



Information Item

Date: March 18, 2013

To: Mayor and City Council
From: Gigi Decavalles-Hughes, Director of Finance
Subject: Business License Discovery and Penalty Waiver Program

Introduction

Businesses operating in the City of Santa Monica are required to obtain a business license annually and pay a tax. In most cases, the amount of the tax is based on prior calendar year gross business receipts. In FY 2011-12, the City collected \$26.3 million in business license taxes and penalties. The Finance Director is authorized to reduce penalties and interest on unpaid taxes to promote the City's fiscal welfare.

As part of the Finance Department's effort to identify unlicensed businesses and collect unpaid taxes, the Department will be conducting a temporary *Business License Compliance Assistance Program* from April 8, 2013 through May 24, 2013. The program will allow unlicensed businesses who voluntarily register during the program's limited timeframe to receive a 90% reduction on any penalties due, regardless of the reason for non-compliance. Following the program, the Finance Department will identify businesses that are still operating without a business license and take steps to bring these businesses into compliance without the benefit of reduced penalties.

Background

Section 6.04 of the Santa Monica Municipal Code (SMMC) requires persons conducting business in the City of Santa Monica to register and obtain a business license, and pay applicable business tax. Monies collected from the tax are deposited into the General Fund to support various City functions, such as police and fire protection, street

maintenance, libraries, and parks. As part of the registration process, businesses also complete the following actions that further benefit businesses, visitors, and residents:

- Obtain required special permits and pay requisite fees (e.g. Police Permits)
- Undergo a review to ensure compliance with applicable laws, including a zoning conformance review
- Pay Business Improvement District (BID) assessments

In most cases, the amount of business license tax paid is based on prior calendar year gross business receipts. There are three major tax categories:

- Professional: \$5.00 for each \$1,000 in gross receipts
- Services: \$3.00 for each \$1,000 in gross receipts
- Other: \$1.25 for each \$1,000 in gross receipts

Some categories pay a flat fee. Businesses with gross receipts between \$40,000 and \$60,000 annually pay a minimum tax of \$75. Businesses with gross receipts less than \$40,000 annually are exempt from tax. If a business does not file before the delinquency date of September 1st of each year, they must pay the tax due in addition to any penalties due.

Business license tax and penalty revenues have fluctuated over the most recent five fiscal years by approximately \$1 to \$3 million, mostly due to the impacts of the economy and the reopening of Santa Monica Place. Revenues increased from \$25.5 million in FY 2010-11 to \$26.3 million in FY 2011-12, a 3.3% increase that is attributed to improvements in the economy and the full year impact of the re-opening of Santa Monica Place. Revenues are anticipated to increase by 2.9% in FY 2012-13 to \$27.1 million.

Late payment of business license tax is subject to penalties ranging from 20% to 100% of the tax due. Operating without a business license is subject to administrative citation or criminal prosecution. Section 2.12.260 of the SMMC grants the Finance Director the

authority to settle tax disputes by reducing or waiving penalty or interest amounts due when such a reduction or waiver serves to promote the City's fiscal welfare by expeditious payment or enhancing revenue. Pursuant to this authority, and as part of its unlicensed business discovery efforts, the Finance Department will be conducting a temporary *Business License Compliance Assistance Program*, granting those businesses that voluntarily report non-payment of taxes, amnesty from the full burden of penalties.

Penalty waiver programs for various types of taxes, including business license taxes, have been utilized by other jurisdictions as a standard means for increasing revenues and gaining compliance. The City of Santa Monica utilized such a program in 2004. Specific data related to the amnesty versus other discovery efforts is not available; however, the program appears to have collected approximately \$588,000 in unpaid taxes due to the waiver of penalties provided. The City of Pasadena held a business license tax amnesty program from October 11, 2012 through January 10, 2013, and San Jose has a program underway currently that ends March 29, 2013. The results of these programs are not yet known. However, a survey that was conducted in March 2011 of members of the California Municipal Revenue & Tax Association (CMRTA) found that the City of Burbank collected approximately \$500,000 from an amnesty program it conducted in 2006; the City of Pasadena collected \$185,000 from an earlier amnesty program it conducted in 2011. The California Franchise Tax Board's amnesty program from August 1, 2011 to October 31, 2011, where most penalties were waived in exchange for full payment of tax and interest from underreporting through tax shelters and offshore accounts, also allowed participants to avoid criminal prosecution for tax evasion. The program was reported to have raised \$350 million. In 2004, the State of California ran a similar "voluntary compliance initiative" which netted \$1.3 billion.

Discussion

The stated goal of the *Business License Compliance Assistant* program is to increase revenue by registering businesses operating in the City and collecting unpaid taxes and fees. The program is scheduled to run from April 8, 2013 through May 24, 2013. During this limited time period, businesses that have failed to comply with the law by registering with the City and paying business license taxes, regardless of the reason, will be able to voluntarily come into compliance and have any penalties that would be due reduced by 90%. Only businesses that are not currently registered with the Business License unit will be eligible for the program. Any business entity that submitted an application in a previous year and stopped renewing its license or that is currently delinquent will not be eligible to receive a reduction of penalty. In all cases, a business would be required to pay all taxes due; no reduction or waivers of taxes will be granted under this program.

In addition to increasing the collection of unpaid business license taxes, the program will increase the business license tax rolls and therefore increase tax collections in future years. Staff estimates there may be more than 700 unlicensed businesses operating in Santa Monica. The amnesty program is estimated to generate \$250,000 in back tax revenue. The new businesses that the amnesty program will add to the tax rolls combined with ongoing proactive discovery collections and enforcement efforts is estimated to generate approximately \$500,000 in revenue annually. These additional revenues will be included in the proposed FY 2013-15 budget. Staff will administer and maintain the program in-house.

The program has a number of other benefits. The self-reporting incentive will reduce enforcement resource demands on Finance Department and Code Enforcement staff. The program will also increase the collection of unpaid regulatory permit fees and assist the Police Department by ensuring that businesses engaged in regulated business activities are also registered. It will also likely increase the collection of BID assessments, increasing funding for these districts.

The program is being implemented immediately preceding the annual business license renewal period to increase the business tax rolls prior to the new fiscal year. After the program ends, the Finance Department will seek to identify unlicensed businesses that did not comply voluntarily.

Community Outreach

Staff will conduct outreach to educate the community of the requirement for all businesses operating in Santa Monica to be licensed and the important City services business license taxes help to fund. Multiple communication channels will be used including print, online, and direct mail. Staff will target a diverse audience of small business owners, corporate managers, property managers, tax professionals, and the general public. Outreach will begin two weeks prior to the start of the program, and will include a press release and advertisements in local newspapers. Advertisements will continue throughout the program along with other more targeted outreach efforts.

Outreach will focus on educating the public that a business license is required and the type of assistance the City will be providing to those businesses that have not yet obtained a business license, in the way of a reduction of penalty. Staff will reach out to local business and trade associations, such as the Chamber of Commerce, the Santa Monica Small Business Development Center, and the Alliance, to promote the program through newsletters, email “blasts”, web sites, and printed materials. A deliberate effort will be made to promote awareness of the program and encourage individuals to spread the word. Some direct mail will also be used to notify tax professionals and specific groups where there may be a high percentage of unlicensed businesses because these industries may not be aware that a business license is required, such as commercial buildings. A custom web page will be posted and printed material will be created to provide the public with details about business licensing requirements and the program. Staff will also work with City TV on preparing a public service announcement.

Staff has also developed tools to assist businesses with completing business license applications; in-house training will be conducted with staff to ensure a high level of customer service and consistent application of the program rules.

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