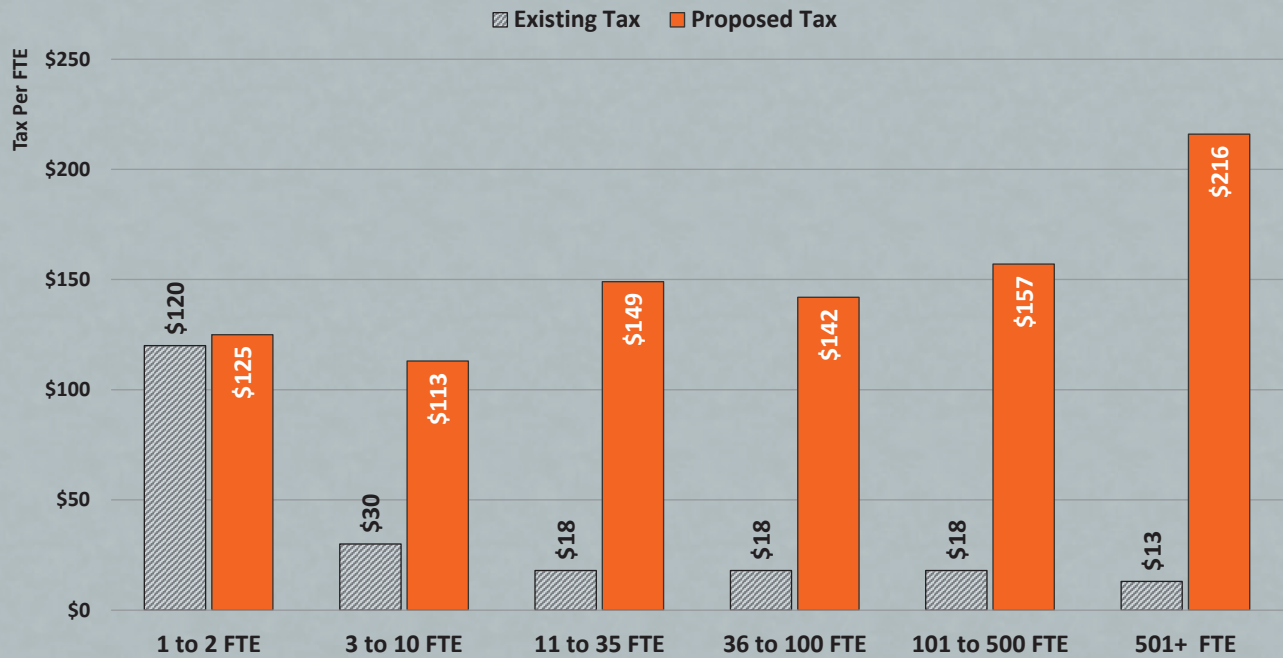


	Existing % Dist.	Proposed % Dist.
501+ FTE	8%	29%
101 to 500 FTE	11%	20%
36 to 100 FTE	7%	13%
11 to 35 FTE	7%	13%
3 to 10 FTE	16%	13%
1 to 2 FTE	50%	11%

AVERAGE TAX PER FTE

AVERAGE BUSINESS TAX PER FTE*: EXISTING AND PROPOSED (BY SIZE)

* Among businesses subject to base tax. Excludes residential and commercial landlords and ~13,000 exempt businesses.



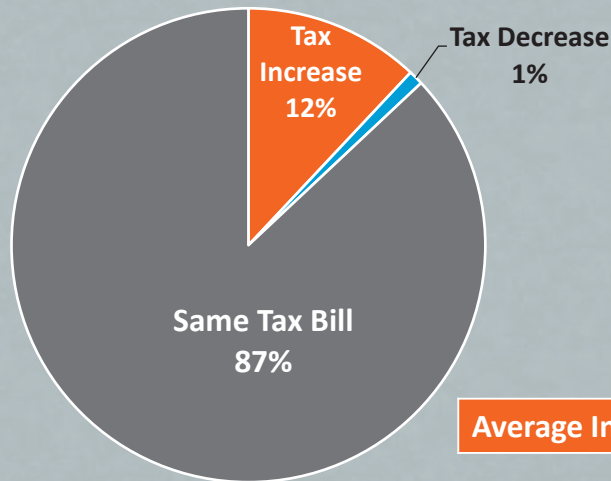
PREPARED FOR THE CITY SAN JOSE BY KEYSER MARSTON ASSOCIATES FEBRUARY 25, 2016

31

% OF FIRMS WITH TAX IMPACT

SHARE OF FIRMS WITH TAX INCREASE/DECREASE UNDER PROPOSAL (BUSINESSES SUBJECT TO BASE TAX)*

* Excludes residential and commercial landlords and ~13,000 exempt businesses.



Average Increase \$6,058

For 12% of firms with tax increase, average annual increase is \$6,058.

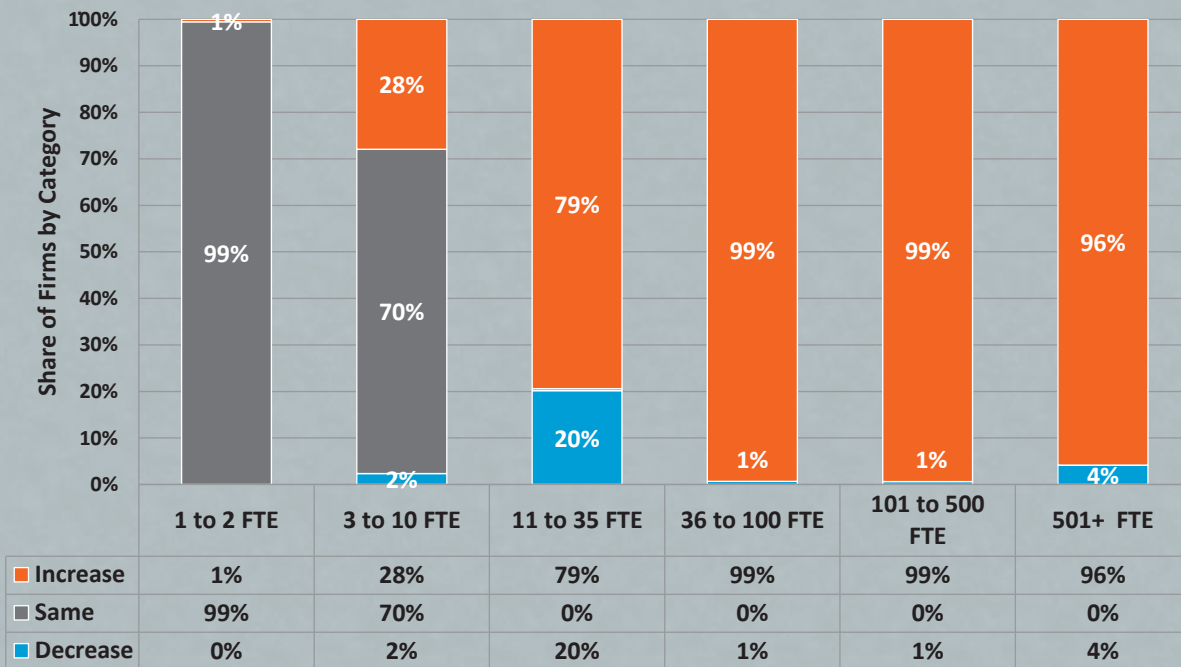
PREPARED FOR THE CITY SAN JOSE BY KEYSER MARSTON ASSOCIATES FEBRUARY 25, 2016

32

TAX IMPACT BY SIZE

% OF FIRMS EXPERIENCING TAX INCREASE/DECREASE BY SIZE*

* Among businesses subject to base tax. Excludes residential and commercial landlords and ~13,000 exempt businesses.



PREPARED FOR THE CITY SAN JOSE BY KEYSER MARSTON ASSOCIATES FEBRUARY 25, 2016

33

TAX IMPACT BY SIZE

Firm Size	Firms	% w/ tax decrease	% w/ tax increase	% w/ same tax bill	Avg. decrease \$	Avg. increase \$
1 to 2 Employees	37,819	0%	1%	99%	-	\$1,056
3 to 10 Employees	11,500	2%	28%	70%	\$(35)	\$1,506
11 to 35 Employees	2,282	20%	79%	0%	\$(111)	\$3,058
36 to 100 Employees	753	1%	99%	0%	\$(1,214)	\$7,222
101 to 500 Employees	322	1%	99%	0%	\$(6,021)	\$27,787
501+ Employees	48	4%	96%	0%	\$(9,837)	\$294,793
Total*	52,724	1%	12%	87%	\$(132)	\$6,058
3+ Employees	14,905	5%	41%	54%	\$(132)	\$6,228
11+ Employees	3,405	14%	86%	0%	\$(189)	\$11,413

* Among businesses subject to base tax. Excludes residential and commercial landlords and ~13,000 exempt businesses.

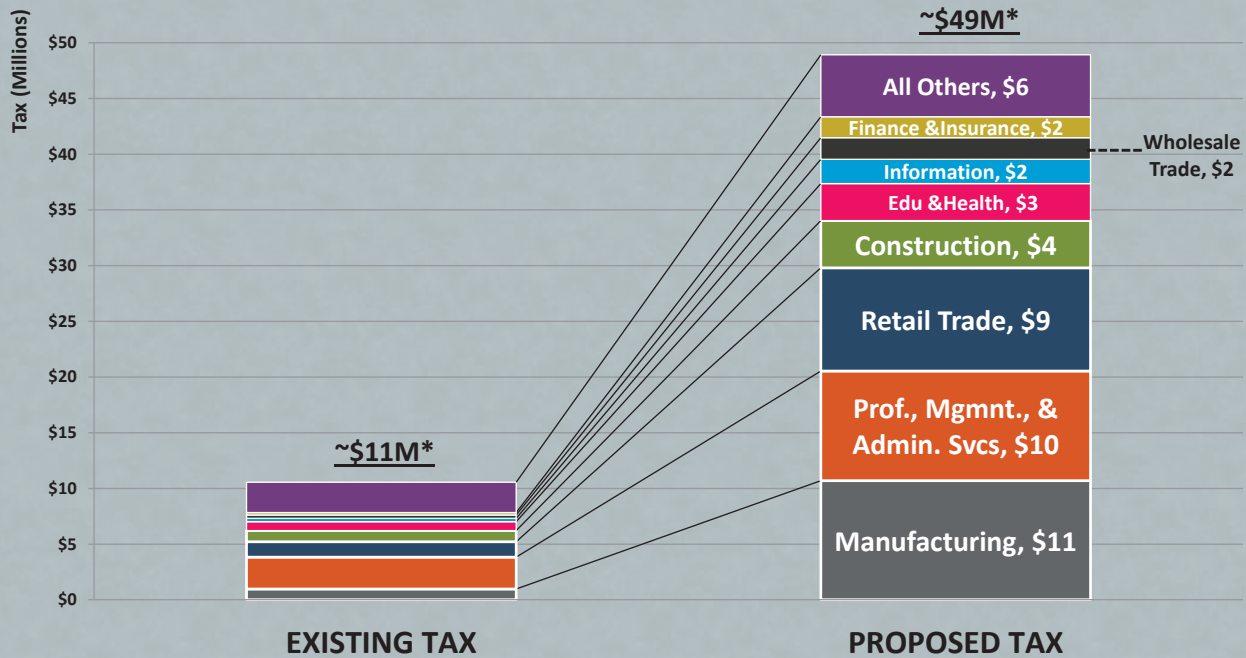
PREPARED FOR THE CITY SAN JOSE BY KEYSER MARSTON ASSOCIATES FEBRUARY 25, 2016

34

TAX IMPACT BY INDUSTRY

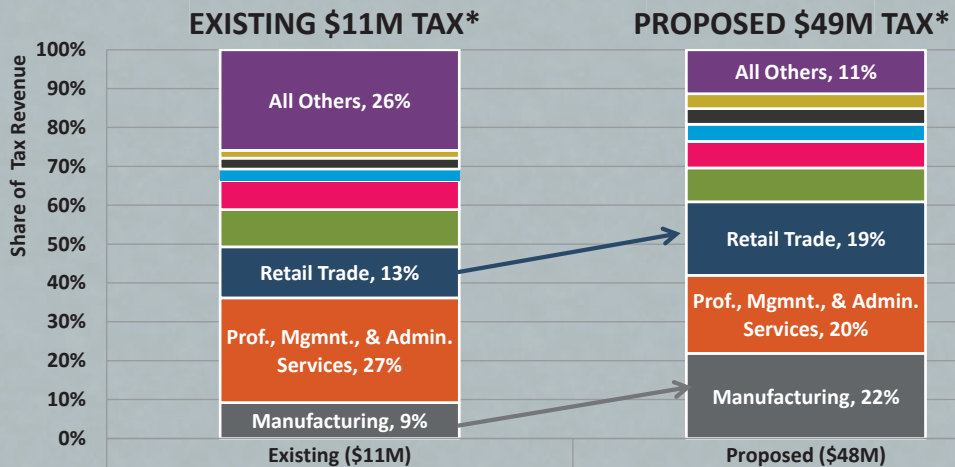
EXISTING VS. PROPOSED TAX BY INDUSTRY* (\$ MILLIONS)

* Among businesses subject to base tax. Excludes residential and commercial landlords and ~13,000 exempt businesses.



TAX DISTRIBUTION BY INDUSTRY

* Businesses subject to base tax. Excludes residential and commercial landlords and ~13,000 exempt businesses.



	Existing (\$11M)	Proposed (\$48M)
All Others	26%	11%
Finance and Insurance	2%	4%
Wholesale Trade	3%	4%
Information	3%	4%
Education and Health Services	7%	7%
Construction	10%	9%
Retail Trade	13%	19%
Prof., Mgmt., & Admin. Services	27%	20%
Manufacturing	9%	22%

TAX IMPACT BY INDUSTRY

NAICS	Industry	Existing Tax (\$000s)	Proposed Tax (\$000s)*	Net Change (\$000s)	Factor Change
11-21	Agriculture/Natural Resources	\$7	\$13	\$7	1.9X
22	Utilities	\$22	\$914	\$892	41.5X
23	Construction	\$1,010	\$4,250	\$3,240	4.2X
31-33	Manufacturing	\$973	\$10,696	\$9,723	11.0X
42	Wholesale Trade	\$301	\$1,940	\$1,639	6.4X
44-45	Retail Trade	\$1,384	\$9,262	\$7,878	6.7X
48-49	Transportation & WH	\$327	\$686	\$359	2.1X
51	Information	\$311	\$2,187	\$1,875	7.0X
53	Real Estate and Leasing	\$331	\$840	\$509	2.5X
54-56	Prof., Mgmt., & Admin. Svcs.	\$2,848	\$9,831	\$6,983	3.5X
61-62	Education and Health Svcs.	\$789	\$3,322	\$2,533	4.2X
71	Arts, Entertainment, and Rec.	\$173	\$407	\$234	2.4X
52	Finance and Insurance	\$210	\$1,884	\$1,674	9.0X
721	Accommodation	\$49	\$293	\$244	6.0X
722	Food Svcs. & Drinking Places	\$573	\$750	\$178	1.3X
811-814	Other Services	\$1,101	\$1,388	\$287	1.3X
Various	Biotechnology/Renewable	\$29	\$148	\$119	5.1X
	Unclassified/Exempt	\$122	\$104	\$(18)	0.9X
	Total**	\$10,559	\$48,915	\$38,356	4.6X

* Includes \$150 base tax.

** Business taxpayers only. Excludes residential and commercial landlords.

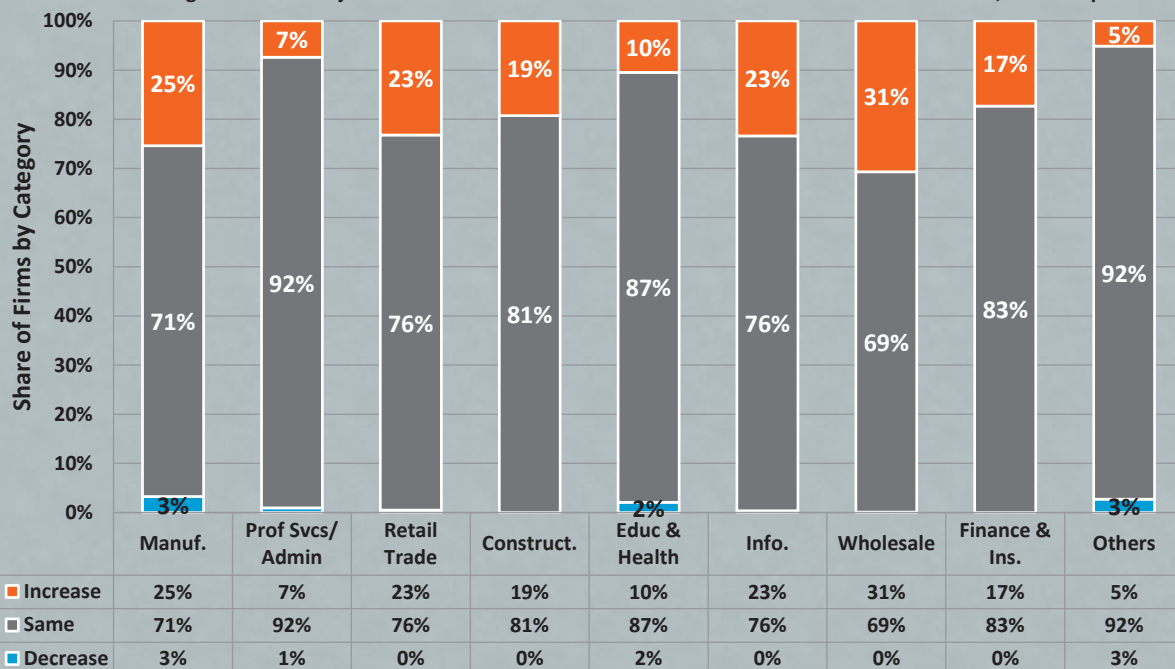
PREPARED FOR THE CITY SAN JOSE BY KEYSER MARSTON ASSOCIATES FEBRUARY 25, 2016

37

TAX IMPACT BY INDUSTRY

% OF FIRMS EXPERIENCING TAX INCREASE/DECREASE* (BY INDUSTRY)

* Among businesses subject to base tax. Excludes residential and commercial landlords and ~13,000 exempt businesses.



PREPARED FOR THE CITY SAN JOSE BY KEYSER MARSTON ASSOCIATES FEBRUARY 25, 2016

38

TAX IMPACT BY INDUSTRY

NAICS	Industry	Firms	% w/ tax decrease	% w/ tax increase	% w/ same tax bill	Avg. decrease \$	Avg. increase \$
11-21	Agriculture/Natural Resources	50	0%	6%	94%	-	\$2,171
22	Utilities	24	0%	58%	42%	-	\$63,722
23	Construction	7,304	0%	19%	81%	\$1,368	\$2,301
31-33	Manufacturing	2,134	3%	25%	71%	\$(69)	\$17,948
42	Wholesale Trade	1,278	0%	31%	69%	\$(54)	\$4,182
44-45	Retail Trade	5,559	0%	23%	76%	\$(148)	\$6,110
48-49	Transportation & WH	1,957	1%	4%	96%	\$(36)	\$4,731
51	Information	880	0%	23%	76%	\$(30)	\$9,104
53	Real Estate and Leasing	1,755	0%	7%	93%	\$(78)	\$4,177
54-56	Prof., Mgmt., & Admin. Svcs.	15,542	1%	7%	92%	\$(75)	\$6,103
61-62	Education and Health Svcs.	4,021	2%	10%	87%	\$(84)	\$6,033
71	Arts, Entertainment, and Rec.	768	2%	8%	90%	\$(1,283)	\$4,173
52	Finance and Insurance	988	0%	17%	83%	-	\$9,791
721	Accommodation	115	3%	47%	50%	\$(168)	\$4,531
722	Food Svcs. & Drinking Places	2,399	12%	10%	78%	\$(83)	\$872
811-814	Other Services	7,025	1%	2%	97%	\$(101)	\$1,806
Various	Biotechnology/Renewable	190	1%	25%	75%	\$(18)	\$2,523
	Unclassified/Exempt	735	2%	0%	98%	\$(1,386)	-
	Total*	52,724	1%	12%	87%	\$(130)	\$6,058

* Among businesses subject to base tax. Excludes residential and commercial landlords and ~13,000 exempt businesses.

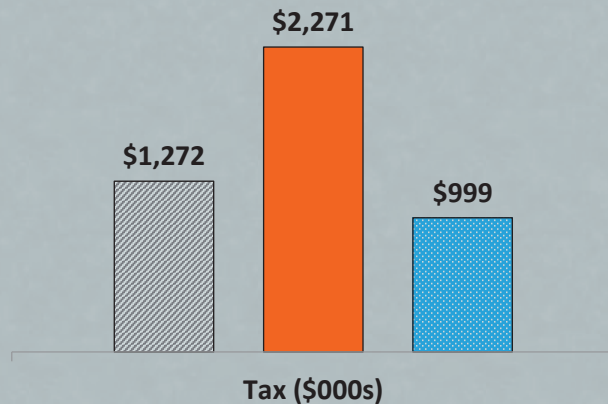
COMMERCIAL LANDLORD TAX IMPACT

Commercial Properties	
Existing Tax	\$1,272,000
Proposed Tax	<u>\$2,271,000</u>
Net Change	\$999,000
Multiplier	1.8X
Existing Tax Per 1,000 SF	\$11
Proposed Tax Per 1,000 SF	<u>\$20</u>
Net Change*	\$8

* Figures do not add due to rounding.

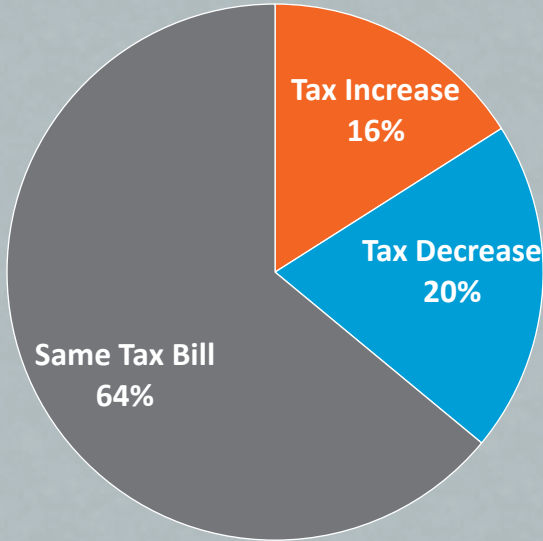
EXISTING VS. PROPOSED BUSINESS TAX

▨ Existing Tax ■ Proposed Tax ■ Net Tax



COMMERCIAL LANDLORD TAX IMPACT

SHARE OF COMMERCIAL LANDLORDS WITH TAX INCREASE/DECREASE UNDER PROPOSAL



Number of Commercial Landlords:

3,509*

* Total landlords varies slightly from estimate prepared by City of San Jose due to differences in the grouping of certain businesses under the commercial landlord category.

Average Increase \$1,915

For 16% of landlords with tax increase, average annual increase is \$1,915.

Average Decrease \$111

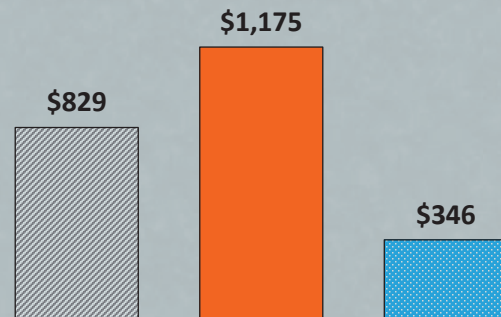
For 20% of landlords with tax decrease, average annual decrease is \$111.

RESIDENTIAL LANDLORD TAX IMPACT

Residential Landlords	
Existing Tax	\$829,000*
Proposed Tax	\$1,175,000
Net Change	\$346,000
Factor Change	1.4X
Existing Tax / Unit	\$6
Proposed Tax / Unit	\$9
Net Change	\$3

EXISTING VS. PROPOSED BUSINESS TAX

Existing Tax Proposed Tax Net Tax



Tax (\$000s)

* Existing tax varies slightly from estimate prepared by City of San José due to differences in the grouping of certain businesses under the residential landlord category.

Note: Account-level data on the share of residential landlords with a tax impact unavailable due to differences in treatment of combined reporting under existing law and the proposed ordinance.

II. BUSINESS PROTOTYPES

Objective:

Illustrate gross receipts tax impact on specific business types

BUSINESS PROTOTYPES APPROACH

- **Define business prototypes by industry and size in coordination with City staff**
- **Determine corresponding tax rate and gross receipts formula**
- **Estimate gross receipts using industry-specific factors based on:**
 - **2014 IMPLAN data for 536 industry sectors in City of San Jose**
 - **Business case studies developed for select prototypes**
- **Apply exemptions and deductions established in the ordinance**
- **Calculate tax due under proposed ballot measure**
- **Compare to tax due under existing business tax**

BUSINESS PROTOTYPES

#	Prototype	NAICS Code / Description	Local Emp.	Sq. Ft. (000s)	Eligible GR (\$M)	GR Tax Rate
1	Small-Mid Manufacturer	334412: Circuit Board Mfg.	100	140	\$12	.06%
2a	Major Corporate	334413: Semi-conductor Mfg.	2,000	500	\$890	.06%
2b	Major Corporate (Admin Office)	334413: Semi-conductor Mfg.	2,000	500	\$377 (PR)	.26% (PR)
3	Tech Growth Co.	511210: Software Publisher	350	70	\$83*	.06%
4	Professional Service	541110: Office of Lawyers	75	20	\$19	.12%
5	Major Retail	452111: Dept. Store	2,000	1,300	\$701	.06%
6	Small Business	722513: Restaurant	40	10	\$4	.06%
7	Car Dealership	441110: New Car Dealer	120	60	\$105	.06%

GR = Gross Receipts.

PR = Payroll.

PREPARED FOR THE CITY SAN JOSE BY KEYSER MARSTON ASSOCIATES FEBRUARY 25, 2016

45

PROTOTYPES SUMMARY

- All prototypes would experience tax increase under proposed ballot measure
- Tax bills to range from 3X to 32X existing bills for prototype businesses
- Average tax per FTE ranges from \$69 to \$524
- Prototypes with largest increase in business taxes:
 - Major Corporate Office (Semiconductor Manufacturer): 21X
 - Car Dealership: 32X
 - Professional Services Firm: 23X
- Payroll tax option would not make economic sense to major corporate semiconductor manufacturer

PREPARED FOR THE CITY SAN JOSE BY KEYSER MARSTON ASSOCIATES FEBRUARY 25, 2016

46

PROTOTYPE TAX IMPACTS (1/3)

#	Prototype	Existing Tax	Proposed Tax*	Net Change in Tax	Factor Change
1	Small-Mid Manufacturer	\$2,000	\$7,000	\$5,000	3.5X
2a	Major Corporate	\$25,000	\$534,000	\$509,000	21.4X
2b	Major Corporate (Admin Office)	\$25,000	\$534,000 OR \$981,000**	\$509,000 OR \$956,000**	21.4X OR 39.2X
3	Tech Growth Co.	\$6,000	\$59,000	\$53,000	9.8X
4	Professional Service	\$1,000	\$23,000	\$22,000	23.0X
5	Major Retail	\$25,000	\$420,000	\$395,000	16.8X
6	Small Business	\$1,000	\$3,000	\$2,000	3.0X
7	Car Dealership	\$2,000	\$63,000	\$61,000	31.5X

GR = Gross Receipts.

PR = Payroll.

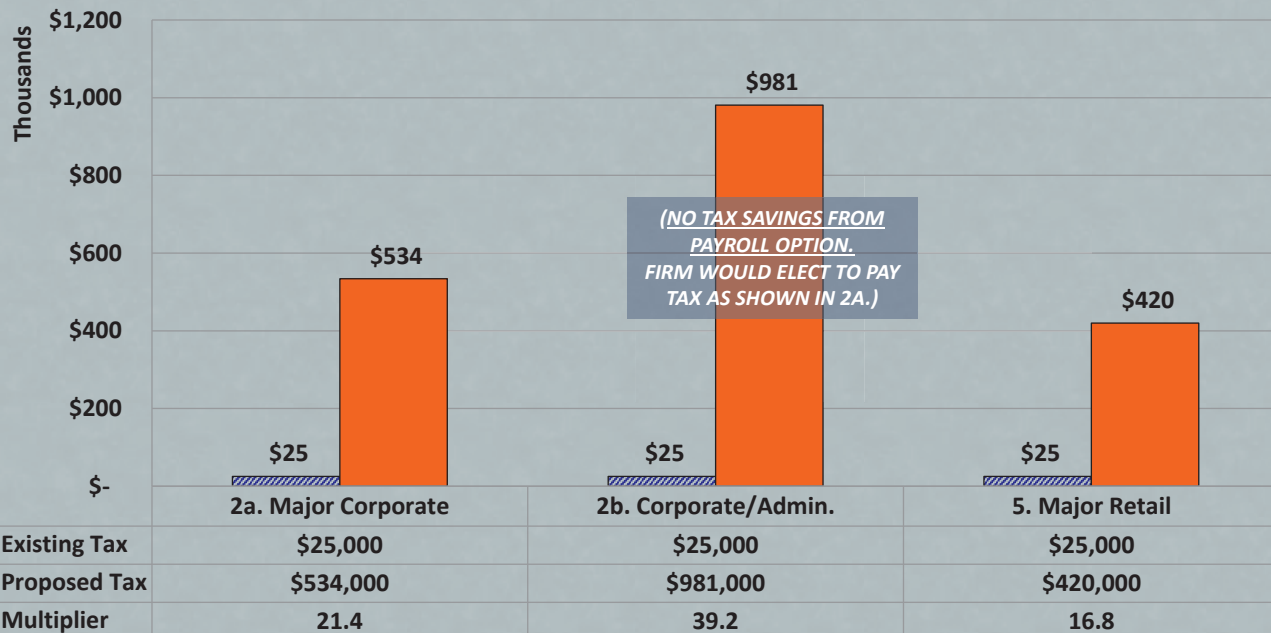
** Includes \$150 base tax. ** Payroll option costlier than standard tax.*

PREPARED FOR THE CITY SAN JOSE BY KEYSER MARSTON ASSOCIATES FEBRUARY 25, 2016

47

PROTOTYPE TAX IMPACTS (2/3)

**EXISTING VS. PROPOSED BUSINESS TAX (\$000):
MAJOR CORPORATE/ RETAIL PROTOTYPES**

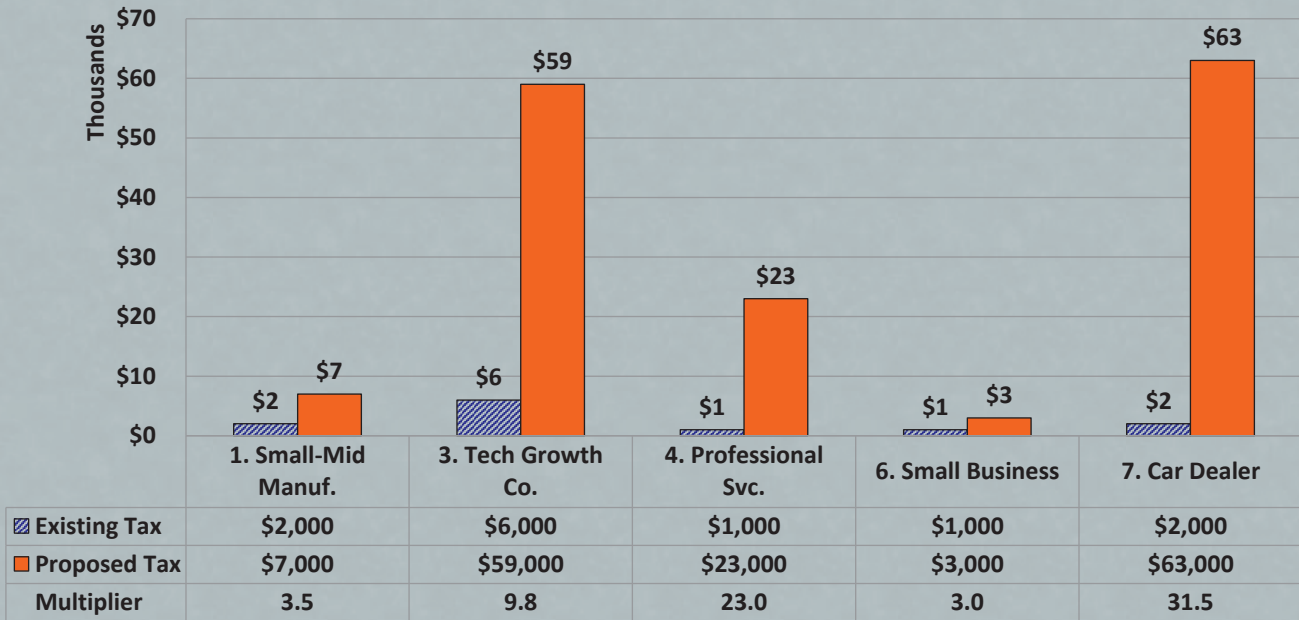


PREPARED FOR THE CITY SAN JOSE BY KEYSER MARSTON ASSOCIATES FEBRUARY 25, 2016

48

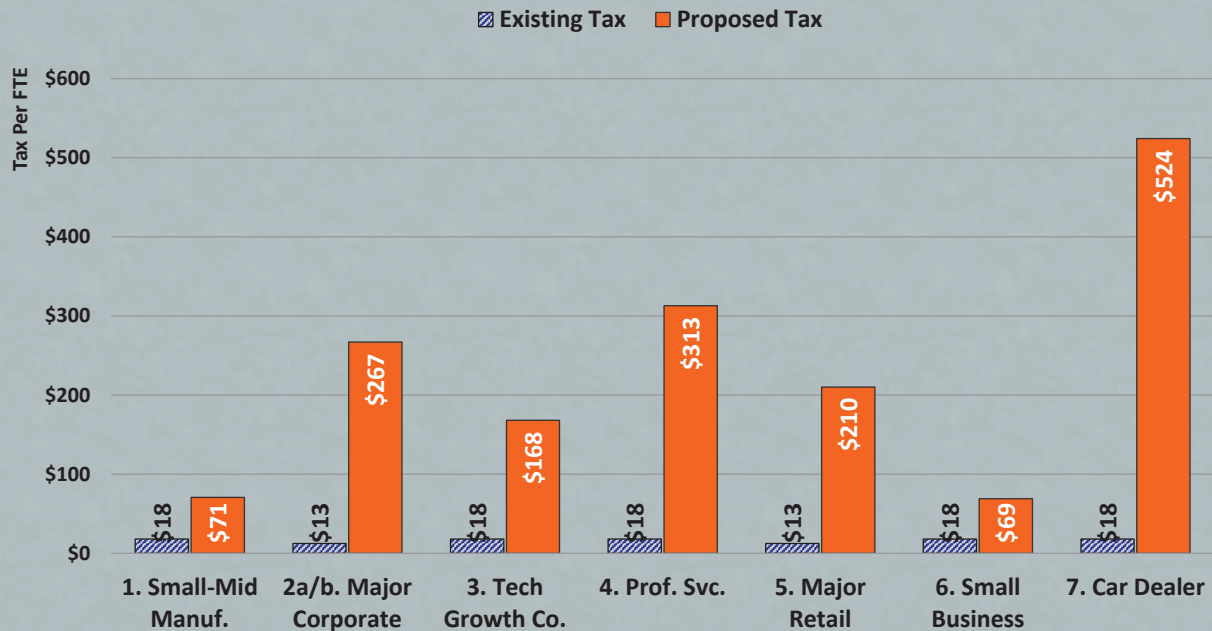
PROTOTYPE TAX IMPACTS (3/3)

EXISTING VS. PROPOSED BUSINESS TAX (\$000s)
ALL OTHER PROTOTYPES



BUSINESS TAX PER FTE BY PROTOTYPE

BUSINESS TAX PER FTE: EXISTING AND PROPOSED (BY PROTOTYPE)



Gross Receipts Tax Ballot Measure

Administrative Analysis

51

Increase in City Administrative Costs

- **Additional audit and collection staff**
- **Training for staff**
- **Outreach and education for businesses**
- **Modification of the Business Tax Billing System**
- **Space for additional staff**
- **Development and promulgation of regulations and instructions**

52

Anticipated Taxpayer Administrative Costs

- **Added complexity – internal resources and time**
 - **employee and revenue apportionment**
 - **multiple business activity rules**
 - **tax filing out of sync with fiscal year**
- **Interpretation – cost of external guidance**
 - **exemptions and exclusions**
 - **definition of gross receipts**
 - **industry codes different from State and Federal**
- **Risk of additional cost due to error**

53

San Francisco: Transition to New Tax Base

Planning Process

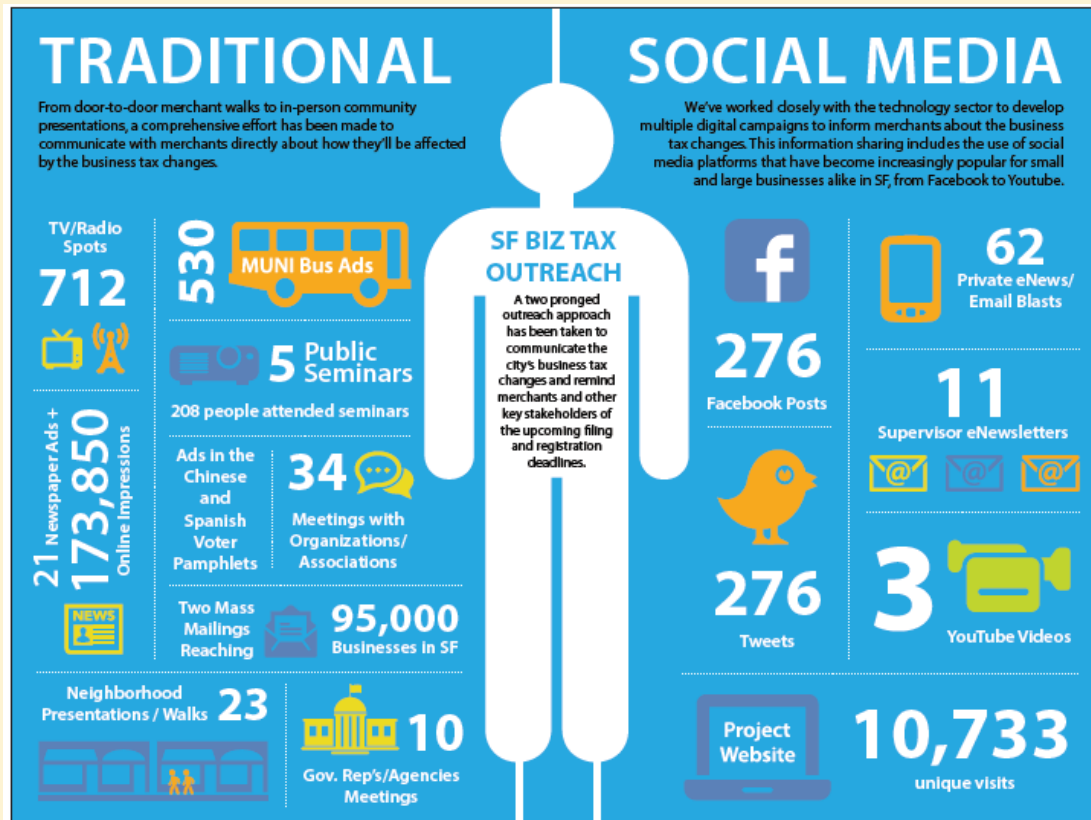
- **2008-2012 Research: alternatives and issues analysis**
- **2012 Stakeholder Engagement: 9 industry working groups @ 3 meetings each**
- **2013-2018 Five-Year Implementation Phase In**

Investment to Launch New Tax

- **\$6-\$7 million transition budget over two years**
- **Craft detailed instructions to taxpayers**
- **Create new online system**
- **Hire and train 30 staff**
- **Extensive legal work**
- **Extensive business education**

54

Outreach for San Francisco Tax Transition



55

Competitive Issues: Initial Identification

- **Substantially higher tax burden for companies located in San José compared to South Bay region**
- **Largest tax increases are for strategically important sectors: manufacturing, retail/car dealers**
- **Sector definitions do not align with San José economy; impossible to change in future without voter approval**
- **Impact on SJC operating costs; SFO and OAK are not subject to a GRT**
- **No Council flexibility to adjust rates for any purpose**

Note: Staff were not charged with doing a full analysis of how adoption of the ballot measure might affect the City's economic development goals, land use plan, fiscal health, and other goals.

56

III. Options for Updating Current Business Tax

Options Principles

57

Options for Updating Business Tax

Levers

1. Increase base tax
2. Increase incremental tax (progressive)
3. Increase or remove the cap
4. Add administrative fee
5. Inflation-based adjustments over time (CPI)
6. Update the definition of "employee"

Additional annual revenue generation: \$10M to \$14M

58

Potential Principles Underlying Business Tax Change

These principles were presented by City staff at the February 13, 2012 Budget Study Session

- a) Generate revenue to support services without unduly influencing business location decisions**
- b) Align tax with service demand**
- c) Minimize administration costs for City and compliance costs for taxpayers**
- d) “Fair” sharing of solutions** (employees, residents, businesses)
- e) Ensure revenue can grow over time as economy expands and City operating costs rise**