

CITY OF SANTA ROSA
CITY COUNCIL

TO: MAYOR AND CITY COUNCIL
FROM: ALAN ALTON, CHIEF FINANCIAL OFFICER, FINANCE
DEPARTMENT
SUBJECT: GENERAL BUSINESS TAX BALLOT MEASURE

AGENDA ACTION: RESOLUTION AND ORDINANCE

RECOMMENDATION

It is recommended by the Finance Department that the Council (1) introduce an ordinance to amend chapter 6-04 of the Santa Rosa City Code, entitled "General Business Tax" to increase the maximum tax to \$10,000 annually, adjust business tax rates, and tax Short-Term Rental businesses, and (2) approve a resolution ordering the submission of a ballot measure to seek voter approval of that ordinance at the November 5, 2024 General Municipal Election, directing related actions, and designating an individual to submit, on behalf of the City Council, an argument in favor of the measure and a rebuttal argument.

EXECUTIVE SUMMARY

The City's General Business Tax was enacted in 1990, without having a thorough review of its rate structure since its inception. The current tax, which is a general tax funding general government services, has a maximum tax of \$3,000. The tax cap, especially one this low, creates an inequity between small and large businesses. It is regressive in that a high-grossing large business pays a low effective tax rate, and a small business pays a higher effective rate.

Staff analyzed the current ordinance and proposed the removal of the maximum tax; creating a modernized rate structure for those businesses paying more than \$3,000 in tax, expanding the definition of residential property rental to include one to three units; and requiring short-term rental operators to pay business tax as part of a revenue measure presentation to the City Council in a July 9, 2024, Study Session. The proposed changes to the Business Tax ordinance would have increased revenue by approximately \$12 million per year. Council directed staff to continue its outreach to the business community and to come back with more options.

To amend the Business Tax ordinance as proposed, the question must be included on the ballot for the November 5, 2024, General Municipal Election. The deadline to have a measure on the November ballot is August 9, 2024.

BACKGROUND

Santa Rosa charges a General Business Tax under Chapter 6-04 of the City Code to any business operating within city limits, subject to narrow exceptions. This tax was enacted in 1990, and until now, has not gone through a thorough review. There are different types of business taxes adopted by cities, including taxes based on employee head count; a flat business tax; taxes based on gross receipts with a maximum tax cap; and, taxes based on gross receipts without a maximum tax cap. Santa Rosa's Business Tax is based on gross receipts, with different tax rates for different business categories. There is currently a minimum tax of \$25 for businesses with annual gross receipts of less than \$25,000. The amount of tax a business will pay is currently capped at \$3,000 annually. The current rate structure has not been changed or updated since 1990.

The City's General Business Tax is a general tax, currently generating funding in the amount of approximately \$4.7 million annually to pay for general City services. In 2018, following legalization of the cannabis industry in California, the City adopted an entirely separate business tax structure for businesses in the cannabis industry under Section 6-10 of the City Code. That cannabis industry tax does not fall into the scope of the proposed changes to the City's General Business Tax.

The changes to the Business Tax ordinance requires voter approval at a general election, and because they are general taxes, passage would require a simple majority. The City conducted an opinion survey in late November 2023 among likely 2024 voters and the proposed ballot measure polled favorably by 66.8% of those polled.

PRIOR CITY COUNCIL REVIEW

The Council received a study session on revenue options, including changes to Business Tax, on July 9, 2024.

ANALYSIS

The City's General Fund has a budget deficit that is projected to continue unless changes are made to bring the budget into sustainable balance. This deficit is the result of several factors including rising non-personnel related operating costs, increased labor costs, the loss of federal and state one-time funds, and the addition of ongoing services.

The Fiscal Year (FY) 2023-24 General Fund is projected to end the year with a \$2 million deficit, and the FY 2024-25 General Fund budget was adopted with \$13.3 million deficit. Each annual deficit requires reserves to be used to fill the gap in funding. At this rate, the General Fund Fiscal Stability Reserves will be gone by FY 2025-26, and available General Fund unassigned reserves will be exhausted by FY 2027-28.

The City's broad strategy of fiscal sustainability is to address the General Fund imbalance with a combination of revenue generation and expenditure reductions. The

GENERAL BUSINESS TAX BALLOT MEASURE

City has already begun making reductions in General Fund expenditure budgets. Budgets have been held flat for non-personnel related costs for the past two years despite increases in operating costs, and departments have been instructed to make additions to the budget on a cost-neutral basis. In the current fiscal year, the City instituted a hiring freeze, and will begin reducing expenditures through mid-year budget adjustments, and propose further reductions as part of the FY 2025-26 budget development.

In addition to reducing ongoing expenditures in the General Fund, staff is proposing adding ongoing revenue to help balance the budget.

Staff commissioned HdL, the City’s Business Tax administrator, to review the City’s Business Tax ordinance (Chapter 6-04) and measure its effectiveness compared to Business Tax ordinances adopted by other jurisdictions in the state. HdL found that Santa Rosa’s Business Tax ordinance underperforms when compared to other jurisdictions, and the main driver of that is the inclusion of a \$3,000 maximum. The maximum tax creates an inequity among businesses by imposing on small and medium businesses a higher effective tax burden than large businesses.

As illustrated on the chart below, Santa Rosa currently has a total of 12,962 businesses that are grouped in four main categories with a tax rate for each category ranging from \$0.34/\$1,000 to \$1.68/\$1,000.

Business Group	Type	Rate	Count	Percentage
Group 1	Corporate HQ	\$0.34/\$1,000	59	0.46%
	Manufacturing	\$0.34/\$1,000	139	1.07%
	Retail	\$0.34/\$1,000	1,979	15.26%
	Wholesale	\$0.34/\$1,000	222	1.71%
Group 2	Commercial Property Rental	\$0.84/\$1,000	675	5.21%
	Residential Property Rental (4+ Units)	\$0.84/\$1,000	674	5.20%
	Health Care Centers	\$0.84/\$1,000	48	0.37%
	General Service	\$0.84/\$1,000	4,760	36.71%
Group 3	Contractors	\$1.09/\$1,000	2,894	22.32%
	Land Developers	\$1.09/\$1,000	18	0.14%
	Public Utilities	\$1.09/\$1,000	3	0.02%
	Recreation and Entertainment	\$1.09/\$1,000	37	0.29%
Group 4	Professional	\$1.68/\$1,000	1,227	9.46%
Groups 5,6,7	Other/Misc, and Exempt		230	1.77%
Total			12,965	100%

Initially Proposed Ordinance Changes

Staff presented revenue measure options at a July 9, 2024 Study Session which included a revised Business Tax ordinance with four significant changes: 1) remove the \$3,000 maximum tax; 2) create a hybrid rate structure that left the current rates in place for those business currently under the maximum tax threshold, but included a new rate structure for businesses over the maximum tax threshold; 3) expand the definition of residential rental properties subject to the tax to include residential rental properties with one to three units; and 4) require all short-term rental operations to pay business tax. The estimated additional revenue from these changes would have been \$12 million per year.

Staff received comments from the City Council and from local businesses. These included:

- The proposed changes would run contrary to the recently adopted Economic Development Strategic Plan, especially the City's ability to attract and retain large businesses.
- Increasing the rate structure only for those businesses above certain thresholds was unfair.
- Removing the maximum tax cap would result in a significant burden on high-grossing businesses in the retail, auto sales, medical practice, and contractor businesses.
- Removing the maximum tax cap and increasing the rate structure represented a double hit to large businesses.
- Concern that expanding the definition of residential property rental subject to business tax to include properties with one to three units would have an adverse impact on low-income rental units.

Staff analyzed a number of options based on the feedback received from the Council and the business community. Staff analyzed a number of options that centered on keeping a tax cap but raising it to an amount between \$10,000 and \$50,000 and tying the cap to the San Francisco/Bay Area Consumer Price Index for All Urban Consumers (CPI-U) with a floor and ceiling. These changes would result in additional new revenue between \$1.6 million and \$2.1 million.

Staff also analyzed the impact of keeping the current rate structure but raising the base Business Tax Fee from \$25 to a range of \$200 to \$1,000 using a segmented scale of fee depending on the amount of gross receipts. The City's current rate structure includes a minimum, or base, tax rate that is factored into the rate calculation. The current amount is \$25, which is the tax for the first \$25,000 of gross receipts. For example, for a retail business with \$100,000 of annual gross receipts the following calculation would apply:

- $\$100,000 - \$25,000 = \$75,000$; $\$75,000 \times .00034 = \25.50 ; $\$25.50 + \$25 = \$50.50$.

Proposed Ordinance Changes

Considering all the information gained and taking into account how to impact businesses the least, while still generating new revenue to offset some of the General Fund structural imbalance, staff is proposing the following changes to the City's Business Tax:

- Leave the current Business Tax rates the same.
- Raise the maximum tax cap from \$3,000 to \$10,000
- Modify the minimum/base Business Tax to the following tax tiers
 - a. Tier 1: Gross Receipts of \$100,000 or less, tax is \$200
 - b. Tier 2: Gross Receipts of \$100,000.01 - \$500,000, tax is \$500
 - c. Tier 3: Gross Receipts of \$500,000.01 - \$1,000,000, tax is \$800
 - d. Tier 4: Gross Receipts of \$1,000,000.01 or more, tax is \$1,000 plus the appropriate rate calculation for any amount over \$1,000,000.
- Adjust the maximum tax, amounts, and flat fees annually based on the December CPI-U for San Francisco/Bay Area, and provide that the annual adjustment will not exceed 4% or go lower than 2%.
- Require Short-Term Rental operations to pay Business Tax, as do all other lodging operators.

Should the ordinance be adopted by Council and the measure be approved by voters, these changes will take effect for the 2025 business tax reporting period or January – March 2025. The estimated additional revenue resulting from this proposal would be about \$3 million per year.

Resolution

In addition to the proposed ordinance amendment, a resolution is necessary to place the tax measure on the ballot for the November 2024 election. The resolution orders the submission of a ballot measure to amend the City's Business Tax ordinance. The resolution contains the wording of the tax measure as it will appear on the ballot. The wording is recommended by the City Manager. The Resolution also directs other actions necessary to putting the ballot on the measure, including directing the City Attorney to prepare an impartial analysis of the measure as required by the Elections Code.

The resolution also allows for the submittal of "rebuttals" to the arguments that may be submitted for inclusion in the ballot pamphlet. The Council, in the exercise of its discretion, may permit or not permit "rebuttals."

Finally, the Resolution also provides an opportunity for the Council to designate an individual or individuals to submit an argument in favor of the measure and a rebuttal argument on behalf of the Council. The Council may, in its discretion, make such a designation.

FISCAL IMPACT

Funds have been included in the Fiscal Year (FY) 2024-25 budget to pay for costs associated with the November election. There is no additional impact to the General Fund.

ENVIRONMENTAL IMPACT

The rate increase adopted by the ordinance is exempt from the provisions of the California Environmental Quality Act (CEQA) pursuant to CEQA Guidelines Section 15061(b)(3) and 15378 in that there is no possibility that such an increase may have a significant effect on the environment.

BOARD/COMMISSION/COMMITTEE REVIEW AND RECOMMENDATIONS

The Long-Term Financial Policy and Audit Subcommittee reviewed the proposed ballot measures on June 13, 2024. The City Council received a presentation on proposed revenue measures on July 9, 2024.

NOTIFICATION

Not applicable.

ATTACHMENTS

- Resolution
 - Exhibit A – Ordinance (Clean)
 - Exhibit B - Ordinance (Redline)

PRESENTER

Alan Alton, Chief Financial Officer