



CONSENT CALENDAR

April 11, 2000

Office of the City Auditor
Ann-Marie Hogan, City Auditor

To: Honorable Mayor and
Members of the City Council

From: Ann-Marie Hogan, City Auditor

Subject: BUSINESS LICENSE TAX AUDIT REPORT

RECOMMENDATION:

That Council accept the Business License Tax Audit Report for FY 1999 and request that the City Manager implement the recommendations made to increase business license tax revenues, and rationalize certain tax rate schedules. We recommend that the City Manager report back to Council on the implementation status of the balance of the report recommendations by February 28, 2001. We further recommend that the City Manager present to Council in May a proposed Business License Ordinance correction (recommendation A) for consideration for placement on the November ballot.

BACKGROUND:

The City Auditor initiated a Business License Tax Audit Program in 1982. Its objectives are to:

- 1) Identify and assess unlicensed businesses,
- 2) Evaluate the accuracy of reported gross receipts of licensed businesses, and
- 3) Ensure the effective and equitable implementation of the Business License ordinance.

Since its inception through June 30, 1999 the program has identified \$3,486,108 in revenues.

Current Year:

Attached is a summary report for the fiscal year ended June 30, 1999. We analyzed and reviewed 1,281 businesses during the fiscal year, and sent 293 audit notifications. Identified revenue totaled \$339,197 from 194 of 324 auditees (including 62 notifications from the prior fiscal year). The program identified:

- 186 unlicensed businesses
- 5 businesses with under reported gross receipts
- 3 with delinquent licenses

Based on these results, it appears that ten percent or more of Berkeley businesses sampled were operating without a license.

Once a business takes out a license, it generally continues to pay in succeeding years. Therefore, the current year's payments should be seen as part of an increased future revenue stream.

In addition to reporting on results of audits of businesses, we have reported on operational issues of the administration of the business license tax ordinance, which is the responsibility of the Finance Department. The auditors noted seven recommendations which were carried over from the previous year, including one which will require Council consideration of a possible November ballot item. This recommendation is summarized below.

FINANCIAL IMPLICATIONS:

New revenue identified for FY 1999 was \$339,197. Over the past three years, \$596,844 in unpaid business license taxes, penalties, and interest was identified. Based on this, we anticipate collecting an additional \$590,000 in future taxes from the previously unlicensed businesses, using a diminishing five-year average business life.

If recommendation A1, to consider a November ballot measure to rationalize the Business License Ordinance, had been previously implemented, as suggested, the revenue identified for FY 1999 would have been increased by over \$140,000. (See pp. 9-12 of report, attachment 1, and summary below).

An estimate of the increased revenue effect of such a ballot measure will be contained in the City Attorney's analysis, to be presented to Council in May.

SUMMARY OF FINDING A, RECOMMENDATION 1: PROPOSED REPEAL OF PREVIOUS AMENDMENT TO BUSINESS LICENSE ORDINANCE, FOR VOTER APPROVAL

In June of 1990, Council took an action which had unintended consequences. An amendment to the Business License Ordinance was proposed, accompanied by a staff report stating that the amendment would increase revenue by \$172,000, by including savings and loans among the taxable businesses. Due to an apparent revision error, the actual ordinance revision voted upon had the effect of reducing revenue.

Prior to the adoption of Ordinance 5984 in 1990, businesses classified as Professional and Semi-professional were named in the ordinance, and were charged a tax on gross receipts at a rate of \$3.60 per thousand of gross receipts. Other, (nonprofessional) services were charged \$1.80 per thousand. These are the same rates that are currently charged by the City of Oakland, whose rate structure is similar to Berkeley's.

The Finance Department attempted to add the category of "Savings and Loans" to the professional category so that these businesses could be taxed. When "Savings and Loans" was added, the rest of the list of professional categories was deleted from the section, and placed in the nonprofessional section in error.

This mistake and its consequences were detailed in previous audits, and is more fully explained starting on page nine of the attached report. Until a finding of incorrect charges was made in a previous audit, City staff had not incorporated this change to the ordinance in Finance's rate schedules.

Because Council voted to amend the Ordinance based on incorrect information, we have asked the City Manager to bring a proposed reversal of this action to Council in May. Because of the passage of Proposition 218, this correction would require approval of the voters, since the result would be to increase the tax rate for professionals to the pre-1990 rate.

The auditors have no opinion as to what tax rates should or should not be. However, it appears that Council acted on incorrect or incomplete information in 1990. The 1990 Council action item is attached to the end of this report for your information.

Reversing that action would bring Berkeley's tax rate groupings into closer conformance with the rate structure of the original ordinance, which is similar to that of the City of Oakland.

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Approved by:

Ann-Marie Hogan, City Auditor