



Office of the Mayor

ACTION CALENDAR
May 28, 2019

To: Honorable Members of the City Council
 From: Mayor Jesse Arreguín
 Subject: Tax Exemption on Federal Research Grants

RECOMMENDATION

Adopt a first reading of an Ordinance to add a subsection to Berkeley Municipal Code Section 9.04.165 to create an exemption on the taxing of business gross receipts relating to federal research grants.

BACKGROUND

Berkeley is an attractive place for tech startups due to its proximity to San Francisco and Silicon Valley, as well as being home to the University of California, Berkeley where many of these innovative companies are conceived, often in partnership with the Lawrence Berkeley National Laboratory. The City of Berkeley is home to more than 330 innovation sector/tech companies, with more than 260 – approximately 80% – being startups. 29% of these companies are in biotech and 12% in cleantech. Both these industries often use research and development (R&D) grants to serve the public good and often receive grant opportunities from various federal sources, such as the Department of Energy, Environmental Protection Agency, National Science Foundation, and Health and Human Services. Berkeley is also home to 8 Accelerators, such as SkyDeck, QB3 East Bay Innovation Center, Bonneville Labs and CITRIS Foundry. Many companies under the accelerators are recipients of federal research grants, including cleantech companies like PolyPlus Battery, All Power Labs and Opus 12, and biotech companies like Aduro, Valitor, Newomics, and CinderBio. Many of these companies are providing public interest research, such as health, clean energy, and other social and environmental solutions, all while providing jobs and investments to our community.

In addition to a lack of adequate office and R&D space, startups that are dependent on federal R&D grants as their primary source of financing face an additional disincentive for remaining/expanding in Berkeley due to the gross receipts taxing of such grants. It creates a perception that Berkeley is not a startup-friendly city, despite its status as a hub of intellectual innovation.

Tech startups often rely heavily on federal grants for R&D. Although the City of Berkeley has a business license fee similar to other cities in the Bay Area and across the country with a high concentration of startups, such as Boulder and Cambridge, we are one of very few that taxes federal grants. Taxing these grants makes the tax burden enormously high for startups and impacts their ability to grow, which in turn limits their overall tax

contributions to the City. Most importantly though, it can cause businesses to move out of Berkeley.

In March 2019, the Office of Economic Development provided its economic update for the City, showing a continual trend of low vacancy for office and non-retail usage commercial space. Berkeley's unemployment rate and office space vacancy is noticeably lower than county and statewide averages, showing a desirability for businesses to take root in Berkeley. However, much of this is a result of existing businesses expanding, leaving little room for startups to flourish. With many of these emerging startups having a high probability of contributing significantly to the innovation sector, and their strong desire to stay, we must do more to make it possible for them to stay and thrive in Berkeley, where they were founded.

Over the past few months, the Finance Department, Office of Economic Development, and the Mayor's Office have been researching best practices and has met with various stakeholders, including local startups reliant on federal research grants. The Ordinance recommends that companies that receive less than \$100,000 in gross receipts (excluding government grants) be exempt from paying taxes on the first \$1,000,000 in federal research grants.

RATIONALE FOR RECOMMENDATION

Providing a tax exemption on the first \$1,000,000 for federal research grants will greatly benefit startups that rely on these grants to move their projects forward, leading to more successful outcomes. Such a change could enable some of today's smaller companies to become tomorrow's engines of the economy. It also levels the playing field, as companies do not have to pay taxes on seed money but do for federal grants. It will also provide an incentive for such business to remain in Berkeley and therefore improve our tax base in the long run, making it a smart way to invest in Berkeley's future economic vitality.

FINANCIAL IMPLICATIONS

Slight loss in tax revenue that will likely be recouped through more businesses remaining in Berkeley. Staff time for application of the Ordinance.

ENVIRONMENTAL SUSTAINABILITY

Not applicable.

CONTACT PERSON

Mayor Jesse Arreguín 510-981-7100

Attachments:

1. Ordinance

ORDINANCE NO. XXXX-N.S

AMENDING BERKELEY MUNICIPAL CODED CHAPTER 9.04 BUSINESS LICENSES

BE IT ORDAINED by the Council of the City of Berkeley as follows:

Section 1. That Section 9.04.165 of the Berkeley Municipal Code is amended to read as follows:

9.04.165 Professional--Semiprofessional--Connected business.

A. Finance, Insurance, Banking (including Savings and Loans) and Real Estate. Every person in any business, profession or occupation within the business field of finance, insurance and real estate, as described in the most practicable version of the U.S. Government Printing Office publication North American Industrial Classification System Manual, except for those persons whose business is primarily renting real property, as defined in Section 9.04.195, shall be classified as a professional-semiprofessional.

B. Health, Veterinary, Legal, Educational, Engineering-Architectural-Surveying, Accounting-Auditing-Bookkeeping, and Miscellaneous Services Not Classified Elsewhere. Every person in any business, profession, or occupation within the business fields of health, veterinary, legal, education, engineering-architectural surveying, accounting-auditing-bookkeeping, and miscellaneous services not classified elsewhere, as described in the current U.S. Government Printing Office publication entitled North American Industrial Classification System Manual shall be classified as professional-semi-professional.

C. Nothing contained in this section shall be deemed or construed as applying to any person engaged in any of the professions or occupations enumerated in this section solely as an employee or partner of any other person or entity conducting, managing or carrying on any such business in the City.

D. Any person subject to a license under provisions of this section may exclude from gross receipts the portion of those receipts paid to subcontractors, providing that a list of such subcontractors and the amounts of payment are reported to the Director of Finance. The Finance Department shall pursue collection of the business license tax from all reported subcontractors.

E. Any person subject to a license under provisions of this section with less than \$100,000 in annual gross receipts, as defined in Section 9.04.025, net of governmental research grants, may exclude from gross receipts up to \$1,000,000 received from governmental research grants, providing that a list of those grants and the amounts of payments received are reported to the City as defined by the Director of Finance.

Section 2. Copies of this Ordinance shall be posted for two days prior to adoption in the display case located near the walkway in front of the Maudelle Shirek Building, 2134 Martin Luther King Jr. Way. Within 15 days of adoption, copies of this Ordinance shall be filed at each branch of the Berkeley Public Library and the title shall be published in a newspaper of general circulation.