TO:      HONORABLE CITY COUNCIL
FROM:    CITY MANAGER    DEPARTMENT:  ADMINISTRATIVE SERVICES
DATE:    JANUARY 23, 2006    CMR: 119:06-REVISED
SUBJECT: REQUEST FROM THE FINANCE COMMITTEE FOR COUNCIL DIRECTION REGARDING INSTITUTION OF A BUSINESS REGISTRY FEE OR A BUSINESS LICENSE TAX AND ON AN INCREASE TO THE TRANSIENT OCCUPANCY TAX

RECOMMENDATION
Staff recommends that Council provide direction on whether to move forward with establishing a Business Registry Fee or a Business License Tax; and, additionally, on whether to pursue an increase in the Transient Occupancy Tax (TOT).

BACKGROUND
On September 20, 2005, a report to the Finance Committee requesting direction on whether to move forward in implementing a Business Registry Fee (BRF) or a Business License Tax (BLT) was presented. This report contained the following topics and information:

- A brief history of BLT discussions in the City of Palo Alto
- The reasons for reviving deliberations on instituting a BRF or BLT
- Purpose, pros and cons, and options for a BRF.
- Purpose, pros and cons, and options for a BLT.
- Chamber of Commerce Government Action Committee (GAC) feedback on a BRF/BLT.
- Comparative data from surrounding cities with a BRF/BLT.
- Impact of a BRF or BLT on new and existing businesses given recent implementation of impact and other fees.

A copy of CMR:378:05, which has considerable information on a BRF and BLT, is attached (Attachment A) for Council reference. The primary reason for presenting the report was to complete one of Council’s Top 5 Priorities to explore new funding sources for new General Fund infrastructure projects and programs.

During the September 20 Finance Committee meeting, Committee members raised a number of questions and concerns about a BRF or BLT. These included:
• A BRF or BLT will have a significant impact on small businesses with narrow operating margins
• The timing of increasing fees or taxes, given tentative economic conditions and the City’s efforts to retain and attract businesses, is not favorable
• Fee or tax increases should be viewed in terms of other tax and fee burdens businesses bear, especially in light of recent impact fees imposed by the City
• The costs for collecting a BRF or BLT are high and inefficient based on recommended revenue yields
• How do businesses benefit from a BLF or BLT? What is the nexus between those who pay the tax and those who will benefit?
• Has staff considered alternative revenue sources such as a higher Transient Occupancy Tax (TOT)
• Does the City need a BLT to replenish the City’s infrastructure reserve that will be depleted over time? The City could increase savings and, therefore, reserves, by reducing expenditures in other areas

During public discussion, two residents spoke in favor of a BLT. One argued that a BLT was necessary to strengthen City’s revenues and to pay for the increased cost of services over time. The speaker argued that businesses have paid low property taxes as a consequence of Proposition 13 and that a BLT is equitable and necessary. The second speaker emphasized that businesses are not paying their fair share for costs incurred by the traffic they generate and the services their employees consume. He pointed to the sharp increase in the City’s daytime population and how service businesses that do not generate sales and transient occupancy taxes are not contributing to City resources. A third person spoke against the BLF or BLT citing arguments similar to those made by the Chamber of Commerce that are presented below.

Staff mentioned at the meeting that should Council indicate willingness to entertain a BLF or BLT, it would return with a variety of fee or taxation models for Council consideration. As mentioned in CMR:378:05, there are a variety of ways to allocate fees and taxes to businesses. An estimate of $5,000 to $10,000 for a consultant to develop these models was proposed.

After questions and comments, the Finance Committee voted 2-2 on whether to move forward with implementing a BLF or BLT and funding a consultant study. A tie vote required that the recommendation by staff be brought to the full Council for consideration and resolution.

**DISCUSSION**
Subsequent to the September Finance Committee meeting, staff met with the GAC. As with prior meetings, the purpose was to keep the GAC informed and to communicate its thoughts on a BLF or BLT to the City Council and senior City staff. Resistance to moving forward with a new fee or tax was clearly stated. There was opposition to a BLF based on the belief that information it would yield is already available and, more importantly, that it would inevitably lead to a tax. A BLT was challenged for a variety of reasons including: it would be burdensome on businesses; send the wrong message during a time of trying to attract and retain businesses; it would be costly to administer; and it would impose a tax on businesses such as home, professional and other services that have not been taxed to date. Additionally, the Chamber opposed spending $5,000 to $10,000 on a consultant to develop fee or tax models.
As mentioned, during the September 20 Finance Committee meeting, Council Member Morton indicated that a BLT was inefficient in raising revenue. To implement a BRF or BLT, first year start-up costs are estimated at $232,000 and second year program costs at $152,000. While a BLT could theoretically generate a wide range of revenue levels, staff preliminarily recommended a revenue target of $1.0 to $2.5 million. Council Member Morton said this return on the City’s investment was low compared to, for example, raising the City’s Transient Occupancy Tax which would incur no additional administrative costs. At current revenue levels, a 1 percent increase in the TOT would raise an estimated $600,000. Should Council want to consider this option, Attachment B provides a comparison between Palo Alto’s 10 percent TOT rate and those in other California jurisdictions. The rate in surrounding communities such as Menlo Park, Los Altos, East Palo Alto, and Mountain View is 10 percent. In addition, both the average and median rate for 67 jurisdictions surveyed is 10 percent.

In conclusion, staff requests that Council provide direction on whether to move forward with establishing a Business Registry Fee or a Business License Tax, or with an increase to the TOT. If Council’s direction is to move forward, then staff requests confirmation of spending $5,000 to $10,000 on a consultant modeling study.

POLICY IMPLICATIONS
This report is following Council direction to evaluate a new tax source to support new projects and programs. Examining a BRF or BLT is a component of one of Council’s Top 5 Priorities “City Finances.”

TIMELINE
Should Council give direction to pursue a BRF or BLT, staff would return with an in-depth study of either option in May 2006. Once this study is completed and a fee or taxation model is approved, implementation dates will be determined.

ENVIRONMENTAL ASSESSMENT
Implementing a fee or tax does not constitute a project for the purposes of the California Environmental Quality Act.

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ATTACHMENTS
Attachment 1: CMR:378:05 “Request for Council Direction Regarding Institution of a Business Registry Fee or a Business License Tax
Attachment 2: Transient Occupancy Rates for California Cities