FORM GEN. 160

CITY OF LOS ANGELES
INTER-DEPARTMENTAL CORRESPONDENCE

Date:	*November 7, 2011*	CAO File No.	016009
		Council File No.	09-1914-S6 & 7
		Council District:	Citywide

To: Jobs and Business Development Committee

From: Miguel A. Santana, City Administrative Officer
Gerry F. Miller, Chief Legislative Analyst

References: Report of Business Tax Advisory Committee Recommending How to Eliminate Gross Receipts Business Tax;

Motion: (Alarcon-Parks) Phased Approach to Eliminating the City's Gross Receipts Tax

Motion: (Garcetti-Parks) How Best to Eliminate the Gross Receipts Tax

Subject: **Business Tax Relief**

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SUMMARY

By the referenced motions, the City Administrative Officer and the Chief Legislative Analyst were requested to report on approaches to reform of the City's gross receipts tax. At the September 28, 2011 meeting of the Jobs and Business Development Committee, a report by the Business Tax Advisory Committee (BTAC) was presented by the BTAC chairman, Lloyd Grief. In its report, the BTAC recommended a four-year phased elimination of the business tax.

In recent years, the City has exempted small businesses and new businesses with receipts below a specified amount from the business tax. It has also provided targeted business tax relief to categories of businesses that could relocate easily and relief for businesses in empowerment zones. The City also reduced general tax rates by 15%.

At the recommendation of BTAC, the City contracted with Professor Charles Swenson of the University of Southern California to conduct an economic analysis of alternative business tax reform proposals. Based on information in Professor Swenson's report, BTAC recommends the elimination of the business tax during a four-year period. This is intended to encourage business expansion, retention and attraction in the City and thereby create employment growth. After a four-year phase-in, the direct revenue loss from this proposed change is an annual reduction of about $439 million in business tax revenue. BTAC uses Professor Swenson's analysis to argue that elimination of the business tax would not only be revenue neutral to the City, it would actually result in substantial additional revenue from increased economic activity. The BTAC report states additional revenue would come from increased property, sales, utility and other taxes; additional fees; and reimbursements and transfers.

Any business tax relief should be implemented in such a manner that permits flexibility and adjustment as the results from tax reform become available. The City has made a number of business tax reforms in recent years. Continued reform would likely prove beneficial, but the benefits of both new proposals and recently implemented reforms should be measured before a decision is made to eliminate the business tax.

DISCUSSION

Consultation – We have had discussions with Professor Swenson; Christopher Thornberg, founding principal of Beacon Economics; Gary L. Toebben, President and CEO, Los Angeles Area Chamber of Commerce; William C. Allen, Los Angeles Area Economic Development Corporation; and other staff to those organizations.

Professor Swenson, who performed the economic analysis for BTAC, states in his report, "It is my recommendation that for any Proposals adopted, their effectiveness be evaluated a year or two after adoption. Increased employment and new businesses in the City can be estimated using the methodology in this Report." Professor Swenson states that his study does not provide a time trajectory for achievement of revenue neutrality.

Christopher Thornberg of Beacon Economics did a preliminary review of Professor Swenson's study and found what he believes to be over-estimates of the potential positive impacts of reducing or eliminating the gross receipts tax on the City's economy. He reports "this study is so flawed as to really provide no guidance on this issue." He did note, however, that the idea that lowering or eliminating the gross receipt tax would result in an increase in overall tax revenues for the City seems improbable at best.

Gary Toebben and staff from the Los Angeles Area Chamber of Commerce and William C. Allen and staff from the Los Angeles County Economic Development Corporation were helpful in our review of Business Tax reform. Both acknowledged that the City's business tax is a barrier to attracting and retaining businesses, but other factors including improvements in audit practices and responsiveness to taxpayer inquiries would also be helpful. Whatever decisions are made, both agree that predictability is important. Smaller changes that will be consistently and fairly applied over time will be more attractive to business than limited or one-time gestures.

Tax Relief– In the most recently completed tax year (City tax receipts in FY 2010-11), the City provided more than $135 million in business tax relief, including:

- Small and new business and empowerment zone credits provided tax relief to promote businesses attraction and retention ($28 million);
- General tax rate reductions provided relief to all businesses ($68 million); and
- Targeted business tax relief provided tax relief to specific industries and situations (estimated $39 million) as detailed below:

Targeted Business Tax Relief Since FY 1994-95
Distribution of Estimated $39 Million Annual Benefit

Beginning Fiscal Year	Tax Relief	On-going Revenue Reduction $ Millions	Note
94-95	Wholesale & Manufacturing Tax Relief	(10.0)	
	Hollywood-North Hollywood Multi-Media	(0.2)	
00-01	End Payroll Expense Tax	(3.0)	
01-02	End Tax on Inter-company Transfers	(3.0)	
	Matching Interest Paid by City to Penalties Imposed	(2.0)	
03-04	Single Category Filing	(2.9)	
04-05	Bad Debt Reform	(3.0)	
05-06	Entertainment Talent Exemption	(0.7)	
	Production Cost Threshold	(2.0)	
07-08	Consolidate Business Tax classes	(0.8)	
09-10	Internet Tax Relief	(3.4)	
10-11	Entertainment Production Cap	(1.0)	
11-12	Mutual Fund Relief	(7.0)	Still pending; tax relief would help protect business tax base.

On a straight-line basis, without the $135 million in business tax relief, budgeted FY 2011-12 business tax receipts would be nearly 24 percent higher.

The Business Tax Advisory Committee Proposal – BTAC recommends an irrevocable phase-out of the business tax by reducing business tax revenue during a four-year period by 25% each year. As proposed, all taxpayers would receive immediate relief, but the greatest relief in the early years would be to taxpayers currently paying taxes at the highest rates and those most likely to leave. Assuming budgeted 2011-12 business tax revenue of about $439 million, tax rates would be reduced to roll back approximately $110 million in business tax revenue for each of the next four years.

BTAC anticipates that implementation of this proposal would:

- Result in a one-time revenue gain of $40 million as businesses react favorably to the phase-out of the business tax;
- Heighten economic activity and employment growth of 131,000 new jobs;
- Generate additional revenue from the property, utility, sales and other revenues which would make up – or more than make up – for the loss of business tax revenue.

BTAC recommends that elimination of the business tax be across the board for all industries and businesses regardless of size since businesses require predictability to make investment decisions. BTAC believes tying the time-table or amount of business tax phase-out to "triggers" or "milestones" would doom this business tax reform effort to failure.

The BTAC proposal claims revenue neutrality to the City since it is premised on a significant immediate increase in local economic activity and job creation. But if the economic growth were lower than anticipated or if the timetable for achievement of this growth were longer than anticipated by BTAC, the City could experience a significant net revenue reduction as business tax revenues decline while other revenues do not grow or do not grow sufficiently to cover the loss in business tax revenue. To be revenue neutral, any growth in other revenues would have to be above the level currently projected.

Cross-check – The BTAC proposal is based upon audited FY 2009-10 business tax receipts of $425 million. The FY 2011-12 budget includes projected business tax receipts of $439 million. This report uses the FY 2011-12 budget of $439 million to project the impact of eliminating the business tax.

BTAC projects the increased economic activity and employment resulting from elimination of the $439 million gross receipts tax would generate between $423 million and $688 million in other General Fund revenue. We take the committee's most conservative estimate which the committee calls the "worst case" and apply actual values from the last completed City fiscal year to cross check the BTAC projection.

In his report, Professor Swenson discusses the "multiplier effect," or "leveraging" which takes into account additional transactions as a result of increased spending. He describes a local firm which buys some of its goods and services from local businesses, which in turn must supply this additional demand by purchasing more goods and services themselves. These firms hire new employees who spend part of their wages on local goods and services. Professor Swenson cites the Bureau of Economic Analysis that such multipliers are typically in the range of 1.1 to more than 3 and suggests using a factor of 2. Dr. Thornberg points out that multipliers used at the national and state level are not appropriate at the city level, since some of the gain would leak out of the City and benefit surrounding communities.

Professor Swenson's report also anticipates that in addition, there would be a "leveraging effect," which would encourage economic activity in the City as a result of the changed economic environment associated with elimination of the business tax.

But to achieve the revenue neutrality projected by BTAC, very large "multipliers" and/or "leveraging" would be needed. For example, the City's effective property tax rate is 1/3 of the 1% property valuations. So to realize each $1 in new property tax revenue, assessed valuation would have to increase by $300. The results are from key revenues are summarized below:

- Achievement of $225 million in additional secured and unsecured property taxes projected by BTAC would require property valuations to grow by $68 billion (300 times);
- Power, gas and telephone company sales would have to increase by about $294 million to generate $30 million in new utility taxes(10 times);

- Power system operating revenue would have to increase by $162 million to generate $13 million (12 times); and.
- Local taxable sales would have to increase by $8 billion to generate the $80 million projected by BTAC (100 times).

The City's economy-sensitive taxes typically closely mirror the economy and show strong growth during periods of economic upturns and revenue declines during downturns. For example in the most recent economic cycle, assessed property values in the City grew by 11 percent in FY 2007-08, but declined by 2.3 percent in FY 2010-11. The 11 percent increase was the City's best year since 1991 and was driven by an increase in assessed valuation of $34 billion. A $68 billion gain in Citywide assessed valuations from elimination of the City's $439 million business tax is not reasonable.

The City taxable sales also reflect the economic cycle, with sales tax growth of 8.3% in 2005-06 and a decline of 10.2% in FY 2009-10. The 8.3 percent increase in 2005-06 required an increase in taxable sales of $3.3 billion. An $8 billion taxable sales gain from elimination of the City's business tax is nearly 2 ½ times the gain in our most recent strong year.

Any growth in the property, sales or other economy-sensitive tax would have to be in addition to economic growth normally included in the budget.

Business Tax Programs in Local Jurisdictions – Many jurisdictions in southern California have a business tax of one kind or another, including cities identified by the Los Angeles Economic Development Corporation (LAEDC) as "business friendly." Attachment 1 provides a Business Tax Comparison Chart by Cities and Industries.

Michigan's Approach to Elimination of Gross Receipts Tax. Earlier this year, Michigan changed to its tax structure which included the elimination of the Michigan Business Tax (MBT). Similar to the Advisory Committee's intent, repealing the MBT in Michigan was to spur economic activity in the state and in particular lure firms and jobs back to Michigan. Unlike the Advisory Committee's proposal, the State of Michigan did not rely on "indirect revenue gains" from any of its other revenue sources to make the business tax elimination revenue neutral. Rather, the state recognized the enormous loss of revenue projected as a result of the elimination of the MBT and concurrently approved additional tax reform changes to offset those losses. Attachment 2 provides additional information on the Michigan experiencé.

The Budget – Business tax revenue is about ten percent of General Fund revenue and six percent of the total budget. Like the Michigan example cited above, the City has traditionally budgeted business tax reform as a revenue reduction which must compete with all other priorities such as public safety, public works, community services and pending litigation. Business tax reform is a continuing City priority and perhaps should be moved higher among the City's priorities. But at least in the early years, any business tax reform should come as a result of a trade-off with other priorities or with new revenue. Additional revenue may be forthcoming from increased economic activity associated with tax reform, but the City should see the results before budgeting replacement revenue.

The long-standing practice of estimating each revenue account based on experience coupled with current economic information has served the City well. This practice should remain the foundation of revenue estimates used in the budget. Add-factors to offset any tax reductions should only be made based on actual experience.

The business tax is a strong City revenue and is part of a balanced revenue approach which attempts to fairly distribute the burden of financing local government among residents, visitors and businesses. The business tax typically grows at a steady rate and experiences less volatility than found in the sales and the documentary transfer taxes. It is important to note that the business tax is one of the few major revenue sources that is locally controlled and collected, and not subject to state intervention. It is a significant revenue source that provides General Fund stability. Even with the business tax reductions in recent years, the business tax has grown at a faster pace than the City's most economy-sensitive revenue, the sales tax. Attachment 3 shows the business tax in context with other City revenue sources. Attachment 4 is a 20-year comparison of the growth in the business and sales taxes.

In light of projected $200-250 million deficit for FY 2012-13, it is strongly recommended that the City adopt a responsible approach similar to the State of Michigan whereby reductions to the business tax be offset with some combination of budget reduction or new revenue.

Proposition 218 – While there are exceptions and qualifications, in general, any tax increase must be ratified by a majority vote of the electorate at a regularly scheduled municipal election. Eliminating or reducing an existing tax or providing by law for the future reduction of an existing tax would limit the City's flexibility to deal with both likely and unforeseen contingencies.

Office of Finance – Elimination of the business tax as proposed by BTAC will certainly result in reductions to the Office of Finance budget through staff reductions and other cost savings. But Finance is responsible for a wide range of revenues and would be required to continue providing services in this area. For example, Finance manages the transient occupancy and the parking occupancy taxes. Staff would still be required to collect these revenues and manage these accounts, and auditors would still be required to ensure compliance with these taxes. A comprehensive review of the Office of Finance would be required to determine the degree of any staffing changes that would result from significant changes to the business tax.

City Financial Policy – The elimination of the business tax as proposed by BTAC is not consistent with the City's adopted financial policies. Uncertainty associated with generation of additional revenues as indicated in the Swenson study are inconsistent with financial policies that prioritize funding for mandated and priority programs, certainty in available funding, and diversity in the revenue stream. The BTAC recommendation that the program be implemented as a permanent elimination is not consistent with the financial policy that requires a sunset clause in any revenue reduction. Key financial policies of note concerning the elimination of the business tax are listed below.

> **Budgetary Policy I.** Current appropriations for all funds are limited to the sum of available, unencumbered cash balances and revenues estimated to be received in the

current budget year.

Budgetary Policy II. General Fund expenditures and subsidy appropriations for mandated and priority programs are to be made against current revenue sources and not dependent upon uncertain reserves or fluctuating prior period cash balances.

Revenue Policy IV. New and expanded unrestricted revenues sources should be first applied to support existing programs prior to funding new programs.

Revenue Policy VI. The City will continuously seek new revenues and pursue a diverse revenue base to limit the dependence on one or only a few revenue sources. This revenue diversity will shelter the City from short-time fluctuations in any one revenue source.

Revenue Policy VII. Any revenue reductions for both the General Fund and special funds shall only be approved as temporary adjustments with a sunset clause. Permanent revenue reductions should not implemented due to Proposition 218 restrictions that prohibit increasing revenue without voter approval.

Alternatives – All options to make Los Angeles more business friendly have some downside revenue risk. But some choices also have upside potential and do not require the loss of ten percent of General Fund revenue. The gross receipts tax is only one of a number of obstacles businesses face in Los Angeles. Among those difficulties are a lengthy and sometimes unpredictable land use and planning approval process, planning and permitting obstacles, and perceived hostility to "big box" retailers and auto dealers. Changes in the City's approval and welcoming process would be challenging but are a better alternative than eliminating ten percent of the General Fund budget. The average gross receipts for each of the eleven largest "big box" retailers in the City is approximately $75 million; this generates about $750,000 in sales taxes per store. The average gross receipts for each of the 52 new car dealers in the City is $60 million; this generates approximately $600,000 in sales taxes per dealership. The population of the City of Los Angeles is about 10.7% of the state population, but it only has 3% of new car dealerships.

The Garcetti-Parks Motion requested information on projected Job growth which may be useful when considering business tax relief measures. Attachment 5 is based on data provided by the U.S. Bureau of Labor Statistics.

To the extent continued business tax reform is to be a part of the mix making Los Angeles more business friendly, repeated studies, most recently, an Evaluation of Alternatives to the City's Gross Receipts Tax performed by MuniServices Company in association with a panel of local revenue experts provide rich insight for comprehensive tax reform. Many options included in that report have been adopted such as rate reductions, tax simplification, and new and small business tax credits. Others could be added such as making City business tax rates more competitive with other cities with a similar tax structure, such as Santa Monica, and continued exploration of alternative taxes.

The Council and Mayor could choose to continue the historical approach to business tax reform which includes monitoring development in business practices and initiating targeted reform in response to developments in business cycles and practices. This ensures greater stability in City finances and delivery of City services. The City currently uses changes to the business tax as a tool to provide incentives to targeted businesses. Elimination of the business tax would also eliminate the City's ability to provide those kinds of targeted assistance.

If additional business tax relief is desired, the following alternatives to elimination of the business tax should be considered:

1. Extend the period of 3-year new business tax holiday scheduled to end in 2012.This would continue a tax relief program currently in effect which excludes from the tax base new businesses for their first three years of operation.
2. In conjunction with alternative No. 1, freeze the tax base for all existing businesses in the City to their current gross receipts level. This would reduce first-year City revenue by an additional $20 million, which would be compounded in future years. But it would be fairer to existing businesses, which do not get the benefit of the tax holiday. And since new business revenue would not be taxed, there is reason to hope this would encourage job creation in the city.
3. Reduce business tax rates across the board by 25 % over a five-year period. This would reduce first year revenue by $22 million and ultimately reduce City revenue by $110 million (FY 2011-12 dollars). While Los Angeles business taxes would still be higher than most surrounding cities, this would put Los Angeles business tax below the level of Santa Monica and well below taxes charged in Beverly Hills.
4. Reduce business tax rates by 25% but apply reduction to only taxclassifications 6-9, the professions tax categories. These classifications represent approximately 53% of all firms in the City of Los Angeles and 58% of all employees in the City. They are also service industry based which presents the most opportunity for growth in employment and attraction of new businesses in today's economy. This would put our highest rate on par with many of the highest rates within the County. This is supported by current industrial space vacancies at 3% vs. 16% vacancy rate for office space in the City. There is more room for growth and impact with these higher classifications if a reduction is applied.
5. Identify an average tax rate based on business tax rates in various "competitor" cities in the Los Angeles area, including Santa Monica, Beverly Hills, Glendale, Burbank, and Santa Clarita, with a reduction alignment in City business taxes to that tax rate over five years. This approach would ensure that the City's tax rate remains below the highest business tax rates in the region.
6. Adopt a different tax methodology, such as a rate per square foot of industrial, commercial, and retail space; a flat tax of a single rate per $1,000 in gross receipts for all businesses; or a net receipts tax whereby tax liability would be determined on total gross receipts less costs for materials, subcontractors, and other specified deductions.
7. If a rate reduction rather than a complete elimination of the business tax is desired, it could be implemented in the same manner as the 15% reduction approved in 2005. That approach ensured that the General Fund continued to receive an increase in revenues to meet inflationary cost increases while using growth in business tax revenues beyond projected collections for overall tax reductions.

Council would need to balance various funding priorities already adopted when determining how a reduction or elimination of the Business Tax would be implemented. For example, during the FY 2011-12, the Council established a new line item in the Unappropriated Balance entitled "Restoration of Neighborhood Fire Services" with $6,971,000 (CF 11-0600). The Council also discussed that any new newly identified revenue should be earmarked for the restoration of fire stations/services, as well as Recreation and Parks that were closed down. Reducing or eliminating the Business Tax would make it necessary to determine how to balance and prioritize such funding policies resulting from the loss of these revenues.

We believe complete elimination of the business tax would be poor public policy. It would increase the tax burden on residents or result in decreased City services which would make Los Angeles a less desirable place to do business. Elimination of the business tax is unlikely to be revenue neutral; it would decrease City revenue.

RECOMMENDATION

That the Mayor and Council establish a policy that the direct revenue loss from any business tax reform measure is to be financed with budget reductions or new revenue sources until there is direct experience that any projected make-up revenue is real.

FISCAL IMPACT STATEMENT

The recommendation from the Business Tax Advisory Committee, if adopted, would phase out the $439 million annual business tax during a four-year period and reduce revenue by 25 percent (approximately $110 million) in the first year and a like additional amount in each of the next three years. Thereafter, the on-going fiscal impact would be a reduction of approximately $439 million in FY 2011-12 dollars in business tax receipts. A portion of that loss could be offset by higher receipts from other revenues sources, but at this time there is no basis to confirm any replacement revenue.

Attachment 1

City	Population	Business Tax Structure by City and Industry (% of first $10,000 in Gr. Rec.)															
		General Office		Professional Office		Retail		Wholesale		Manufacturing		Personal Office		Commercial Propert		Residential Property	
		Type	Rate	Type	Rate	Type	Rate	Type	Rate	Type	Rate	Type	Rate	Type	Rate	Type	Rate
Los Angeles	3,833,995	Gr. Rec.	0.550	Gr. Rec.	0.550	Gr. Rec.	0.137	Gr. Rec.	0.109	Gr. Rec.	0.109	Gr. Rec.	0.385	Gr. Rec.	0.137	Gr. Rec.	0.276
Santa Monica	87,664	Gr. Rec.	0.128	Gr. Rec.	0.503	Gr. Rec.	0.128	Gr. Rec.	0.128	Gr. Rec.	0.128	Gr. Rec.	0.303	Gr. Rec.	0.128	Gr. Rec.	0.128
Culver City	38,580	Gr. Rec.	0.301	Gr. Rec.	0.301	Gr. Rec.	0.101	Gr. Rec.	0.101	Gr. Rec.	0.101	Gr. Rec.	0.101	Gr. Rec.	0.101	Gr. Rec.	0.101
Inglewood	112,714	Gr. Rec.	0.110	Gr. Rec.	0.165	Gr. Rec.	0.110	Gr. Rec.	0.100	Gr. Rec.	0.100	Gr. Rec.	0.110	Gr. Rec.	0.110	Gr. Rec.	0.185
El Monte	121,791	Gr. Rec.	0.021	Gr. Rec.	0.147	Gr. Rec.	0.021	Gr. Rec.	0.021	Gr. Rec.	0.021	Gr. Rec.	0.021	Gr. Rec.	0.021	Gr. Rec.	0.186
San Fernando	23,818	Gr. Rec.	0.132	Gr. Rec.	0.132	Gr. Rec.	0.066	Gr. Rec.	0.053	Gr. Rec.	0.053	Gr. Rec.	0.132	Gr. Rec.	0.125	Gr. Rec.	0.300
Claremont	35,005	Employee	0.004	Gr. Rec.	0.111	Gr. Rec.	0.031	Employee	0.004	Employee	0.004	Gr. Rec.	0.101	Gr. Rec.	0.111	Gr. Rec.	0.031
Compton	93,851	Gr. Rec.	0.029	Gr. Rec.	0.107	Gr. Rec.	0.029	Gr. Rec.	0.029	Gr. Rec.	0.029	Flat/Other	0.029	Flat/Other	0.020	Flat/Other	0.185
Gardena	58,554	Gr. Rec.	0.101	Gr. Rec.	0.101	Gr. Rec.	0.051	Gr. Rec.	0.051	Gr. Rec.	0.055	Gr. Rec.	0.101	Flat/Other	0.050	Flat/Other	0.093
Hawthorne	84,305	Gr. Rec.	0.100	Gr. Rec.	0.100	Gr. Rec.	0.100	Gr. Rec.	0.100	Gr. Rec.	0.100	Gr. Rec.	0.100	No Tax	0.000	Flat/Other	0.231
Lomita	20,156	Gr. Rec.	0.073	Gr. Rec.	0.073	Gr. Rec.	0.073	Gr. Rec.	0.073	Gr. Rec.	0.073	Gr. Rec.	0.073	No Tax	0.073	Flat/Other	0.073
Palmdale	138,790	Gr. Rec.	0.006	Gr. Rec.	0.056	Gr. Rec.	0.006	Gr. Rec.	0.006	Gr. Rec.	0.006	Gr. Rec.	0.006	Gr. Rec.	0.013	Gr. Rec.	0.030
Bell	36,657	Gr. Rec.	0.044	Gr. Rec.	0.044	Gr. Rec.	0.044	Gr. Rec.	0.044	Gr. Rec.	0.044	Gr. Rec.	0.044	Gr. Rec.	0.044	Gr. Rec.	0.222
Huntington Park	60,898	Gr. Rec.	0.040	Gr. Rec.	0.040	Gr. Rec.	0.040	Gr. Rec.	0.040	Gr. Rec.	0.040	Gr. Rec.	0.040	Gr. Rec.	0.040	Gr. Rec.	0.040
Irwindale	1,451	Gr. Rec.	0.033	Gr. Rec.	0.033	Gr. Rec.	0.033	Gr. Rec.	0.033	Gr. Rec.	0.033	Gr. Rec.	0.033	Gr. Rec.	0.033	Gr. Rec.	0.033

City	Population	Business Tax Structure by City and Industry (% of first $10,000 in Gr. Rec.)															
		General Office		Professional Office		Retail		Wholesale		Manufacturing		Personal Office		Commercial Propert		Residential Property	
		Type	Rate	Type	Rate	Type	Rate	Type	Rate	Type	Rate	Type	Rate	Type	Rate	Type	Rate
Austin	743	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No	0.000	No Tax	0.000	No Tax	0.000
Baltimore	637,455	No Tax	0.000	No Tax	0.000	Flat/Other	0.021	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000
Boston	590,763	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000
Chicago	2,853,114	Employee	0.044	Employee	0.043	Gr. Rec.	0.129	Employee	0.043	Employee	0.045	Employee	0.043	Employee	0.043	Gr. Rec.	0.044
Dallas	1,227,082	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000
Detroit	916,952	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No	0.000	No Tax	0.000	No Tax	0.000
Houston	2,208,180	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	No	0.000	No Tax	0.000	No Tax	0.000
New York	836,370	Flat/Other	0.885	Flat/Other	0.885	Flat/Other	0.885	Flat/Other	0.885	Flat/Other	0.885	Flat/Other	0.885	Flat/Other	0.885	Flat/Other	0.885
Oakland	404,155	Payroll	0.048	Gr. Rec.	0.252	Gr. Rec.	0.120	Gr. Rec.	0.120	Gr. Rec.	0.108	Gr. Rec.	0.180	Flat/Other	0.140	Flat/Other	0.140
Philadelphia	1,447,395	Flat/Other	1.063	Flat/Other	1.063	Flat/Other	1.063	Flat/Other	1.266	Flat/Other	0.896	Flat/Other	1.060	Flat/Other	1.060	Flat/Other	1.060
Phoenix	1,512,986	No Tax	0.000	No Tax	0.000	Gr. Rec.	2.000	No Tax	0.000	No Tax	0.000	No Tax	0.000	Gr. Rec.	2.100	Gr. Rec.	2.000
San Diego	1,256,951	Employee	0.006	Employee	0.006	Employee	0.006	Employee	0.006	Employee	0.006	Employee	0.006	Employee	0.006	Flat/Other	0.076
San Francisco	808,976	Payroll	0.605	Payroll	1.055	Paryroll	0.605	Payroll	0.303	Payroll	0.605	Payroll	0.605	Payroll	0.605	Payroll	0.303
Seattle	594,210	Gr. Rec.	0.216	Gr. Rec.	0.216	Gr. Rec.	0.216	Gr. Rec.	0.216	Gr. Rec.	0.216	Gr. Rec.	0.416	No Tax	0.216	No Tax	0.216

Source: 2010 Kosmont-Rose Report

Attachment 2

Case Study – Michigan Gross Receipts Tax

Earlier this year, Michigan lawmakers approved changes to its tax structure which included the elimination of the Michigan Business Tax (MBT). Similar to the Advisory Committee's intent, the repealing of the MBT in Michigan was to spur economic activity in the state and in particular lure firms and jobs back to Michigan.

The MBT is a tax on all businesses with apportioned gross receipts above $350,000 with business activity in Michigan. The MBT was projected to generate close to $1.5 billion or 20% of the state's total General Fund revenue and $742 million or 6% of the state's School Aid Fund Revenue for Fiscal Year 2010-11. According to the Michigan House Fiscal Agency, the elimination of the MBT on its own would result in a net loss of about $785 million from the General Fund and $750 million from the School Aid Fund in Fiscal Year 2011-12. The lost revenue from the MBT alone in Fiscal Year 2012-13 would climb to $1,717 million for the General Fund and $764 million for the School Aid Fund.

Unlike the Advisory Committee's arguments, the State of Michigan did not rely on "indirect revenue gains" from any of its other revenue sources to make the business tax elimination revenue neutral. Rather, the state recognized the enormous loss of revenue projected as a result of the elimination of the MBT and concurrently approved additional tax reform changes to offset those losses. The tax reform changes included the following:

- Enactment of a 6% Corporate Income Tax projected to generate $460 million in General Fund revenue in Fiscal Year 2011-12 and $749 million in Fiscal Year 2012-13;
- The elimination of several personal income tax credits such as Earned Income Tax Credit (EITC) which alone is valued at $374 million for Fiscal Year 2012-13;
- The elimination of several personal income tax deductions and exemptions such as the child deduction the exemptions granted to private and public pensions;
- Freezing the personal income tax rate at 4.25% by reserving previously planned rate reductions that would have decreased the income tax rate by .1 percentage points each year until it reached 3.95%.

These collective changes will generate $1,111 million in General Fund revenue for Fiscal Year 2011-12 and $2,183 million for Fiscal Year 2012-13 which more than offset the loss of General Fund revenue from the MBT elimination. Nevertheless, with regard to Michigan's School Aid Fund, the increased revenues from the personal income tax changes ($153 million in Fiscal Year 2011-12 and $233 million in Fiscal Year 2012-13) are insufficient to offset the MBT reduction to this fund. As a result, for the Fiscal Year 2011-12 budget, the state relied on significant expenditure reductions in the School Aid

Fund, spending down of prior year surplus, and additional appropriations from the General Fund to balance the School Aid Budget.

State of Michigan Projected Tax Changes Effective January 1, 2012 (Millions of Dollars)

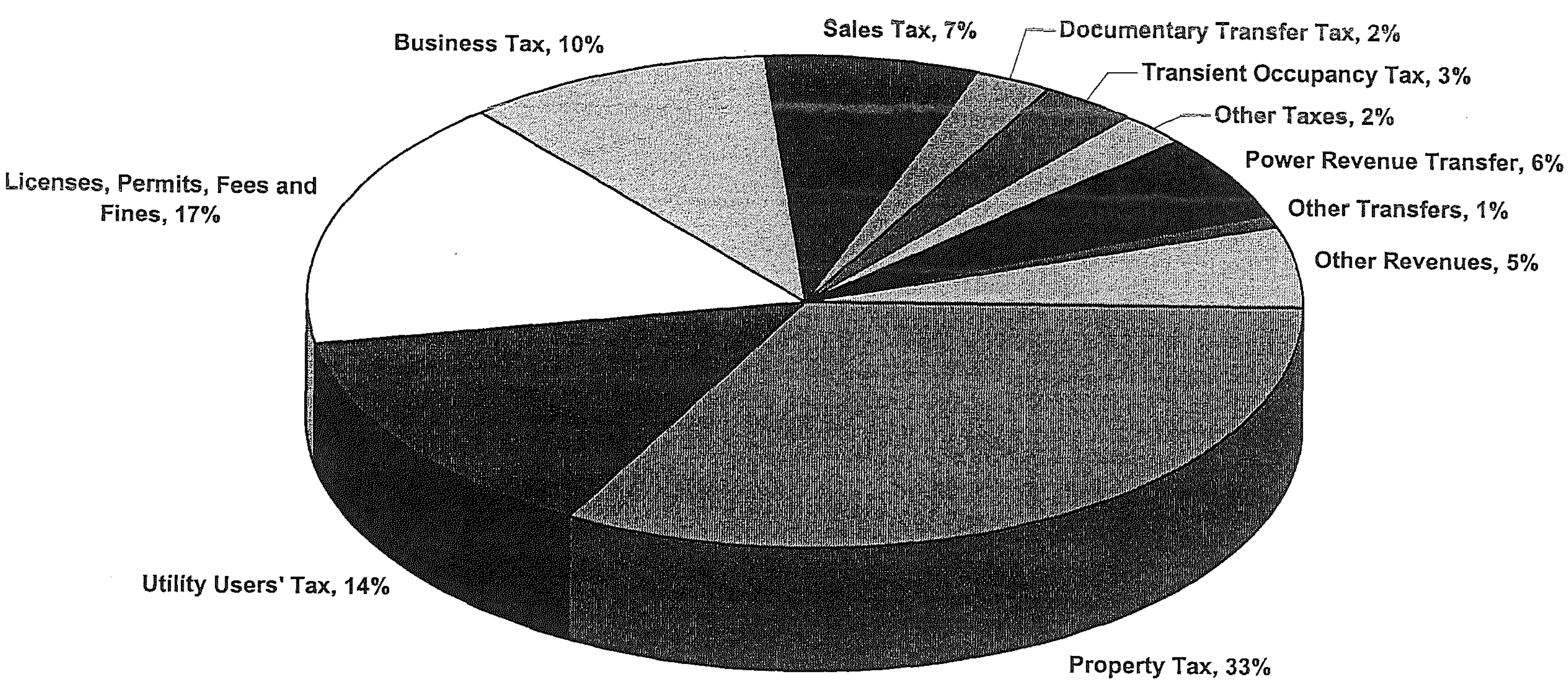
	FY 2011-12 Estimates			FY 2012-13 Estimates		
	General Fund	School Aid Fund	Total	General Fund	School Aid Fund	Total
MBT Related						
Repeal MBT	(1,419.80)	(750.20)	(2,170.00)	(1,260.70)	(763.70)	(2,024.40)
Partial Year MBT	900.20	-	900.20	-	-	-
Financial Institutions Tax	27.70	-	27.70	43.90	-	43.90
Honor Existing Firm-Specific Credits	(293.00)	-	(293.00)	(500.00)	-	(500.00)
Net MBT Elimination	**(784.90)**	**(750.20)**	**(1,535.10)**	**(1,716.80)**	**(763.70)**	**(2,480.50)**
Corporate and Income Related						
6% Corporate Income Tax	460.10	-	460.10	748.80	-	748.80
Freeze Income tax Rate at 4.25%	-	-	-	171.00	-	171.00
Eliminate Private Pension Exemption	363.50	95.40	458.90	553.00	146.50	699.50
Eliminate Public Pension Exemption	121.60	31.30	152.90	184.40	48.80	233.20
Retain Military Pension Exemption	(12.30)	(3.20)	(15.50)	(19.80)	(3.70)	(23.50)
Eliminate Investment Income Exemption by Seniors	28.10	7.20	35.30	42.90	11.00	53.90
Eliminate Some Special Exemptions	6.70	2.10	8.80	40.90	-	40.90
Phase-Out Personal Exemptions	41.40	13.00	54.40	63.20	19.70	82.90
Eliminate Child Deductions	-	-	-	57.00	-	57.00
Eliminate Miscellaneous Subtractions	28.10	7.20	35.30	42.90	11.00	53.90
Eliminate Non-refundable Credits	74.0	-	74.00	102.5	-	102.50
Eliminate Refundable Credits	-	-	-	1.00	-	1.00
Eliminate Earned Income Tax Credit	-	-	-	373.70	-	373.70
Other Changes	-	-	-	(7.20)	-	(7.20)
Tax and Fee Reform Reserve Fund	-	-	-	(171.00)	-	(171.00)
Net Income Tax Changes	**1,111.20**	**153.00**	**1,264.20**	**2,183.30**	**233.30**	**2,416.60**
Net of Total Tax Changes	**326.30**	**(597.20)**	**(270.90)**	**466.50**	**(530.40)**	**(63.90)**

Source: Michigan House Fiscal Agency and Michigan Department of Treasury

This case study demonstrates a practical method to implementing the elimination of the business tax whereby the revenues lost from the business tax are offset by predictable and quantifiable revenues from other tax increases. Additionally, as in the case of the School Aid Fund, shortfalls in revenues that cannot be offset by other revenue sources must be made by an appropriate level of expenditure reductions.

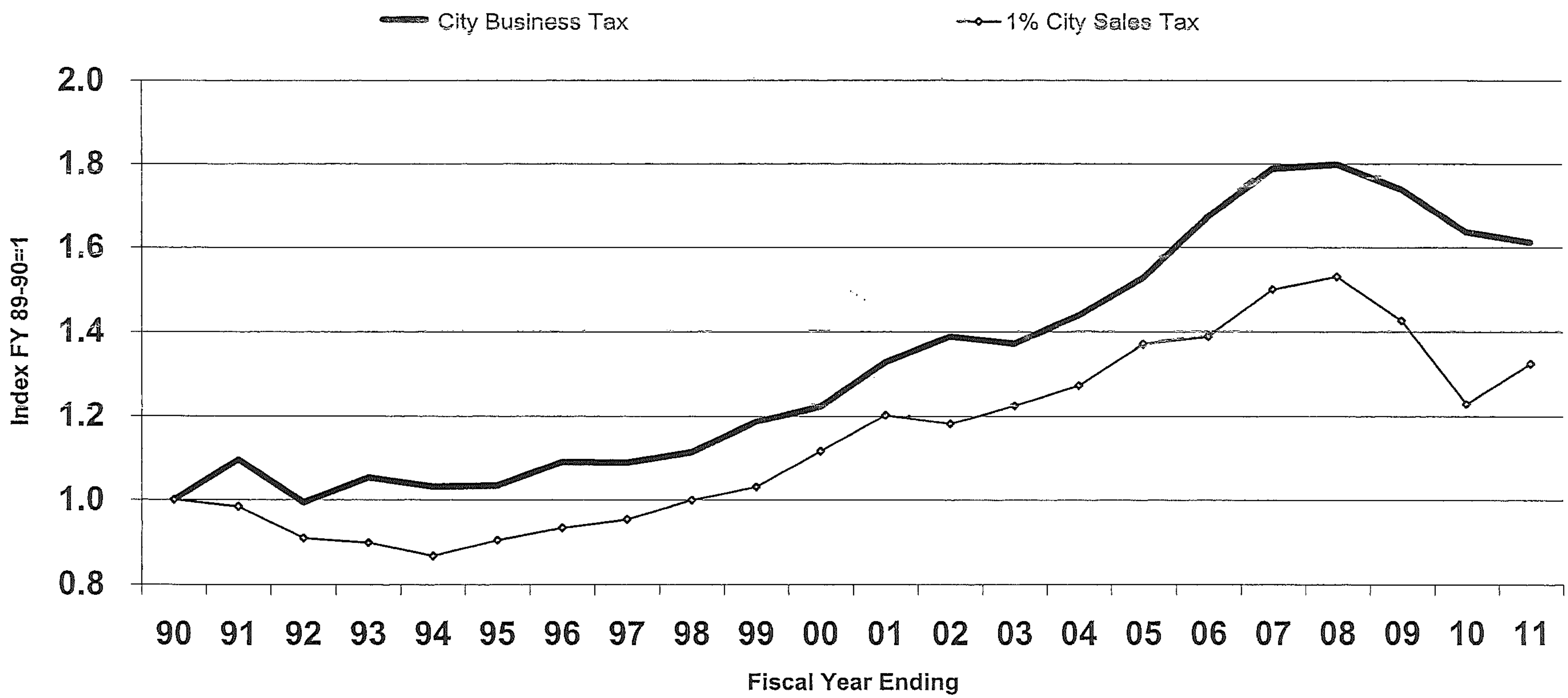
Attachment 3

FY2011-12 General Fund Revenue Sources



Attachment 4

Change in City Business and Sales Taxes FY 89-90 to FY 10-11



The City business tax (dark line) displays actual receipts; the City 1%-sales tax (light dotted line) includes both the 3/4%-portion currently remitted by the Board of Equalization and the 1/4%-portion currently remitted by the County Auditor-Controller. There were several relatively minor changes to the sales tax during the this period, but the business tax changed more significantly. The highest business tax rate was $5.38/$1,000 in FY 89-90. It increased to $6.35/ $1,000 in FY 93-94 but is now $5.07/$1,000. There were also targeted business tax adjustments including small and new business exemptions, bad debt reform, single category filing, inter-company transfers, wholesale and manufacturing relief, and several others. Even with these reductions, business tax growth out-performed that of the sales tax. The business tax in FY 09-10 benefited from a tax amnesty program, which suppressed business tax growth in FY 2010-11. Even with significant tax reductions, the business tax has historically been a stronger General Fund revenue source than the sales tax.

Attachment 5 – Projected Job Growth

As requested by Motion (Garcetti- Parks), below is a preliminary list of industries that create or are anticipated to create the most jobs between 2008 and 2018.

Source: Bureau of Labor Statistics

Industry Sector	# of Jobs Projected
Management, scientific and technical Consulting services	835,000
Offices of Physicians	772,000
Computer Systems Design and Related Services	656,000
General Merchandise Stores	607,000
Employment Services	600,000
Local Government	487,000
Home Health Care Services	441,000
Services for the Elderly and Persons w/ Disabilities	431,000
Nursing Care Facilities	394,000
Full-Service Restaurants	343,000
Limited-Service Eating Places	341,000
Legal Services	253,000
Offices of Dentists	233,000
Wholesale Electronic Markets and Agents and Brokers	226,000
State Government	207.000
Accounting, Tax Preparation, Bookkeeping and Payroll Services	199,000
Personal Care Services	198,000
Federal Government	192,000
Landscaping Services	179,000
Pharmacies and Drug Stores	156,000