



TAX REFORM

EXECUTIVE SUMMARY

**A MESSAGE FROM
MAYOR RICHARD J. RIORDAN
AND COUNCILMAN RICHARD ALATORRE
CHAIRMAN, BUDGET AND FINANCE COMMITTEE
DECEMBER 15, 1998**

Over the past five years, Los Angeles has worked to make our City government more accountable, efficient and responsive to its residents and its businesses. However, the challenge of reforming our tax system still remains. The City's antiquated Business Tax Code, created in the early 1900s, critically needs modernization. The City's existing Business Tax system is overly complex, highly uncompetitive and too often stifles the growth of industries critical to our economic and civic prosperity.

Certainly, multiple factors are considered in a company's decision to locate or expand in the City of Los Angeles. While some factors are outside the control of City Hall, many elements fall under our domain. Public safety, quality infrastructure, an efficient development process and a competitive tax system are cornerstones of a healthy economic foundation. While City government has been vigilant in moving forward on the first three initiatives, the strength of our economic growth also relies on our efforts to comprehensively reform our outdated Business Tax system.

Much analysis and debate has been dedicated to the development of this Tax Reform Proposal. First, we have carefully incorporated the concerns of the community, including the business community, who must face the challenges of our Business Tax Code every day. We have also integrated the insight, assistance and recommendations provided by Councilmembers, City departments and the City's tax consultants. This public and private sector input has guided the recommendations in this proposal. Implementation of the Tax Reform recommendations will:

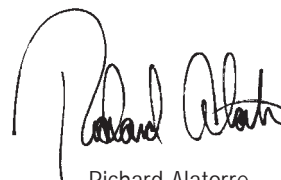
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| <ul style="list-style-type: none"> • SIMPLIFY THE TAX SYSTEM • ESTABLISH A MORE COMPETITIVE BUSINESS TAX • MAINTAIN FISCAL RESPONSIBILITY • DECREASE TAX LIABILITY UNCERTAINTY | <ul style="list-style-type: none"> • PROMOTE QUALITY JOB GROWTH • PROMOTE ENTREPRENEURIALISM AND SMALL BUSINESSES • PROMOTE CIVIC PROSPERITY • INCREASE TAXPAYER COMPLIANCE |
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As co-chairs of the Council-created Tax Reform Committee, our primary goal behind formulating this Tax Reform Proposal is to establish a system that will lead the City of Los Angeles, one of the world's largest and most entrepreneurial economies, into the next millennium. Reforming our tax system will improve the quality of life of every Angeleno by enhancing our business climate, growing jobs and creating fiscal health in our communities. To preserve our place as the capital city of the 21st century, we must implement a Business Tax system that is fiscally sound, responsive to the new economy and easy to understand. By pursuing these fundamental goals, we will foster the continued growth of quality jobs and improve the quality of life for our City's residents.

Sincerely,



Richard J. Riordan
Mayor



Richard Alatorre
Councilman, District 14
Chairman, Budget and Finance Committee

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The Los Angeles Business Tax system is highly complex and often inhibits new business attraction, retention, expansion and quality job creation. The source of the complexity is the system's sixty-four different tax categories. Many businesses pay taxes in multiple categories, making the existing system confusing, uncertain and costly. As a result, both the payment and collection of the Business Tax have been problematic.

Non-compliance rates of 15-30%, along with underreporting, cost the City an estimated \$75 million in lost revenue each year.

In order to address these issues, the City retained Arthur Andersen, the Milken Institute, UT Strategies and Landmark Partners to conduct a thorough analysis of the current Business Tax system. Input was also provided by the Los Angeles City Council, business and community organizations and the City's financial staff. The result of this collective effort is the Los Angeles Business Tax Reform Proposal.

This Proposal is a critical component of a larger effort to make Los Angeles a more business-friendly city. The Proposal creates a simpler, more competitive Business Tax system that will promote the creation of new businesses and quality jobs for our residents. The Proposal will provide \$23 million of broad-based tax relief to businesses throughout our City and increase taxpayer compliance. Importantly, the proposed compliance and efficiency measures will ensure that lost revenues are recaptured, thus protecting City services and the City's General Fund.

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The Los Angeles Business Tax Reform Proposal will be phased in over the next three years. Many of its components will require voter approval. The following is recommended:

TAX SIMPLIFICATION AND RELIEF

The Primary Industry Code (PIC) system has been developed to simplify the current tax structure. This system will reduce uncertainty and accounting costs for businesses and make Los Angeles more competitive.

- Business locations will pay business taxes under only one tax rate, based on the company's site-specific Standard Industrial Classification.
- Virtually all industries will receive a tax reduction.
- There will be a consistent minimum tax level in all tax categories.
- \$23 million in broad-based tax relief will be provided to businesses throughout the City.
- Artists, musicians, educational services, social services and membership organizations will now contribute at the lowest tax rate.
- Most flat tax categories will disappear.
- Revenue enhancement measures will be established to ensure that the General Fund is adequately protected.
- The definition of the multimedia industry has been broadened to provide more businesses with the City's most competitive rate.
- Companies with fewer than 5 employees will receive an average tax savings of 14%.
- Self-employed business owners will receive an average tax savings of 25%.

EXEMPTIONS FOR START-UP COMPANIES

- Start-up companies will be exempted from paying the Business Tax during their first year of operation in an effort to improve their prospects for success.

EXEMPTIONS FOR BUSINESSES EARNING LESS THAN \$5,000

- Business activity generating less than \$5,000 in gross receipts will be exempted from paying the Business Tax in order to provide greater tax equity to very small companies.

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FISCAL YEAR FILING

- Currently, Business Tax filing occurs on a calendar year basis. The recommended move to fiscal year filing will save businesses from the time consuming, burdensome and costly process of reallocating their gross receipts into their appropriate calendar year intervals.

INCREASED COMPLIANCE

- A new up-front Business Tax collection system for entertainment production activities will enhance compliance.
- Simplified forms and procedures will enhance compliance.
- Increased auditing capacity will generate revenues from businesses not currently paying the Business Tax.

USE TAX CREDITS

- Currently, the City loses an estimated \$29 million annually in Use Tax revenues due to the local allocation formula. Under this Proposal, businesses that designate Los Angeles as the recipient of the local portion of their Use Tax will receive a Business Tax credit that is equivalent to 20% of the net Use Tax gain to the City. This tax credit will provide financial benefits to both the City and businesses.

AMNESTY 2000

- A Business Tax amnesty will be held in the fall of 2000. This will enable the City to collect back taxes and add former non-complying businesses to the City's Business Tax rolls. Through an aggressive advertising campaign emphasizing the risk of non-compliance, the City will collect a portion of the estimated \$75 million lost each year. The last amnesty held in 1995 was only modestly advertised and generated approximately \$13.7 million in back taxes and \$6 million in on-going Business Tax revenue for the City.

BUSINESS TAX ADVISORY GROUP

- Convened by the Mayor's Office and the Chair of the Budget and Finance Committee, this advisory group of business people and accountants will provide a taxpayer's perspective relative to the continued simplification of our tax process. The Tax Advisory Group will make specific recommendations on the types of documented information needed by businesses, business license forms, auditing and compliance procedures, mailings and processes, such as on-line filing.

This Proposal represents a critical step toward improving the Business Tax system in the City of Los Angeles. Improving our Business Tax system will further the prosperity of the Los Angeles business community and ensure that our residents continue to benefit from our growing job base.