

2013 Council Study Issue

FIN 13-01 Explore Business License Tax Exemption for Low Income Businesses

Lead Department Finance

History **1 year ago** None **2 years ago** None

1. What are the key elements of the issue? What precipitated it?

This study issue will address whether an exemption of the Business License Tax requirement should be granted to low income businesses. This tax is a significant revenue source for the General Fund; over \$1.5 million in tax was collected in FY 2011/12. In recent years, staff has enhanced audit efforts to find businesses operating without a license. As a result, requests for exemptions have come up. At the Council meeting of June 19, 2012, a business owner asked the Council to consider an exemption for businesses with low income.

The current Business License Tax ordinance does allow for some exemptions. Non-profit organizations are exempt from the tax. Honorably discharged or relieved veterans who are physically unable to earn a livelihood by manual labor and who desire to hawk, peddle or vend goods, wares or merchandise owned by him/her are also exempt from the tax. In addition, if no expenses are deducted on the business tax return in order to reduce federal and state taxable income and the income received can be reported on a tax return other than the Schedule C (Profit or Loss from Business), staff will generally exempt these "hobby" businesses from the Business License Tax requirement.

Creating an exemption for businesses with low income will provide some relief for those businesses struggling financially and assist in creating a business friendly environment. However, it will also result in a reduction of revenue and an increase in expenditures because additional resources will be required to annually verify the exemption requests.

Because this is a tax, if the City created an exemption and then wanted to repeal it later, the City would have to go to the voters to eliminate the exemption under Proposition 218.

2. How does this relate to the General Plan or existing City Policy?

Chapter 5.04 of the Sunnyvale Municipal Code (the Business License Tax ordinance) imposes a tax on every person transacting, engaging in, or carrying on any business within the City. Business is defined in the ordinance as: "professions, trades and occupations and all and every kind of calling or enterprise, and carried on for profit or livelihood." Per Section 5.04.110, the tax is based on the number of employees (including the owner) working in Sunnyvale. It is not based on gross or net income.

3. Origin of issue

Council Member(s) Griffith, Moylan

4. Staff effort required to conduct study Moderate

Briefly explain the level of staff effort required

Staff will need to research other cities that provide an exemption from the Business License Tax requirement based on income and the process these cities employ for verifying that a business is exempt. Options for the basis of the exemption (gross or net income, Sunnyvale based businesses only or all businesses) and the income level for the exemption would need to be developed. In addition, staff must determine the appropriate documentation needed for verification purposes. Staff

would also obtain a small sample of tax return data from the Franchise Tax Board in order to estimate the potential revenue impact of exempting certain businesses.

5. **Multiple Year Project?** No **Planned Completion Year** 2013

6. **Expected participation involved in the study issue process?**

- Does Council need to approve a work plan?** No
- Does this issue require review by a Board/Commission?** No
- If so, which?**
- Is a Council Study Session anticipated?** No

7. **Briefly explain if a budget modification will be required to study this issue**

Amount of budget modification required 0

Explanation

8. **Briefly explain potential costs of implementing study results, note estimated capital and operating costs, as well as estimated revenue/savings, include dollar amounts**

Are there costs of implementation? Yes

Explanation

Fifty percent of the approximately 11,000 businesses currently in the Business License Tax database have 1 employee and 33% have 2 to 5 employees. The tax for a 1 employee business is currently \$64.16 every two years. If every 1 employee business met the exemption criteria, the revenue loss would be over \$175,000 per year. Many two employee businesses are husband and wife sole proprietorships. The tax for a 2 to 5 employee business is \$106.96 every two years. If every 2 to 5 employee business met the exemption criteria, the revenue loss would be almost \$195,000. In reality, only a portion of the businesses will be exempt. However, the loss of revenue will not be known for certain until all tax returns have been reviewed and the exemptions granted since the City currently does not collect income information on businesses. In addition to the revenue loss, there will be an increase in expenditures. In order to provide an exemption for those businesses that fall under a certain gross or net income threshold, additional staff hours will be required to verify eligibility annually and handle the additional correspondence. The number of additional hours required will depend on the number of exemption requests, which in turn, depends on the income threshold. This change, if implemented, will also financially impact our audit efforts as staff expends resources to reach out to businesses that will end up being exempt from the tax.

9. **Staff Recommendation**

Staff Recommendation None

If 'Support', 'Drop' or 'Defer', explain

Staff has no recommendation on this study issue.

Reviewed by


Department Director

8/8/12
Date

Approved by


City Manager

8/8/12
Date