



BUSINESS OPERATIONS TAX MODERNIZATION

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- During the Fiscal Year 2023-24 Budget Hearings, Council directed staff to explore modernization options for Business Operations Tax (BOT).
- The BOT on non-cannabis businesses has not been updated since 1991, and the limits established in 1991 have not been adjusted for inflation.
 - In 2010, Council considered a recommendation to increase the gross receipts rate and the maximum payment cap, but did not advance it to the ballot
 - Proposal was to increase BOT rate from 0.04% to 0.064% over 3 years and increase the maximum payment cap to \$30,000
- As the voters have recently acted on the Business Operations Tax for cannabis businesses, the following presentation is to present options for updating the BOT for non-cannabis businesses.

CURRENT SACRAMENTO BOT

- Established in 1975 and last updated in 1991.
- The maximum BOT payment cap is \$5,000 per year for all businesses.
- Charitable and non-profit organizations that are exempt under State or Federal law are exempt from payment of the City's BOT.
- Landlords renting 3 or fewer units are exempt from BOT.

Professional Business Owners

- Accountants, Architects, Attorneys, Doctors, Engineers etc
- Flat rate based on # years with license up to \$300 plus \$30 per licensed employee

Professional Brokers

- Real Estate Broker, Insurance Broker, or Stock Broker
- Flat rate of \$100 for primary broker plus \$30 per licensed employee

Housing & Shelter

- Flat rate of \$50 for hotel/motel/short term rental plus \$0.75 for each unit in excess of 4
- If renting 4 or more residential units, \$25 flat fee + \$1.75 per each unit in excess of 4

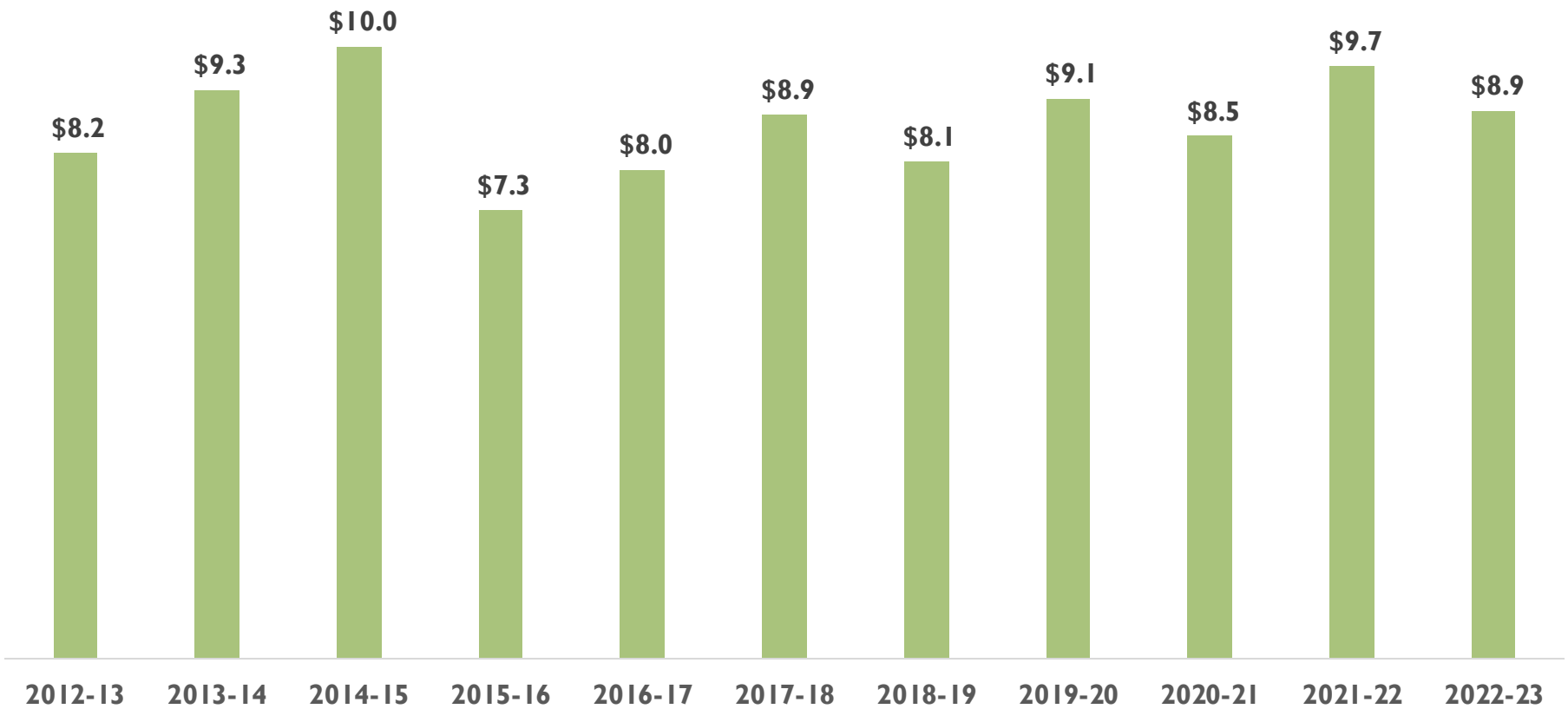
Construction / Manufacturing / Admin Headquarters

- Gross receipts equivalent amount determined by expenses in the City or by building permit cost.
- 0.04% of gross receipts equivalent (\$0.40 tax for every \$1,000 in gross receipts) for gross receipts over \$10,000

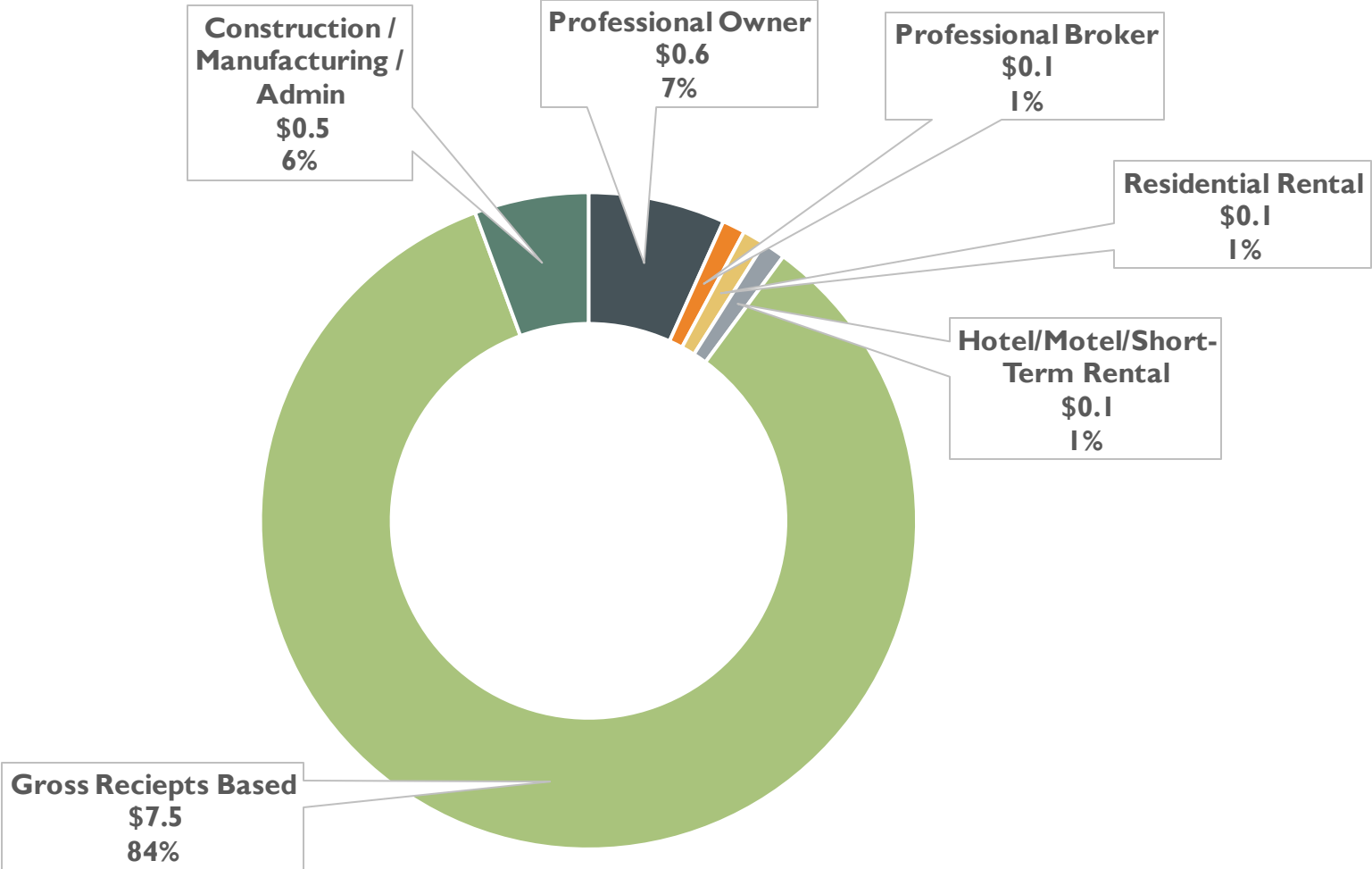
All Other Businesses

- 0.04% of gross receipts (\$0.40 tax for every \$1,000 in gross receipts) for gross receipts over \$10,000.

BOT REVENUES BY FISCAL YEAR EXCLUDING CANNABIS (MILLIONS)



BOT REVENUE BY CATEGORY FY 2022-23 (MILLIONS)



BOT BUSINESS PROFILE – FY 2022-23

Annual Gross Receipts FY 23	# Businesses	Total BOT Revenue	Effective BOT Rate
\$0 - \$10,000	6,433	\$0.3	0.869%*
\$10,001 - \$100,000	5,872	\$0.3	0.125%
\$100,001 - \$1,000,000	5,306	\$1.0	0.051%
\$1,000,000 - \$5,000,000	2,310	\$2.1	0.042%
\$5,000,001 - \$12,500,000	569	\$1.8	0.040%
\$12,500,001 - \$25,000,000	201	\$1.0	0.029%
\$25,000,001 - \$50,000,000	96	\$0.5	0.014%
\$50,000,001 - \$100,000,001	54	\$0.3	0.008%
\$100,000,000+	37	\$0.2	0.001%
Total – Gross Receipts Businesses	20,878	\$7.5M	0.020%
Total Professionals	1,859	\$0.7M	
Total Rentals	1,735	\$0.2M	
Total Other	155*	\$0.5M	
Grand Total	24,627	\$8.9M	

*Excludes count of construction businesses (associated revenue is included)

COUNCIL REQUEST METHODOLOGY

To examine BOT modernization options, staff considered the following:

- Practices in peer city jurisdictions to examine best practices among similarly sized California cities.
- Generally accepted criteria for a good tax system:
 - Adequacy – provides enough revenue to meet demand for public services;
 - Administrative Ease – rules are well known and fairly simple; the taxing authority can tell if taxes are paid correctly and on-time, and the taxing authority can conduct audits in a fair & efficient manner;
 - Efficiency – minimize economic distortions of a tax;
 - Fairness/Equity – similarly situated taxpayers pay similar amounts & differing ability to pay taken into account;
 - Simplicity - taxpayers can easily calculate how much they owe; and
 - Transparency – taxpayers can easily find information about the tax system & how tax dollars are spent.

PEER JURISDICTIONS (EXCLUDING CANNABIS)

Jurisdiction	Min	Max	Gross Receipts Threshold	Tax Rate	Other Info
Bakersfield	\$25	None	None	0.03% then lower at higher GR levels	
Folsom	\$40	None	None	Varies based on level of GR with high of 0.125% and low of 0.005%	Indexed to inflation For certain businesses flat fee plus per employee or per sq ft charge
Fresno	Some businesses assessed flat fee	\$21,200	\$5,000 (\$1,250 per quarter)	0.09% to 0.28% (lower rate at higher GR level)	
Long Beach	\$272	None	N/A	Per employee charge ranging from \$11 to \$34 per employee	Some businesses have flat rate plus per vehicle, per space etc charge
Oakland	\$60	None	Varies from \$17k to \$120k	0.05% to 0.5% based on business type & GR levels	Property rentals 1.395%
San Francisco	None	None	None	0.09% to 0.94% based on business type & GR levels	
San Jose	\$213	\$176,439	N/A	Per employee tax ranging from \$35 to \$71 per employee	Indexed to inflation

FINDINGS

- **Inflation** – The \$5,000 maximum established in 1991 would equate to over \$11,000 in 2023 dollars. City operating costs have also experienced inflation. A modernized BOT should adjust for inflation & contain a mechanism for future inflationary adjustments.
- **Peer Jurisdictions** – Many peer jurisdictions do not have a cap on annual BOT payments. Those with a cap have it set significantly higher than the current \$5,000 cap in the City of Sacramento.
- **Administrative Factors** – Standardizing rules where possible makes the tax easier to understand and administer.

MODERNIZATION OPTIONS

Based on the findings, staff developed 3 modernization options for consideration:

- Option 1 – Inflation Adjustment
- Option 2 – Increase Rate / Remove Annual Cap
- Option 3 – Staff Recommendation (Maintain Rate / Higher Annual Cap)

In each of the options, staff is recommending other modernizations such as indexing any caps or thresholds to inflation, standardizing flat & per employee rates for brokers & professionals, standardizing flat rate and per unit rate for rentals and hotels, and lowering the exemption for rentals to fewer than 2 units.

OPTION 1 – INFLATION ADJUSTMENT

Assumptions:

- Gross receipts tax:
 - Gross Receipts minimum threshold from \$10,000 to \$22,810;
 - Minimum payment from \$30 to \$68; and
 - No change to 0.04% rate.

- Flat fee for all professionals to \$684 & Per Employee Rate to \$68 to account for inflation.

- Flat fee for all rentals/hotels to \$114 and per room/unit rate to \$2.85 to account for inflation.

- Annual inflation adjustment going forward tied to Consumer Price Index.

- Increase annual maximum payment cap from \$5,000 to \$11,405.

Revenue Impact:

~\$3.0M in the first full Fiscal Year with increases in future Fiscal Years

OPTION 2 – INCREASE RATE / REMOVE CAP

Assumptions:

- Gross receipts tax:
 - Gross receipts minimum threshold from \$10,000 to \$22,810
 - Minimum payment from \$30 to \$68
 - Increase rate from 0.04% to 0.06%.
- Flat fee for all professionals to \$684 & Per Employee Rate to \$68 to account for inflation.
- Flat fee for all rentals/hotels to \$114 and per room/unit rate to \$2.85 to account for inflation.
- Annual inflation adjustment going forward tied to Consumer Price Index.
- Remove annual maximum payment cap.

Revenue Impact:

~\$17.2M in the first full Fiscal Year with increases in future Fiscal Years

OPTION 3 – STAFF RECOMMENDATION

Assumptions:

- Gross receipts tax:
 - Gross receipts minimum threshold from \$10,000 to \$50,000;
 - Minimum payment from \$30 to \$50; and
 - No change to 0.04% rate.

- Flat fee for all professionals to \$684 & Per Employee Rate to \$68 to account for inflation.

- Flat fee for all rentals/hotels to \$114 and per room/unit rate to \$2.85 to account for inflation.

- Annual inflation adjustment going forward tied to Consumer Price Index.

- Increase annual maximum payment cap from \$5,000 to \$150,000.

Revenue Impact:

~\$6.6M in the first full Fiscal Year with increases in future Fiscal Years

OPTIONS REVENUE IMPACT BY BUSINESS SIZE

Revenue Impact vs Current BOT (\$ millions)

Annual Gross Receipts FY 23	# Businesses	Option 1	Option 2	Option 3
\$0 - \$10,000	6,433	\$0.14	\$0.14	\$0.03
\$10,001 - \$100,000	5,872	\$0.13	\$0.16	(\$0.01)
\$100,001 - \$1,000,000	5,306	\$0.08	\$0.46	(\$0.07)
\$1,000,000 - \$5,000,000	2,310	\$0.04	\$1.05	(\$0.03)
\$5,000,001 - \$12,500,000	569	\$0.01	\$0.89	(\$0.00)
\$12,500,001 - \$25,000,000	201	\$0.41	\$1.11	\$0.41
\$25,000,001 - \$50,000,000	96	\$0.60	\$1.54	\$0.87
\$50,000,001 - \$100,000,001	54	\$0.34	\$1.93	\$1.19
\$100,000,000+	37	\$0.24	\$8.76	\$3.11
Total – Gross Receipts	20,878	\$2.00	\$16.05	\$5.49
Total Other Categories	3,749*	\$1.00	\$1.13	\$1.07
Total	24,627	\$3.0	\$17.2	\$6.6

*Excludes count of construction businesses (associated revenue is included)

GROSS RECEIPTS EFFECTIVE TAX RATE BY BUSINESS SIZE

Annual Gross Receipts FY 23	# Businesses	Current	Option 1	Option 2	Option 3
\$0 - \$10,000	6,433	0.869%*	1.486%*	1.486%*	1.093%*
\$10,001 - \$100,000	5,872	0.125%	0.176%	0.186%	0.121%
\$100,001 - \$1,000,000	5,306	0.051%	0.056%	0.074%	0.048%
\$1,000,000 - \$5,000,000	2,310	0.042%	0.043%	0.062%	0.041%
\$5,000,001 - \$12,500,000	569	0.040%	0.041%	0.061%	0.040%
\$12,500,001 - \$25,000,000	201	0.029%	0.040%	0.060%	0.040%
\$25,000,001 - \$50,000,000	96	0.014%	0.032%	0.060%	0.040%
\$50,000,001 - \$100,000,001	54	0.008%	0.017%	0.060%	0.040%
\$100,000,000+	37	0.001%	0.003%	0.060%	0.022%
Total		0.020%	0.026%	0.063%	0.035%

*Excludes businesses with zero reported gross receipts

AVERAGE \$ INCREASE FOR BUSINESS BY OPTION

Annual Gross Receipts FY 23	# Businesses	Option 1	Option 2	Option 3
\$0 - \$10,000	6,433	\$22	\$22	\$5
\$10,001 - \$100,000	5,872	\$22	\$27	(\$2)
\$100,001 - \$1,000,000	5,306	\$15	\$87	(\$13)
\$1,000,000 - \$5,000,000	2,310	\$17	\$455	(\$13)
\$5,000,001 - \$12,500,000	569	\$18	\$1,564	\$-
\$12,500,001 - \$25,000,000	201	\$2,040	\$5,522	\$2,040
\$25,000,001 - \$50,000,000	96	\$6,250	\$16,042	\$9,063
\$50,000,001 - \$100,000,001	54	\$6,296	\$36,296	\$22,037
\$100,000,000+	37	\$6,486	\$236,757	\$84,054
Overall Average	20,878	\$95	\$770	\$263

MODERNIZATION OPTION SUMMARY

Option 1 – Inflation Adjustment

- Adjusts all levels for inflation
- Maintains 0.04% rate
- Standardizes professional/rental rates & adjusts for inflation
- Future inflation adjustments
- Maintains more regressive structure
- \$3M/year revenue impact

Option 2 – Higher Rate / Remove Cap

- Adjusts all levels for inflation
- Increases rate from 0.04% to 0.06%
- Standardizes professional/rental rates & adjusts for inflation
- Future inflation adjustments
- Removes annual payment cap
- \$17.2M/year revenue impact

Option 3 – Staff Recommendation

- Smaller adjustment to minimum payment & raises gross receipts threshold
- Maintains 0.04% rate
- Standardizes professional/rental rates & adjusts for inflation
- Future inflation adjustments
- Maximum annual cap to \$150k
- Businesses under \$12.5M per year in gross receipts generally see reduction in BOT
- \$6.6M/year revenue impact

MODERNIZATION OPTION IMPACTS

Option 1 – Inflation Adj

Pros

- Lowest impact on businesses
- Accounts for inflation in future years

Cons

- Lowest revenue increase
- Maintains regressive tax rate structure

Option 2 – Raise Rate / Remove Cap

Pros

- Largest revenue impact
- Accounts for inflation in future years
- More progressive tax structure

Cons

- Largest impact on business
- Larger share of revenue reliant on smaller number of businesses
- Potential impact on sales tax revenue

Option 3 – Staff Recommendation

Pros

- Significant revenue impact
- Firms with GR under \$12.5M see net decrease
- Accounts for inflation in future years

Cons

- Lower revenue than Option 2
- Higher impact on business than Option 1

OTHER CONSIDERATIONS

- Projected structural budget deficit
 - BOT limits unchanged since 1991 & not indexed to inflation
 - City expense growth outpacing revenue growth
- Impact on businesses
 - Low \$5k current tax creates regressive effective tax rate structure on businesses
 - Gross receipts tax is 'top line' tax and can have larger impact on lower margin businesses
 - Large gross receipts businesses may also be large sales tax generators & too large of a BOT could cause firms to close or leave
- Increases could be phased in to help mitigate impact on businesses
- Timing of ballot measure & budget development process

NEXT STEPS

Earliest opportunity to put on the ballot would be the March 2024 primary. To make March 2024 ballot deadlines, the City would need to follow the timeline below:

- Oct 3, 2023 - Law & Leg Committee to provide direction and/or advance recommendation to Council
- Oct 31, 2023 – Council considers BOT Modernization Ordinance
- Nov 14, 2023 – Council acts to put item on March 2024 Primary Election



QUESTIONS & DISCUSSION

