

**Proposition L: City of Solana Beach Business Tax Proposal**

March 2010

**Board Recommendation:**

**OPPOSE**

**Rationale:**

Although the City of Solana Beach has made laudable expenditure reductions, the City has failed to address one of its largest expenditure issues: public pensions. If the City were to eliminate the employer-paid pick-up on behalf of employees (EPMC), it would save approximately 85% (\$423,314) of what it is hoping to raise with a fully-implemented business tax. The argument that the City should implement such a tax because it is one of only a few cities that do not have one is inadequate and should not be given serious consideration. The fact remains that the City has not done all it can do in regard to its finances before approaching voters for a tax increase.

Furthermore, this business tax has components within it that disproportionately tax certain industries as well as businesses with specific earning levels at higher rates.

**Background:**

The City Council of Solana Beach began considering revenue enhancement options after reaching a consensus that despite making budget cuts summing to over one million dollars<sup>1</sup>, a sizable operating deficit remained. At the May 27, 2009 city council meeting, the City declared a state of fiscal emergency. At this meeting, it was anticipated that the 2010 fiscal year (FY) would have about \$1,430,050 less revenue than the previous fiscal year (or about 10.4% of its General Fund budget).<sup>2</sup> At this time, the City maintained a reserve totaling almost \$5 million (approximately 36% of the City's General Fund budget).

City staff argues that there are two reasons the City faces these budget issues: large decreases in revenues and state takeaways of \$650,000 (5% of the City's General Fund budget).

Budget cuts were made in every department for FY 2010, including the following specific reductions:

- Eliminating 2.5 full-time positions.<sup>3</sup>
- Freezing vacant staff positions.
- Reducing part-time personnel and increasing use of unpaid interns.
- Removing the 3% cost-of-living adjustment for employees' salaries (including fringe benefits).
- Preventing an increase in Flex Credit health benefits.<sup>4</sup>
- Producing only three "Shoreline" newsletters instead of four and completely cutting the postage budget (\$20,000) by only offering them electronically (except in certain city venues).<sup>5</sup>
- Outsourcing a Speed Survey for \$20,000 instead of paying the \$50,000 originally allocated for the project.<sup>6</sup>
- Placing many capital improvement projects (CIP) on hold or removing them entirely from the budget.<sup>7</sup>
- Entering into an agreement with the City of Del mar, City of Encinitas, and the Rancho Santa Fe Fire Departments to save on overhead costs.<sup>8</sup> Together the partnership agreements are expected to cost

<sup>1</sup> City of Solana Beach Staff Report "Proposed Revenue Enhancement Action to Partially Address Long-Term Financial Stability" prepared by David Ott and released November 18<sup>th</sup> 2009 (page 1).

<sup>2</sup> Presentation by City Manager David Ott at the May 27<sup>th</sup> 2009 City Council meeting

<sup>3</sup> Presentation by City Manager David Ott at the February 24<sup>th</sup> 2010 City Council meeting

<sup>4</sup> Presentation by City Manager David Ott at the February 2<sup>nd</sup> 2009 City Council meeting

<sup>5</sup> Presentation by City Manager David Ott at the April 29<sup>th</sup> 2009 City Council meeting

<sup>6</sup> Presentation by City Manager David Ott at the May 5<sup>th</sup> 2009 City Council meeting

<sup>7</sup> Ibid

<sup>8</sup> Staff Report by David Ott given to the Council for the January 27<sup>th</sup> City Council meeting

\$128,567<sup>9</sup>, but this allows for the elimination of the Director of Public Safety position, which has a savings of about \$223,000<sup>10</sup>. This leads to a net savings of \$94,433.

- Cutting a total of \$572,725 designated for Materials, Supplies and Services as follows:
  1. General Government (\$218,225)
  2. Community Development/ Building (\$70,600)
  3. Safety (\$67,400)
  4. Public Works (\$193,800)
  5. Community Services/ Recreation (\$22,700)

Since these aforementioned cost-saving measures were implemented, there remains a shortfall of \$557,815. City staff concluded that more cuts will need to be made due to even lower tax revenues than expected<sup>11</sup>. The following options have been provided as a means to address the City's budget issues:

- Furloughs (unpaid time off)
- Salary and benefit reductions for city employees
- Layoffs
- Further service reductions
- The use of undesignated reserves and/ or reserves designated for contingencies
- Possible postponements of the General Plan Update and the Local Coastal Plan, which will cost the City between \$1.2 to \$1.5 million<sup>12</sup>

**Proposal:**

The language that will appear before voters is as follows:

Shall Ordinance No. 404, that establishes and implements a Business Tax in the City of Solana Beach to increase locally-controlled revenue for general City services and operations, including but not limited to law enforcement, fire, parks and recreation, street repairs, and capital improvements program projects, be adopted?

The City's proposed business tax would be implemented mostly through using a tier-based system, which will be a hybrid between a flat tax and a tax based solely on gross receipts (revenues)<sup>13</sup>. The gross receipts a business collects will determine which "tier" that business is placed in; the business owner will then need to pay either the flat tax associated with that tier, or the gross revenues received by his or her business multiplied by a specific "multiplier" given below, whichever amount is smaller. Businesses earning less than \$66,500 will be obliged to pay a minimum fee of \$50. Home-based businesses would be assessed at a \$75 flat rate and residential rental properties would be assessed at a \$25 per unit rate.<sup>14</sup>

<sup>9</sup> Staff Report from Council Meeting Agenda Item 6.1, February 10, 2010.

<sup>10</sup> Ibid

<sup>11</sup> Interview with City Manager David Ott on January 29<sup>th</sup> 2010

<sup>12</sup> Staff Report from the City Manager to the City Council for the January 27<sup>th</sup> 2010 meeting

<sup>13</sup> Presentation by David Ott at the January 27<sup>th</sup> 2009 City Council meeting

<sup>14</sup> Residential property rentals consisting of five or more units would be assessed the \$25 per unit fee.

The following table outlines how the tax will be levied<sup>15</sup>:

| Tier | Gross Revenues          | Option "A" Flat Tax | Option "B" Multiplier |
|------|-------------------------|---------------------|-----------------------|
| 1    | \$0-\$66,499            | \$50                | N/A                   |
| 2    | \$66,500-\$99,999       | \$70                | 0.000675              |
| 3    | \$100,000-\$999,999     | \$300               | 0.000675              |
| 4    | \$1,000,000-\$2,499,999 | \$650               | 0.000426              |
| 5    | \$2,500,000-\$4,999,999 | \$1,100             | 0.000326              |
| 6    | \$5,000,000+            | \$1,675             | 0.00027               |

For a business that works exclusively in Solana Beach, an example of how this would work in practice is as follows:

**Example of Proposed Tax Burden on a Small Business in Solana Beach**

If a business makes \$250,000 in gross revenues, the business owner would have the choice to pay the flat tax of \$300 (option "A"), or 0.000675 multiplied by \$250,000, which would equal \$168.75 (option "B").

In tier 2, it will always be less expensive for a business to pay using Option B. In tiers 3, 4, and 5, there is a point at which it costs less if one pays only the flat tax instead of using the multiplier to calculate the amount owed; however, in tier 2, it will always cost less to use the multiplier. In tier 3, a business earning above (approximately) \$444,000 will no longer benefit by using the multiplier. The similar (approximate) amounts corresponding to tiers 4, 5, and 6 are \$1,525,000, \$3,375,000 and \$6,204,000, respectively.

If a business does at least some of its business outside the city, it is not legally responsible for the entire tax amount<sup>16</sup>. Instead, the business owner will need to pay an apportioned amount of the tax based on the percentage of time spent conducting business inside the City; this will be the case whether the business owner decides to pay based on the flat tax or the multiplier option<sup>17</sup>. An example of such a scenario is shown below:

**Example of Proposed Tax Burden on a Small Business in Solana Beach That Conducts Some Business Outside of City**

If a business makes \$250,000 in gross revenues, but only spends 75% of its time doing work in the City of Solana Beach, the business owner will be responsible for paying either \$300 multiplied by 0.75, or (using the number for option B that was calculated above) \$168.75 multiplied by 0.75, because the business owner is only responsible for 75% of the original tax amount. These two amounts end up being \$225 and \$126.56, respectively.

If a business has earned revenue by working outside of the City but the owner does not want to calculate how much of the time was spent working outside of the City, or feels s/he will not be benefited enough by the apportionment, the owner has the option to pay the whole tax without having to justify the apportionment time<sup>18</sup>.

The exceptions to the tiered model include businesses renting out five or more units of residential property, which will pay a fixed amount of \$25 per rental unit<sup>19</sup>, and home-based businesses, which will only need to pay \$75<sup>20</sup>,

<sup>15</sup> City Council meeting February 24<sup>th</sup> 2010

<sup>16</sup> City Attorney Johanna N. Canlas at the City Council meeting on October 14<sup>th</sup> 2009

<sup>17</sup> Ibid

<sup>18</sup> Ibid

<sup>19</sup> Ibid

regardless of gross revenue earned; also, because of state law, farmers markets and banks will be exempt from paying this tax<sup>21</sup>.

#### **Example of Proposed Tax Burden on an Apartment Complex in Solana Beach**

Suppose a residential rental complex has 200 units in the City of Solana Beach, its business tax burden would be \$5,000.

Other elements of the tax include a proposed adjustment for inflation that would be capped at a 2% increase in amount levied and would not take effect until at least 2012<sup>22</sup>. It is also important to note that the amount assessed would be based on the gross revenues earned in the past (calendar) year (2009), and the tax would go into effect on July 1<sup>st</sup> 2010 (the start of fiscal year 2011)<sup>23</sup>.

If the tax measure passes, the City Council will only collect 50% of the tax owed by the business/rental residential properties for the first year that the tax is collected. The Council would vote next year about whether or not to have a similar “phasing in” policy for FY 2011/2012<sup>24</sup>.

Solana Beach is one of only three municipalities in the County of San Diego without a business tax, the other two being Encinitas and Poway.<sup>25</sup> Currently, Solana Beach has an initial business licensing fee of \$70 (for administrative costs), and an annual renewal fee of \$16<sup>26</sup>. As of the October 14<sup>th</sup> City Council meeting, there were approximately 1,600 businesses in the City of Solana Beach that would be required to pay the new business tax. Over fifty percent of these businesses make less than \$100,000 in gross revenues annually, and about eighty percent of these businesses currently receive less than \$1 million annually<sup>27</sup>.

If approved, the City of Solana Beach would require all persons engaged in business within the City to apply for a Business Tax Receipt/Certificate and pay the initial Business Tax due (based on 2009 receipts) on October 15, 2010 or 90 days after the effective date of this measure.<sup>28</sup> This rate will be set at 50% of the tax owed for the first year the tax is in effect—the City’s established “phasing in” policy. Thereafter, the tax period will begin on July 1<sup>st</sup> of each year. If the tax is not paid within 30 days of being due, the City will assess a 10% penalty (of the entire tax still owed) on the first day of each month 60 days after being due. The penalties will not be assessed in excess of 30% of the total business tax due. However, once this 30% limit is reached, the City will impose a 1.25% per month interest rate.

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<sup>20</sup> Presentation by David Ott during the February 10<sup>th</sup> 2009 City Council meeting

<sup>21</sup> Interview with City Manager David Ott on January 29<sup>th</sup> 2010

<sup>22</sup> City Council meeting on January 27<sup>th</sup> 2010

<sup>23</sup> City Council meeting on February 24<sup>th</sup> 2010

<sup>24</sup> Discussion at the February 24<sup>th</sup> 2010 City Council meeting

<sup>25</sup> Interview with City Manager David Ott on January 29<sup>th</sup> 2010.

<sup>26</sup> Presentation by City Manager David Ott at the May 13<sup>th</sup> 2009 City Council meeting

<sup>27</sup> Discussion during City Council meeting on November 18<sup>th</sup> 2009

<sup>28</sup> This measure will go into effect 10 days following the City Council certification of election results.

## City of Solana Beach Municipal Analysis:

### Key Findings:

- Revenue levels for the City have been on a downward decline for the past three fiscal years (2008, 2009, and projections for 2010), falling first by 1.16%, then by 3.33% and 6.55%, respectively. The total drop in revenues since FY 2007 has been 11%.
- Expenditure levels for the City had decreased 10.16% in FY 2008, increased by 2.84% in FY 2009, and decreased 6.81% in FY 2010 (projected). The total increase in expenditures since FY 2007 has been 0.04%.
- The City’s reserve levels for FY 2010 are 25% less than what they were in FY 1999 (when adjusting for inflation).
- Total pension costs have increased by 114% since 1999 (adjusted for inflation).
- If the City were to eliminate EPMC, the City would have saved \$423,314 in FY 2009.

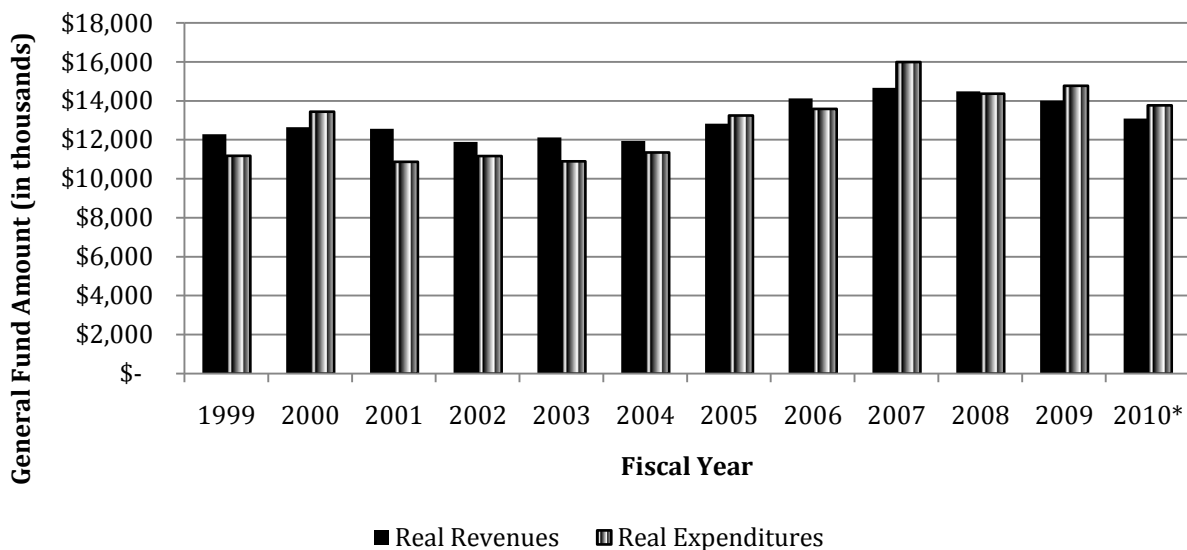
### Revenues vs. Expenditures

The following graph outlines revenues and expenditures within the City of Solana Beach for the last 11 years, and includes updated projections of revenue and expenditure amounts for the current fiscal year. Between Fiscal Year (FY) 1999 and FY 2010 (projected), average annual total General Fund revenues increased 0.7%, while total General Fund expenditures experienced average annual increases of 2.58% during the same period. Revenue levels for the city have been on a downward decline for the past three fiscal years (2008, 2009, and projections for 2010), falling first by 1.16%, then by 3.33% and 6.55%, respectively. The total drop in revenues since FY 2007 has been 11%.

## **City of Solana Beach General Fund Revenues and Expenditures from FY 1999 - FY 2010\***

(in 2009 dollars, adjusted for inflation)

**Source: FY 1999 - FY 2008 CAFRs and FY 2009- FY 2010 Budget**



The City of Solana Beach experienced budget deficits (when accounting for transfers in and transfers out) in fiscal years 2000, 2005, 2007, 2009, and is expecting another major shortfall in 2010. The largest budget deficit occurred in 2007 at the peak of both real expenditures and real revenue; however, it's important to note that a large quantity of almost \$2.5 million was transferred out of the General Fund in that year, which would otherwise not have made 2007 a deficit year.

**Reserve Levels:**

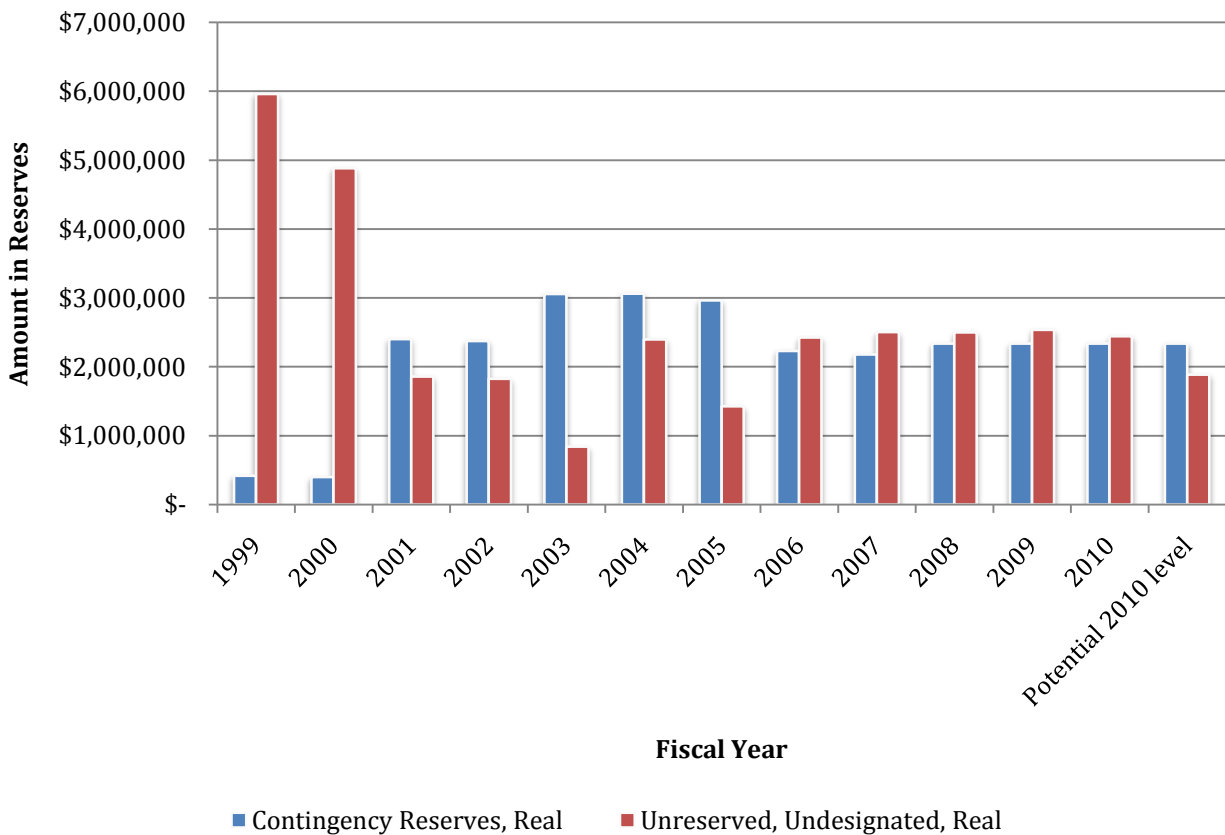
The City currently has a contingency fund for times of economic uncertainty. Combined with its other General Fund reserves, the City has \$4.8 million in unrestricted funds.

The City's undesignated reserves and contingency reserve levels have remained relatively constant since 2006, as can be seen in the following graph:

## City of Solana Beach Reserve Levels for FY 1999 - FY 2010\*

(In 2009 dollars, adjusted for inflation)

Source: Solana Beach historical budgets, financial statements, and Public Records Act Requests



The City's reserve target is at least seventeen percent of General Fund operating expenditures<sup>29</sup>. If we use the expenditure level for FY 2009<sup>30</sup>, \$14,769,599, 17% of that amount would be \$2,510,832, which is very close to the

<sup>29</sup> Interview with City Manager David Ott on January 29<sup>th</sup> 2010

amounts in the undesignated reserve account over the past few years. If the City continues drawing on reserves, it will have a very difficult time replacing the reserves it has already used, which could directly affect the City’s credit rating as well as its long-term financial health and stability.

**Tax Revenues:**

Property taxes are the highest revenue generator for the City of Solana Beach, and they have made up close to 40% of total taxes and fees since 1999, with the exceptions of the three most recent fiscal years (2008, 2009, and 2010), in which they made up 43.1%, 46.1%, and 51.5% of total tax and fee revenues, respectively.

In FY 2008, sales tax revenue declined by 4.6%. In 2009 and 2010 (projected), the decline was much steeper with sharp falls of 11.8% and 11.7% respectively. The total fall in sales tax revenue has been 26.7% since FY 2007.

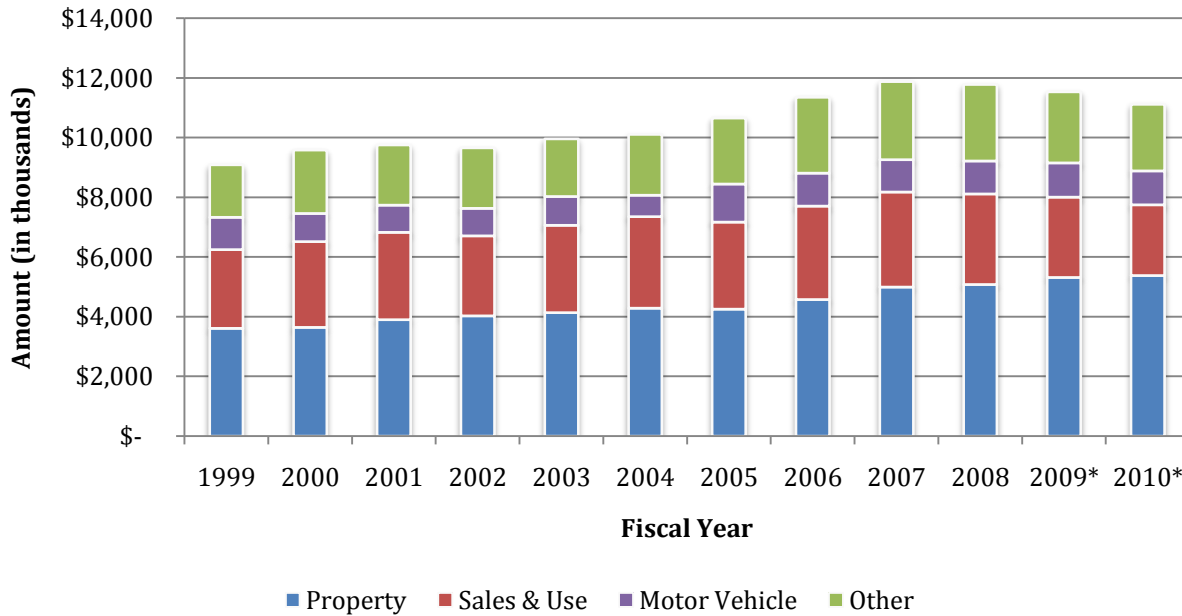
Other miscellaneous tax and fee revenue, including those from: franchise fees; the transient occupancy tax (TOT); property transfer tax; fire benefit fees; etc, has followed the same pattern over the past three fiscal years, dropping first by 2.28% in FY 2008, then by 7.2% and 6.2% in the next two (most recent) years, which means an absolute decrease of 14.9% in “other” tax revenue since FY 2007.

The following chart shows the proportion of property, sales, and other taxes and fees levied by the City of Solana Beach for FY 1999 to the most recent projected amounts for FY 2010:

## Governmental Tax Revenue Sources From FY 1999 - FY 2010\*

(in 2009 Dollars, adjusted for inflation)

Source: City of Solana Beach FY 1999 - FY 2008 CAFRs and Budgets



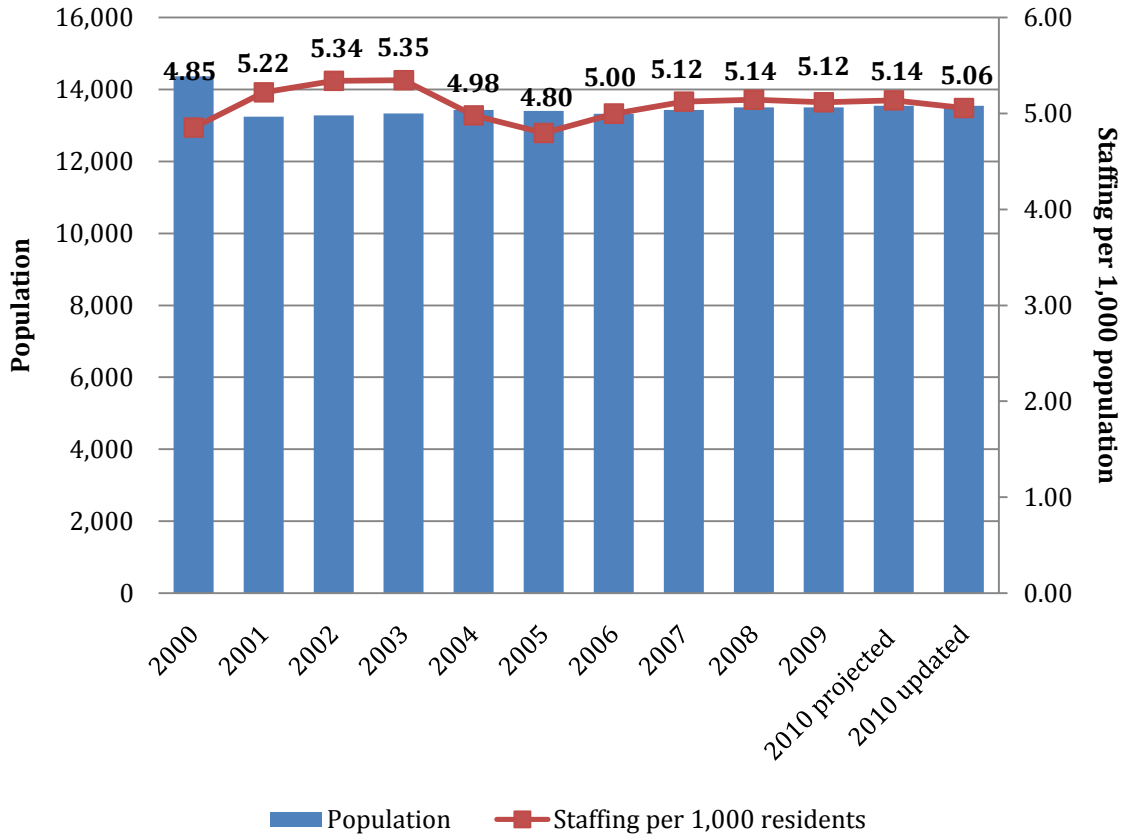
<sup>30</sup> Staff used FY 2009 numbers instead of numbers from FY 2010 because many of the cuts made for the current fiscal year were either deferments for a later year, or cuts that should not be put in place permanently for other reasons, making 2009 a better model for this purpose.

**Staffing Levels:**

Staffing levels at the City of Solana Beach have remained relatively constant over the past few years, with an average growth rate of 0.3%. The maximum staffing level of 71.28 full-time equivalent (FTE) employees occurred in 2003, and the minimum of 64.27 FTEs in 2005<sup>31</sup>. The current level of FTEs for the City of Solana Beach is 68.49, which is slightly below the twelve-year average of 68.7.

## Staffing Levels per 1,000 Population

Data from FY 2009 CAFR and 2009/2010 Adopted Budget



From the graph above we can see that the highest value of staffing per 1,000 people occurred in 2003 with 5.35, and that the lowest value since FY 1999 occurred in the following fiscal year, 2004, with 4.98. Currently this ratio stands at about 5.06, which is the lowest it has been since FY 2006. If the amount of staff projected for FY 2010 in the 2009/2010 Adopted Budget were currently employed by the City, this ratio would be 5.14 instead of 5.06; however, since some staffing cuts have been made, the current level is 5.06.

**Pension Costs:**

The city currently has Memorandums of Understanding (MOU) with various labor groups. These MOUs outline all of the benefits that the respective groups of city employees receive, including salary increases and pension benefits. The City’s current MOUs for all labor groups expire on June 30, 2010.

<sup>31</sup> 2009 Comprehensive Annual Financial Report





The City contributes to the California Public Employees’ Retirement System (CalPERS), an agent multiple-employer public employee defined benefit pension plan. PERS provides retirement and personal disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State of California.

Solana Beach active plan members are “required” by State statute to contribute 8% for miscellaneous, nonsafety employees, and 9% for fire safety and marine safety workers of their annual covered salary. The City employer picks up 6.5%, 7% and 7.3% of the contribution required of City employees for miscellaneous, marine safety, and safety employees, respectively (this is known as Employer-Paid Member Contributions or EPMC).

| <b>Fire Safety Employee Example</b> |                 | <b>Miscellaneous Employee Example</b> |                 |
|-------------------------------------|-----------------|---------------------------------------|-----------------|
| Single Highest Year Salary          | \$100,000       | Single Highest Year Salary            | \$85,000        |
| Inclusion of EPMC at 7%             | \$7,000         | Inclusion of EPMC at 6.5%             | \$5,525         |
| Total Calculated Salary             | \$107,000       | Total Calculated Salary               | \$90,525        |
| Service Years                       | 30              | Service Years                         | 30              |
| Benefit Factor                      | 3%              | Benefit Factor                        | 2.50%           |
| <b>Total Pension Benefit</b>        | <b>\$96,300</b> | <b>Total Pension Benefit</b>          | <b>\$67,894</b> |

| <b>City of Solana Beach Employee Retirement Benefits</b>   |
|--|
| <b>CalPERS Formula:</b> 2.5% @ 55 for miscellaneous employees and 3% @ 50 for both marine and fire safety  |
| <b>Employee Contribution:</b> City pays 6.5% of the employee contribution for miscellaneous members, 7.3% for marine safety and 7% for fire safety |
| Single highest year benefit for final compensation   |
| EPMC is reported as income for purposes of calculating compensation at retirement for all employees  |

A summary of the benefits afforded to each labor unit is presented in the following table:

| <b>Labor Unit</b>   | <b>Benefit Formula</b> | <b>Employees pay</b> | <b>City picks up</b> | <b>EPMC value reported</b> |
|---|------------------------|----------------------|----------------------|----------------------------|
| Solana Beach Firefighters Union                           | 3% @ 50                | 2.0%                 | 7.0%                 | Yes                        |
| Solana Beach Firefighters' Association Marine Safety Unit | 3% @ 50                | 1.7%                 | 7.3%                 | Yes                        |
| Solana Beach Employees' Association Miscellaneous Unit    | 2.5% @ 55              | 1.5%                 | 6.5%                 | Yes                        |

The next table lists the total pension costs for the City of Solana Beach from FY 1999 through FY 2009, showing a noticeable upward trend:

| <b>City of Solana Beach Annual Pension Costs</b>                      |                                      |  |   |                 |
|---|--------------------------------------|--|---|-----------------|
| <i>Source: Public Records Act Requests, City Financial Statements</i> |                                      |  |   |                 |
| <b>Fiscal Year</b>  | <b>Total Pension Costs (nominal)</b> | <b>Total Pension Costs (in 2009 dollars, adjusted for inflation)</b> | <b>Ratio of Total Pension Costs to General Fund</b> | <b>% Change</b> |
| 1999  | \$ 470,269                           | \$ 659,329   | 7.34%   | -               |
| 2000  | \$ 381,836                           | \$ 506,057   | 4.48%   | -23.25%         |
| 2001  | \$ 337,450                           | \$ 427,584   | 4.82%   | -15.51%         |
| 2002  | \$ 321,022                           | \$ 392,996   | 4.34%   | -8.09%          |
| 2003  | \$ 392,985                           | \$ 463,753   | 5.20%   | 18.00%          |
| 2004  | \$ 526,309                           | \$ 599,196   | 6.56%   | 29.21%          |
| 2005  | \$ 953,636                           | \$ 1,047,314   | 9.56%   | 74.79%          |
| 2006  | \$ 1,019,931                         | \$ 1,083,291   | 9.82%   | 3.44%           |
| 2007  | \$ 1,260,334                         | \$ 1,308,674   | 9.85%   | 20.81%          |
| 2008  | \$ 1,372,433                         | \$ 1,372,189   | 11.77%  | 4.85%           |
| 2009  | \$ 1,410,333                         | \$ 1,410,333   | 11.91%  | 2.78%           |

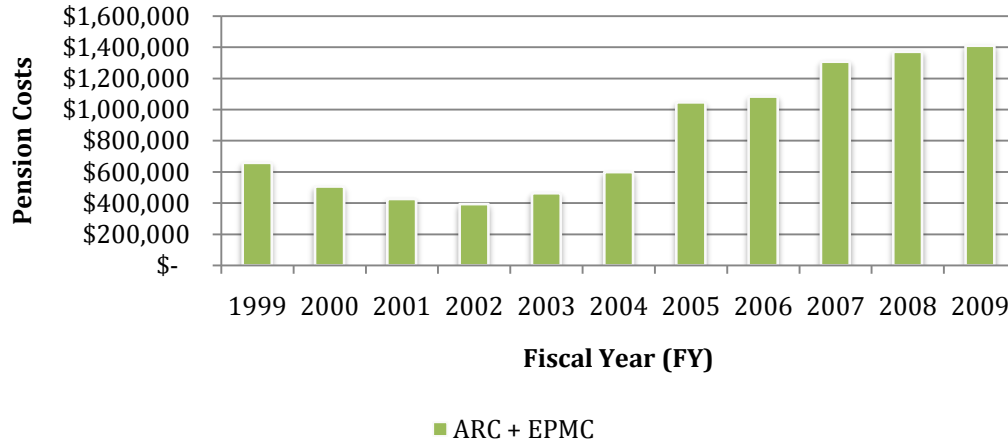
When adjusting for inflation, the city’s total pension costs have increased 114% between FY 1999 and FY 2009. During much of this time, the city’s pension fund was super-funded (where assets far exceeded liabilities), which meant that the city had a very low payment on its required contribution to CalPERS. During this time, however, payment toward EPMC did not stop.

Payment toward pensions will continue to consume greater portions of the City’s General Fund. This past fiscal year, CalPERS lost nearly 1/3 of its portfolio. These rates, in return, get pushed back onto cities in the coming years through higher rates.

## Solana Beach Pension Costs FY 1999 - FY 2009

(in 2009 dollars, adjusted for inflation)

Source: FY 1999-2009 financial statements, Public Records Act Requests



For a more comprehensive look at public pensions in the region, please review SDCTA’s Phase I report issued in October of 2009.

SDCTA recognizes that while pension costs consume increasing portions of a City’s General Fund, total compensation needs to be taken into account as well. SDCTA has reviewed three “typical” positions in city government: firefighter/paramedics, executive assistants, and assistant planners and each of their corresponding monthly salaries.

| City         | Position                  | Monthly Salary | Position            | Monthly Salary    | Position          | Monthly Salary |
|--------------|---------------------------|----------------|---------------------|-------------------|-------------------|----------------|
| Carlsbad     | Firefighter/<br>Paramedic | \$6,415        | Executive Assistant | \$6,050           | Assistant Planner | \$5,504        |
| Coronado     | Firefighter/<br>Paramedic | \$6,022        | Executive Assistant | \$5,713           | Assistant Planner | \$5,587        |
| Del Mar      | Firefighter/<br>Paramedic | \$5,846        | Executive Assistant | \$4,623           | Assistant Planner | \$5,309        |
| Encinitas    | Firefighter/<br>Paramedic | \$6,582        | Executive Assistant | \$5,561           | Assistant Planner | \$5,561        |
| Poway        | Firefighter/<br>Paramedic | \$6,088        | Executive Assistant | \$4,499 - \$5,468 | Assistant Planner | \$5,632        |
| Solana Beach | Firefighter/<br>Paramedic | \$6,183        | Executive Assistant | \$5,021           | Assistant Planner | \$5,124        |
| San Marcos   | Firefighter/<br>Paramedic | \$6,104        | Executive Assistant | \$6,060           | Assistant Planner | \$5,361        |

Source for Firefighter/Paramedic Data: Del Mar Compensation Survey Data (dated thru October 2009).

Source for Executive Assistant Data: Coronado Compensation Survey Data (dated thru April 2009). City of Poway’s Salary Schedule for FY 2008/2009.

Source for Assistant Planner Data: Coronado Compensation Survey Data (dated thru April 2009).

As can be seen in the compensation table, out of selected neighboring cities, Solana Beach pays the third highest for Firefighters/Paramedics, third lowest for Assistant Planners, and between the second and third lowest for Executive Assistants.

### **Proponent Arguments:**

- The City does not currently have the ability to collect sales tax on products or services offered online, and this tax can help recover some of the lost sales tax revenue it has experienced in the past few years due partly to the change in consumer habits.
- This measure has gained support from many businesses in Solana Beach. Peter House, president of the Village Walk Highway 101 Association, wrote a letter addressing the Council and stated that the tax proposal “does protect our small and struggling businesses and it does give us the flexibility, certainty, and simplicity that we asked for<sup>32</sup>.” This letter was signed by twenty-three members of the Solana Beach business community, including David Carroll, who serves as President of the Solana Beach Chamber of Commerce.
- The sharp decreases in tax revenues collected by the City add significantly to potential financial instability, which would surely affect the residents and businesses of Solana Beach if the problem worsened.
- Even if the economic situation improves in the recent future, in order to deal with this budget deficit, the City will most likely need to not only cut service levels currently offered by the City, but also use some of its reserves, just to break even.
- The City should not only be concerned about a lower level of reserves in case of later financial difficulties, but also a plan to replace the reserves that were used for the deficit in the current year.
- The City has elected to include a clause into the proposal that would allow the Council to stop collecting the tax revenue in the years it deems it unnecessary for funding of city services.
- If the tax measure does not pass this year, and the City were to find itself in a worse fiscal condition with fewer options, city staff would have to begin the process of placing a revenue enhancement option on the ballot all over again, which would be costly in terms of both time and taxpayer dollars.

### **Opponent Arguments:**

- This measure has gained support from many businesses in Solana Beach. However, not all businesses in the City of Solana Beach are in support of this measure, and a few continue to express their concerns for the proposed tax. At the May 27th 2009 City Council meeting, many business owners expressed dissatisfaction with the proposed business tax, and asked for more community involvement in the decision-making process.<sup>33</sup> After hearing this request by many members of the community, city staff met with the City Council Business Liaison Standing Committee on June 2, 2009 in order to compromise on a business tax model that would not be seen as an unnecessary burden on local businesses. According to a Solana Beach Staff Report, discussions continued with the Committee and many members of the local business community over the following months in order to come up with an acceptable model<sup>34</sup>; however, many business owners are still opposed to the measure for a variety of reasons.
- Many residents hoped that a “sunset clause” would be written into the proposal, which would oblige the City to stop collecting the business tax if and when the City became more financially stable.<sup>35</sup> This issue was discussed at the May 13, 2009 City Council meeting, and the consensus was to not include the clause because in the case that the City did still need the funds (or needed the funds later) but the criteria were already met to do away with the tax, the City would have to restart the initiative process of drafting a new proposal and going through the work to get it on the ballot, which would undoubtedly use a large amount

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<sup>32</sup>Mannes, Tanya. “Council OKs Business Tax for Voter Approval.” San Diego Union Tribune article released on November 27, 2009. <<http://www.signonsandiego.com/news>> Last accessed on January 21, 2010.

<sup>33</sup> Public participation session at the May 27<sup>th</sup> 2009 City Council meeting

<sup>34</sup> City of Solana Beach Staff Report “Proposed Revenue Enhancement Action to Partially Address Long-Term Financial Stability” prepared by David Ott and released November 18<sup>th</sup> 2009 (page 2).

<sup>35</sup> Public participation session at the May 27<sup>th</sup> 2009 City Council meeting

of taxpayer funds. The council decided that a better alternative would be to only implement the tax in years that it was necessary, which would be controlled by a simple majority vote on the City Council<sup>36</sup>.

- Other businesses think that the City should not be implementing a tax at such a poor time for businesses already, and many consider it unfair that the tax is targeting businesses as opposed to a combination of demographics, namely residents.<sup>37</sup> Some who disagree with the tax proposal itself think that it should offer an exemption for start-up businesses and/ or those not making profit.<sup>38</sup>

### Analysis:

- The projected revenues from the business tax are expected to equal about \$500,000 per year, which would be an increase of roughly \$460,000 from the business license fee model already in place (the current plan is to discontinue the system currently used in the event that this proposal is passed by the voters)<sup>39</sup>. However, since the city is “phasing in” this tax over at least the first year, only half of those funds are expected for FY 2011. The costs associated with implementing and enforcing the proposed business tax would be approximately \$25,000.<sup>40</sup>
- Other costs associated with the business tax proposal include an estimated \$13,000 required to put the measure up for a public vote in June 2010, and about \$12,000 for “annual costs incurred for data collection”<sup>41</sup>. Of the \$13,000 needed to place the measure before voters, \$9,600 has already been allocated from the 2008 General Election.<sup>42</sup>
- This proposed business tax increase would not be earmarked for any particular purposes, and would go directly into the general fund. In 2006, this organization supported Proposition E, which allowed Solana Beach to increase its Transient Occupancy Tax rate from 10 to 13% over a three-year period, but part of the proposal specifically outlined that the extra funds would be used for Sand Replenishment/ Retention, Coastal Access Capital Projects, and for Coastal Area Business/ Visitor Assistance and Enhancements. The current proposal to adopt a business tax would be paid for exclusively by business owners of Solana Beach, but the extra revenue created would go straight into the General Fund, which can be used for many purposes that have little benefit to the business community in particular.
- The City of Solana Beach could have saved over \$423,314<sup>43</sup> (or about 3% of the City’s General Fund) in FY 2009 alone if employees paid their full “required” share of pension costs. This is approximately 84.66% of the anticipated business tax revenue.
- Residential rental units are disproportionately taxed higher than businesses with this proposed tax. Since residential rental units already pay property taxes to provide for city services, it is of concern that some complexes may end up paying close to three-times more than a business earning \$5,000,000 in gross receipts.
- In many ways, this tax remains a regressive tax. The clearest example of this is the transition from Tier 1 to Tier 2. In Tier 1, businesses earning between \$0 and \$66,499 must pay a \$50 minimum flat tax. In Tier 2, businesses earning between \$66,500 and \$74,000 will pay less using the multiplier (Option B) than those in the lowest tier.

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<sup>36</sup> Discussion during the January 27<sup>th</sup> 2009 City Council meeting

<sup>37</sup> Public comment section of the May 27<sup>th</sup> 2009 City Council meeting

<sup>38</sup> Public comment section of the October 14<sup>th</sup> 2009 City Council meeting

<sup>39</sup> Interview with City Manager David Ott on January 29<sup>th</sup> 2010

<sup>40</sup> City of Solana Beach Staff Report “Proposed Revenue Enhancement Action to Partially Address Long-Term Financial Stability” prepared by David Ott and released November 18<sup>th</sup> 2009 (page 5).

<sup>41</sup> Ibid

<sup>42</sup> City of Solana Beach Staff Report for City Council Meeting, February 24, 2010.

<sup>43</sup> Amount deduced from subtracting employer contributions in the 2009 financial statements from the total pension costs to the city provided through a Public Records Act Request.



- The City is establishing a \$75 flat rate for home-based businesses. Currently, home-based businesses are an allowable accessory use in all residential zones. If a home-based business earns less than (approximately) \$111,000 per year, it will be assessed a higher rate than those in the first and second tiers and some of those in the third tier.
- Finally, the City charges a \$75 initial applicant tax for all businesses that begin operation after June 9, 2010. This unfairly penalizes new businesses that come in at the first and second tier. While this provides an encouragement for new business development outside of these tiers, this also penalizes current business operators—including residential property rentals.