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MEMORANDUM

To: Mayor and City Council

From: Chris Pike, Finance Director

Date: October 19, 2009

Subject: **DISCUSSION OF THE BUSINESS LICENSE ORDINANCE**

ITEM DESCRIPTION

To provide a review of the occupation tax program during the initial year of the City

BACKGROUND

An occupation tax, sometimes referred to as a business license tax, is a tax imposed on businesses for the purpose of raising revenue.

In 1993, the Georgia General Assembly passed HB 362 and later amended the law in 1995 with minor modifications since that time. Under the revised law, Dunwoody may levy and collect occupation taxes on businesses and practitioners that have an office or location within the city limits and in some cases where no office or location exists within the city limits. The law is codified in OCGA § 48-13-5 through § 48-13-28. **This is relevant in that Dunwoody can only assess taxes in manners stipulated in OCGA § 48-13-5 through § 48-13-28. This substantially limits our creativity and ability to use some best practices from across the Country.** OCGA § 48-13-10 states Dunwoody can establish an occupational tax structure using **ONLY** one or more of the following:

(1) The number of employees of the business or practitioner;
(2) Profitability ratio for the type of business, profession, or occupation;
(3) Gross receipts of the business or practitioner in combination with the profitability ratio for the type of business, profession, or occupation; or
(4) A flat fee.

Dunwoody inherited a tax structure that combines numbers 1 and 3 above. This requires that we categorize the businesses and practitioners according to a profitability ratio scheme. This scheme is established to maintain equity in taxation by accounting for different levels of profitability in different industry sectors. Regarding the employee fee, Dunwoody is authorized but not required to adopt more than one rate of taxation per employee.

We currently have six tax classes; each class with a different gross receipts charge and different per employee charge. Special rules apply to practitioners (such as doctors, lawyers, CPA's, etc…), banks, and insurance companies. This discussion will not address these exceptions, but rather will focus on the "normal" procedures for most businesses.

OBSERVATIONS

1. Where is the money coming from? Here are a few tidbits regarding collected revenues through September for the 1914 final and pending applications with a total tax of $2,013,586.32.

    a. Average tax was $1,052.03. If you exclude the top 20%, the average drops to $267.72 per business.
    b. The top 10% of businesses accounted for 69% of revenues.
    c. The top 20% of businesses accounted for 80% of revenues.
    d. Home Occupied Businesses are 14% of applications (271) with just 2.5% of revenues ($50,618.70) with an average of $186.78 per business.
    e. The most common industries are medical and other licensed professionals (doctors, lawyers, CPA's, etc), clothing and general retailers, restaurants, and consultants. However, nearly 300 different industry codes were provided indicating a widely diversified business base.
    f. The breakdown of revenues is:

Tax Class	# of Businesses	Total Tax	Average
1	18	3,086.95	171.50
2	73	98,810.60	1,353.57
3	471	487,950.22	1,035.99
4	54	18,883.53	349.70
5	113	50,424.62	446.24
6	1177	1,354,430.41	1,150.75
Other	8	-	

Note: Regarding the $98,810.60 for class 2, over half was from one company. Excluding the one, the average was $654.16.

As you can see, the two main groups are tax class 3 and tax class 6. Tax class 3 consists mostly of your restaurants and retailers. Virtually everyone operating within Perimeter Mall is a tax class 3. Tax class 6 consists mostly of your service providers such as consultants; although in practice, it's just about everyone who is not a tax class 3.

    g. Businesses reporting less than $20,000 in gross receipts were 364.
    h. Businesses reporting less than two employees were 719.
    i. The largest employer reported was Six Continents Hotels with 967 employees.
    j. Over 300 applications have been processed since August 1st.

2. Many businesses complained and argued the current progressive tax structure was unfair. Based on the structure inherited from DeKalb County, approximately 60% of businesses and 67% of our revenues were taxed at the class 6 rate. Many of those businesses felt it was not right to charge different rates to different industries; whether or not it was authorized by law.

   On one end, the first year resulted in much confusion on both staff's part and the business community's part in properly determining and applying the applicable tax rate for each business. Most of our early 2009 collections shortfall was the result of the confusion. On the other hand, much of the confusion was addressed, learning curves overcome, and the likelihood of continued confusion significantly reduced. At Council's direction, staff could implement both a flat gross receipts tax for all businesses or continue with the current progressive tax format without duplicating the problems incurred earlier this year.

   We compared our process to neighboring jurisdictions and determined our method of taxation was the same as many others including Chamblee, Doraville, Sandy Springs, Johns Creek, DeKalb County, and Fulton County. Gwinnett County charges a progressive gross receipts tax but does not tax a per employee charge.

Jurisdiction	# of Classes	Per EE Fee	Low (per $1k)	High (per $1k)	Retail	Restaurant	Service
Dunwoody /DeKalb	6	$4-$14	$.1800	$.7800	$.4200	$.4200	$.7800
Doraville							
Fulton	24	$13	$.5000	$2.2000	$.9500	$1.1500	$1.40-$1.65
Gwinnett	6	$0	$.6500	$1.3000	$.7800	$.7800	$1.0400
Johns Creek	24	$13	$.5000	$2.2000	$.9500	$1.1500	$1.40-$1.65
Sandy Springs	24	$13	$.5000	$2.2000	$.9500	$1.1500	$1.40-$1.65

   Another issue we noted with EVERY one of these jurisdictions is that no one can recall the last time the profitability ratios were examined and the tax classes for each NAICS code was updated. The DeKalb and Dunwoody ordinance requires a review every two years.

3. Home based businesses represented 14% of the applications filed, but provided just 2.5% of the revenues generated. Significant time and resources goes to documenting these businesses with little revenue to offset these costs. Home-based businesses are required to complete an additional "Home Occupation Supplemental License Form" to ensure they are aware of the various zoning requirements of conducting business within a residential area. My recommendation would be to consider an administrative fee attached to the Home Occupation Supplemental License Form for the Community Development and Finance time incurred to monitor these businesses. Given the time devoted to these businesses, $50 seems reasonable.

4. Another item that seems to go hand-in-hand with home-based businesses is whether to charge certain industries an occupation tax at all. Currently, the only industries excluded are nonprofit organizations such as government, religious and civil organizations. Dunwoody can provide an exemption or reduction in the occupation tax to one or more types of businesses in order to attract and maintain certain selected types of businesses. Dunwoody cannot apply the exempt to just one business though. Everyone in that particular type of business would be entitled to the same exemption. In order to avoid being arbitrary and capricious, Council should state in the ordinance the specific economic (or other) benefit expected as a result of providing the exemption. Two groups of home-based businesses have argued the occupation tax should not be applied to their industry. Those groups are tutors and musical instructors. Providing such exclusion would have virtually no impact on the City's cashflow. Many could argue these two groups of businesses provide a cultural value to the City that exceeds any monetary value received from the occupation tax. However, opening the door to one exclusion could potentially open the door to many other less-worthy exclusions down the road. Council should consider each exclusion very carefully.

5. The DeKalb program waived the occupation tax for any package store that obtained an alcohol license. The current Dunwoody ordinance does not provide a similar exclusion. We consistently applied the Dunwoody ordinance and only one package store has yet to pay the occupation tax. This is a topic of discussion merely because it is a new tax that did not exist prior to Dunwoody's incorporation. Half a dozen or so have paid the tax already, but one package store has not paid and is requesting clarification as to whether it should be paid.

DUNWOODY'S METHOD OF TAXATION

1. *Number of Employees:* Based on the profitability ratio for the type of business, Dunwoody would charge a per employee fee of $4, $6, $8, $10, $12, or $14. This fee is computed on full-time equivalent (FTE) employees who work under the direction and supervision of an employer who withhold employment taxes, W-2's issued, etc.

   OPTIONS:

   a. Dunwoody can apply a flat per employee fee to all businesses regardless of the profitability ratio of the business,
   b. Dunwoody can maintain the current method of applying a progressive scale based on the profitability ratio,
   c. Dunwoody can apply a progressive or regressive tax on businesses based on the number of employees at the business. For example, the city could charge $20 for the first 50 employees and a higher/lower amount for each employee over 50.

2. *Gross Receipts:* Dunwoody bases a portion of the tax due on the gross receipts of a business in combination with the profitability ratio of each business. Each business provides or is assigned a NAICS code as determined by the US Census. The City uses profitability ratios published by the IRS. Each business is taxed based on their industry's profitability ratio as compared to other businesses. Dunwoody currently charges a fee of $0.18, $0.30, $0.42, $0.54, $0.62, or $0.78 per $1000 of gross receipts, exempting the first $20,000 of gross receipts.

Gross Receipts Include:
- Total income, without deduction for the cost of goods sold or expenses incurred;
- Capital gains;
- Proceeds from commissions of the sale of property, goods or services;
- Proceeds from fees charged for services rendered; and
- Unearned income such as rent, interest, royalty or dividend income.

Gross Receipts Does Not Include:
- Sales, use, or excise taxes;
- Sales returns, allowance and discounts;
- Certain intercompany sales and transfers;
- Certain payments made to a subcontractor or independent agents;
- Certain grants; and
- Certain interstate revenues.

   OPTIONS:

   a. Dunwoody can apply a flat gross receipts fee to all businesses regardless of the profitability ratio of the business based on comparisons to other jurisdictions in our area,
   b. Dunwoody can maintain the current method of applying the same progressive scale based on the profitability ratio, or
   c. Dunwoody can apply a new progressive scale based on comparisons to other jurisdictions in our area.

RECOMMENDED ACTIONS

1. Staff recommends the same tax structure of taxing both gross receipts and employees. Many businesses reported no employees and many reported no gross receipts. Taxing a combination of the two provides more equitable solutions to those cases.
2. Staff recommends elimination of the progressive rate structure and application of the same gross receipts and per employee rate to all taxable Dunwoody businesses.
3. Staff recommends taxing the employee rate used by neighboring jurisdictions. This amount would be $13 per employee regardless of the tax class.
4. Staff recommends taxing businesses at rates substantially the same or slightly lower than neighboring municipalities. All but 26 of 3676 Sandy Springs businesses pay a higher rate than Dunwoody's highest tax class rate of $0.78 per 1000. To remain competitive, but not significantly underprice neighboring municipalities, Council should consider a rate within the $1.101 average rate and the $1.4666 average effective rate. **For over half of the City's businesses, this increase would be less than $40 per year and over a fourth of the businesses would see a decrease or no increase in the tax.** The majority of the increases from changing the rates would come from businesses headquartered outside the city.
5. Staff recommends Council consider whether or not to waive the tax for package stores as was done in DeKalb County.