**REPORT FROM**

## OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: January, 18, 2013

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Council File No. 09-1914-S13
Council District: All

To: Antonio R. Villaraigosa, Mayor
Herb J. Wesson, Council President
Eric Garcetti, Chair, Jobs and Development Committee

From: Miguel A. Santana, City Administrative Officer Miguel A. Santana

Subject: **TAXING SYSTEM - RADIO AND TELEVISION BROADCASTING INDUSTRIES**


### SUMMARY

On November 16, 2012, the City Council requested additional information concerning proposals to change the methodology used to calculate the gross receipts business tax for the radio and television broadcasting industry (C.F. No. 09-1914-S13). Specifically, the Council requested: 1) a study to be conducted by the Office of Economic Analysis (OEA) to analyze the impact of revising the tax structure and implementing a new tax rate secure from Proposition 218 challenges; 2) the identification of funding for the OEA study by the Office of the City Administrative Officer (CAO); and, 3) that the City further discuss the business tax issues raised by the Motion Picture Association of America (MPAA) in its letter dated September 7, 2012. This report provides an update on information gathered as a result of the subsequent discussion held pursuant to the Council's request. Specifically, this update revises the projected impact to General Fund revenue from the implementation of a new tax structure as a reduction in business tax revenue of approximately $417,000. The OEA study and the necessary identification of funding are pending upon further direction from Council. Additional recommendations to proceed with implementing changes to the tax rate and methodology for the radio and television broadcasting industries include defining a new taxpayer subclass, making necessary findings to justify changing the taxing methodologies, and identifying changes to tax methodology and rate that minimize lost general fund revenue.


### FINDINGS

On July 25, 2012, the City Council instructed the Offices of the CLA and CAO to review the City's taxing system for the radio and television broadcasting industries and to evaluate a proposed maximum tax similar to the entertainment production cap (C.F. No. 09-1914-S13). Additionally, on September 7, 2012, the MPAA submitted comments to City staff, relative to the City's taxing methods for radio and television broadcasters.

The Offices of the CAO, CLA and Finance met with MPAA representatives to discuss the proposed changes to tax methodology and other expressed concerns in August, the outcome of which was detailed in the CLA's October 23, 2012 report. The report summarized the existing taxing methodologies for the radio and television broadcasting category, the business tax receipts received from the category, and the projected impact to receipts with the implementation of the proposed cap. The report noted that the tax category also included theater operators, so that the number of potential business that would be affected by the proposed changes (4,241) and the potential impact to General Fund receipts ($3.2 million) would be lower. The Office of Finance reported that it was not able to break out the category data for broadcasters alone due to limitations of the LATax system.

On October 24, 2012, the Jobs and Business Development Committee considered the CLA's report and made recommendations for the OEA to study proposed revisions to the tax structure that would be secure from Proposition 218 challenges and for this Office to identify funding for this study. Additionally, the Offices of the CAO, CLA, and Finance, along with the City Attorney, were requested to meet with the MPAA for continued discussion of proposed tax changes and to further refine figures for the number of broadcasters that would be entitled to the lower tax rate and for the corresponding impact to revenue.

The OEA study is pending the identification of funds for the hiring a consultant. The City met with the MPAA on November 7, 2012 to further discuss its concerns with the business tax methodology and to settle on a approach to identify relevant "broadcasters" within the existing business tax category. The MPAA has provided a list of 52 businesses that it has identified as broadcasters using data from the Federal Communications Commission's website by pulling all FCC-licensed stations in a 30-mile radius and eliminating those licensees that did not have a station address of "Los Angeles" in the media buyers' guide. The Office of Finance then identified the licensed stations within the LATax system. After eliminating exempted businesses (e.g. non-profits, schools, churches) and business with multiple licenses, Finance determined that 30 businesses generated approximately $440 million in gross receipts for which they paid $566,000 in taxes in the 2012 tax period.

Currently gross receipts for the current television and radio broadcasters and theater operators category are taxed at a rate of $1.27 per $1000 (0.127 percent). The proposed tax structure is based on the rate structure for the entertainment production cap for motion picture, radio and television producers. The minimum tax would be $145, or fractional part thereof, for the first $5 million of gross receipts (0.0029 percent) and $1.30 for each additional $1,000 in excess of $5 Million (0.13 percent) with a maximum tax capped at $9,245. Gross receipts above $12 million will not be taxed (0 percent).

Table 1. Proposed tax structure for broadcasters

| Gross Receipts | Business Tax Rate | Percent of Gross Receipts |
|---|---|---|
| Less than $5 million | $0.029/$1000 ($145 max) | 0.0029 percent |
| Between $5 million and $12 million | $1.30/$1000 ($9,245 max) | 0.13 percent |
| Greater than $12 million | $0/1000 | 0 percent |

For the proposed new tax structure, maximum gross tax receipts are projected to be $149,000 (based on 2012 tax figures). The resulting impact to the General Fund is estimated $417,000 in lost revenue.

Table 2. Actual and estimated gross tax receipts for MPAA-identified stations

| Gross Receipts Range | Number of Taxpayers | 2012 Total Gross Receipts | 2012 Taxes Paid | Estimated Taxes under Cap | Net Impact to General Fund |
|---|---|---|---|---|---|
| Less than $5 million | 8 | $19 million | $32,000 | $1,000 | $31,000 |
| Between $5 and $12 million | 8 | $54 million | $68,000 | $19,000 | $49,000 |
| Greater than $12 million | 14 | $367 million | $466,000 | $129,000 | $337,700 |
| Total | 30 | $440 million | $566,000 | $149,000 | $417,000 |

However, the Office of Finance has cautioned that the number of potential businesses that may be eligible under a new "broadcaster" category may be higher than 30 businesses identified by the MPAA and Finance. Specifically, Finance reported that prior to the consolidation of the broadcasting category with theater operators, taxpayers in the broadcaster category numbered more than 3,500, with General Fund receipts amounting to $3.3 million in the 2007 tax period. For comparison, taxpayers in the consolidated category numbered 4,200 with receipts at $3.9 million in the 2012 tax period.

Table 3. Comparison of broadcaster categories gross tax receipts before and after consolidation

| Tax Period | Tax Category | No. of Accounts | Tax Receipts |
|---|---|---|---|
| 2007 | L389 & L589, TV & Radio Broadcasters | 3,556 | $3,323,000 |
| 2012 | L045, TV & Radio Broadcasters and Theater Operators. | 4,241 | $3,932,000 |

The discrepancy between the number of MPAA-identified broadcasters and of taxpayers falling within both the old and new broadcasting categories may be attributed to the definition of the tax categories. If the City seeks to implement a cap targeting only some within in the category, this would require creating a new "sub-class" within the present L045 classification rather than using the previous broadcaster category. If the City declines to create a subclass, the reported revenue loss would be greater, as reported in the CLA's October 23, 2012 report. According to the Office of the City Attorney, as long as the City has a rational basis for treating these businesses differently, a new subclass and tax structure could be implemented that would reduce the potential for legal challenges. The City may opt to implement other taxing methodologies and rates, but caution is required to avoid Proposition 218 challenges should the change result in a higher tax burden for individual taxpayers.

To move forward with the gross receipts tax cap or other tax methodology changes for broadcasters, the City needs to make legislative findings that the different tax treatment is appropriate. Prior to making such legislative findings, the City Council will need to define the new sub classification through the policy process. As such, continued discussion is necessary between the broadcasting stakeholders, policy makers, and the Offices of the Chief Legislative Analyst, Finance and the City Attorney.

Aiding legislative findings is the identification of positive benefits (e.g., new business formation, job growth, offsetting tax revenue) that would result from the favorable tax treatment of the new subclass. Should the City wish to pursue a study of the proposed tax changes, the next step would be to release a Request for Proposals to the OEA's on-call consultant list. Therefore, as previously directed, this Office will work with policy makers to identify funding for the OEA study to be included in the next Financial Status Report. Alternatively, Council may consider reforming the tax structure for broadcasters as part of larger gross receipts tax reform.

**RECOMMENDATIONS**

That the Council, subject to the approval of the Mayor:

1. Instruct the Office of Finance, with the assistance of the City Attorney, to report to City Council on the establishment of a new subclass for radio and television broadcasters from the existing L045, Television and Radio Broadcasters and Theater Operators gross receipts business tax category;

2. Instruct the Office of the Chief Legislative Analyst to report to the City Council on findings that justify modifying the existing tax rate and methodology for the proposed subclass; and,

3. Instruct the Offices of the City Administrative Officer, the Chief Legislative Analyst and Finance, with the assistance of the City Attorney, to report to City Council in 45 days on options for modifying the existing tax methodology and rate for the proposed subclass to address the comments of stakeholders and to minimize the revenue impact from zero to less than $100,000 annually.

**FISCAL IMPACT STATEMENT**

Implementation of a tax rate and maximum cap on gross receipts business taxes for the radio and television broadcasting industry as defined in this report will reduce general fund receipts from business taxes by $417,000 annually.

*MAS:RPC:BC/MCK: 01130057*