



# Finance Committee

*City of Arts & Innovation*

**TO: FINANCE COMMITTEE**

**DATE: MARCH 13, 2024**

**FROM: FINANCE DEPARTMENT**

**WARDS: ALL**

**SUBJECT: BUSINESS TAX DISCOVERY PROGRAM UPDATE AND ORDINANCE REVIEW**

## **ISSUE:**

Receive and provide feedback on an update of the City's Business Tax Discovery Program and consider proposed amendments to RMC Section 5.04 Taxes, Licenses and Regulations.

## **RECOMMENDATIONS:**

That the Finance Committee:

1. Receive and provide feedback on the status and financial impact of the City's Business Tax Discovery program; and
2. Recommend that the City Council adopt an Ordinance to amend specific sections of Riverside Municipal Code Section 5.04 Taxes, Licenses and Regulations.

## **LEGISLATIVE HISTORY:**

Chapter 5.04 of the Riverside Municipal Code (RMC) outlines the purpose and guidelines for assessing business tax. Specifically, Chapter 5.04.040, titled "Business tax payment required" establishes the foundation for the Business Tax Discovery Program:

*"It is unlawful for any person to transact and carry on any business, trade, profession, calling or occupation in the City without first having procured a business tax certificate from the City and paying the tax hereinafter prescribed or without complying with any and all applicable provisions of this chapter."*

For businesses that become delinquent in paying their business license tax, RMC Chapter 5.04.220 prescribes penalties of 30 percent of the business tax 60 days after the due date; 50 percent 90 days after the due date; and 75 percent 120 days after the due date.

## **BACKGROUND:**

The Business Tax Division is responsible for ensuring that all entities conducting business in the City of Riverside obtain a business tax certificate. One of the methods by which the Business Tax

Division ensures compliance with the RMC is by performing discovery, i.e., identification of entities subject to licensure/taxation that are not currently registered or are otherwise non-compliant. A Business Tax Inspector receives information from City departments and staff that a business may be operating within the City limits but requires an in-person contact for verification. The Inspector, through a series of letters and ultimately in-person contact, verifies the entity's compliance with the RMC and assists the business in applying for a business tax certificate.

The City contracts with Hinderliter de Llamas & Associates (HdL) to assist with various tax administrative services. As part of the Business Tax Compliance Services, HdL will assist the City with discovery services. The Business Tax Discovery Program was recommended by staff as a Priority Based Budgeting Insight during the development of the FY 2022-2024 Biennial Budget as a potential source of new revenue that may help fund critical unfunded needs of the General Fund. Subsequently, Finance staff contacted HdL to research options for a Discovery Program and quantify potential new revenue generation.

In the Fall of 2022, HdL conducted a search for non-compliant businesses utilizing business registration data from the California Secretary of State and business tax filings with the Franchise Tax Board. HdL separated the data into two main discovery categories:

1. **General Businesses:** This category is comprised of various business types such as software companies, realtors, home businesses, retail, service, contractors, etc. HdL obtained data from the Secretary of State reflecting approximately 19,000 Riverside businesses that registered within the preceding year (Fall 2021 to Fall 2022) but have not registered their business with the City.
2. **Property Rentals:** HdL identified a total of 14,508 property rentals via the City's property tax records and the County's data of single-family homes registered as "absentee". These properties are considered potential discovery accounts and are comprised of 12,638 residential and 1,870 commercial property rentals.

- **Residential Rentals:** In June 2016, the City's Internal Audit Division presented to the Governmental Affairs Committee recommendations stemming from an audit of the City's Business Tax Division. The Finance Department worked in close collaboration with the Chambers of Commerce to develop a plan to enhance the City's Business Tax Administration Program. On August 2, 2017, the Finance Department presented the jointly developed action plan to the Governmental Affairs Committee, and it was recommended that the City Council review and approve recommended enhancements to the City's Business Tax Administration Program and a six-month Amnesty Program. One of the approved action items was to update the RMC to remove the requirement to register one residential rental unit by omitting the following from Section 5.04.010, "any person claiming to have only one single-family residential rental unit shall declare such on a form provided by the Collector and shall obtain a tax-free certificate".

Taking into consideration the RMC update to remove the registration requirement for owners with only one single-family residential rental, the number of identified non-compliant property rentals decreased from 12,638 to 1,024.

- **Commercial Rentals:** HdL identified 1,870 non-compliant commercial rentals.

Per HdL, the industry standard and statute of limitations in the California Code of Civil Procedure Sec. 338(a) is to charge three years' back taxes plus penalties to all businesses identified as non-

compliant plus the current year's tax. Although the RMC is silent on this subject, past City practice has been to charge three years' back taxes plus the current tax due, plus penalties as described in RMC Chapter 5.04.220.

On September 6, 2022, the City Council approved staff's recommendation to initiate a Citywide Discovery Program. The City Council's selected approach, referred to as Option 3, involves HdL collecting three years of back taxes and waiving penalties owed via a 3-month amnesty program targeting each discovery category. This option provides businesses with an opportunity to pay their back taxes while creating a foundation of compliance moving forward. The City Council also approved staff's recommendation that, following the initial amnesty program, all new discoveries be equitably and fairly assessed at the statewide industry standard of charging three years back taxes plus the current year's tax, plus penalties set forth in RMC Chapter 5.04.220 Delinquent taxes - Penalties.

## **DISCUSSION:**

### **Discovery program:**

In collaboration between HdL and the City's Business Tax Division, the City initiated the Discovery Program on November 1, 2022, with a focus on property rentals. HdL's Discovery and Compliance Team actively assisted the City of Riverside in pursuing businesses non-compliant with the City's Code. Using diverse data sources, HdL identified and pursued compliance for 2,894 commercial and residential property rentals lacking business licenses. Employing correspondence and direct contact, HdL has successfully brought approximately 745 accounts into compliance, resulting in approximately \$683,000 in new revenue to date. Subsequently, in response to inquiries regarding the interpretation and enforcement of the RMC, the City's Business Tax Division temporarily paused the Discovery Program in March 2023 to conduct a comprehensive review of the municipal code and strategize enforcement moving forward.

### **Ordinance Review:**

During the amnesty program, HdL inquired about the City's interpretation and enforcement of specific sections of the Riverside Municipal Code (RMC), specifically Chapter 5.04, pertaining to business licenses and taxes. Inconsistencies were identified, leading to suboptimal revenue collection compared to RMC allowances. Consequently, the Discovery Program was temporarily halted in March 2023 to conduct a thorough review of the municipal code and formulate an enhanced enforcement strategy moving forward.

Per the existing contract terms, HdL promptly initiated a comprehensive review of the City's ordinance in March 2023. This review involved benchmarking against industry standards, resulting in HdL presenting an initial draft of findings and recommendations to City staff in June 2023. Over the subsequent months, the Business Tax team collaborated with HdL to thoroughly review and refine the draft, seeking additional analyses in specific areas. City management has diligently examined HdL's findings and recommendations, seeking guidance from the City Attorney's Office on specific items.

Proposed changes to the Riverside Municipal Code (RMC) are designed to provide clarity to business owners and staff regarding business tax practices. These changes include updating language to align with current business practices, modernizing pronoun usage, introducing clear definitions, improving clarity, and incorporating language to reference state law, where applicable. The recommended updates are as follows:

RMC CODE	RECOMMENDED CHANGE
<p><b>5.04.010 - Definitions (C)(1)</b></p> <p>“One or more business rental units on the same parcel or adjoining parcels shall be considered a separate place of business and a tax certificate must be obtained for each separate place of business.”</p> <p>Interpretation: For example, in an office building, a business tax certificate is required for each rental suite.</p>	<p>Update the RMC to reflect current practice, which is to require one business tax certificate per assessor's parcel number (APN) for business rental units. This practice provides a streamlined and business-friendly approach to the taxation of business rental units, reducing the administrative burden for both the City and businesses.</p> <p>There is no fiscal impact to amending the code to reflect current practice; however, the current code allows for a base tax of \$151.50 for each rental unit. As a result, there is a lost opportunity for enhanced revenues.</p>
<p><b>5.04.010 - Definitions (I)</b></p> <p>“Convalescent hospital” is referenced in 5.04.300 Business tax (A)(1) but is not defined.</p>	<p>5.04.010 Definitions (Q) provides the definition for <i>Professional services</i>. The definition states “...such professions to include but not be limited to... audiologist, chiropractor, family and child counselor, mortician, optician, optometrist, osteopath, physician (all types), podiatrist, psychologist, registered nurse, speech pathologist...”</p> <p>Some of these professions may also be employed at a Convalescent hospital, which, under this chapter, is taxed on a different basis than professional services. To provide clarity, add the definition of <i>Convalescent hospital</i>, to include alignment with the State of California’s definition by specifying that:</p> <p>“A convalescent hospital must be licensed by the State as such.”</p>
<p><b>5.04.010 - Definitions (R)</b></p> <ol style="list-style-type: none"> <li>1. Two or more single-family residential rental units and multiple-residential rental units of two or three units shall be taxed as one business using the property owner's physical address as the business address.</li> <li>2. Four or more residential rental units on the same parcel or adjoining parcels shall be considered a separate place of business and a tax certificate must be obtained for each separate place of business.</li> </ol>	<p>Update the RMC to reflect current practice, which is to require one business tax certificate per APN for residential rental units. This practice provides a streamlined and resident-friendly approach to the taxation of residential rental units, reducing the administrative burden for both the City and residents.</p> <p>There is no fiscal impact to amending the code to reflect current practice; however, the current code allows for a base tax of \$151.50 for each rental unit. As a result, there is a lost opportunity for enhanced revenues.</p>
<p><b>5.04.080 - Exemptions</b></p>	<p>Add: "If the exemptions under this chapter conflict with state law, the state law shall govern."</p>

RMC CODE	RECOMMENDED CHANGE
<p><b>5.04.130 - Statements and records</b></p> <p>“All persons subject to the provisions of this chapter shall keep complete records of business transactions, including sales, receipts, purchases, and other expenditures, and shall retain all such records of examination by the Collector. Such records shall be maintained for a period of at least three years.”</p>	<p>Extend the record retention requirement to four years to align with the City’s right to audit and collect taxes for the current year plus the previous three years.</p>
<p><b>5.04.170 - Extension of time and waiver of penalty</b></p> <p>“For owners of a newly registered Residential Rental business, the Collector shall have the power, for good cause shown, to waive any past due tax assessed for prior years that would otherwise have accrued, provided that the business owner has less than four residential rental properties containing two or fewer residential rental units.”</p>	<p>Remove sentence. This provision, specific to a select group, is unnecessary; the final sentence in the same section applies to all persons and businesses subject to the business license requirement:</p> <p>“The Collector shall also have the authority, for good cause shown, to waive any penalty imposed, charge demanded, or any past due tax assessed for prior years that would otherwise have accrued.”</p>
<p><b>5.04.180 - Business tax certificate nontransferable - changed location and ownership</b></p> <p>This section outlines the nontransferable nature of business tax certificates, with provisions for transfer in the event of a changed location or ownership.</p>	<p>To align with current City practice, remove provisions allowing the transfer of business tax certificates. A new business tax certificate is not required for a changed location or ownership. This change will reduce the related administrative burden.</p>
<p><b>5.04.190 - Duplicate business tax registration notice and/or certificate</b></p> <p>This section stipulates a fee of \$10.00 for providing copies of a business tax certificate.</p>	<p>Update this section to specify that the fee applies to “physical” copies of the business tax certificate.</p>
<p><b>5.04.200 - Posting and keeping business tax certificate</b></p> <p>B. “Any certificate holder transacting and carrying on business but not operating at a fixed place of business in the City shall keep the certificate upon his person at all times while transacting and carrying on the business for which it is issued.”</p>	<p>HdL states that requiring that all businesses entering the City to carry a copy of their business certificate is unusual, but it is a common practice to require solicitors and peddlers to do so.</p> <p>Update this provision to restrict it to solicitors and peddlers. To facilitate this change, definitions for <i>Solicitor</i> and <i>Peddler</i> were added to RMC Section 5.04.010 - Definitions. Additionally, the definition of <i>Peddling</i> was moved from 5.04.300 Business tax (B)(5)(i) to Section 5.04.010 - Definitions.</p>

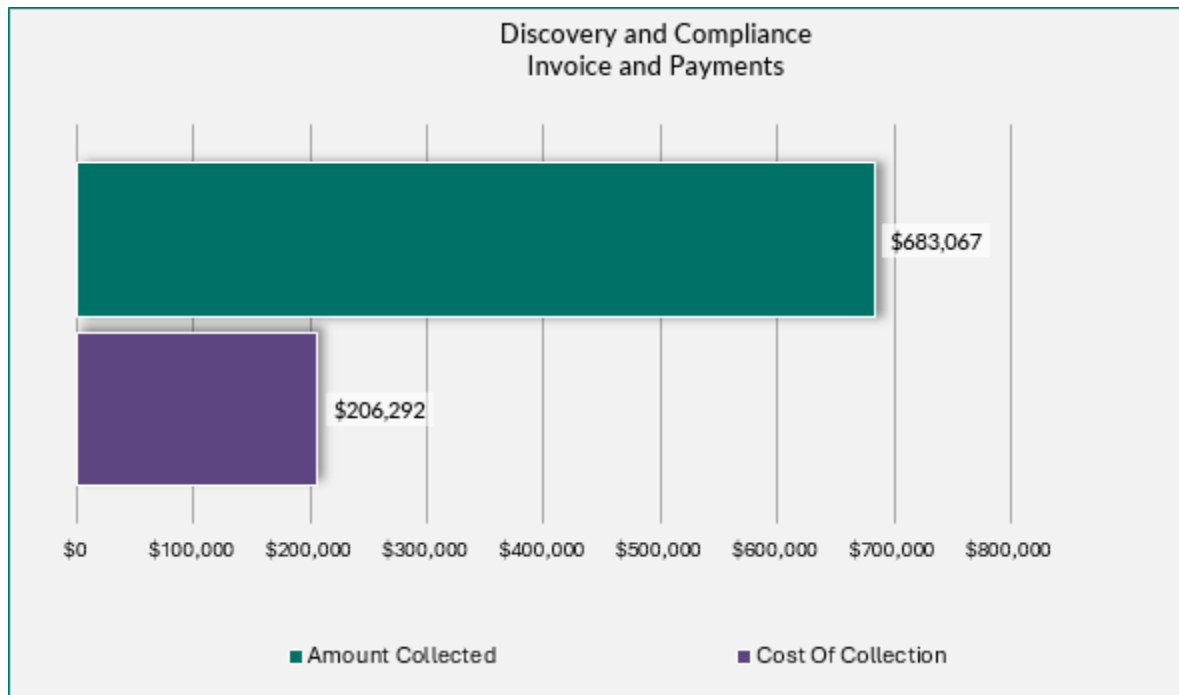
RMC CODE	RECOMMENDED CHANGE
<b>5.04.250 Enforcement</b> “The Collector in the exercise of the duties imposed upon him hereunder, and acting through his deputies or duly authorized assistants, shall examine or cause to be examined all places of business in the City to ascertain whether the provisions of this chapter have been complied with.”	Update the language to shift from a mandatory responsibility to an authorized privilege to convey that the Collector has the authority, but not the obligation, to examine places of business in the City to ensure compliance with the provisions of the chapter.  “The Collector shall have the right, and acting through his deputies or duly authorized assistants...”

All other recommended updates to RMC Chapter 5.04 Taxes, Licenses and Regulations are nonsubstantial, relating to modernizing the code to be gender neutral.

### Discovery Program Projections

The Discovery Program initially focused on the property rental sector, including both residential and commercial properties. Before expanding to include the general business category, a temporary pause was instituted to conduct a thorough examination of the municipal code and offer precise guidance to HdL in addressing businesses that were not in compliance. The following summary presents the current financial status of the Discovery Program to date.

Out of the total funds collected, approximately \$683,000, HdL is entitled to a contingency fee of 25% for collection accounts and 35% for discovery accounts, explicitly referred to as the "Cost of Collection" in the accompanying chart, totaling \$206,292.



The City of Riverside, in collaboration with HdL, remains committed to enhancing overall compliance within the City with a projected revenue of \$6.1 million based on the ability to collect three years of back taxes and associated penalties. The attainment of this goal is contingent upon the City's commitment to enforcing the RMC as written.

## Next Steps

Per the Finance Committee's direction, staff will take the proposed changes to amend Riverside Municipal Code Section 5.04 Taxes, Licenses and Regulations to the City Council for adoption. Following Council adoption, staff will collaborate with HdL to resume the Business Tax Discovery program, initially focusing on completing the rental properties category, followed by the General Business category.

## STRATEGIC PLAN ALIGNMENT:

The topics included in the report support **Strategic Priority 5 – High Performing Government**, and **Goal 5.4**: Achieve and maintain financial health by addressing gaps between revenues and expenditures and aligning resources with strategic priorities to yield the greatest impact.

This action aligns with each of the five Cross-Cutting threads as follows:

1. **Community Trust** – Community trust will be enhanced within the business community through consistent and equitable application of the City's business tax code and administration of the business tax discovery program, as well as adherence to the City's municipal code.
2. **Equity** – The business tax discovery program seeks to ensure fairness and treatment, recognition of rights, and equitable application of the City's business tax code and administration of the business tax discovery program.
3. **Fiscal Responsibility** – RMC 5.04.020 states "This chapter is enacted solely to raise revenue for municipal purposes..." The City is committed to ensuring all businesses subject to the business tax requirements as set forth in the Riverside Municipal Code are compliant and to raise revenue for municipal purposes and the General Fund, which may in turn enable the City to expand services and fund critical needs.
4. **Innovation** – The City contracts with HdL which has access to sales and property tax data from various sources. Utilizing the most current resources, HdL implements the business tax discovery program with zero additional cost to the City utilizing the latest technologies and strategies to ensure compliance.
5. **Sustainability & Resiliency** – Since the initial amnesty portion of the discovery program, there has been a continued effort to ensure compliance to the municipal code. Best practices will be reviewed and implemented to ensure the highest level of compliance to City laws and regulations.

## FISCAL IMPACT:

There is no fiscal impact related to receiving this report. To date, the discovery program has generated approximately \$683,000 in new revenue, with an optimistic outlook for projected one-time total revenue of \$6.1 million based on three years of back taxes and penalties as the City aims to increase the overall compliance rate. HdL based the \$6.1 million estimate on 2,894 unregistered property rentals and approximately 19,000 Riverside businesses identified in the general businesses category that have registered with the California Secretary of State but have

not registered their business with the City. HdL also based the estimate on strict application of the RMC, regardless of current practice. As a result, the actual amount collected may be affected by the findings and recommendations of the ordinance review. As businesses are brought compliant, ongoing revenue may reach \$1,500,000 annually.

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Attachments:

1. RMC Section 5.04 Taxes, Licenses and Regulations
2. Redlined Business Tax Ordinance
3. Presentation