

Internet Business Tax Ordinance – Economic Summary

Background

- The Multi-media business classification was established in 1997 to attract and grow new and dynamic industries including emerging Internet based businesses.
- The City's business tax classifications have not evolved to reflect the growth and changing business models of the 21st century. The Internet industry has grown beyond the scope of the Multi-media business classification.
- Recently, audits by the Office of Finance determined that Internet businesses should be taxed at the rate imposed on Professions and Occupations, resulting in a quintupling of taxes for these businesses.
- The proposed Internet Tax Ordinance is necessary to achieve the original intent behind the establishment of the Multi-media classification.

Economic Considerations for Maintaining Internet Industry Tax Rate

Impact of Proposed Changes on General Fund Revenue

- If the Internet Business Tax is not adopted, the City would likely suffer an on-going revenue loss in future years that exceeds the \$3.4 million projected by the Office of Finance and CAO.
- The failure to implement the Internet Business Tax Ordinance will almost certainly result in the relocation of numerous Internet businesses outside the City of Los Angeles severely impacting City revenues.
- Additionally, new Internet businesses will choose not to locate in the City of Los Angeles if this ordinance is not passed.
- Also important to consider – the revenues generated by this industry are highly concentrated in its largest companies. In fact, the relocation of only a handful of the largest Internet companies could result in a loss of fifty percent of the General Fund's revenue from this industry.

Internet Companies Present a Very Real Flight Risk

- The Office of Economic Development and Business Policy is aware of a number of internet companies that have left the City of Los Angeles already, representing over 1,000 jobs.
- Three internet companies have informed the Office of Economic Development and Business Policy that they will re-locate outside the City of Los Angeles if the Internet Tax Ordinance is not passed.
- Internet-based businesses are extremely mobile, unlike a manufacturing company or similar business with extensive infrastructure and equipment needs. Internet companies can easily relocate to other nearby cities to take advantage of significantly lower business taxes.
- Internet-based companies serve customers located throughout the United States and abroad. The global accessibility of the internet creates no business need to remain in the City of Los Angeles.
- The City cannot assume immediate filling of office space should companies leave. Vacancy rates are high and rising. Consequently, the City of Los Angeles will lose the business taxes associated with internet businesses without replacing this revenue in the near-to-immediate term.

Proposed Ordinance has Significant Impact on Job Retention and Creation

As the City recently learned by Northrup Grumman's announced departure, most companies do not inform the City of its intentions to re-locate. The three companies referenced above represent the proverbial tip of the iceberg in the internet sector. The examination of these three Internet-based business shows the following common traits:

- Internet companies produce well-paying jobs, the average salary per employee for the sampled businesses is reported to be \$100,596.
- Internet companies have an enormous potential for job growth - the three companies sampled have 659 employees and expect to grow their payrolls to 880 jobs by 2012.

There is also a multiplier effect of Internet business jobs. According to the Los Angeles County Economic Development Corporation (LAEDC):

- One new job in the Internet publishing, broadcasting and web search portal arenas creates 2.8 additional jobs. The combined 3.8 new jobs, with an aggregate annual wage and benefit package of \$278,147, produce \$39,000 in annual revenue from state and local taxes and fees.

- One new job in the data processing field creates one additional job. The LAEDC further indicates that the two new jobs, with an assumed aggregate annual wage and benefit package of \$129,649, produce \$15,200 in annual revenue from state and local taxes and fees.
- It is important to remember that businesses and employees generate ancillary revenues for the City and local business in many different areas including parking, shopping, and services.

CONCLUSION

The failure to pass the proposed Internet Tax Ordinance will result in a long term loss of revenue and jobs to the City of Los Angeles.