

MEMORANDUM OF LAW

DATE: June 14, 1993

TO: Conny M. Jamison, City Treasurer

FROM: City Attorney

SUBJECT: Business Taxes Relating to Professionals Practicing
Outside San Diego But Performing Services Within
City

You sent a request to us for advice on the following issue:
Are professionals who practice outside of
San Diego, but perform services at locations
within the city limits of San Diego, subject
to the City's business tax regulations?

The answer to your question is yes.

We note that the current business tax is a flat fee tax
of one hundred twenty-five dollars (\$125.00) and five dollars
(\$5.00) per employee.

BACKGROUND

The general authority for governmental entities to impose
a business tax is derived from the California Constitution. The
California Supreme Court has held that "the taxation power is
vital and is granted to charter cities by the Constitution. (Cal.
Const., art. XI, Section 5, subd. (a).)" *The Pines v. City of
Santa Monica*, 29 Cal. 3d 656, 660 (1981), citing *Weekes v. City
of Oakland*, 21 Cal. 3d 386, 392 (1978). In the *Weekes* case, the
court held that a charter city's "right to enact a
revenue-raising tax is not at issue unless the city's own charter imposes
restrictions upon its taxing power . . . or the city ordinance is
in direct and immediate conflict with a state statute or
statutory scheme." *Weekes v. City of Oakland*, 21 Cal. 3d at 392.
The court continued, "yet the power of a governmental entity to
tax the privilege of engaging in any and all types of trade or
business within its jurisdiction is not open to serious
question." *Id.* at 395.

California Government Code section 37101(a) authorizes a
legislative body to impose a license tax upon "every kind of
lawful business transacted in the city" Subsection (b)
further states:

Any legislative body, including the legislative

body of a charter city, which imposes a license tax pursuant to subdivision (a) upon a business operating both within and outside the legislative body's taxing jurisdiction, shall levy the tax so that the measure of tax fairly reflects the proportion of the taxed activity actually carried on within the taxing jurisdiction.

In approving cities' rights to impose a license tax on intercity businesses as a method to raise revenue, the California Supreme Court has upheld a two-step standard on which to test the validity of a business tax on intercity businesses: 1) The tax must be measured by a taxable event, i.e., doing business within the city; and 2) the tax must be measured or apportioned so that it is not unfair or discriminatory. *City of Los Angeles v. Shell Oil Co.*, 4 Cal. 3d 108, 122 (1971), citing with approval, *Security Truck Line v. City of Monterey*, 117 Cal. App. 2d 441, 451 (1953). The California Supreme Court continued, ". . . no measure of apportionment can satisfy the constitutional standard if the measure of tax is made to depend upon a factor which bears no fair relationship to the proportion of the taxed activity actually taking place within the taxing jurisdiction." *City of Los Angeles v. Shell Oil Co.*, 4 Cal. 3d at 124.

Where an intercity business tax is a set minimum tax, rather than a gross receipts tax, reasonable apportionment, though more difficult to ascertain, is imperative. The court in *City of San Jose v. Ruthroff & Englekirk Etc. Engineers, Inc.*, 131 Cal. App. 3d 462 (1982), found that a set minimum amount tax was improperly imposed upon an engineering firm which had performed services in San Jose for a period of only twelve (12) hours. The holding in that case was based on the fact that the tax bore no reasonable relation to the taxable event, which was the brief amount of time spent by the firm in the city. The opinion addressed the constitutional implications of intercity business taxes and noted that "what is proscribed is 'the possibility of duplicate taxation by another taxing jurisdiction based upon the same activity . . .'" *Id.* at 466, citing *City of Los Angeles v. Shell Oil Co.*, 4 Cal. 3d 108 (1971) emphasis in original. In *Brabant v. City of South Gate*, 66 Cal. App. 3d 764 (1977), the court held that the City of South Gate could not require a real estate firm with offices in Huntington Park to pay the business tax on a sales transaction on property located in South Gate, where most of the transaction was processed in the plaintiffs' Huntington Park office.

The holdings in these cases were based on specific fact situations in which the service actually performed within the taxing jurisdictions was nominal. The City of San Jose's current

business tax of \$150 per business and \$17 per employee, with a five-day per year involvement within the city, has not been challenged since 1982.

Burden on Taxpayer

If the City's method of taxation were challenged, it would be the taxpayer's responsibility to prove that the tax is unconstitutional. Courts have consistently held that "a taxpayer claiming immunity from a tax has the burden of establishing his exemption." *City of Los Angeles v. Moore Business Forms, Inc.*, 247 Cal. App. 2d 353, 362 (1966), quoting the United States Supreme Court in *General Motors Corp v. Washington*, 337 U.S. 436, 441 (1949). The same burden extends when a city's apportionment methods are disputed. In *City of Los Angeles v. Shell Oil Co.*, 4 Cal. 3d 108 (1972), the California Supreme Court held that a business tax based on a substantial out-of-city sales activity was unconstitutional.

It is clear, however, that a taxpayer who challenges an apportionment formula on constitutional grounds must show more than the possibility of erratic or unconstitutional application. "One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed."

Id. at 126, quoting *Butler Bros. v. McColgan*, 315 U.S. 501 (1941).

Therefore, a taxpayer challenging the City's business tax would have to show that the City's apportionment method taxed activity other than that occurring exclusively within the taxing jurisdiction, and therefore resulted in an unfair discrimination against particular intercity businesses.

Application

Your inquiry as to whether professionals with offices outside the City but performing some services within the City are subject to the City's business tax can be answered in the affirmative. Although San Diego's business tax is not based on gross receipts which are more easily apportioned, as in the *Los Angeles v. Shell Oil* and *General Motors v. Los Angeles* cases, your memo stated that the City currently requires payment of the business tax by out-of-city businesses performing work or services for more than six days in a twelve-month period of time.

Where a business tax is reasonably apportioned and levied

consistently on all out-of-city businesses doing business within the City, the tax has been upheld. For example, the court in *Security Truck Line v. City of Monterey*, 117 Cal. App. 2d 441, 451 (1953), stated that

if the tax here involved is imposed upon a taxable local event, that is, if the carrier is doing business in Monterey and if the measure of the tax is not discriminatory, then, in our opinion, the tax is valid. But if the tax is basically upon an event occurring outside the city, or, if the tax is discriminatory as to plaintiff, then it is invalid.

Conclusion

Any tax levied on intercity businesses and professionals will be defensible in court if it meets the following two-part standard: The tax imposed must be based upon a local taxable event; and it must not impose an unfair or discriminatory burden on any particular business. For example, the tax must be based upon a reasonable time spent or services performed within the City; i.e., surgeries performed at hospitals located within the City, and cannot be based upon only a de minimis level of services therein, since the amount of activity is directly proportional to the two-pronged test of unconstitutionality discussed above. If the above standard is met, it is our opinion that professionals who practice outside San Diego but perform services at locations within the city limits of San Diego are subject to the City's business tax regulations.

JOHN W. WITT, City Attorney

By

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