MEMORANDUM OF LAW

DATE: April 20, 1990

TO: Mary Ford, Suggestion Awards Program Administrator

FROM: City Attorney

SUBJECT: Taxing Non-City Residents For Privilege of Working in the City

Recently an employee submitted a suggestion to increase City revenue. He suggests that all employees who work within the City limits but who reside outside the City limits be taxed for the privilege of working within the City and for the use of City benefits and services. Additionally, he has suggested that the revenue raised from the tax be used to fund the City employee retirement fund. You have asked if such a tax is legal and if so, how the tax would be enacted?

The suggestor indicated the tax could be either based on income or calculated as a flat fee. An income tax is impermissible. Revenue and Taxation Code section 17041.5 specifically prohibits municipalities from levying any taxes on income. It reads:

> Section 17041.5. Authority of public agency to levy income tax; Applicability to license tax measured by gross receipts
>
> Notwithstanding any statute, ordinance, regulation, rule or decision to the contrary, no city, county, city and county, governmental subdivision, district, public and quasi-public corporation, municipal corporation, whether incorporated or not or whether chartered or not, shall levy or collect or cause to be levied or collected any tax upon the income, or any part thereof, of any person, resident or nonresident.
>
> This section shall not be construed so as to prohibit the levy or collection of any otherwise authorized license tax upon a business measured by or according to gross receipts.

However, despite the specific prohibitions of the Revenue and Taxation Code, certain cities in the state have instituted taxes that look suspiciously like income taxes but are called something else. Oakland adopted this type of tax in June of 1974. The

local ordinance imposed a tax on the privilege of engaging in any business, trade, occupation or profession as an employee in the City of Oakland. The tax was measured as 1 percent of the city-derived earnings of each employee. In somewhat tortured reasoning, the court held that the tax was a license fee and not a tax upon income so as to be prohibited by Revenue and Taxation Code section 17041.5. It based its finding on the fact that state and federal income taxes include:

> "Compensation for services" and "gross income derived from business" . . . and also "interest," "rents," "royalties," "annuities," "income from discharge of indebtedness," "income from an interest in an estate or trust," and other items and sources of revenue which the Oakland tax does not purport to reach. Moreover, the traditional assessment commonly recognized as an income tax is ordinarily a tax upon net income-that is, gross income reduced by other taxes, business expenses, and cost incurred in the production of the income. The Oakland ordinance, in contrast, expressly includes, as compensation subject to the levy, sums deducted "before 'take home' pay is received" and forbids deduction of business-related expenses, except that the taxpayer may claim a credit for any other business license tax paid to the city.

Weekes v. City of Oakland, 21 Cal. 3d 386, 393 (1978).

The court further distinguished the Oakland tax from an income tax because the tax did not seek to tax all earned income of City residents, whether generated inside or outside the taxing jurisdiction. The Oakland tax was calculated only by Oakland derived earnings thus a resident of Oakland who was employed outside the jurisdiction was not subject to the tax.

It is interesting to note that although the court upheld the Oakland tax scheme, the Oakland city council never actually put the tax into effect. After having adopted the ordinance, the council determined such a tax was politically inadvisable.

Under the Oakland case, it would appear that a tax on earnings might be permissible if properly structured. However, the suggested tax is highly discriminatory and as such cannot be instituted. Government Code section 50026 precludes discriminatory taxation and provides in pertinent part:

> Section 50026. Limitation on occupation tax on nonresidents

> The legislative body of any local agency, chartered or general law, which is otherwise authorized by law or charter to impose any tax on the privilege of earning a livelihood by an employee or any other tax, fee or charge on or measured by the earnings, or any part thereof, of any employee, shall not impose any such tax, fee or charge on the earnings of any employee, when such employee is not a resident of the taxing jurisdiction, unless exactly the same tax, fee or charge at the same rate, with the same credits and deductions, is imposed on the earnings of all residents of the taxing jurisdiction who are employed therein (emphasis added).

A case in San Francisco directly addresses the issue presented by Mr. McCarthy's suggestion. San Francisco taxed commuters from outlying counties who worked in the City. San Francisco residents who worked in the City were not taxed. In striking down the tax, the court said: "even though a city has justification for allocating certain costs to nonresidents, the city may not accomplish this end by imposing a tax solely upon nonresidents engaged in a particular activity, while totally exempting residents engaged in the same activity." County of Alameda v. City and County of San Francisco, 19 Cal. App. 3d 750, 756 (1971). To subject nonresidents to a tax that residents are not subject to would deny nonresidents equal protection of the laws. It would also subject them to taxation without representation as they would have no input concerning the tax either through ballot propositions or elected officials.

Additionally, it would be manifestly unfair to subject nonresidents to a tax, ostensibly because they enjoy the benefits

and privileges of the City through the use of City facilities, and then use the tax entirely for City employee retirement funds. At a minimum, if a tax were imposed on nonresidents income, it should be directed for general funds that benefit the whole City and not targeted for a discrete group of City employees.

As currently written, the suggestion is contrary to the law and cannot be instituted. Therefore, it is unnecessary to address the question of the mechanics required to institute the proposed tax.

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By
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