GOODBYE BUDGET DEFICITS, HELLO ECONOMIC GROWTH AND FAIRNESS

A Clear Path Forward for the City of Sacramento to Eliminate Budget Deficits While Increasing Economic Growth and Fairness

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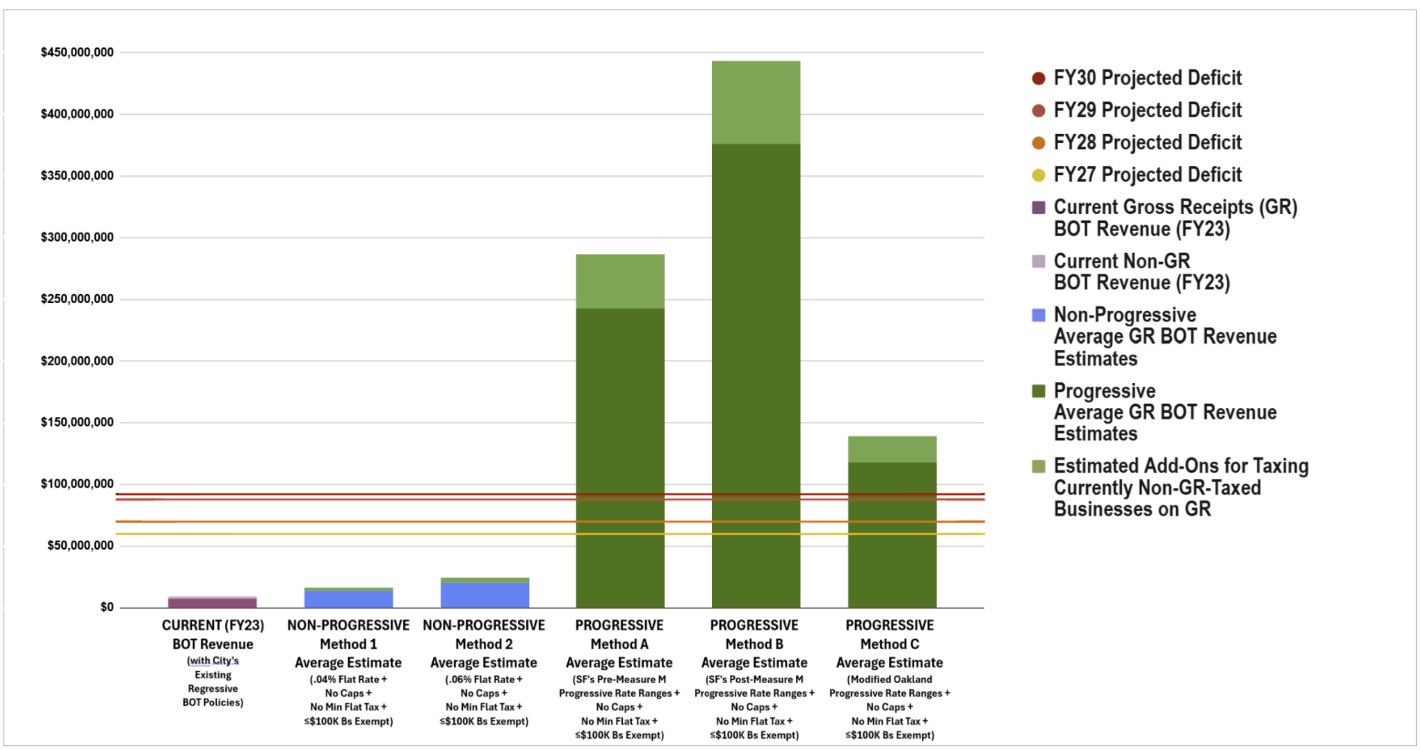
I. Introduction

If the city of Sacramento were to take inspiration from some of its self-identified peer jurisdictions and pass a *progressive* business operations tax (BOT)—instead of continuing on with some version of a *regressive* BOT—we could not only *more than eliminate our large and growing projected budget deficits,* but also simultaneously *jump-start small businesses and economic growth*, while dramatically increasing *fairness and net-income sensitivity* in our tax system.

The following chart gives some indication of what is possible, *without factoring in any* resulting increased revenue from boosting small businesses and economic growth.

ESTIMATED CITY OF SACRAMENTO BOT REVENUE APPLYING PROGRESSIVE BOT POLICIES (COMPARED TO ALTERNATIVES) WITHOUT FACTORING IN RESULTING BOOST TO SMALL BUSINESSES AND ECONOMIC GROWTH



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To realize all of that potential, Sacramento's progressive BOT reform would need to contain four critical components:

- First, exempting small businesses up to a significant, negotiated income level. Following the lead of our peer jurisdictions, we could exempt businesses making up to $5 million annual gross receipts without affecting revenue much, so long as the other three components were in place.
- Second, eliminating the unusually low (and non-existent in most peer jurisdictions) artificial tax caps. Five out of seven our the city's peer jurisdictions have no tax caps at all and in the two that do, the caps are 4-35x higher.
- Third, opting all non-gross-receipts-taxed businesses into gross receipts taxation—or at least allowing them to opt themselves in—so that, going forward, no business is *required* to pay the kind of unusually high, income-insensitive flat taxes some currently pay. For example, most types of professional solo practitioners licensed 7 years or more are taxed as though they all gross $685,000 annually, whether they are in fact semi-retired grossing under $50,000 a year, or making millions.
- Fourth, replace the one-size-fits-all gross receipts tax rate with a series of progressive marginal rate ranges that are relatively net-income sensitive by being sector-specific, crafted in close consultation with each sector, with higher or lower rates depending on each sector's typical profit margins, and potentially also its typical employment contributions, sales tax burdens, city fee burdens, etc.

Thankfully, this *can* be done. Just last year one of the city's peer jurisdictions doubled down on this approach and its measure passed by a wide margin, with a broad coalition in support. There is something in this for every constituency and clear answers to every objection.

Moreover, this *must* be done—in part because the city truly needs significant additional revenue. With ever increasing unfunded pension liabilities and other inflation-sensitive labor costs, like wages and medical benefits, continuing to grow, we cannot get out of this with belt-tightening alone, so long as we want to have a vibrant, thriving city that's a place customers want to frequent.

Furthermore, progressive BOT reform is the only viable option sufficient to raise the needed revenue. With Proposition 13 continuing to artificially restrict property tax revenues and sales tax measures being an intrinsically regressive, legally limited and difficult option, city staff has acknowledged year after year that, besides dramatically raising fees to an impossible level or looking to the state to save us, BOT reform is one of just a few options Sacramento has left for raising revenue—and progressive BOT reform is by far the most promising of those options.

II. Background

With large and growing budget deficits projected for years to come, the city of Sacramento needs to modernize its BOT system, which has not been updated since 1991. Relatedly, in late 2024 and again in 2025, city staff listed BOT reform as one of just three "options and opportunities" for increasing revenues—with the other two being the questionable options of either further increasing city fees or getting the state to take action. In addition, a number of council members have recently expressed their desire to see BOT reform reconsidered.

Although the city made an attempt with Measure C in 2024, I helped defeat it, in part because it was not only not progressive, but it doubled down on the already unusually high, *regressive* flat taxes licensed professionals like me pay, while not asking nearly enough from our city's largest businesses. On top of that, Measure C would have done precious little to stem the bleeding, especially compared with a progressive BOT.

Therefore, I propose the city put a robust, progressive BOT measure on the ballot, to bring both needed *resources* and needed *economic growth and fairness* to our city.

III. Sacramento *Needs* the *Significant Resources* a Progressive BOT *Uniquely* Offers

A. **Sacramento has large and growing [projected annual budget deficits]** of $60.392M-$92.592M for fiscal years 2026 through 2030—and that's assuming no recession and consistent federal funding.

B. **Sacramento's budget deficits have so far resulted in unusual service cuts and fee hikes** (e.g., home business permit fees), with more of the same and likely layoffs to come—although narrowly averted this budget cycle, they were originally expected.

C. **Such large and growing annual budget deficits are unavoidable without *either* untenable service cuts and layoffs, *or* dramatic, ongoing revenue increases, given:**

1. **The cost of the city's unfunded pension liabilities continuing to rise** until predicted to slowly decline after 2030;

2. **Ever-increasing, inflation-sensitive labor costs**, including medical and wages, as employees absorb the rising costs of inflation for housing, food, energy, healthcare, etc. Notably, CalPERS assumes a rate of payroll growth of 3% per year to account for this, and the Social Security Administration's COLA is currently a not-unusual 2.5% per year. However, these estimates may understate the potential for inflation, given the additional inflation possible with President Trump's tariffs.

D. **Alternative revenue options are limited, given:**

1. **Proposition 13's limit on property tax revenue**, with, incidentally, the biggest beneficiaries being the largest businesses that own property that doesn't change hands frequently.

2. **The inherently regressive nature of sales taxes**, in addition to the legal restrictions on increasing them beyond a certain level.

3. **The fact that, as mentioned above, even city staff sees BOT reform as the only noteworthy alternative** for increasing revenue, other than dramatic increases to city fees or state action.

E. **Sacramento's BOT revenue leaves a great deal of revenue on the table compared with what would be possible by following the lead of some of the city's peer jurisdictions and instituting a progressive BOT:**

1. **Sacramento's BOT revenue under current code: Only $8.9M/year**, most of which ($7.5M) reportedly came from businesses taxed on gross receipts (data from FY23).

2. **Measure C would have increased revenue by *less* than $6.6M**—see projections regarding the *more* revenue-generating version of Measure C (before the cap was lowered and other deals were cut) at "Option 3" column of this table and on this page.

3. **Another option city staff presented in the lead-up to Measure C**, which would have involved removing the tax cap, but only slightly raising the *flat, non*-progressive gross receipts tax rate from .04% to .06%, and doubling down on unusually high flat taxes just as Measure C would have, **was projected to increase revenue by only about $17.2M**—See "Option 2" column of this table and on this page.

4. **Similarly, Non-Progressive Methods 1 and 2 discussed herein**–almost exactly the same as Progressive Methods A, B and C, i.e., *with* a $100K small business exemption, removal of tax caps and opting all into gross receipts taxation, but *without* replacement of a single, one-size-fits all gross receipts tax rate with a series of progressive marginal rate ranges–**generated average estimates of between only $16M-$24M.**

5. **By contrast a *progressive* BOT**, a version of what the city's self-identified peer jurisdictions San Francisco and Oakland have, embodied in Progressive Methods A, B and C and *including* the series of progressive marginal rate ranges, **could produce annual revenue of potentially *hundreds of millions of dollars*—enough to eliminate the city's projected budget deficits many times over.**

IV. Sacramento *Needs* the *Economic Growth* and *Fairness* a Progressive BOT *Uniquely* Offers

A. **Sacramento needs economic growth** to fund the kind of safe, appealing, world class city experience necessary to keep Sacramento functioning and Sacramento businesses in business.

B. **Small businesses are *the primary* driver of economic growth in this country:**

1. **Constituting about 99.9% of all businesses,**

2. **Creating more jobs (62% between 1995 and 2020—12.7 million compared to 7.9 million by large businesses) and**

3. **Accounting for 44% of U.S. economic activity, according to the U.S. Small Business Administration.**

C. **Yet the city of Sacramento does not currently do all it can to support small businesses—far from it.** From our home occupation permit fees (some of the highest in the nation) to our BOT, Sacramento is burdening such businesses when it needs to be super-charging them the way some of our peer jurisdictions do.

D. **For example, right now our BOT is *regressive*. This means the *smallest* businesses pay the *highest* effective tax rates and the *biggest* businesses pay the *lowest*.** Indeed, the smallest businesses can sometimes pay in excess of a hundred percent of their gross income in BOT, while the biggest businesses pay a tiny fraction of a hundredth of a percent. That is because:

1. **Some business types, such as most types of licensed professionals (per Sac. Code § 3.08.180), pay unusually high *flat* taxes, *regardless* of income.**

    a) Although Sacramento arguably attempts to provide some proxy for income for such licensed professionals, by providing three tiers of flat taxes that get successively higher the more years a professional has been licensed, this effort falls short for a number of reasons, including because often those professionals licensed the *longest* earn the *least*, as near retirement they frequently transition to part-time work as self-employed independent contractors.

    b) This means that, for example, most types of solo practitioners licensed seven years or more are taxed as though they *all* gross $685,000 annually—whether they are in *fact* semi-retired making under $50,000 per year, or making millions per year. That's because they are *all* taxed a flat $300 per year, which is what a business taxed on gross receipts would pay *only* if they were grossing $685,000 per year, in accordance with the city's main gross receipts tax, which is $30 + .04% of annual gross receipts over $10,000 (per Sac. Code § 3.08.170).

    c) This also means that a professional whose work does *not* require a state license and who is grossing $300,000 a year would owe *half* as much BOT as a part-time, home-based, family-focused or semi-retired professional licensed seven years or more who is making *less*, even ten times less, i.e., $3,000 a year. That is the former would pay only about $150 in BOT while the latter would owe a flat $300–*simply* because of the *immaterial* fact that the profession practiced by the resident making $3,000 *requires* a state license and that of the resident making $300,000 does *not*.

    d) By contrast, most of the city's peer jurisdictions would tax such low earning professionals far less. For example, as I explained in an op-ed published during my push against Measure C, "all of the city's peer jurisdictions would tax me [a home-based, family-focused, part-time licensed professional] far less than [$300 currently, without Measure C], i.e., $0 in San Francisco, $0 in San Jose, $25 in Bakersfield, $40 in Folsom, $60 in Oakland, $87.07 in Fresno (making the "alternate election") and $272 in Long Beach (as a home-based business)."

2. **Other businesses**, e.g., those taxed on gross receipts (per Sac. Code § Code 3.08.170):

    a) ***Still* pay a minimum *flat* tax**;

    b) **Have a low $5,000 *cap* at the top, such that even multinational corporations like Walmart pay a maximum of $5,000 in annual BOT and businesses generating over $500 million in annual gross receipts pay the same amount of BOT as businesses earning $12.4 million in gross receipts**; and

    c) **Are otherwise subject to a single, flat, low, one-size-fits-all tax rate of .04%**, which:

        (1) **Does not vary based on its industry/sector's** typical business expenses, sales tax or fee burdens; and

        (2) **Does not "progress" upwards the more income is earned**, the way our progressive federal income tax and more than one of our city's self-identified peer jurisdictions' BOT systems tax rates do.

E. **Therefore, both economic growth and fairness require a *progressive* BOT** so that those businesses earning the *most* pay the *highest* effective tax rates, and not the other way around.

V. Specifically, Sacramento Needs a Progressive BOT That Will:

A. **Exempt small businesses up to a significant, negotiated income level.** That is, Sacramento needs to implement BOT and fee exemptions for first year and low-income/small businesses, the size and scope of which could be negotiated with the business community, but could be largely modelled after exemptions made available to such businesses in peer jurisdictions like San Jose (BOT exemption) and San Francisco (BOT exemption; fees exemption).

1. **Peer jurisdiction BOT exemptions range greatly.** San Francisco currently exempts businesses grossing $5M or less annually from its BOT. Before San Francisco's recent passage of Measure M[1] its exemption covered businesses making $2M or less annually. By contrast, San Jose only exempts businesses grossing $31,300 or less annually and businesses that have annual adjusted gross incomes of $62,600 or less.

2. **I recommend the city consider an approach like San Jose's, *in terms of having both gross income and adjusted gross income exemptions*, *but* with *expanded* eligibility.**

[1] Notably, San Francisco's Measure M (also known as "Proposition M") made that city's progressive BOT even *more* progressive and supportive of small businesses by *increasing* the city's rate ranges significantly while *expanding* the definition of "small business enterprise" in its "small business exemption" provision to include all those grossing less than $5M annually (versus the already generous definition exempting businesses grossing less than $2M annually). For more detail, see Measure M and the text of current SF Code § 954.1). Also notable, San Francisco applied/applies various *additional* progressive rates to certain business types, e.g., those with "overpaid executives" (see SF Code §§ 3301 *et sec.*); and those earning over $25M annually, the latter in order to fund homelessness abatement projects (see SF Code §§ 2801 *et sec.*). However, I am not *necessarily* proposing Sacramento do the same, at least not at this time, and have included no such additional taxes in the estimates described herein. That said, it might be an option to keep in mind during negotiations.

3. **What level of expanded eligibility could be an area negotiated with the business community.** ***To supercharge and win support from as many small businesses as possible, I propose opting for the highest eligibility level the city feels comfortable with.***

    a) **Notably, this would be affordable because, according to my estimate calculations , revenue doesn't vary much whether exempting businesses making equal to or less than $100,000 or $5M**. For example, whether applying Progressive Estimate Methods A, B or C, the "average" estimates still more than offset the projected budget deficits, and in some cases still many times over, even exempting businesses making up to $5M.

4. **Another option to consider would be exempting "the first" x dollars for *all* businesses.**

    a) **The benefit with this would be avoiding a "cliff" effect,** where a business earning $1 over the exemption eligibility maximum pays BOT on all earnings, not just that $1.

    b) **And, again, exempting the first x dollars would be affordable because it wouldn't drastically reduce revenue either.** Whether applying Progressive Estimate Methods A, B or C, the "average" estimates still more than offset the projected budget deficits, even when exempting the first $5M.

5. In any event, purely for the sake of simplicity and given limited data, the estimate calculations provided herein and in linked spreadsheets exempted businesses based *solely* on gross receipts and only exempted those grossing $100,000 or less annually.

B. **Eliminate the city's unusually low, artificial tax caps, from both the gross receipts tax (Sac. Code § 3.08.170(B)) and other BOT tax methods (e.g., Sac. Code 3.08.190)**, to the extent those other BOT tax methods are maintained. This would align the city with *most* of its self-identified "peer jurisdictions," which, according to the city's own staff report, have no BOT tax cap at all, while the two peer jurisdictions with tax caps are 4-35x higher than Sacramento's $5,000 tax cap.

C. **Opt all or most non-gross-receipts-taxed businesses into gross receipts taxation—or at least allow them to opt themselves in. That is, either**:

1. **Opt *all* such businesses into the gross receipts tax—my recommendation and what a number of our peer jurisdictions do, including Bakersfield, Oakland and San Francisco** (integrated into the chart/estimates referenced herein as "estimate add-ons"); or

2. **At the very least, allow them to opt *themselves* in by, for example, following peer jurisdiction Fresno's lead and allowing licensed professionals to opt out of the regressive and unusually high flat taxes Sacramento currently levies, and into the gross receipts tax** that most businesses in the city pay.

With either of these two approaches, going forward no business would be *required* to pay the kind of regressive, completely income-*insensitive*, unusually high flat taxes most types of licensed professionals in Sacramento pay now. So, for example, no longer would solo professionals licensed seven years or more be required to be taxed as though they *all* gross $685,000 annually, even if they are in fact working part-time, due to partial retirement, family obligations or health issues.

Although the first proposal above would garner more revenue and be more progressive at both lower and higher income levels, the second proposal is better than the status quo. That's because allowing non-grossed receipts taxed licensed professionals to opt themselves into gross receipts taxation wouldn't cost much in terms of revenue loss, given the small number of licensed professionals compared with other business types, and the even smaller number who would likely opt into gross receipts taxation; would bring significantly more fairness and progressivity to our BOT system; and would likely garner enthusiastic support from the very same licensed professionals who helped defeat Measure C.

D. **Replace the single, one-size-fits-all .04% gross receipts tax rate with a series of progressive marginal rate ranges that are relatively net-income sensitive,** and implement other, related policies. To elaborate, I recommend the city:

1. **Eliminate the minimum flat tax element of our gross receipts tax**, as peer jurisdiction San Francisco (§§ 953.20-953.26) has (although San Francisco does have a separate flat *fee*, it is on the low end and first year businesses are exempt from it); and

2. **Negotiate a number of progressive marginal rate ranges that are relatively net-income sensitive** by being sector-specific, crafted in close consultation with each sector, and higher or lower depending on each sector's typical profit margins, city fee and sales tax burdens, employment contributions, etc. While cities in California may not levy net-income taxes per se, gross receipts taxation of businesses is permitted and can be levied with greater net-income sensitivity by introducing progressive marginal rate ranges that vary by sector.

    a) **These rate ranges would *increase* marginal tax rates as gross receipts *rise***, the way that that peer jurisdictions San Francisco (§§ 953.20-953.26) and Oakland (§ 5.04.205) progressive marginal rate ranges do. San Francisco's main pre-Measure M 2025 progressive BOT tax rates started as low as .079% and topped out at 1.04% (see prior versions of SF Code §§ 953.31-953.7, no longer in San Francisco's code online, since Measure M went into effect in late 2024, but viewable redlined in the text of Measure M). San Francisco's current, main *post*-Measure M 2025 rates start as low as .1% and top out at 3.36%. A simplified/modified version[2] of Oakland's rates start as low as .05% and top out at .55%.

b) To get a sense of how the progressive marginal rate ranges work, consider the following rate range, San Francisco's pre-Measure M lowest main 2025 rate range, applicable to designated business types as described in the pre-Measure M version of SF Code § 953.3(a)(2)(B):

(1) 0.079% (e.g., $.79 per $1,000) for taxable gross receipts between $0 and $1,000,000
(2) 0.105% (e.g., $1.04 per $1,000) for taxable gross receipts between $1,000,000.01 and $2,500,000
(3) 0.142% (e.g., $1.42 per $1,000) for taxable gross receipts between $2,500,000.01 and $25,000,000
(4) 0.224% (e.g., $2.24 per $1,000) for taxable gross receipts over $25,000,000

3. **Keeping open the possibility of *phasing in* higher rate ranges** over a number of years to ease the transition, as San Francisco has done, see e.g., SF Code §§ 953.20-953.26.

VI. Summary of Estimates Showing Tremendous Revenue Possibilities:

A. **Applying progressive BOT policy parameters like those listed in the section above to the best data available as of late 2024 (per public records requests and discussions with the city's Finance Director Pete Coletto) yielded *impressive* results—not just *eliminating the city's projected budget deficits* but potentially doing so with a *great* deal to spare**.

B. **Details regarding the estimates summarized here,** can be found in these spreadsheets. Specific tax policies, assumptions and data applied in generating the estimates are detailed in those spreadsheets and in the appendix at the end of this paper.

C. High level overview of tax policies applied in calculating estimates (for more details see the appendix at the end of this paper):

1. Exempted businesses grossing $100K or less annually in gross receipts from BOT taxation;

2. Eliminated the BOT tax cap;

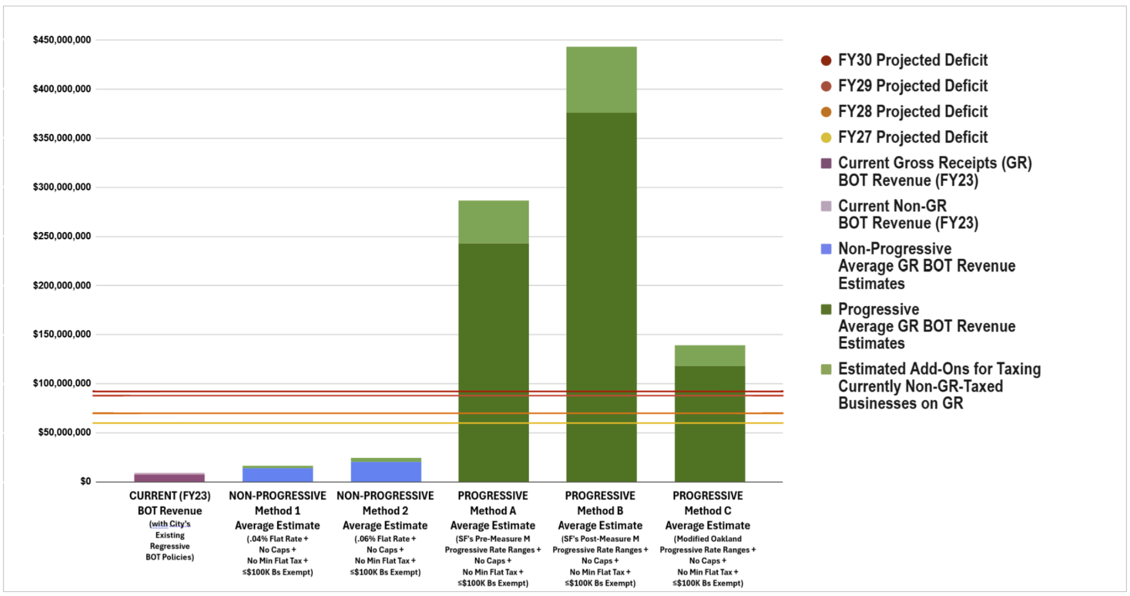
[2] This paper and supporting spreadsheets describe Oakland's rate ranges as "simplified/modified" for a few reasons. First, Oakland's rate ranges start a little inconsistently and are essentially a $60 flat tax at very low income levels. Second, as rates are applied from there they are not written as percentages, but as dollar amounts per $1,000. Third, there are a number of additional classifications per Oakland Code §§ 5.04.205(O)-(S) that are more complex and apply to very narrow business categories. Therefore, for the sake of simplicity and consistency with this proposal's elimination of flat tax elements and its use of rates expressed as percentages, Oakland's rate ranges have been simplified/modified by including only the ranges covered in Oakland Code §§ 5.04.205(A)-(N), translating the dollar amounts per $1,000 into percentages and applying the lowest resulting percentage rate to gross receipts from $0 to the first rate threshold ($1 million). To get a better sense of what that looks like, compare Oakland Code § 5.04.205 to these cells in Method C's "average estimate" table in the supporting spreadsheets.

3. Opted all non-gross-receipts-taxed businesses into gross receipts taxation and *out* of the unusually high, income-insensitive flat taxes many currently pay.

4. Altered the gross receipts tax to eliminate the minimum flat tax and replace the current, single .04% tax rate with the progressive marginal rate ranges that peer jurisdictions San Francisco and Oakland have used (*except* Oakland's ranges were simplified/modified as described in fn 2 above; and for the two *non*-progressive "Method 1" and "Method 2" estimates below *flat* rates were used); and

D. Repeat of chart from first page *partially* summarizing some of the key results, comparing the $8.9M total BOT revenue in FY23 applying city's current flat rate, regressive BOT with estimates generated by applying progressive (and non-progressive) BOT alternatives:

ESTIMATED CITY OF SACRAMENTO BOT REVENUE APPLYING PROGRESSIVE BOT POLICIES (COMPARED TO ALTERNATIVES)
WITHOUT FACTORING IN RESULTING BOOST TO SMALL BUSINESSES AND ECONOMIC GROWTH



E. Progressive BOT Estimates:

1. Progressive Method A Estimates:

Summary of Method A (w/ SF Pre-Msr. M Rates) Estimates:			
Estimate Level	Annual Method A GR BOT Revenue Base Estimate	Add-on if *All* Businesses Taxed on GR with Method A	TOTAL METHOD A + ADD-ON ANNUAL BOT REVENUE ESTIMATE
Highest estimate:	$543,052,900	$97,749,522	**$640,802,422**
High estimate:	$382,607,930	$68,869,427	**$451,477,357**
Average estimate:	$242,659,756	$43,678,756	**$286,338,512**
Low estimate:	$64,861,853	$11,675,133	**$76,536,986**
Lowest estimate:	$37,625,061	$6,772,511	**$44,397,572**

2. Progressive Method B Estimates:

Summary of Method B (w/ SF Post-Msr. M Rates) Estimates:			
Estimate Level	Annual Method B GR BOT Revenue Base Estimate	Add-on if *All* Businesses Taxed on GR with Method B	TOTAL METHOD B + ADD-ON ANNUAL BOT REVENUE ESTIMATE
Highest estimate:	$1,541,466,438	$277,463,959	**$1,818,930,397**
High estimate:	$1,053,144,669	$189,566,040	**$1,242,710,709**
Average estimate:	$376,040,799	$67,687,344	**$443,728,143**
Low estimate:	$129,564,291	$23,321,572	**$152,885,863**
Lowest estimate:	$61,639,650	$11,095,137	**$72,734,787**

3. Progressive Method C Estimates:

Summary of Method C (w/ Modified Oakland Rates) Estimates:			
Estimate Level	Annual Method C GR BOT Revenue Base Estimate	Add-on if *All* Businesses Taxed on GR with Method C	TOTAL METHOD C + ADD-ON ANNUAL BOT REVENUE ESTIMATE
Highest estimate:	$271,636,222	$48,894,520	**$320,530,741**
High estimate:	$191,554,063	$34,479,731	**$226,033,795**
Average estimate:	$117,883,814	$21,219,086	**$139,102,900**
Low estimate:	$58,723,791	$10,570,282	**$69,294,073**
Lowest estimate:	$33,183,725	$5,973,071	**$39,156,796**

F. Alternative ***Non*-Progressive** Estimates (generated applying the same tax policies as progressive estimates, ***except* continuing on with flat rate v. progressive marginal rate ranges**):

1. *Non*-Progressive Method 1 Estimate:

Summary of Method 1 Non-Progressive .04% Estimate:			
Estimate Level	Annual Method 1 GR BOT Revenue Base Estimate	Add-on if *All* Businesses Taxed on GR with Method 1	TOTAL METHOD 1 + ADD-ON ANNUAL BOT REVENUE ESTIMATE
Average estimate:	$13,772,080	$2,478,974	**$16,251,054**

2. *Non*-Progressive Method 2 Estimate:

Summary of Method 2 Non-Progressive .06% Estimate:			
Estimate Level	Annual Method 1 GR BOT Revenue Base Estimate	Add-on if *All* Businesses Taxed on GR with Method 1	TOTAL METHOD 1 + ADD-ON ANNUAL BOT REVENUE ESTIMATE
Average estimate:	$20,658,120	$3,718,462	**$24,376,582**

VII. Addressing Potential Concerns

A. **<u>Potential Concern #1</u>: "Won't businesses leave Sacramento or not come in the first place, reducing our sales tax and BOT revenue?"**

<u>Answer</u>: No and/or not to a problematic extent, because:

1. As explained earlier, according to the U.S. Small Business Administration (SB), **the vast majority of businesses are *small* businesses—which provide the lion's share of employment and economic activity—and many of these businesses would receive unprecedented support with a BOT exemption and the elimination of minimum flat taxes**. Even a relatively low exemption, exempting businesses grossing a maximum of $100,000 or less annually, would relieve about half of Sacramento's businesses, per FY23 data.

2. Businesses would have customized rate ranges based on business/industry/sector type, and these ranges would *factor-in* typical, sector/industry-specific profit margins, as well as potentially city fee burdens, sales tax revenue generation, contribution to area employment opportunities, etc..

3. Businesses could play an integral role in negotiating rate ranges and which rate ranges apply to which business/industry/sector types.

4. Rate ranges could start lower and increase gradually over a number of years, as was done in San Francisco (see, e.g., [SF Code § 953.3(a)(2)(B)]).

5. Many factors other than local taxation levels affect business location decisions. These include factors such as market demand, market growth, competition, transportation costs, labor availability and cost, proximity to resources, zoning, accessibility, security, growth/expansion potential, etc.—all of which would be enhanced with a well-funded, well-staffed city.

6. While it is true that in some cases *multinational* corporation situs decisions may be impacted by tax incentives, about 85% of the time *other* businesses, including small businesses, which are 99.9% of businesses and are the biggest drivers of our economic growth and employment (see links listed at part IV.B on page 3), will choose the same location *with* or *without* tax incentives. See Mast, Evan (2020). "Race to the Bottom? Local Tax Break Competition and Business Location". American Economic Journal: Applied Economics. 12 (1): 288–317. doi:10.1257/app.20170511. ISSN 1945-7782, summarized here, available for purchase here, or in its raw form free of charge here.

7. That said, when it comes to multinational corporations, while it may be *inadvisable* because of how often they simply displace small businesses that generate more economic activity and tax revenue, in extraordinary circumstances a default progressive BOT system should not *prevent* city officials from creating special (although, from an economic and fairness perspective, ideally only introductory) incentive packages to attract particular multinational corporations.

B. **<u>Potential Concern #2</u>: "How could we ever hope to pass such a large tax increase?"**

<u>Answer</u>: Actually, the majority of businesses would see a tax *cut* not a tax *increase* with this proposal, given the small business exemption component. However, businesses that make more than that exemption amount would likely see tax increases, on the margins at least, depending on what progressive marginal rate range they fell into and how high the rates in their applicable rate ranges were. We could pass such a measure because:

1. More than one of Sacramento's peer jurisdictions have. Moreover, one of these peer jurisdictions, San Francisco, which already had a progressive BOT, just last year passed a measure cleaning up and doubling down on the approach. San Francisco passed this measure, Measure M, by a high margin of nearly 70%, with a remarkably broad coalition in support, including organized labor, non-profits, elected leaders, and businesses large and small. Measure M shows what is possible when all come together to find common ground.

2. The small business community will support this given increased fairness and support it will offer small businesses, where the larger the BOT exemption the more support from small businesses the measure would garner.

3. Licensed professionals, the group that sunk Measure C, would support this because it would at last take their business income into consideration or at least allow them to opt themselves into a taxation method that takes their income into account.

4. With enough time spent negotiating and possibly phasing in fair progressive marginal rate ranges that take particular, industry/sector specific profit margins, city fee burdens, sales tax revenue generation, contribution to employment opportunities in the city, etc., even big businesses could be brought along, knowing the resulting funding will provide the kind of stability and improvements to the city critical to their success.

5. Labor unions will support because the incoming resources would lower the likelihood of layoffs and allow the city to fill vacant positions and pay competitive wages.

6. Special interests, such as those supporting more homelessness funding, climate action funding, etc., could be encouraged to support on the principle that "a rising tide lifts all boats." In addition, the council could opt to commit some of the extra revenue generated to their particular areas of interest. Although to ensure passage it would be best if any such commitments are as enforceable as possible without constituting earmarks requiring a two-thirds vote of the public for passage.

7. Residents tired of the continuing rollout of fee hikes and service cuts will have every reason to support this.

C. **<u>Potential Concern #3</u>: "Progressive marginal rate ranges aren't acceptable because they 'punish success,' since a slightly higher tax rate applies to each higher portion of income earned."**

<u>Answer</u>: While an understandable interpretation, this perspective is at odds with a considered analysis conducted through a lens of enlightened self-interest.

1. Merriam Webster defines "enlightened self-interest" as "behavior based on awareness that what is in the public interest is eventually in the interest of all individuals and groups."

2. When looked at through a lens of enlightened self-interest, progressive marginal rate ranges in the city's BOT would not "punish success," but rather would celebrate success, spread success and increase success.

3. Progressive marginal rate ranges would celebrate success by inviting those who have gained the most from our city and our system to savor the knowledge that they can uniquely contribute what no one else can and thereby help spread success and increase their own success.

4. Progressive marginal rate ranges would spread success by making a significant contribution towards balancing our city budget, so that we can maintain full staffing; attract the best employees by paying competitive wages; increase public safety, in part by fully funding programs that help our unhoused population transition to housing and programs that keep young people, new businesses and others occupied, thriving and contributing; fully fund city services; and catch-up on deferred maintenance.

5. Progressive marginal rate ranges would increase success, because all of the foregoing makes the city a better place to do business by being safer, cleaner, more beautiful and more welcoming, so that it's a place customers want to frequent and high caliber employees want to live.

D. **Potential Concern #4: "Path dependency" *requires* making only minor changes to essentially the same tax system, rather than significantly reforming such a system, even when the reformed system would arguably be significantly more effective, progressive, fair, lucrative and efficient.**

Answer: This misunderstands and misapplies the lessons of path dependency theory. Path dependency is primarily a theoretical *explanation* for why institutional inertia often takes hold, not an independent reason by *itself* for *allowing* it to continue. Indeed, much research has been done into finding ways to empower institutions to break free from path dependency, so that they can regain the ability to enact needed policy changes and avoid a slide into terminal managed decline.

What follows is an analysis of how the city might avoid this fate, using a method of listing needs typically met by path dependency and alternative strategies for meeting those needs in this particular context. Although protection of incumbent interests benefiting unfairly from the status quo is not a reason to forego needed change, the following are legitimate needs that would ideally be met as much as possible:

1. **Ease and cost of compliance and administration**: This need could continue to be met fully with a progressive BOT, because the classification, calculation and payment system could be similarly simple, as follows:

   a) Regarding determining which business qualifies for which BOT method: There is currently a need to initially determine whether or not a business is of a *type* taxed on gross receipts or is instead subject to one of the various other BOT taxation methods (e.g., most licensed professionals are subject to a specific set of flat taxes that vary according to years licensed). The approach under the progressive BOT described herein need not be significantly different. Both then and now the process could still *just* involve either the city and/or each business determining what *type* of business they are, i.e., what category they fall into, e.g., licensed professional, rental real estate, cannabis, grocery, general retail, etc., because which *rate range* would apply would flow seamlessly from that initial determination, just as which BOT tax method applies flows seamlessly from that initial determination currently.

b) Regarding calculating gross receipts tax due: With the applicable gross receipts progressive marginal rate range already having been determined, per the foregoing, the rest would happen automatically, just as it does now. That is, the business owner or their representative would simply insert the same gross receipts total that they would insert now into the online tax form and the *form* would apply the relevant formula to calculate tax due. The only difference would be that the form's calculation would involve automatic application of the relevant *progressive marginal rate range* for that business instead of application of the current flat *.04% rate* or other applicable tax method.

    (1) Indeed, the process could be even *simpler* than it is now, by permitting *all* businesses to input gross receipts generated in their prior *tax year,* rather than in the prior *12 months*, as is the case currently. This significant improvement could more than offset the additional burden on the very small number of businesses not currently having to report their gross receipts at all, e.g., licensed professionals.

2. **Predictability and Stability**: While these needs would be met by maintaining the exact same compliance requirements and financial burden of the status quo tax structure, the proposed progressive BOT would also materially meet these needs for most businesses because 1) the progressive BOT proposed xould have a nearly *identical* compliance process, as discussed above; 2) most businesses would experience a *reduced* tax burden (with the small business exemption); and 3) some changes could be phased-in and all could accompanied by educational outreach to the business community. However, for those minority of businesses that would specifically see *increased* tax burdens various additional, specific options could be explored. For example:

    a) A year-by-year phase-in of increases in the rates contained in each of the progressive marginal rate ranges. San Francisco has taken this approach (see, e.g., SF Code § 953.3(a)(2)(B)); and/or

    b) Targeted incentives for those businesses that make specific contributions to the city, related to, for example, job creation, development, sustainable practices, etc.

3. **Assuring benefits outweigh costs**: There is a strong argument for maintaining the status quo when either the benefits of change would be minor or there are equally beneficial options that would be significantly less costly to implement. However, for reasons

discussed earlier in this paper, neither of those is the case here. The benefits of instituting progressive BOT reform of the sort described herein would be profound, not minor, jumpstarting small businesses and economic growth, while more than eliminating the city's large and growing projected budget deficits in the face of otherwise potential managed decline, given a steady march of increasing unfunded pension costs, other inflation-sensitive labor costs, etc. Moreover, there are no other revenue options being discussed that are anywhere near as promising, in a context where property tax revenue remains artificially constrained by Proposition 13 and increasing sales taxes is an intrinsically regressive, legally limited option.

XI. Conclusion

In the face of looming, large and growing projected budget deficits, on top of serious concerns about federal funding, inflation and possible recession, Sacramento needs to take bold and decisive action to save the day.

This paper proposes just that—not by coming up with a plan out of thin air. More than one of the city's own self-identified peer jurisdictions have shown us the way. Let us follow their lead, in close consultation with all stakeholders. This path will lead us out of the darkness of endless budget deficits, fee hikes, service cuts and layoffs and into the light of economic growth and fairness.

<u>APPENDIX</u>

TAX POLICIES, ASSUMPTIONS AND DATA UTILIZED TO GENERATE REVENUE ESTIMATES DESCRIBED HEREIN

(For more detail see these spreadsheets)

E. **Tax Policies Applied to All Estimates (except as noted)**:

1. Exempted businesses grossing $100K or less annually gross receipts from taxation;

2. Eliminated the BOT tax cap

3. Altered the gross receipts tax to eliminate the minimum flat tax and replace the current, single, flat .04% tax rate, applied to all businesses taxed on gross receipts, with:

    a) The progressive, graduated rate ranges that peer jurisdiction San Francisco *had* slated for 2025 *before* Measure M passed in 2024 (Method A);

    b) The progressive marginal rate ranges San Francisco *currently* has designated for 2025, put in place *after* Measure M passed (Method B); and

    c) A simplified/modified version of the progressive marginal rate ranges peer jurisdiction Oakland currently has in place (see fn 1 earlier for details).

    Except for the two *non*-progressive estimates *flat* rates were retained (.04% for Method 1 and .06% for Method 2); and

4. Opted businesses *not* currently taxed on gross receipts *into* the gross receipts tax.

F. **Assumptions Made in Calculating Estimates**:

1. The "highest" base estimates

    a) Assume all Sacramento businesses in a given gross receipts range earn the highest gross receipts in that range; and

    b) Apply the relevant peer jurisdiction's highest 2025 rate range, i.e., the rate range that yielded the highest revenue in the relevant spreadsheet's "average" estimate table.

2. The "high" base estimates

    a) Assume all Sacramento businesses in a given gross receipts range earn the average gross receipts in that range; and

    b) Apply the relevant peer jurisdiction's highest 2025 rate range, i.e., the rate range that yielded the highest revenue in the relevant spreadsheet's "average" estimate table.

3. The "average" base estimates

    a) Assume all Sacramento businesses in a given gross receipts range earn the average gross receipts in that range; and

    b) Are subject in equal numbers to each of the relevant peer jurisdiction's 2025 rate ranges.

4. The "low" base estimates

    a) Assume all Sacramento businesses in a given gross receipts range earn the average gross receipts in that range; and

    b) Apply the relevant peer jurisdiction's lowest 2025 rate range, i.e., the rate range that yielded the lowest total revenue in the relevant spreadsheet's "average" estimate table.

5. The "lowest" base estimates

    a) Assume all Sacramento businesses in a given gross receipts range earn the lowest gross receipts in that range; and

    b) Apply the relevant peer jurisdiction's lowest 2025 rate range, i.e., the rate range that yielded the lowest total revenue in the relevant spreadsheet's "average" estimate table.

6. The "estimated add-ons" add an additional 18% of base estimate revenue on in order to account for the tax policy opting those businesses not currently taxed on gross receipts into the gross receipts tax. 18% was chosen because:

    a) About 18% of the number of Sacramento's FY23 businesses that were taxed on gross receipts were taxed via alternative methods, e.g., flat taxes; and

    b) No gross receipts data were collected from those businesses, leaving the 18% add-on method as the best method available for estimating the gross BOT revenue they might generate.

G. Data Used in Calculating Estimates:

1. Best city of Sacramento BOT data publicly available as of my September 27, 2024 public records request and ensuing direct communication with Finance Director Pete Coletto, e.g., this table listing number of businesses taxed on gross receipts in FY23 (but not by sector/industry) in each of the tightest gross receipts ranges publically available;

2. Data and procedure used to estimate $1,955,990,382 "high end" gross receipts is presented in "High End GR" spreadsheet;

3. City of Sacramento's self-identified peer jurisdictions sourced from this table; and

4. Peer jurisdictions' progressive marginal rate ranges, i.e., SF's *pre*-Measure M 2025 rate ranges, SF *post*-Measure M 2025 rate ranges and a simplified/modified version of Oakland's 2025 rate ranges are described, along with source citations, in each of the "Progressive Estimates-Method. . ." spreadsheets and earlier in this paper.