

**CITY OF OAKLAND**  
**AGENDA REPORT**

OFFICE OF THE CITY CLERK  
2005 JUN 16 PM 9:20

TO: Office of the City Administrator  
ATTN: Deborah A. Edgerly  
FROM: Finance and Management Agency  
DATE: June 23, 2005

RE: **A REPORT AND ORDINANCE AMENDING CHAPTER 5, ARTICLE 4 OF THE OAKLAND MUNICIPAL CODE TO EXEMPT BUSINESSES WITH ANNUAL GROSS RECEIPTS OF \$2,500 OR LESS, ADJUST THE EXEMPTION AMOUNT PERIODICALLY BY THE CHANGE IN THE CONSUMER PRICE INDEX, AND TO DELETE THE CURRENT EXEMPTION FOR POVERTY JANUARY 1, 2006**

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**SUMMARY**

During the FY 2004-05 mid-cycle budget review, the City Council directed staff to submit a revision to Chapter 5, Article 4 of the Oakland Municipal Code (OMC), commonly referred to as the Business Tax Ordinance, to provide for an exemption of the tax for business with gross receipts of \$2,500 or less. The council directive was in response to citizens' concerns about the AB63 Tax Compliance program, which resulted in a number of small businesses being added to the City's business tax database. At its June 7, 2005 budget hearing, the Council asked staff to address three issues: 1) the fiscal impact of waiving the \$30 registration fee for businesses that would be subject to the \$2,500 exemption; 2) the fiscal impact of applying a CPI adjustment to the \$2,500 exemption; and 3) the impact of deleting the poverty exemption on persons currently receiving the poverty exemption.

**FISCAL IMPACT**

Businesses with gross receipts of \$2,500 or less are currently subject to an annual \$60 business tax. In FY 2004, 4,650 businesses reported gross receipts of \$2,500 or less. If the proposed small business exemption is applied to these 4,650 businesses, it would result in a loss of \$280,000 in Business Tax revenue. The estimated loss of revenue has been included in the FY 2005-07 Proposed Budget.

The number of businesses registering varies; however, staff estimates that approximately 500 businesses earning \$2,500 or less would register annually. The total revenue lost is \$15,000. The estimated loss of revenue has not been included in the FY 2005-07 proposed budget.

A periodic CPI adjustment to the small business tax exemption would not materially decrease revenue but would add a significant administrative burden, especially if enacted on an annual basis. Adjusting the small business tax exemption level every 3 years by the cumulative change in the CPI would be a more practical approach for taxpayers and staff.

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Between FY 2001-02 and 2003-04 only 16 persons used the poverty exemption resulting in a revenue loss of \$960 over the 3 year period. Currently, there are twelve (12) persons using the poverty exemption and only four (4) would likely qualify under the new small business tax exemption, leaving the other eight (8) subject to the minimum tax of \$60. Annual business tax revenue generated from those eight (8) accounts would total \$480 or more, depending on their actual gross receipts. The revenue impact from imposing the business tax on the poverty exempt persons has not been included in the FY 2005-07 proposed budget.

## **BACKGROUND**

Assembly Bill AB 63 (AB63) allows a city government to purchase lists from the Franchise Tax Board (FTB) disclosing certain records related to the business activities of residents, corporations and other entities within the city. In February 2003, the City purchased a list containing twenty-eight thousand ninety-two (28,092) records of persons with addresses within the jurisdictional boundaries of the city who reported business income on their 2001 State income tax return. Eleven thousand one hundred sixty-two (11,162) of those records were registered with the City. The remaining sixteen thousand nine hundred thirty (16,930) records are considered non-registered businesses.

Prompted by citizens' response to the implementation of AB63, the City Council sought a solution that would be fair to the taxpayers without a substantial revenue loss to the City. Originally, council proposed to waive penalty and interest assessments to respondents of the program. However, the City Attorney's Office advised that providing a waiver to AB63 taxpayers would require the City to waive penalties and interest assessed to all taxpayers resulting in an estimated \$5.9 million revenue loss. During the FY 2005-05 Mid-cycle budget review, the Council, in an effort to minimize fiscal impact to the City, instructed staff to prepare a revision to the Business Tax Ordinance. This revision will define small businesses as those grossing \$2,500 or less and exempt them from payment of the business tax. However, these small businesses are still required to register with the City and pay the one-time registration fee of \$30.

Section 5.04.620 of the OMC currently authorizes the Director Finance to allow for an annual exemption from the payment of business taxes by reason of poverty as defined by the Federal Register. However, the City Attorney's Office has advised that it has concerns about the legality of the poverty exemption because it treats taxpayers engaged in the same business activity differently.

## **KEY ISSUES AND IMPACTS**

### **\$2,500 Gross Receipts Exemption**

The proposed \$2,500 exemption eliminates the tax on very small businesses to encourage growth while limiting the negative financial impact to the City. Small businesses are defined in the Business Tax Ordinance as entities whose tax basis is set as gross receipts, excluding persons subject to taxation pursuant to Sections 5.04420 and 5.04.430 of the OMC (rental property owners) and who gross receipts do not exceed \$2,500 on all gross receipts (from within and without the city).

### **Registration Fee Waiver**

Although these small businesses are exempted from the business tax, they are, along with all businesses, required to register and pay a one-time registration fee of \$30. The \$30 registration fee covers only a fraction of the total cost of administration. Basic administration includes registering all new businesses into the City's database, sending them annual renewal requests and issuing them annual business tax certificates. The certificate identifies a business to their customers as a legitimate business licensed to do business in the City. The business registration process serves to identify all businesses operating within the City to insure zoning compliance for health and safety purposes, to update the City's economic database and offer business outreach and assistance, to minimize the potential for falsely identifying them as non-compliers through other tax enforcement efforts, and to ensure that only qualified businesses are exempted from the business tax. It is common practice among the Federal, State and local governments to have all businesses make annual filings even if they are not subject to taxation.

At its June 7, 2005 budget hearing, the Council asked for the fiscal impact of waiving the \$30 Business Tax registration fee on all small businesses with gross receipts under \$2,500. If the registration fee is waived, the City could lose approximately \$15,000 annually. The fee only covers a fraction of the overall administrative costs and is comparable to the fee charged in most other cities. The registration fee is an essential vehicle that supports tax compliance efforts and helps track the City's economic base. There would be little incentive to register a small business if no registration fee existed. If the registration fee were zero, no penalty or interest would apply for failure to register. However, if a business failed to register for their small business tax exemption, the business would be subject to the normal business tax along with any penalties and interest for late filing. The potential revenue loss from waiving the registration fee would be in addition to the loss of the minimum level tax of \$60 on these same small businesses, which is estimated at approximately \$280,000.

### **CPI Adjustment**

Also at its June 7, 2005 budget hearing, the Council asked staff to consider adding a periodic CPI adjusted threshold on the small business tax exemption. Applying an annual CPI adjustment to

the small business tax exemption in the range of three to four percent would increase the exemption amount by approximately \$100. A periodic CPI adjustment would best be considered on a cumulative basis every few years to avoid the administrative burden and cost to modify forms and re-educate staff and the public. The staff recommends adjusting the small business tax exemption level every 3 years by the cumulative change in the CPI over the prior 3 years, and rounding the exemption amount to the nearest \$100.

### **Poverty Exemption**

Section 5.04.620 of the OMC currently allows an exemption from the business tax for one year due to poverty for persons defined as physical persons as opposed to legal entities or organizations. The poverty exemption is based on household income, and not necessarily business income. The City Attorney's Office has advised that it has concerns about the legality of the poverty exemption because it treats taxpayers engaged in the same business activity differently. Given the creation of the exemption for small businesses, staff is recommending replacing the poverty exemption with the small business exemption. Currently, there are twelve (12) businesses that receive the poverty exemption. Based on a review of business tax records and some personal contacts with those holding a poverty exemption, it is estimated that only four (4) of the current twelve (12) accounts with poverty exemptions would receive an exemption under the proposed gross receipts exemption of \$2,500. The other eight (8) poverty exemption accounts would likely be subject to a business tax of \$60. To address the potential impact on these eight persons who would be subject to at least the minimum \$60 business tax, a simple grant program could be established to provide qualifying persons that meet poverty income requirements with the funds necessary to pay their annual business tax.

### **SUSTAINABLE OPPORTUNITIES**

**Economic:** The small business exemption will encourage the incubation and growth of small businesses in Oakland.

**Social Equity:** The small business exemption treats taxpayers involved in the same business activity the same.

### **DISABILITY AND SENIOR CITIZEN ACCESS**

None.

### **RECOMMENDATION(S) AND RATIONALE**

Staff recommends that the Council approve the proposed ordinance amending Chapter 5, Article 4 of the Oakland Municipal Code exempting businesses with gross receipts of \$2,500 or less from business tax, adjusting the small business tax exemption amount by the change in the Consumer Price Index every three years to the nearest one hundred dollars (\$100), and deleting

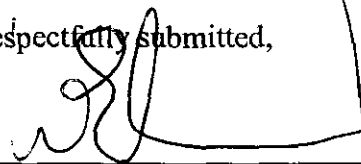
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the existing poverty exemption, all changes commencing January 1, 2006. Staff does not recommend eliminating the \$30 registration fee.

**ACTION REQUESTED OF THE CITY COUNCIL**

Staff requests that the Council approve the proposed ordinance amending Chapter 5, Article 4 of the Oakland Municipal Code exempting businesses with gross receipts of \$2,500 or less from business tax, adjusting the small business tax exemption amount by the change in the Consumer Price Index every three years to the nearest one hundred dollars (\$100), and deleting the existing poverty exemption, all changes commencing January 1, 2006.

Respectfully submitted,



William E. Noland

Director, Finance and Management Agency

Prepared by:

Terry Adelman, Revenue Manager

APPROVED AND FORWARDED TO THE  
CITY COUNCIL:



OFFICE OF THE CITY ADMINISTRATOR

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FILED  
OFFICE OF THE CITY CLERK  
OF OAKLAND

ORDINANCE NO. 2005 JUN 9: 22

**AN ORDINANCE AMENDING CHAPTER 5, ARTICLE 4 OF THE OAKLAND MUNICIPAL CODE COMMENCING JANUARY 1, 2006 TO EXEMPT PERSONS WITH ANNUAL GROSS RECEIPTS OF \$2,500 OR LESS FROM THE BUSINESS TAX ORDINANCE, TO ADJUST THE EXEMPTION AMOUNT PERIODICALLY BY THE CHANGE IN THE CONSUMER PRICE INDEX AND TO DELETE THE EXEMPTION FOR POVERTY SET FORTH IN CHAPTER 5.04 OF THE OAKLAND MUNICIPAL CODE**

**WHEREAS**, the City of Oakland (the "City") wants to provide an environment which encourages the growth of small businesses; and

**WHEREAS**, in order to encourage the growth of small businesses, the City desires to, commencing January 1, 2006, exempt businesses with annual gross receipts of \$2,500 or less from the payment of business taxes; and

**WHEREAS**, due to concerns as to its legality, the City of Oakland desires to delete the exemption for poverty set forth in Section 5.04.620 of the Municipal Code;

**NOW, THEREFORE, THE COUNCIL OF THE CITY OF OAKLAND DOES HEREBY ORDAIN AS FOLLOWS:**

SECTION 1. The City Council finds and determines the forgoing recitals to be true and correct and hereby adopts and incorporates them into this Ordinance.

SECTION 2. The Municipal Code is hereby amended to add, delete, or modify sections as set forth below (section numbers and titles are indicated in **bold type**; additions are indicated by underscoring and deletions are indicated by ~~strike-through type~~; portions of the regulations not cited or not shown in underscoring or strike-through type are not changed.

SECTION 3. Section 5.04.620 of the Municipal Code is hereby deleted in its entirety:

**~~5.04.620 Exemption for poverty.~~**

~~Director of Budget and Finance, acting by and through the Business Tax Section shall, if it determines that any person by reason of poverty merits exemption from the business tax requirements of this chapter, grant such person an exemption of one free certificate for the conduct of any one business taxed by any provisions of this chapter; provided, however, that when it appears to the satisfaction of the Director of Budget and Finance that the conditions which warranted an exemption under this section no longer exist, said Director of Budget and Finance may revoke such exemption and the certificate issued.~~

~~A. For purposes of this section "person" is deemed to be a physical person as opposed to a legal person or organization. Legal persons and organizations cannot file for a poverty exemption under the provisions of this chapter.~~

~~B. For purposes of this section "poverty" means that the combined family income from all sources does not exceed poverty income levels as defined by the Federal Register.~~

~~C. For purposes of this section, appeals from the determination of the Director of Budget and Finance must be filed with the City Manager within twenty (20) days from the date of the notice of said determination.~~

SECTION 4. Section 5.04.620 is hereby added to the Municipal Code to read as follows:

**5.04.620 Small Business Exemption.**

(a) Notwithstanding any other provisions of this Chapter, "small business enterprises" as hereinafter defined, shall be exempt from payment of business tax; provided, however, that small business enterprises shall pay the registration fee pursuant to Section 5.04.100 and shall submit an annual statement pursuant to Section 5.04.090.

(b) The term "small business enterprise" shall mean and include any person (other than persons subject to taxation pursuant to Sections 5.04.420 and 5.04.430 of this Code):

(1) Whose tax basis under this Chapter is set as gross receipts;  
and

(2) Whose annual gross receipts do not exceed \$2,500; and

(3) Any person claiming exemption from the requirement of paying the business license tax under this Section shall be required to obtain a business license and timely file for exemption and subsequent renewals before the delinquency date. The failure to timely file or renew prior to the date the taxes would otherwise have been delinquent, shall render the small business exemption inapplicable and shall subject the person to the tax that would otherwise be payable as well as to any interest and penalties applicable thereto. Persons claiming exemption shall be required to pay the business licenses application fee and all other applicable City fees, and to obtain all permits required for the operation of the business.

(4) Any person claiming exemption under this Section shall submit documentation evidencing the total taxable and nontaxable gross receipts of the applicant in support of the initial exemption registration and the annual exemption renewal. Such documentation shall comply with the requirements established by the Finance Director to ensure accuracy and validity of the City's determination on the exemption claim.

(5) Beginning with the 2010 tax year, the maximum annual gross receipts threshold for the small business exemption shall be adjusted to reflect the rate of inflation every three (3) years to the level equal to the cumulative change in the U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index (CPI) or other method of measuring the rate of inflation which the City Administrator determines is reliable and generally accepted, over the three (3) preceding fiscal years, and rounding the exemption amount to the nearest \$100.00.

SECTION 5. This ordinance shall become effective immediately upon its final adoption by a three-fourths vote of all members of the City Council of the City of Oakland.

IN COUNCIL, OAKLAND, CALIFORNIA, \_\_\_\_\_, 2005

**PASSED BY THE FOLLOWING VOTE:**

AYES- BROOKS, BRUNNER, CHANG, KERNIGHAN, NADEL, QUAN, REID, AND  
PRESIDENT DE LA FUENTE


NOES-

ABSENT-

ABSTENTION-

ATTEST: \_\_\_\_\_

LATONDA SIMMONS  
Interim City Clerk and Clerk of the  
Council of the City of Oakland,  
California

  
\_\_\_\_\_  
JUN 21 2005