



ERIC GARCETTI
MAYOR

November 20, 2017

The Honorable Members of the Los Angeles City Council
City Clerk
City Hall, Room 395

ANALYSIS OF IMPACT OF EXTENDING THE CITY'S BUSINESS TAX RENEWAL DEADLINE FROM FEBRUARY 28 TO APRIL 15 TO ALIGN WITH THE CALIFORNIA FRANCHISE TAX BOARD AND FEDERAL INTERNAL REVENUE SERVICE TAX DEADLINES

Dear Honorable Members:

SUMMARY

Per Council instruction regarding the motion (Englander-Blumenfeld) introduced on June 14, 2017 (C.F. 17-0675), the Office of Finance (Finance) has obtained and integrated input from the City Administrative Officer (CAO) and Controller within this report regarding the analysis and impact of the proposal to extend the City's business tax deadline from February 28 to April 15 to align with California Franchise Tax Board (FTB) and Federal Internal Revenue Service (IRS) tax deadlines. Included in the analysis are the following issues:

- a. The potential to recover any initial implementation costs and provide estimates of ongoing savings that can be expected under the alignment.
- b. Recommendations on mitigating the impact on small individual filers paying City business tax liabilities at the same time as State and Federal tax liabilities under the alignment.
- c. Proposals for outreach to business on the alignment.
- d. Impacts to the City's ability to forecast and budget revenues from the Gross Receipts Tax
- e. Impacts on revenue and cash flow from late filers under the alignment, and cost to the City for short-term borrowing.

Office of Finance's assessment of the proposal to extend the current business tax renewal from February 28 to April 15 is that such an extension is technically feasible. The purpose of this report is to address the concerns noted above (a – e) and to clarify financial and logistical impacts as indicated by Finance, CAO and Controller that would need to be addressed prior to implementing such an extension.

RESPONSE

The Los Angeles Municipal Code (LAMC) established the current City of Los Angeles annual business tax due date to be paid by the first day of January of each year under Section 21.04 and subsequent delinquency date at the close of business on the last day of the month following the month in which the tax became due under Section 21.05. As such, any

proposed change to the City's business tax deadline would require an amendment to Section 21.05 to extend the renewal period by 45 days to April 15.

a. Potential to recover any initial implementation costs and provide estimates of ongoing savings that can be expected under the alignment:

Analysis indicates no potential recovery of implementation costs or ongoing savings would be realized by the City from the proposed extension of the business tax deadline to April 15. Extension of the annual business tax renewal period to April 15 would still require Finance to provide the appropriate renewal forms and notices to the active businesses within the City. However, the proposed ordinance amendment to extend the business tax due date from the existing February 28 deadline to April 15 would provide Finance staff an additional 45 days to transition to the business tax renewal deadline and more time to complete the Police, Fire and Tobacco permit renewals which begins on November 1 and has a deadline of December 31 of each year.

b. Recommendations on mitigating the impact on small individual filers paying City business tax liabilities at the same time as State and Federal tax liabilities under the alignment:

Currently 67% of the small individual business tax filers qualify for the small business exemption and would not be impacted by the proposed alignment if they file on or before the proposed April 15 deadline. It is recommended that no mitigating actions be taken for the remaining 33% of the City's business tax filers that would still have business tax liabilities due to the City. The proposed extension to April 15 would allow these taxpayers an additional 45 days to delay the timely payment of their business tax liabilities for the initial year that the extension is implemented. Furthermore, the primary goal of this extension and alignment with the Federal and State tax liabilities is to provide additional time for taxpayers to correctly report their gross receipts to the City and the convenience of streamlining any workload that is incurred by the taxpayer's accounting staff, any additional attempts at mitigating or further delaying remittance of the taxpayer's business tax liabilities would impact the City's overall revenue further than the 45 days incorporated into this proposal.

c. Proposals for outreach to business on the alignment:

Outreach proposals for the implementation of the April 15 extension would be initiated under a five-point communications plan that would encompass.

- Notifying local businesses of the change to the City's Business Tax annual renewal filing deadline via CPAs and tax preparation organizations.
- Communicating with local Chamber of Commerce and business associations to inform their members of the extension.
- Development of physical mailers that would be transmitted to existing businesses within the current Finance database.
- E-mail notifications.
- Social Media campaign including the use of Finance's website and Twitter account.

Please note that all outreach proposals would require time to enact and would incur additional costs.

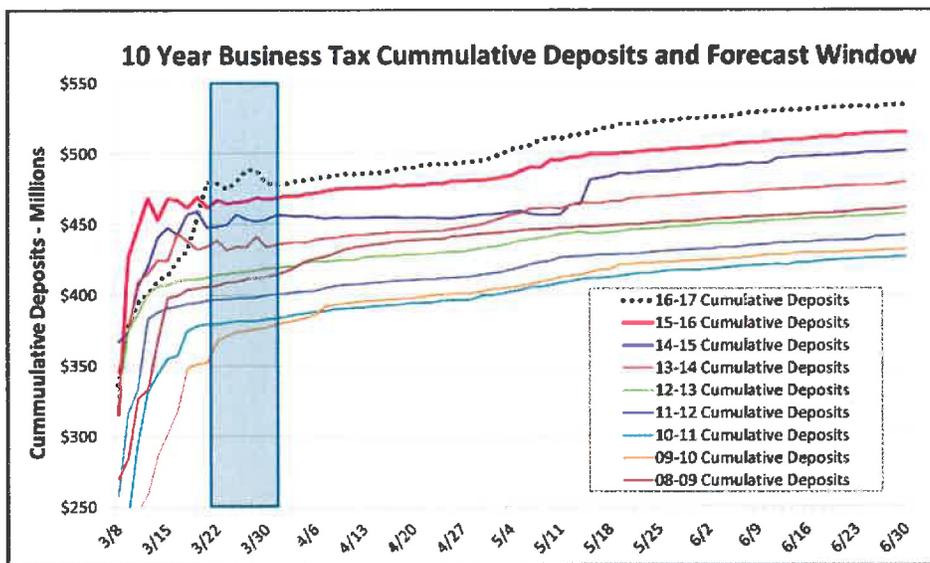
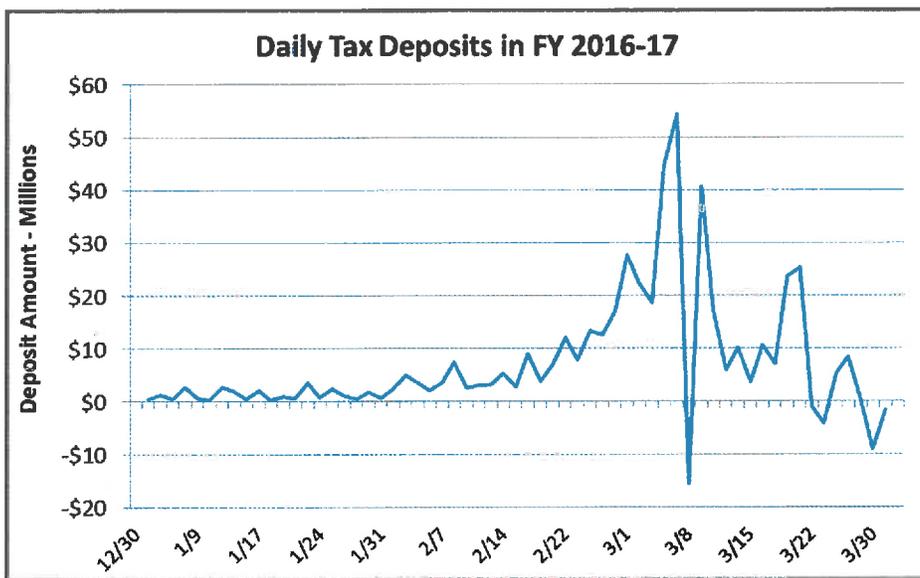
d. Impacts on the City's ability to forecast and budget the revenues from the Gross Receipts Tax:

According to the CAO, extending the due date to April 15, would mean there would be no current tax year data available to estimate revised and proposed year business tax revenue for the Mayor's proposed budget. Moreover, while sufficient current receipts may be recorded to make initial revised and proposed estimates during Council's consideration of the budget, the accuracy of the final budget numbers will be diminished. To use the formulation of the fiscal year 2017-18 budget as an illustration, the loss of five additional weeks of tax data would have denied Council the opportunity to increase the estimates by \$6.6 million and make equivalent budget appropriations.

Development of Business Tax Revenue Estimates (\$ millions) for the FY 2017-18 Adopted Budget

	<u>Date</u>	<u>Revised 2016-17</u>	<u>Proposed 2017-18</u>
<i>Finance</i>	<i>February 15, 2017</i>	<i>\$503.5</i>	<i>\$501.0</i>
<i>Controller</i>	<i>March 1, 2017</i>	<i>504.0</i>	<i>504.0</i>
CAO	April 10, 2017	513.7	515.6
Adopted Budget	May 15, 2017	517.0	518.9
Actual Revenue	June 30, 2017	528.1	

The difficulty in forecasting business tax is apparent in the change in annual revenue projections from Finance, the Controller, and the CAO, in contrast with the final adopted budget. Approximately 93 percent of total receipts are received after January 1, with receipts growing exponentially between January 1 and approximately three weeks after the delinquency date. As this pattern of receipts precludes monthly trend analysis, the revised current year estimate for business tax—which serves as the base for the proposed year estimate—cannot be projected with any level of confidence until late March when the bulk of tax receipts are recorded. Moreover, as there has been significant noise in recorded receipts for the past four fiscal years, this date for a reliable forecast may be as late as April 1. Following are charts that exhibit the growth of receipts during the fiscal year to better illustrate the unusual receipt pattern.



The Controller indicates that under the current structure, approximately 90% of the Gross Receipts tax revenue is recorded by the time the Mayor must finalize his budget, and about 5% more comes in by the time Council makes its changes. However, it is important to note that these are multi-year averages, and vary enough to make it impossible to extrapolate accurately. If the delinquency rate is moved six weeks later (from February 28 to April 15), the Mayor would have no meaningful current-year information on which to base the budget estimate. The Council would likely have around 80% of the receipts to work with, though as previously mentioned this is not as conclusive as it might seem. Note that if April 15 is the due date with a delinquency date two months later, revenues could not be confirmed until after the end of the fiscal year.

e. Impacts on revenue and cash flow from late filers under the alignment, and costs to the City for interim short-term borrowing:

CAO indicates that the first year of implementation may result in a one-time shortfall, up to \$22.2 million, as a result of the later due date. This presumes the majority of taxpayers remit payments according to the new date, while reflecting the pattern of historical receipts (i.e., receipts increase exponentially as the final due date approaches). No assumptions are made for reduced tax penalty receipts as a result of more timely remittances. The reduction in revenue will need to be addressed by offsetting expenditure reductions of \$22.2 million. Because the change in deadline will be permanent, there will not be increased cash flow to offset the loss of the \$22.2 million in the following fiscal year.

Additionally, CAO is concerned that with the cash flow of business tax receipts permanently shifted to later in the fiscal year, the City loses flexibility in structuring its TRAN (tax revenue anticipation note) debt, as it will be necessary to issue notes with later maturity dates. The cost of interest in carrying this debt longer also increases, and these costs will grow as interest rates, which are currently below historical rates, rise.

Controller states that, assuming the change would be made with enough advance notice to allow for the CAO to plan the TRAN accordingly, there would probably not need to be any additional short-term borrowing. The Controller would request a restructuring of the debt service set-aside dates, and it would be more important for the first DWP Power Transfer Payment to be transmitted in a timely fashion, but the TRAN generally matures late enough in the year not to be impacted by this proposed change. There could be a one-time negative fiscal impact as late filers who would have paid in June might pay in July or August, but the Controller does not have enough information to estimate that amount.

ADDITIONAL CONSIDERATIONS

Should Council move to change the annual business tax payment deadline, Finance recommends that the change be implemented subsequent to the 2018 business tax renewal period to provide the necessary time to make the programming changes in LATAX, revise forms, conduct outreach to the business community and to allow CAO and Controller time to address the revenue impacts as noted. Finance is currently completing the final review and revisions to the 2018 business tax renewal notices that will be going out in December 2017 and does not have the ability to implement the extension without impacting deadlines required under the current ordinance. In addition, Council should request and allow City Attorney time to draft the appropriate Ordinance to effectuate the change and amend Los Angeles Municipal Code Section 21.05.

Sincerely,



Claire Bartels

Director of Finance / City Treasurer