



**OFFICE OF THE CITY MANAGER**

CITY HALL

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**CITY COUNCIL STAFF REPORT**

Meeting: June 5, 2018

Subject

Study session on potential revenue measures related to business license tax and storm drain fee.

Recommendation

Provide staff direction on next steps towards exploring an increase in the City's business license tax that is employee-based and increasing the storm drain fee.

Background

On March 6, 2018, Council adopted the City's 2018-19 Work Program. Under the financial sustainability category, the work program includes two items on exploring revenue measures: (1) an employer-based revenue measures to address issues such as traffic congestion and (2) an increase to the storm drain fee to fully recover the cost of the program.

Staff recently began gathering background information on revenue measures identified in the Work Program as well as the process required for approval. Staff also engaged with a polling company to conduct a public opinion poll on both revenue measures.

Discussion

***Employee-Based Business Tax***

While the strong economic recovery has led to increased hiring in job centers like Cupertino, it has come with adverse effects on traffic congestion and housing costs. Based on the American Community Survey, Cupertino had 38,200 jobs in 2012, a 23% increase from 2009 with the vast majority of workers (75%) commuting into the City in single occupancy vehicles.<sup>1</sup> With the large influx of employees commuting to Cupertino, it is not surprising that residents identified traffic as their biggest concern in the last community-wide survey conducted in 2017.

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<sup>1</sup> [CTPP Profile: Census 2000, 2007-2009 ACS, Census 2010 and 2010-2012 ACS](#)

The idea of an employee-based business tax for transportation has been discussed informally by elected officials in Cupertino and other cities in the region for some time. The City of Mountain View began exploring an employer-based business tax in January along with other revenue measures. In April, the City of Mountain View released the results of a public opinion poll that showed support for an employer-based business tax. Given Mountain View’s positive results, staff began doing background research on revenue measures and engaged with a polling company to conduct a similar public opinion poll.

*Cupertino Business License Structure*

Business license tax structures vary by agency based on number of employees, gross receipts, or square footage. Currently, Cupertino’s business license fee is based on a regressive rate structure using square footage of commercial space for general businesses (see Attachment A). As shown in the chart below, the City’s basic business license fee is \$144 plus an additional charge per square footage. The rate charged per square foot is highest for the smallest commercial spaces and decreases as the square footage amount increases. It is important to note that the City collects only \$140 of flat rate fee as it includes a \$4 state fee to improve disability access.

**Cupertino Business License Fee Structure**

<i>Square Footage Range</i>	<i>Rate</i>	<i>Tax Range</i>
Home Occupations - 0	0	\$144
1-5,000	0.0380	\$144-\$334
5,001-25,000	0.0331	\$334-\$996
25,001-75,000	0.0287	\$996-\$2,431
75,001-100,000	0.0237	\$2431-\$3,024
100,001-150,000	0.0189	\$3,024-\$3,969
150,001+	0.0048	\$3,969+

According to the 2016 Economic Development Strategic Plan, over 80% of businesses in Cupertino have less than 10 employees. Home-based businesses pay a base fee of \$144 and are not subject to the square footage charge, which only apply to commercial spaces. There are also distinct fee structures for specific business types related to lodging, entertainment, housing, and coin-operated devices.

The following chart provides examples of typical square footage for business types and their corresponding business license tax based on the City’s current tax structure. A sole proprietor with a one room office space would likely pay about \$160, while a small retail store or average-size restaurant occupying a 2,000 square foot commercial space would pay about \$220. A large grocer like Safeway would pay about \$1,700 per year. Given the

business tax rate is regressive, businesses with large square footage pay proportionally less in business license fees compared to smaller businesses.

### Sample Business License Tax Paid by Business Types

Example	Square Footage	Base	Marginal/SF	Tax
Sole Proprietor	400	\$144	0.0380	\$159
Small Restaurant	2,000	\$144	0.0380	\$220
Large Restaurant	5,000	\$334	0.0331	\$334
Large Grocer	50,000	\$996	0.0287	\$1,714
Large Retail	135,000	\$3,024	0.0189	\$3,685
Large Office	1,000,000	\$3,969	0.0048	\$8,049
Apple Park	2,800,000	\$3,969	0.0048	\$16,689

The City issued over 3,800 business licenses in FY 2016-17, which generated \$729,000 in General Fund revenue. Given our structure, businesses in Cupertino obtain a business license for each location, making the application process more cumbersome. Additionally, square footage is self-reported by the applicant and there is not an easy way for staff to verify the accuracy of the self-reported information.

### Employee-Based Business Tax Models

Under an employee-based business tax model, employers pay a flat base fee and a progressive employee fee rate that increases as the employee count increases. The neighboring cities of Sunnyvale, San Jose, and Redwood City use this structure. Mountain View is likely to place a measure on the November 2018 ballot to restructure its business license tax. Under Mountain View's proposal, businesses would pay a progressive flat rate amount and progressive per employee rate with the goal of generating \$10 million in revenue.

If Cupertino were to propose a rate structure similar to Mountain View, the City would generate roughly \$ 8 million as shown in the chart below:

Range	Estimated Businesses	%	Estimated Employees	Base Rate	Employee Rate	Total BL Tax
1-10	3,000	90.77%	3,000	150	0	\$450,000
11-50	250	7.56%	4,000	300	0	75,000
51-100	35	1.06%	2,000	425	0	14,875
101-250	15	0.45%	2,000	450	50	31,750
251-500	3	0.09%	950	450	50	33,850
501-1,000	1	0.03%	550	450	200	30,450
1,001-5,000	0	0.00%		450	250	-
5,001+	1	0.03%	26,000	450	300	7,420,450
Total	3,305	100.00%	38,500			\$8,056,375

Given that Cupertino has fewer medium to large businesses, if Council's goal is to generate \$10 million, like Mountain View, our rates would need to be higher. A flat rate of \$260 per employee would be needed to generate \$10 million in revenue. If Council wishes to implement a progressive model like Mountain View, rates for our largest employers may require a \$400/ employee rate.

These models are based on data from our business license application and the Employment Development Department (EDD). Unfortunately, our current application does not ask business license holders to self-report their employee count. EDD provides employee count ranges, which are not ideal. Therefore, the data in the model is based on very rough estimates that need to be refined to provide Council with more accurate modeling.

#### *Expenditure Plan*

Council has expressed interest in using revenue from an employee-based business tax for transportation infrastructure to alleviate traffic. However, no specific expenditure plan has been developed. While an expenditure plan is not required to place a measure on the ballot, it can be a useful tool to communicate with residents and stakeholders about the purpose of the tax increase. The business community has already expressed reservations about supporting a measure without a detailed expenditure plan.

#### *Timeline and Process*

Under Proposition 218, a general tax measure must be placed on the ballot when there is a general election of the City Council unless an emergency is declared. If the employee-based business tax is placed on the ballot as a general tax, it would need to be approved by 50% of voters. If revenue generated from the measure is to be used for a specific purpose, it is considered a specific tax that requires 67% voter approval.

In general, revenue measures have a higher chance of success during general elections with larger voter turnout. If the Council desires to place an employer-based business license tax on the ballot, upcoming general election opportunities include the November 2018 election and November 2020 election. For November 2018, the county deadline for placing a measure on the ballot is August 10<sup>th</sup>. However, given that the July 17<sup>th</sup> and August 7<sup>th</sup> Council meetings have been cancelled, the last opportunity for Council to adopt a resolution calling for an election would be July 3<sup>rd</sup>. Attachment D details the 2018 election timeline.

If the Council wishes to consider placing an employee-based business tax on the November 2020 ballot, staff would recommend a 12 to 10 month process allowing for a community dialogue about the need for additional revenue, the development of an

expenditure plan, and fully preparing the measure for the ballot. The basic phases of the process could include:

- Community dialogue on needs/priorities
- Additional surveying
- Modeling
- Expenditure Plan
- Council vote to place measure on the ballot

Once the Council votes to place a measure on the ballot, the City's role is limited to informational. The campaign is typically led by a volunteer campaign committee.

The Registrar of Voter fee for placing a measure on the ballot is estimated at \$60,000-\$70,000. Additional fees for legal services, consultants, and surveying could add up to an additional \$150,000 depending on the timeline and extent of planning and outreach.

### ***Storm Drain Fee***

The storm drain fee, passed in 1992, has been on the Council's radar for several years as revenue has not kept up with program expenses. The storm drain fee of \$12 per residential dwelling pays for the construction and maintenance of storm drain facilities, including drainage and sanitary sewer facilities as mandated by State law. The City's Stormwater Management Program also includes an optional 3rd grade creek field trip for Cupertino Union School District students as well as educational programs at McClellan Ranch. The fee currently funds about one-half of program costs and is subsidized by the General Fund.

Currently, about half of the Stormwater Management Program's costs are being recovered through the storm drain fee. The program costs \$670,000, while the fee generates only \$372,000. Staff is interested in fully recovering the cost of the program by doubling the Storm Drain Fee from \$12 to \$24 per residential dwelling.

### ***Process and Timeline***

Unlike a general tax measure, a Special Assessment fee such as the City's Storm Drain Fee follows a separate process consisting of a written notice, a public hearing 45 days after the notice, consideration of protests, and an all-mail ballot with majority approval. The written notice must be sent to each parcel owner with information on the proposed fee increase amount, reason for increase, and public hearing information.

If the Council wishes to consider pursuing an increase in the storm drain fee, further research would be needed to determine the cost and ideal timeline.

### *Polling*

The City contracted with Voxloca, a startup company providing low-cost polling services for local governments and civic organizations, to conduct a statistically valid poll of likely voters in Cupertino. Voxloca used publicly available information to randomly survey over 350 registered voters in Cupertino who are likely to vote in November elections. The poll consisted of seven questions related to a business license tax increase and a potential increase in the City's storm drain fee (see Attachment B). The survey was conducted May 23-25, 2018 via text message and email.

While Voxloca has informed us that the majority of residents have expressed support for both revenue measures, we are still awaiting final results. The survey results will be made available by June 5<sup>th</sup> and provided to Council as a desk item.

### *Next Steps*

At this time, staff is seeking Council direction on next steps. If Council desires to move forward with the revenue measures, staff needs direction on the timeline. If Council would like to place a measure on the November 2018 ballot, a next step could include directing staff to prepare modeling based on Council priorities for consideration on June 19<sup>th</sup> with proposed ballot language considered on July 3<sup>rd</sup>. Council could also direct staff to continue studying the item and preparing an expenditure plan for a ballot measure on the November 2020 election.

### Sustainability Impact

To the extent that revenue measures support transportation infrastructure that reduces single vehicle miles traveled in Cupertino, there would be a reduction in greenhouse gases.

### Fiscal Impact

If approved by voters, these measures could increase revenues by millions of dollars.

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Prepared by: Jaqui Guzmán, Deputy City Manager

Approved for Submission by: David Brandt, City Manager

### Attachments:

A – Cupertino Business License Tax 2018

B – Voter Poll

C – Voter Poll Results (available on June 4<sup>th</sup>)

D – 2018 Election Timetable