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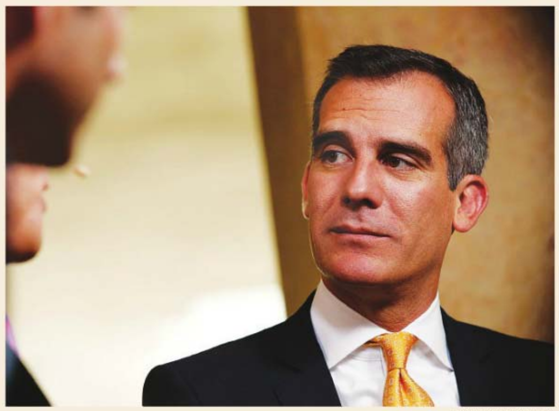
Business in Need of Relief

Cutting tax on gross receipts a step in right direction, but Los Angeles must pursue full phase-out.

By LLOYD GREIF

The Los Angeles City Council this month will debate and vote on a draft budget submitted by Mayor Eric Garcetti on April 14. In his budget, the mayor endorses a plan proposed by a blue-ribbon panel to phase out L.A.'s onerous, job-killing gross receipts business tax. Under his "A Prosperous City" platform, the mayor proposes reducing the highest tax bracket, $5.07 for $1,000 in a company's gross receipts (sales), to $4.25 between 2016 and 2018, in order to spur job growth by incentivizing businesses to come to, stay in and expand in Los Angeles.



BLOOMBERG NEWS

Boon for Business?: Los Angeles Mayor Eric Garcetti.

Los Angeles leads the region in the unemployment rate, which, at 9.7 percent, is 23 percent higher than California and 47 percent higher than the nation. Los Angeles also leads in lost jobs. The city's population grew 30 percent between 1980 and 2014, but the number of jobs dropped 4.4 percent.

This is smart fiscal policy and the right move, but this move by itself won't get the job done. Those employed in the City of Angels need a strong signal from City Hall that the city will stop pushing their employers out of town, and the unemployed need to know that the city is doing everything it can to encourage employers to come to Los Angeles. Attracting new companies will provide local jobs for the city's residents, reducing commute times and traffic congestion along with both unemployment and underemployment. Increased business investment will also revitalize and rebuild areas of the city that need it most, making them safer and more productive.

Los Angeles leads the region in the unemployment rate, which, at 9.7 percent, is 23 percent higher than California and 47 percent higher than the nation. Los Angeles also leads in lost jobs. The city's population grew 30 percent between 1980 and 2014, but the number of jobs dropped 4.4 percent. In case you think this is a state or countywide problem, it's not: Over the same period, the other 87 cities in Los Angeles County experienced similar population growth of 36 percent *but also achieved job growth of 26 percent.* Since 1980, Los Angeles has lost two-thirds of its *Fortune 500* companies and now has only four. New York has 43.

So, what's wrong with this picture? L.A.'s business tax is the highest of the county's 88 cities and *nearly 10 times* the county average. Although the city employs nine Byzantine classifications to tax its employers ranging from $1.01 to $5.07 per $1,000 of revenues, the highest rate is, no surprise, where the city places the vast preponderance of its taxpayers – nearly half the businesses in Los Angeles.

Unlike 1936, when this archaic gross receipts tax was first enacted and manufacturing was the economic driver for the region, Los Angeles is now a service-driven economy, with service-based businesses (excluding wholesale and retail) making up 55 percent of the economy. Those businesses just happen to fall into the city's three highest tax brackets, ranging from $3.15 to $5.07. They also happen to be the most mobile, and include high- and clean-tech companies, healthcare firms, professional, scientific and technical occupations, architects, entertainment services firms and other service industry businesses that can, and do, easily move to other cities in the region. These businesses are also the ones that provide living-wage jobs and create more "spillover" jobs in the local economy than other businesses.

Location for these types of companies is a *choice*, not a requirement; the business tax is a huge disincentive for them to choose to locate in Los Angeles. **LegalZoom** moved its headquarters from Hollywood to Glendale and **Creators Syndicate** from Los Angeles to Hermosa Beach because of the business tax, and **Western Asset Management** would have relocated from Pasadena to downtown Los Angeles were it not for the city's business tax. Glendale has no business tax, and Pasadena's and Hermosa Beach's are a tiny fraction of L.A.'s. Automotive dealerships have fled the city *en masse*, driven out by the exorbitantly high business tax and taking their far more lucrative sales tax proceeds with them: in 1983, LA had 149 auto dealers—today, only 51 remain. **Amazon** and other high-profile, fast-growing e-commerce companies are locating their corporate offices or Southern California distribution centers everywhere but in Los Angeles. Need I go on?

Reducing top rate

Garcetti is acting to remedy this problem by targeting his initial cuts to reduce the highest rate by 16 percent over three years. This important first step is consistent in spirit, if not degree, with the Business Tax Advisory Committee's recommendation to cut the top rate in half to $2.55 in five years, while also simultaneously reducing the next two highest rates to $2.55. Ultimately, BTAC recommends phasing out the gross receipts tax completely over 15 years, with "stoplights" every two to three years to ensure that receipts to the city from other revenue sources tied to anticipated higher levels of economic activity stemming from the resulting business attraction, retention and expansion – sales taxes, property taxes, utility taxes, transient occupancy taxes, permits, licenses and fees, etc. – are more than sufficient to cover the city's investment in business tax reform. If they are not by a given stoplight, then the reductions halt until the alternate revenue sources "catch up" to the business tax reductions. At the end of the phase-out, projected alternative revenues generated by tax reductions should handily exceed the lost business tax revenue while creating more than 100,000 jobs in the process. If those projections don't pan out, then the stoplights kick in to safeguard the city's revenues.

We are pleased the city is taking action to reverse decades of job losses and commend Garcetti and the City Council for their leadership in this important arena. The mayor's budget reaffirms his longstanding commitment to phasing out the city's burdensome business tax and to creating badly needed jobs for the city's residents. Los Angeles will continue to have a shrinking economic pie if it does not encourage, instead of impede, economic development. Investing in reform *now* will allow Los Angeles to compete for jobs, reduce unemployment and create greater financial stability and prosperity for the city. This is a vital first step of hopefully many more such steps to come.

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