

CITY OF CUPERTINO, CALIFORNIA

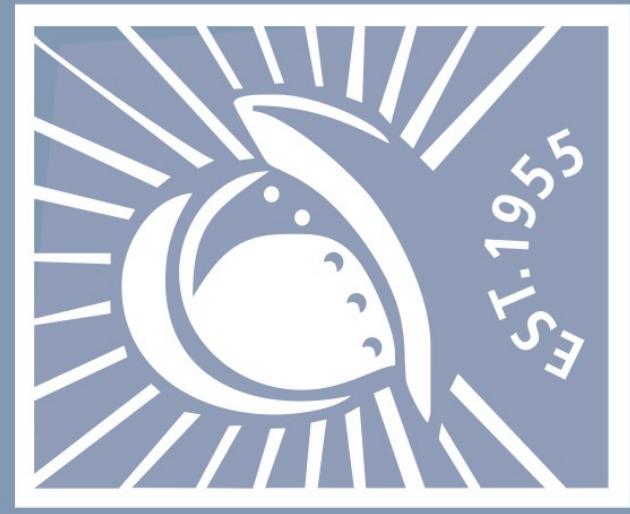
December 5, 2023

Updated Tax Revenue Options



Public Finance | Public Management |
Analytics & Compliance





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Tax Revenue Options General Fund



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General Fund Revenue Taxes – 4 Basic Considerations

1. Adequacy and Certainty

- Sustainably generates annual needed revenue
- Not subject to significant variation (low volatility)

2. Equity and Fairness

- Fiscal burden appropriately spread
- Proportionate to surrounding communities
- Does not highly skew economic incentives

3. Transparency

- Easy to find information on the revenue/tax structure and understand how it operates

4. Simplicity

- Does not require multiple ballot measures (voter confusion and fatigue)
- Not highly burdensome, costly or complicated to administer (by city or payors)



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Transaction and Use Tax (TUT)



Basics of a TUT

- Functionally similar to state Sales and Use Tax (SUT) with important difference:
 - SUT – Point of Sale
 - Where did sales transaction occur?
 - TUT – Point of Delivery/Use
 - Where did Buyer receive goods or put them to use?
- 2022 – 73% of TUT measures for new or increased rate approved (30 of 41)
- 2020 - 74% of TUT measures for new or increased rate approved (65 of 88)

Santa Clara Countywide Base Rate	9.125%
State Sales Tax	6.25%
<i>Bradley-Burns Local Share</i>	1.00%
Santa Clara County Transit District (1976)	0.50%
Santa Clara County Valley Transportation Authority (2006)	0.50%
Santa Clara VTA BART O&M Transactions and Use Tax (2012)	0.125%
Santa Clara County Retail Transactions and Use Tax (2013)	0.125%
Silicon Valley Transportation Solutions Tax (2017)	0.50%
Peninsula Corridor JPA Retail Transactions and Use Tax (2020)*	0.125%

*Authorized by special State legislation.



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Transaction & Use Tax (TUT)



- **Available TUT to City = 0.25%**
 - Statewide Cap = 9.25% + special leg.
 - County Rate = 9.0% + .125% special leg.
 - Available TUT to Cupertino = 0.25%
 - Total Rate in Cupertino w/ TUT = 9.375%
- **Additional Annual Revenue (est.)**
 - @ 0.25% = \$5.4 million annually
 - Excludes roughly 90% business-to-business sales (67% of City's net state sales tax from 2 large multi-nationals)
 - Realization rate on remaining 33% is assumed close to 100% due to type of businesses (plus additional est. revenues from auto sales)

City/Area	Rate*
Santa Clara Countywide	9.125%
Campbell	9.375%
Los Gatos	9.25%
Milpitas	9.375%
San Jose	9.375%
San Mateo Countywide	9.375%
Belmont	9.875%
Brisbane	9.875%
Burlingame	9.625%
Daly City	9.875%
East Palo Alto	9.875%
Pacifica	9.875%
Redwood City	9.875%
San Bruno	9.875%
San Mateo	9.625%
South San Francisco	9.875%
San Francisco	8.625%
Alameda Countywide	10.25%

*Effective rates as of April 2023.



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Transaction & Use Tax (TUT)



➤ Pros:

- ✓ Standard Voter Approval Requirement – 50% + 1 voter approval required for TOT.
- ✓ High Approval – recent TUT measures in 2020 and 2022 have high approval rates (74% and 73% respectively) despite COVID-19 pandemic.
- ✓ Competitiveness/Adequacy – 0.25% TUT rate keeps City generally proportionate to surrounding communities while generating more revenue than TOT or parcel tax.
- ✓ Who Bears Tax Burden – tax burden spread across residents, businesses and visitors (which includes significant daytime workforce – 60,000+ pre-pandemic).
- ✓ “Use it or lose it” – 0.25% TUT currently available to the City could be obligated (“used”) if a regional agency or the county passed a new or increased TUT measure. Once obligated, City’s only option would be special state legislation.

➤ Cons:

- Volatility – sales tax is more elastic than property/parcel tax but less than TOT (generally correlates with overall economic trends).
- Equity – TUT is not applicable to large number of business-to-business sales in which purchaser is located outside the City.



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Transient Occupancy Tax (TOT)



Basics of a TOT

- Authorized under Revenue and Tax Code s. 7280 (stays of 30 days or less) imposed on occupant based on room rate
- TOT has been called a “painless” tax – paid by non-residents – but can impact hotel occupancy and future growth if disproportionate to surrounding areas
- 2022 – 77% of TOT measures to increase rate approved (24 of 31)
- 2020 – 91% of TOT measures to increase rate approved (21 of 23)

Statewide Facts on TOTs*

- Most cities and counties have a TOT (over 480 total)
- Rates range from 3.5% to 15.5% (Palo Alto)
- Statewide mean rate = 10.2%
- On average, TOT provides 7% of General Fund revenue

*Data as of FY 2021 – CaliforniaCityFinance.com



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Transient Occupancy Tax (TOT)



- **City's Current TOT = 12.0%**
- **Additional Annual Revenue (est.)**
 - @ 13.0% = \$625,000
 - @ 14.0% = \$1.25 million
 - @ 15.0% = \$1.875 million
- Recent Trends in City's TOT
 - City's TOT ordinance already updated to improve collection from short-term rentals (e.g., Airbnb, VRBO, etc.)
 - Trendline for TOT growth is conservative (1.9% annual growth). Hospitality industry continues to recover post-pandemic and seek a “new normal.”

City/Area	Rate*
Santa Clara County	
Gilroy	9.0%
Mountain View, San Jose, Saratoga	10.0%
Los Altos, Morgan Hill	11.0%
Campbell, Los Gatos, Sunnyvale	12.0 - 12.5%
Los Altos, Milpitas, Santa Clara	13.5 - 14.0%
Palo Alto	15.5%
San Mateo County	
Burlingame, Colma, East Palo Alto, Foster City, Menlo Park, Pacifica, Redwood City	12.0%
Daly City	13.0%
Belmont, Brisbane, Millbrae, San Bruno, San Carlos, San Mateo, South San Francisco	14.0%
Half Moon Bay	15.0%
San Francisco	14.0%

*Rates as of November 2022.



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Transient Occupancy Tax (TOT)



➤ Pros:

- ✓ Standard Voter Approval Requirement – 50% + 1 voter approval required for TOT.
- ✓ High Approval – recent TOT measures in 2020 and 2022 have high approval rates (91% and 77% respectively) despite COVID-19 pandemic.
- ✓ Who Bears Tax Burden – TOT tax burden borne almost exclusively by non-residents.

➤ Cons:

- Competitiveness - City is currently in middle of regional TOT rates @ 12% but adding 3% would place it second only to Palo Alto for the region (and make it one of the highest in state).
- Adequacy - smallest overall revenue generation unless rate significantly higher than surrounding communities (increasing competitiveness concern – see above).
- Volatility – TOT is more elastic than either TUT or parcel tax, resulting in higher potential fluctuation in annual revenue.



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Parcel Tax



Basics of a Parcel Tax

- Non-ad valorem (non-value based) tax levied on parcels of property
- Methodology: Either a fixed/flat rate per-parcel or a variable rate depending on the size, use, or number of units on the parcel
 - Can establish different rates for residential & commercial property but rate must be applied uniformly
 - Can include inflationary index
 - Voter approval required: 2/3 vote required (funds restricted to specified purposes); only majority approval required if proposed by citizen initiative

Statewide Facts - Parcel Tax

- Since 2010, largest percentage of approved parcel taxes (41%) are for education.
- Most common methodology: flat rate per parcel.
- For cities, between 2010 and 2022, 66% of proposed parcel taxes were approved by the required 2/3 vote.



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Parcel Tax



- **No current City parcel tax**
 - City's clean water/storm protection assessments are property fees (not taxes).
 - Schools – Fremont Union HS \$98 parcel tax was reauthorized in 2020 (expires 2028). Cupertino Union \$250 parcel tax expired in 2022 (reauthorization with increase to \$398 rejected in by voters in 2021).
- **Parcel tax measures in Santa Clara & San Mateo counties**
 - 18 non-school parcel taxes on ballot from 2008 to 2022.
 - 83% approved.
 - All for special purposes: libraries, roads, police, water and open space.
 - Since 2018, 24 school parcel taxes on ballot with only 54% approved.

City/Area	Rate/yr.
Santa Clara County	
Santa Clara - Libraries	\$34 parcel
Santa Clara – Open Space	\$24 parcel
San Jose – Libraries	\$30 parcel
North County - Libraries	\$76 parcel
Santa Clara Water Dist.	\$0.006 per sf
El Matador - Roads	\$350-\$750 parcel
San Mateo County	
E. Palo Alto – Office Space	\$2.50 per sf
Portola Valley – Roads	\$950 parcel
Highlands – Police	\$65 parcel
San Mateo – Police & Fire	\$65 parcel
Atherton – Police	\$750 parcel*

*Not renewed in 2017



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Parcel Tax



Additional Annual Revenue (est.)

Fixed/Flat Rate per Parcel			
Parcel Type	# of Parcels**	Per Parcel Tax	Annual Revs. (est.)
Single-Family Residential (SFR)*	14,152	\$250	\$3,537,900
Multi-Family (three-family & larger)	205	\$250	\$51,250
Commercial/Office/Ind.	471	\$250	\$117,750
Total			\$3,706,900

Variable Rate per Square Foot (SF) of Parcel Size			
Parcel Type (annual tax median parcel size)	Total Ac.**	Per SF Tax Rate	Annual Revs. (est.)
SFR* – 5,000 sf (\$27)	178	\$0.021	\$163,010
SFR* – 5,000 to 10,000 sf (\$155)	1,499	\$0.021	\$1,370,768
SFR* – 10,000 to 17,500 sf (\$247)	310	\$0.021	\$283,210
SFR – Over 17,500 sf (\$613)	407	\$0.021	\$372,124
Multi-Family (\$219)	232	\$0.021	\$212,224
Commercial/Office/Ind. (\$613)	1,500	\$0.021	\$1,372,140
Total			\$3,773,476

*includes condos, townhomes & duplexes

**excludes vacant parcels and parcels with \$0 assessed value; and assumes 10% SFR exemption rate



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Parcel Tax



➤ Pros:

- ✓ Low Volatility – parcel tax revenue not impacted by overall economic trends (non-ad valorem) and inflationary index helps revenues keep pace with rising expenses.
- ✓ Flexibility – parcel tax provides some flexibility in designing tax structure to help mitigate equity concerns (see below) using a variable rate.
- ✓ High Approval but for Special Purpose – voter approval rates for city parcel taxes has been strong (83%) but all have been restricted to special not general purposes.

➤ Cons:

- 2/3 Voter Approval Required – state law requires 2/3 approval by electorate.
- Equity – flat/fixed rate parcel tax often considered very regressive but can be mitigated with variable rate (see above).
- Adequacy/Competitiveness - rate equivalent to recently expired local school district parcel tax (\$250/parcel or \$0.020 per SF) is significantly higher than most parcel taxes in surrounding communities but generates significantly less revenue than TUT.
- Who Bears Tax Burden – parcel tax burden borne exclusively by residents and businesses.



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Business Operations Tax



Basics of Business Operations Tax

- Tax on businesses for privilege of conducting business within the City.
- Methodology: Either a fixed/flat rate per business (often varies by type of business) or a variable rate based on some measurable aspect of the business operations, such as: gross receipts/payroll, number of employees (headcount), square footage of business, etc.
- Cities have wide discretion in determining methodology, rates and applicability (cannot be discriminatory or confiscatory, and state/federal law exempts certain activities).
- Tax is only on business activities conducted within the City. Multi-jurisdiction businesses must be able to apportion.

Statewide Facts – Business Operations Tax

- More than 95% of cities impose one or more business operations taxes.
- Average city generates around 3% of revenue from business operations taxes.
- Top 20 cities generate between 10% and 25% of total revenue from one or more business operations taxes.
- Since 2010, 65 business operations taxes on ballot with 74% approved (excludes cannabis) statewide. 92% approved in Bay Area region.



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Business Operations Tax



- **City's Existing Business Operations Taxes**
 - \$75 flat rate per business + rate per square foot of the business (ranging from \$0.02/sf for small businesses to \$0.0025/sf for largest business)
 - City also has operations taxes (both flat and variable) for specific businesses, such as apartments (per unit), hotels (per room), taxis (per vehicle), theaters (per seat), etc.
 - Annual Amount Generated = \$725,000 (\$12 per capita)

City	Annual Revenue	Per Capita
Santa Clara County		
Mountain View*	\$6 million	\$74
Sunnyvale	\$2.1 million	\$14
Los Gatos*	\$1.1 million	\$34
Santa Clara*	\$6 million	\$47
Los Altos	\$490,000	\$16
Palo Alto*	\$9.6 million	\$144
Campbell	\$723,000	\$17
San Mateo County		
San Carlos	\$1.2 million	\$40
San Mateo	\$6.3 million	\$62
Foster City	\$1.6 million	\$48

* New or updated within last 5 years



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Business Operations Tax



Employee Count Tax* (est.)

Employee Range	# of Businesses	% of Businesses in Tier	Estimated Employee Count	Base Rate Per Business	Per Employee Rate	Total Tax	Effective Tax Rate Per Employee	Effective Tax Rate Per Avg. Business
1-9	3,128	89.37%	3,400	\$25	\$0	\$78,200	\$23	\$25
10-49	300	8.57%	4,000	\$100	\$15	\$90,000	\$23	\$300
50-99	40	1.14%	2,400	\$250	\$25	\$70,000	\$29	\$1,750
100-249	25	0.71%	3,300	\$250	\$50	\$171,250	\$52	\$6,850
250-499	5	0.14%	1,300	\$250	\$75	\$98,750	\$76	\$19,750
500-999	1	0.03%	600	\$250	\$100	\$60,250	\$100	\$60,250
1,000-4,999	-	0.00%	-	\$250	\$125	-	-	-
5,000+	1	0.03%	24,000	\$250	\$150	\$3,600,250	\$150	\$3,600,250
Totals	3,500	100.0%	39,000			\$4,168,700		

*Business and employee count data provided by City from 2018 research. Current data likely different post-Covid.



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Business Operations Tax



➤ Pros:

- ✓ Standard Voter Approval Requirement – 50% + 1 voter approval required for business license taxes.
- ✓ High Approval – since 2010, business license tax measures in Bay Area Region have high voter approval rates (94%).
- ✓ Low Volatility – business operations tax based on employee count (pandemic notwithstanding) provides a stable tax base, subject to unknown longer-term impact on business location decisions (see below)

➤ Cons:

- Who Bears Tax Burden/Equity – tax burden borne exclusively by local businesses but setting varying rates and caps can allocate the tax burden differently across different size businesses.
- Competitiveness/Equity/Adequacy - City currently has a very low business license tax rate compared to surrounding cities as measured on a per capita basis. If an employee count tax is set at top rate in the region (\$75 per capita), the annual tax revenue generated is significantly less than the 0.25% TUT and it likely requires shifting tax burden to a few very large businesses. Additionally, there is an unknown potential impact on locational choices of existing and future businesses that could erode the annual tax revenues.



Recommendations & Next Steps



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Tax Revenue Options – Recommended Ranking

Rank	Revenue Option	Est. Annual Revenue	Pros	Cons
1	Transaction & Use Tax (TUT)	\$5.4 million	<ul style="list-style-type: none">• 50% + 1 vote required with high voter approval in recent elections.• Generates most revenue with rate proportionate to surrounding cities.• Tax paid by residents, businesses and visitors/daytime workforce.• “Use it or lose it.”	<ul style="list-style-type: none">• TUT is more volatile and subject to annual revenue fluctuation than parcel tax but not TOT.• TUT not applicable to large portion of business-to-business sales in which purchaser located outside the City.
2	Transient Occupancy Tax (TOT)	\$1.9 million	<ul style="list-style-type: none">• 50% + 1 vote required with high voter approval in recent elections.• Tax paid by non-residents/visitors.	<ul style="list-style-type: none">• TOT is more volatile and subject to annual revenue fluctuation than TUT and parcel tax.• Smallest overall revenue generation unless rate significantly higher than surrounding communities.



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Tax Revenue Options – Recommended Ranking (cont.)

Rank	Revenue Option	Est. Annual Revenue	Pros	Cons
3	Parcel Tax	\$3.7 million	<ul style="list-style-type: none">• Parcel tax has lowest volatility and annual revenues are very stable.• High voter approval but for restricted special purposes (not general fund).	<ul style="list-style-type: none">• 2/3 vote required.• Tax paid by residents and businesses.• Flat/fixed parcel tax often considered regressive tax (but can use variable rate to improve equity).• Rate equivalent to expired school parcel tax generates significantly less revenue than TUT and is higher than other parcel taxes in the area.
4	Business Operations Tax – Employee Count	\$4.1 million	<ul style="list-style-type: none">• 50% + 1 vote required with high voter approval over last decade.• Employee count tax has low volatility but could erode annual revenues if tax impacts business location decisions.	<ul style="list-style-type: none">• Tax paid exclusively by local businesses, but varying rates/caps can allocate burden.• Setting rate at top of region generates significantly less tax revenue than TUT, and likely requires shifting tax burden to a few very large businesses.



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November 2024 Ballot Measure – Potential Timeline

Dates	Task
January & February	Community opinion research conducted.
March & April	Staff develops options for revenue measure based on community opinion research and feedback, Council input, and other relevant considerations.
April to August	Public information disseminated explaining why and how Council is considering placing a revenue measure on the ballot.
June	Council decision on appropriate revenue measure and direction for staff to prepare ballot measure language and required resolutions.
July 16, 2024	Last regularly scheduled meeting of Council for Introduction/First Reading of revenue measure ordinance.*
August 6, 2024	Last regularly scheduled meeting of Council for Second Reading/Adoption of revenue measure ordinance and approval of resolution calling the election.
August 9, 2024	Deadline for City submission of ballot measure to Registrar of Voters.
August 20, 2024	Deadline for City's submittal of impartial analysis of ballot measure to Registrar of Voters.
November 5, 2024	Election Day.



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Recommended Action

Provide direction to staff regarding exploring the feasibility of one or more potential revenue tax measures—Transaction and Use Tax, Transient Occupancy Tax, Parcel Tax, and/or Business Operations Tax—through opinion research for the November 2024 election.