REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

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CAO File No. 0160-00323-0050
Council File No. 09-1914-S13
Council District: All

To: City Council

From: Miguel A. Santana, City Administrative Officer

Subject: **TAXING SYSTEM - RADIO AND TELEVISION BROADCASTING INDUSTRIES PROPOSED MODIFICATION TO GROSS RECEIPTS TAX RATE**

SUMMARY

On January 23, 2013, the Jobs and Business Development Committee met for consideration of proposed changes to the business (gross receipts) tax rate for radio and television broadcasters, specifically the implementation of a maximum cap for a new broadcaster subclassification (C.F. No. 09-1914-S13). The Office of the City Administrative Officer (CAO) estimated in its January 18, 2013 report that the cap for the proposed subclass would reduce business tax revenue by $417,000. The Committee made subsequent recommendations, adopted by Council on February 26, 2013, instructing: 1) the Office of Finance (Finance) to report on the establishment of the new subclass for radio and television broadcasters; 2) the Office of the Chief Legislative Analyst (CLA) to report on findings that justify reducing the existing tax rate and methodology for the proposed subclass; and, 3) the CAO, CLA, and Finance to report on options for modifying the existing tax methodology and rate for the subclass to address the comments of stakeholders and to minimize the revenue impact to less than $100,000 annually.

In order to address the final recommendation, Finance has provided gross receipt data for the 2014 tax period that corresponds to the proposed subclassification initially defined by the Motion Picture Association of American (MPAA) as FCC-licensed stations with addresses in Los Angeles. The CAO has evaluated several tax structures to minimize tax loss to approximately $100,000 annually, which are discussed in further detail in the findings.

FINDINGS

On July 25, 2012, the City Council instructed the Offices of the CLA and CAO to review the City's taxing structure for the radio and television broadcasting industries and to evaluate replacing the current tax rate of 0.127 percent of gross receipts with a maximum tax structure similar to the entertainment production cap (see Table 1).

Table 1. Entertainment production cap tax structure

Gross Receipts	Business Tax Rate	Percent of Gross Receipts
Less than $5 million	$0.029/$1000 ($142 max)	0.0029 percent
Between $5 million and $12 million	$1.30/$1000 ($9,242 max)	0.13 percent
Greater than $12 million	$0/$1000 ($9,242)	0.0 percent

The CLA subsequently reported on October 23, 2012 that changes to the existing broadcasting tax structure would also apply to theater operators, potentially impacting 4,241 businesses and reducing General Fund receipts by $3.2 million (C.F. No. 09-1914-S13). In an effort to reduce the impact to General Fund receipts, City staff met with the MPAA, per Council instruction, and narrowed down eligible businesses to 30 (now 29 in tax period 2014) broadcasters. This smaller group generated approximately $408 million in gross receipts and paid $514,000 in business taxes in the 2014 tax period. The CAO estimates that implementing a tax structure based on the entertainment production cap for this smaller group would result in $366,000 in lost revenue (Table 2).

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

Gross Receipts Range	Number of Taxpayers	2014 Total Gross Receipts	2014 Business Taxes Paid	Estimated Taxes under Cap	Net Impact to General Fund
Less than $5 million	9	$21 million	$25,000	$1,000	$24,000
Between $5 and $12 million	8	$67 million	$85,000	$37,000	$48,000
Greater than $12 million	12	$320 million	$404,000	$110,000	$294,000
Total	29	$408 million	$514,000	$148,000	$366,000

Pursuant to Council's instructions, this Office has developed options to modify the existing tax structure while limiting the corresponding revenue reduction to $100,000 or less. Finance provided 2014 tax period data for the previously identified broadcasters. Using this data, five proposed tax methodologies benefiting some or all of the broadcaster taxpayers are presented below (Table 3), followed by an explanation of each option.

The options presented employ two basic adjustments to the tax structure: capping the amount of gross receipts that are taxable and/or reducing the tax rate applied to gross receipts. Applying a cap establishes a fixed dollar amount for taxable gross receipts, whereby receipts above the cap amount are exempt from taxation. A consequence of using a cap is that only taxpayers with gross receipts above the cap will benefit from its use, owing the same amount in taxes regardless of the amount of gross receipts earned. Alternatively, a reduction in a tax rate lowers the amount of tax that must be paid on receipts by a certain percentage for all taxpayers regardless of the amount of gross receipts earned. A rate reduction may also be designed to provide additional relief to taxpayers with lower gross receipts by using a progressive tax rate structure, wherein the tax rate increases as earnings increase. In each of the options presented below, the estimated annual reduction to the City's business tax revenue is approximately $100,000.

Table 3. Actual and estimated gross tax receipts for MPAA-identified broadcasters

Options	**Gross Receipts Tax Rate**	**Cap on Taxable Gross Receipts**	**Description**
Current	*0.127 percent*	*None*	*Current rate applicable to Tax Classification 5, Radio/Television/ Theater Operators*
1.	0.103 percent	None	Equal benefit for all taxpayers in subclass.
2.	0.100 percent <$5 million 0.103 percent <$25 million 0.105 percent <$50 million 0.107 percent >$50 million *0.107 percent maximum effective tax rate*	None	Maximum benefit to businesses with lower gross receipts, some benefit to all others decreasing with gross receipts income.
3.	0.127 percent	$25,500,000	Maximum benefit to businesses with over $25.5 million in gross receipts, no benefit to others.
4.	0.117 percent	$50,000,000	Maximum benefit to businesses with over $50 million in gross receipts, some benefit to all others.
5.	0.110 percent <$5 million 0.120 percent <$25 million 0.130 percent <$50 million *0.124 percent maximum effective tax rate*	$50,000,000	Maximum benefit to businesses with over $50 million in gross receipts, some benefit to all others decreasing with gross receipts income.

- Option 1 would reduce the current rate of 0.127 percent ($1.27 per $1000) to 0.103 percent ($1.03 per $1000) of gross receipts for all taxpayers eligible for the new subclassification. This is the lowest rate possible while limiting revenue loss to $100,000 or less.

- Option 2 uses a more complex, progressive tax structure to increase the benefit to businesses with lower gross receipts. The maximum effective tax rate would be approximately 0.107 percent ($1.07 per $1000) of gross receipts. The effective rate would decrease for those taxpayers with gross receipts less than $50 million as a result of the progressive rate structure.

- Option 3 incorporates the lowest possible cap on taxable gross receipts (where receipts above $25.5 million would remain untaxed) while limiting revenue loss to $100,000 or less. All other taxpayers would continue to pay at the established rate of 0.127 percent ($1.27 per $1000) of gross receipts.

- Option 4 has a higher cap of $50 million, while reducing the existing rate from 0.127 percent to 0.117 percent ($1.17 per $1000) of gross receipts for all other taxpayers in the subclassification. This methodology provides a cap, while providing a smaller rate reduction to broadcaster taxpayers with lower gross receipts.

- Option 5 includes the same cap as Option 4 of $50 million, combined with a progressive rate structure. The maximum effective tax rate would be approximately 0.124 percent ($1.24 per $1000) of gross receipts, which is below the current rate of 0.127 percent ($1.27 per $1000), thereby ensuring compliance with Proposition 218. The maximum tax obligation ($61,890) would be paid by broadcaster taxpayers with $50 million or more in gross receipts. The effective rate would decrease for those taxpayers with gross receipts less than $50 million as a result of the progressive rate structure, and it would also decrease for those taxpayers with gross receipts greater than $50 million as a result of the cap. Broadcaster taxpayers with $56,500,000 or more in gross receipts will have effective rates lower than those taxpayers with $5 million or less in gross receipts.

It should be noted that as broadcaster gross receipts increase, the corresponding reduction to business tax revenue would also increase in absence of an adjustment to the tax structure. Tax structures that utilize a cap (Options 3, 4, and 5) will see a greater reduction to business tax revenue as gross receipts increase beyond the cap and become exempt from taxation.

Prior to implementing a new tax structure, language to clearly define the members of the new broadcaster subclassification will need to be provided to the City Attorney in order to develop the ordinance. Additionally, the City should determine whether there is sufficient benefit in implementing the new subclassification and corresponding tax rate structure. Should Council make such a finding, the tax methodology proposed under Option 1 has several advantages: it maintains the simplicity of the existing gross receipts tax structure; minimizes increasing revenue losses that would arise from a gross receipts cap; and provides equal treatment to all taxpayers within the proposed subclassification. Furthermore, it is recommended that the implementation of a new tax structure include a sunset provision to allow the City to evaluate the continuing impact to revenue and to make appropriate adjustments to the structure if needed.

RECOMMENDATIONS

1. Adopt Option 1 of the proposed tax methodologies, which reduces the current business (gross receipts) tax rate from $1.27 per $1000 to $1.03 per $1000 of gross receipts for radio and television broadcasters, contingent upon Council approval of the establishment of the new tax subclassification; and,

2. Request the City Attorney to prepare and present an ordinance to establish a new radio and television broadcasters subclassification and tax rate, to include a four-year sunset provision.

FISCAL IMPACT STATEMENT

Reducing gross receipts tax rate from $1.27 per $1000 to $1.03 per $1000 of gross receipts for the radio and television broadcasting industry will reduce general fund receipts from business taxes by approximately $100,000 annually.

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