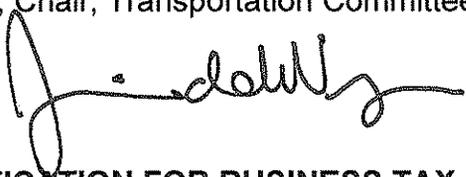


**CITY OF LOS ANGELES  
INTER-DEPARTMENTAL MEMORANDUM**

Date: June 19, 2013

To: Honorable City Council  
c/o City Clerk, Room 395, City Hall  
Attention: Honorable Bill Rosendahl, Chair, Transportation Committee

From: Jaime de la Vega, General Manager  
Department of Transportation 

Subject: **CITY TRANSIT CONTRACT MODIFICATION FOR BUSINESS TAX  
RECLASSIFICATION**

**SUMMARY**

This report recommends that the City Council, subject to the approval of the Mayor, authorize the Department of Transportation (LADOT) to reimburse three City transit contractors with Proposition A (transit) Local Return funds for an increase in operating costs resulting from a retroactive change in their City business tax classification by the Office of Finance.

**RECOMMENDATIONS**

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

1. AUTHORIZE the Department of Transportation to reimburse its transit contractors for the increase in City business taxes paid to the Office of Finance resulting from the retroactive reclassification of their business tax classification, subject to acceptance of the audit findings by the contractors, as follows:
  - a.) MV Transportation in an amount not-to-exceed \$1,499,847
  - b.) Veolia Transportation in an amount not-to-exceed \$1,875,640
  - c.) First Transit in an amount not-to-exceed \$1,231,019
  
2. AUTHORIZE the appropriation and transfer of \$4,638,211 from the Proposition A Local Transit Fund No. 385/94, Reserve for Future Transit Service Account No. 94J399, to a new account number to be determined entitled "Business Tax Reclassification"; and process payments therefrom to MV Transportation Inc., Veolia Transportation Services Inc. and First Transit Inc. not-to-exceed amounts indicated in Recommendation No. 1.

## **DISCUSSION**

### **Office of Finance Audit**

The City's Office of Finance recently conducted audits of three LADOT transit contractors, MV Transportation, Veolia Transportation and First Transit, and determined that City business tax certificates issued to these firms during the three year audit period should have reflected a different classification. The new classification carries a significantly higher tax burden. The Office of Finance determined that all three LADOT transit contractors shall retroactively pay the City for the difference between the tax amount paid under the original classification and the amount owed under the new classification during the three year audit period.

### **Retroactive vs. Prospective Reclassification**

LADOT supports enforcement of the newly designated City business tax classification for contracted transit operators moving forward on a prospective basis. However, LADOT does not believe that its transit contractors should be required to shoulder the significant unexpected financial burden associated with the City changing their business tax classification on a retroactive basis.

LADOT's transit contractors are performing work on behalf of the City and are reimbursed a fixed amount for costs and profit margin based on their cost proposal. Changing the terms of these contracts in mid-term or after- the-fact creates what LADOT believes is an unfair and disadvantageous business environment for City contractors. LADOT transit contractors assume the business tax cost as part of their total cost to provide the service. The business tax cost is reimbursed by the City to LADOT transit contractors as part of the hourly service cost rate. Under normal circumstances there is no net increase in revenues to the City (redistribution of funds from Proposition A to the General Fund).

Further, LADOT believes it is unreasonable to expect that its transit contractors could have been reasonably expected to use the revised business tax reclassification given that the Office of Finance has apparently been issuing business tax certificates using the original classification for over 20 years. LADOT was not consulted with or provided information / materials by the Office of Finance at any stage of the audit process.

### **Reimbursement of Retroactive Business Tax Increase**

Based on preliminary information provided by all three contractors, the total amount of the retroactive increase in business taxes paid / owed to the Office of Finance is estimated to be \$4,638,211 (includes 2% contingency). This amount covers transit contracts with the City only (excludes non-LADOT transit contracts) and includes related penalties and interest assessed by the Office of Finance. Attached is a breakdown of the additional amounts by firm. As the business taxes are deposited in the City's General Fund, LADOT is recommending that the City reimburse its transit contractors

documentation, and only for services provided under contracts (specifically the cost proposals submitted by contractors) that preceded the audit findings by the Office of Finance.

## **BACKGROUND**

Per the Office of Finance, the City's business tax is a self-reported tax subject to verification through the audit process. Through the City's taxing authority, as codified in Article 1 Chapter 2 of the LAMC, a taxpayer determined to have under-reported and/or under-paid its business tax liability may be issued an assessment of tax.

According to the Office of Finance, LADOT's transit contractors should have been classified under "Common Carrier Bus" (LAMC 21.187) instead of "Transporting Persons for Hire" (LAMC 21.194). LADOT believes that the definitions are somewhat vague and the distinctions between the two classifications are not clear as they relate to LADOT contracted transit services.

The classification "Common Carrier Bus" under LAMC 21.187 includes a specific exemption for any municipal corporation or other public entity. LADOT is a public, municipal transit operator. LADOT owns the vehicles and establishes the routes, stops, fares, etc. The Department's transit contractors operate the services on behalf of LADOT and the City.

LADOT has been competitively contracting for public transit services since 1985. LADOT's transit RFPs have included the city requirement to obtain a City business tax certificate. LADOT's understanding is that the Office of Finance has historically issued business tax certificates to our transit contractors using the "Transporting Persons for Hire" classification for past 20+ years.

First Transit and the City reached a settlement agreement in 2012 (C.F. 12-0102). First Transit received a \$750,000 City business tax credit as part of the settlement agreement with the City. LADOT's understanding is that Veolia Transportation and MV Transportation have appealed the findings to the Office of Finance. Veolia and MV are waiting to hear the results of their appeal to the Office of Finance. An appeal to the Board of Review and a civil action are potential next steps for both firms.

## **FINANCIAL IMPACT**

LADOT is recommending the use of City Proposition A Local Transit Assistance (PALTA) funds to reimburse its transit contractors. There are sufficient unallocated funds in the City's adopted FY 2012-13 and FY 2013-14 Proposition A budgets to fund the Department's recommendation. Therefore, there is no impact on the City's General Fund.

JTV:jml

Attachment

**SUMMARY**  
**ESTIMATED RETROACTIVE BUSINESS TAX INCREASE (1)**  
**LADOT TRANSIT CONTRACTORS**

Tax License Renewal Year	Tax Increase - Veolia	Tax Increase - MV	Tax Increase - First Transit (2)	TOTAL
2004	--	--	\$260,296	\$260,296
2005	--	--	\$487,378	\$487,378
2006	--	--	\$525,985	\$525,985
2007	--	--	\$75,897	\$75,897
2008	--	--	\$9,119	\$9,119
2009	\$254,242	\$278,911	\$5,238	\$538,391
2010	\$405,885	\$120,772	(\$3,387)	\$523,270
2011	\$455,627	\$158,006	\$313,365	\$926,998
2012	\$394,838	\$124,390	\$46,740	\$565,968
2013	\$328,271	\$204,442		\$532,713
2014	--	\$204,442	--	\$204,442
2015	--	\$204,442	--	\$204,442
2016	--	\$204,442		\$204,442
Tax Credit			(\$513,750)	(\$513,750)
Contingency (3)	\$36,777	\$29,997	\$24,138	\$92,620
<b>Total</b>	<b>\$1,875,640</b>	<b>\$1,499,847</b>	<b>\$1,231,019</b>	<b>\$4,638,211</b>

Notes:

- (1) Annual and total amounts by contractor include additional interest and fees assessed by the Office of Finance.
- (2) First Transit figures included pro-rated share of \$750,000 tax credit from the City through settlement.
- (3) 2% contingency as-needed included.