



OFFICE OF THE CITY MANAGER

CITY HALL

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CITY COUNCIL STAFF REPORT

Meeting: July 31, 2018

Subject

Proposed measure to restructure Cupertino's basic business license tax from a tax based on square footage to a tax based on employee count.

Recommendation

Take action to approve submission to the voters of a measure to amend the City's business license tax or defer the measure and provide further direction to staff. Council can take the following actions:

- A. (1) Adopt draft Resolution No. 18-, "A Resolution of the City Council of the City of Cupertino ordering the submission to the qualified electors of the City a measure to amend the business license tax at the Tuesday, November 6, 2018 general election called by Resolution No. 18-054, and providing for written arguments regarding the measure and directing the City Attorney to prepare an impartial analysis"; and (2) submit to voters at the November 6, 2018 General Municipal Election "An Ordinance of the people of the City of Cupertino amending Chapter 5.04 of the Cupertino Municipal Code regarding business license taxes, fees, and charges;" or
- B. Defer placing the business license tax measure to the November 2020 election and direct staff to undertake further study and continue working with stakeholders on preparing a transportation spending plan and draft business license tax measure.

Background

The City's business license tax was enacted in 1992 with minor amendments in 2001. Rates have been increased periodically based on inflation and are estimated to generate approximately \$800,000 in fiscal year (FY) 2017-18. Council requested that staff work on a proposal to restructure the City's business license tax from a square footage-based tax to an employee-based tax as part of the FY 2018-19 Work Program.

As shown in the timeline below, staff has presented information on restructuring the City's business license tax at three previous Council study sessions.

Date	Activity
<i>March 6, 2018</i>	Council adopts work plan
<i>May 23-25, 2018</i>	Public opinion poll
<i>June 5, 2018</i>	Study session – Council directs staff to develop several models for restructuring the business tax and conducting business outreach
<i>June 18, 2018</i>	Business outreach, including forum
<i>June 19, 2018</i>	Study session – Council directs staff to prepare sample resolution and ordinance for November 2019
<i>July 3, 2018</i>	Study session - Council directs staff to prepare draft resolution and ordinance for November 2018 election and conduct additional outreach

Discussion

Per Council direction at the July 3, 2018 study session, staff has refined business tax models previously presented to Council to generate proposed revenue targets, prepared a draft resolution placing the business tax measure on the November 6, 2018 ballot, prepared a draft ordinance, drafted a sample resolution for spending priorities, engaged in community and business outreach, and conducted community polls to test the ballot language.

Business Tax Models

Based on Council direction, staff prepared two tax models estimated to generate \$8 million and \$10 million in revenue. As previously presented, the models protect small and medium size businesses from the impacts of a per employee tax rate with businesses paying a flat fee for the first 99 employees. The employee tax rate progressively increases as the number of employees increase. The effective tax rate summarizes the total estimated business tax by total estimated number of employees.

Model 1: Per Employee Rates Up to \$325							
Employee Range	# of Businesses	% of Businesses in Tier	Estimated # Employees	Base Rate	Employee Rate	Total BL Tax	Effective Tax Rate
1-9	3,128	89.4%	3,400	\$150	\$ -	\$ 469,200	
10-49	300	8.6%	4,000	\$250	\$ -	\$ 75,000	
50-99	40	1.1%	2,400	\$500	\$ -	\$ 20,000	
100-249	25	0.7%	3,300	\$500	\$ 50	\$ 53,750	\$ 16
250-499	5	0.1%	1,300	\$500	\$ 100	\$ 45,250	\$ 35
500-999	1	0.0%	600	\$500	\$ 175	\$ 50,525	\$ 84
1,000-4,999		0.0%		\$500	\$ 250	\$ -	
5,000+	1	0.0%	24,000	\$500	\$ 325	\$ 7,295,250	\$ 304
Total	3,500	100.0%	39,000			\$ 8,008,975	

Model 2: Per Employee Rates Up to \$425							
Employee Range	# of Businesses	% of Businesses in Tier	Estimated # Employees	Base Rate	Employee Rate	Total BL Tax	Effective Tax Rate
1-9	3,128	89.4%	3,400	\$150	\$ -	\$ 469,200	
10-49	300	8.6%	4,000	\$500	\$ -	\$ 150,000	
50-99	40	1.1%	2,400	\$500	\$ -	\$ 20,000	
100-249	25	0.7%	3,300	\$500	\$ 50	\$ 53,750	\$ 16
250-499	5	0.1%	1,300	\$500	\$ 100	\$ 45,250	\$ 35
500-999	1	0.0%	600	\$500	\$ 200	\$ 53,050	\$ 88
1,000-4,999		0.0%		\$500	\$ 300	\$ -	
5,000+	1	0.0%	24,000	\$500	\$ 425	\$ 9,407,775	\$ 392
Total	3,500	100.0%	39,000			\$10,199,025	

Draft Resolution

Staff worked with outside counsel and the City Attorney's Office to draft a resolution adding a measure to amend the business license tax on the November 6, 2018 election (Attachment A). The ballot question was drafted in consultation with the Council's ad-hoc committee (Council Member Steven Scharf and Council Member Barry Chang), however, no consensus was reached. The committee recommended two ballot questions for Council consideration:

- A. Shall the measure to fund priorities such as infrastructure to reduce traffic congestion in Cupertino by imposing a yearly general business license tax of \$150 to \$500 per business, plus a progressively increasing per-employee rate of \$50 (100+ employees) to \$425 (5,000+ employees), replacing the existing square footage-based business license tax, raising about \$10 million yearly for general fund purposes, effective until voters amend or appeal it, with annual audits, be adopted?
- B. Shall the measure to fund priorities such as infrastructure to reduce traffic congestion in Cupertino by imposing a yearly business license tax of \$8 to \$392 per employee, on average, with larger companies paying more per employee, replacing the existing square footage-based business license tax with no changes to provisions for particular businesses taxes, generating about \$10 million yearly for general fund purposes, until ended by voters, with independent yearly audits, be adopted?

Option A explains the proposed tax structure, whereas option B focuses on the effective per-employee rate of the overall tax. Both questions are legally acceptable. Outside legal

counsel recommended option B, which is most similar to Mountain View's ballot question, however polling revealed that option A may be slightly more successful. For this reason, staff included the option A language in the draft resolution.

Draft Ordinance

The draft ordinance (Attachment B) is modeled after Mountain View's proposed measure. However, staff retained some provisions from our current business license tax code. Below is a summary of the key provisions of the draft ordinance:

- Replaces the "basic license" currently calculated based on square footage with one based on employee-count
- Proposes the Model 2 structure that generates approximately \$10 million per year with an effective per employee tax rate of \$17 to \$392 for businesses with 100 or more employees (basic license only).
- Retains rates for specified business, including auctioneers, amusement centers, apartments, coin operated devices, concerts/circuses/performances, contractors, home occupations, hotels/motels/lodging houses, lumberyards/materials yard/junkyards/nurseries, mobile vendors, private schools, rest/care homes/childcare centers, seasonal lot sales, solicitors, taxicabs, and theatres/shows.
- Maintains a reduced rate for small income business with gross receipts of \$1,000-\$5,000 of \$75 (or half the flat rate fee for businesses with 1-10 employees). Businesses with less than \$1,000 in gross receipts are exempt from the business license fee.
- Requires out-of-town businesses pay the same incremental tax rate based on number of employees, but prorated based on the average number of days working in the City in a calendar year (similar to San Jose).
- Authorizes Council to adjust the tax for CPI increases, subject to the annual fee resolution.
- Makes tax effective in 2020 for the smaller businesses subject to the flat "registration fee" with larger companies phased in from 2020 to 2022.

New provisions not currently included in the City's business license tax ordinance were included based on best practices from Mountain View's model ordinance:

- Allows for the Council to establish business license application and renewal fees to recover the cost of processing business licenses as part of the annual adoption of the City fee schedule.
- Includes a disturbance response charge for any disturbance which is directly or indirectly caused by a violation of business license provisions.

- Allows City to deny or suspend a business license for criminal convictions related to the business, felony convictions, and convictions for acts involving dishonesty, fraud, or deceit.

The draft ordinance currently does not include a sunset provision, which is similar to Mountain View's measure.

Spending Priorities

Council requested information on a resolution that would signal to voters the Council's commitment to use the revenue generated from the measure for transportation purposes. Staff has included a sample resolution (Attachment D) that could serve this purpose. Mountain View is using this approach for their ballot measure. However, it should be noted that such resolutions are not binding and spending priorities could be changed by subsequent Councils.

Business Outreach

Given the limited timeframe, staff targeted business outreach to the Cupertino Chamber of Commerce and the approximately 30 businesses that would likely be impacted by the restructuring. Email messages explaining the possibility of a business license tax restructuring and its implications to local businesses were sent to larger employers including Apple, Seagate, The Forum at San Antonio, Kaiser, Target, Whole Foods, and the California Restaurant Association (CRA). The email message requested an opportunity to meet one-on-one for a briefing on the issue. Phone messages were also left for store managers of Safeway and Ranch 99 who do not have a working email on file. Follow-up calls were made to and messages left for these larger employers who did not send representatives to the Business Forum event on Monday, June 18, 2018 with a request to meet in person or via conference call.

A second Business License Tax Forum was held on Tuesday, July 24 from 9:30am-11:00am at Cupertino Community Hall. The Business License Tax Forum was promoted in the City's Economic Development Business Buzz electronic newsletter issued on July 23, 2018. Invitation emails were sent to property managers of Nineteen800, The Marketplace, Main Street, Homestead Square, and the Cupertino Chamber of Commerce, and CRA inviting their tenants and members to attend and provide their input. Forum flyers were distributed at the Chamber's July 13, 2018 Legislative Action Committee Meeting.

At both Business Forums, attendees expressed that they believe it is a rushed process. They would like more time for the City to meaningfully engage with stakeholders (businesses and residents) in order to identify and discuss the best possible business tax structure to fund transportation projects. They voiced that there must be a clear link

between the tax revenues raised and the intended projects. Additionally, the attendees felt regional transportation projects would be most effective in addressing the area's transportation issues.

Staff also engaged one-on-one with the City's largest employer and business groups, and has a scheduled meeting with the City's second largest employer. Based on one-on-one conversations with these business leaders, including the Chamber of Commerce, there is a recognition that traffic is a significant issue affecting both residents and businesses. However, there continues to be concern that this measure does not provide a spending plan that clearly articulates how this measure would provide a solution to traffic congestion. They recommend that Council consider partnering with the business community to study potential solutions to traffic congestion instead of pursuing the proposed business license tax measure.

The Cupertino Chamber of Commerce has committed to partnering with the City to explore transportation solutions and has begun meeting with staff on a weekly basis. An Apple representative has also been in attendance and expressed support for such a collaborative approach, but the company has not yet committed to a partnership. Both the Chamber and Apple have expressed deep concern with the short timeline and limited dialogue regarding a restructured business license tax. They would like more time to explore transportation solutions and funding options with the City and are requesting that Council consider delaying the proposed measure to 2020 if alternative funding cannot be secured.

Community Outreach

To provide information on the proposed business license tax measure, staff created a webpage on the City's website (www.cupertino.org/businessstax) with background information for residents and businesses interested in the issue.

In addition, staff used Open City Hall to conduct a short survey on support for an employee-based business tax and funding preferences, which was promoted through Nextdoor and our BizBuzz Newsletter. The survey had over 85 responses. The vast majority of respondents reported that they live and/or work in Cupertino, however, only about half are registered users that have been verified by the platform. It's important to note that Open Town Hall survey is a self-selected survey and not a scientific poll that is statistically valid.

Among registered respondents, nearly 43% of respondents in the Open City Hall survey expressed support for a restructured business license tax with 49% opposed and 8% undecided. Including both registered and non-registered respondents, support for the

measure was only 38% with 56% opposed. Support for enhancing pedestrian/cyclist safety, local community shuttle, and improving mass transit in the West Valley all received 35-37% support.

Scientific Voter Polling

Staff also conducted three scientific polls with a third-party polling firm, Voxolca. In May, nearly 71% of likely November voters said they would support an increase in the business license tax with large business paying more than small businesses. The poll also showed 63% support for an increase in the business license tax for general purposes. However, when polled on the specific ballot questions in July, support eroded.

Voxolca conducted two polls of 300 likely November voters testing the two ballot question options the week of July 16-23, 2018 (Attachment E). In addition to a ballot question, the polls presented two arguments for and two arguments against the measure to determine the impact of messaging on support for the measure. Respondents were also asked what the most important factor was in considering the proposed business license tax measure.

Overall, the polling results show less support for this specific proposal compared to initial polling results. Both polls show initial support of 49% with 7-8% undecided. After presenting arguments for and against the measure, support increased to 51% in one poll and 55% in the other. Respondents indicated that the most important factor in considering the ballot measure was a well-designed spending plan and long-term stability and growth.

While a solid majority of respondents believe that it is fair for businesses to pay more to fund transportation improvements in Cupertino, a super majority agree with the “blank check” argument that this is a general tax measure with no transit solution. Given these polling results, staff is not confident that the proposed measure would be successful if placed on the November 2018 ballot.

Implementation Considerations

Implementing a revised ordinance will require some internal analysis of business license processing related to the City’s current business license application as well as the policies and procedures regarding the administration and collection of business license taxes and processing fees, respectively.

Additional resources will be vital in order to remain operationally efficient and compliant as we transition to a new collection structure. If the measure is implemented, the new

collection structure will require additional staffing and/or outside consultant support to ensure compliance with the new fees. Most significantly, the number of employees (full-time and part-time) will need to be obtained and recorded, information which has never been requested of applicants. Upon receiving head-count information from applicants, staff will need to verify this information via form DE-9C, submitted to the Employment Development Department. Ongoing staffing and/or consultant help may be required to monitor and ensure that all business are in compliance with the City's new business license fees.

Additionally, there will be a financial and staffing cost to reconfigure, adjust, and test the City's enterprise system from a fee based on square footage to a fee based on employee count, which is anticipated to take at least six months' time. Staff will also need 6-12 months to notify businesses of the change.

Staff Recommendation

Options for Council to consider, include:

1. Approving the draft resolution and draft ordinance to place the measure on the ballot for November 2018, authorize the subcommittee to prepare arguments and rebuttals for the proposal, and consider adopting a resolution on spending priorities at a future meeting.
2. Defer placing the measure on the ballot until 2020 and direct staff to continue working with business partners, including the Chamber of Commerce, on transportation solutions with the goal of developing a spending and funding plan by December 2019. This timeline would allow for more robust community and business engagement for a potential revenue measure in November 2020, if alternative funding is not identified.

Given that polling data does not show a clear majority of residents would support the proposal currently being considered by Council and the business community has been unsupportive for moving forward in November 2018, staff recommends that Council consider deferring the ballot measure to 2020. This would give staff time to meaningfully engage with all stakeholders to develop an infrastructure spending plan and work with the Chamber of Commerce and large businesses to consider a partnership for alternative funding, while working on the restructuring of the business license tax.

A November 2020 target, would also provide staff with ample time to prepare an internal transition plan and external communication plan. This may shorten the lead time needed to implement the tax and still allow full implementation by 2022, instead of the proposed phase in starting in 2020 with full implementation in 2022.

Sustainability Impact

To the extent that revenue measures support transportation infrastructure that reduces single vehicle miles traveled in Cupertino, there would be a reduction in greenhouse gases.

Fiscal Impact

If approved by voters, the proposed business license tax measure could increase revenues by millions of dollars and provide a consistent source of revenue for infrastructure projects. However, it is also anticipated that additional staffing, consultant, and system reconfiguration costs will be incurred to implement and monitor the new fee structure. The two business license models proposed will be more than adequate to support the additional resources required.

Prepared by: Jaqui Guzmán, Deputy City Manager

Reviewed by: Aarti Shrivastava, Assistant City Manager

Approved for Submission by: Amy Chan, Interim City Manager

Attachments:

- A – Draft resolution
- B – Draft ordinance
- C – Redlined draft ordinance
- D – Sample resolution on spending priorities
- E – Scientific voter polls