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Economy & Efficiency Commission Presentation

**PRESENTATION OF
Elaine Reardon, Ph. D.,
Research Economist Milken Institute
May 7, 1997**

Topic: Modeling the Los Angeles City Tax Structure

Chairman Abel introduced Dr. Reardon and welcomed her to the Commission. He explained that, although Dr. Reardon's study was specific to the City of Los Angeles, the issues involved are similar to those examined by the California Constitution Revision Commission.

Dr. Reardon thanked Chairman Abel and gave background on the Milken Institute. The Milken Institute is a nonpartisan nonprofit economic think tank based in Santa Monica and is a part of the Milken Foundation. Primarily, they perform economic research on job growth and capital formation.

The Milken Institute was involved in a consortium that examined the tax and fee structure of the City of Los Angeles. A task force was created that involved representatives from the Mayor's office, CAO, City Clerk, Controller's Office, CLA, and coordinated through Rex Oliff of the CAO. The consortium included the Milken Institute, UT Strategies, Arthur Anderson, and Landmark Partners. Arthur Andersen provided an overview of the tax code, Landmark Partners looked at the effect of taxes and fees on business location (in and out of the city), Milken provided a report on the distribution of taxes across residence and businesses, and is also building a tax simulation model with which the City can examine the effects on employment and revenue by changes in the tax code.

The Arthur Andersen report found a wide variation in taxes across industries. The report also found the tax code to be unnecessarily complicated. These complications make it difficult to audit and to comply. According to the City Clerk, 40% of businesses are not in compliance. The Andersen report recommends revising and simplifying the tax code, in addition to smaller recommendations, such as, including the instructions on how to classify your business with the tax form to be filed.

The Landmark Partners report compared the taxes and fees of the City of Los Angeles with competitor cities. This report found that primary factors that draw a business to an area are real estate costs, market opportunities, the labor pool, etc. Taxes and fees are essentially a tie-breaker. L.A.'s taxes and fees are higher. This report also found that the complexity of the tax and fee schedule was its biggest deterrent. One of the features that highlights the complexity of L.A.'s system is that development fees can change and rise as the project is being built. This inhibits business from forecasting total cost.

The Milken Institute prepared a report examining the distribution of taxes across residents and businesses. Dr. Reardon focused on the \$2.7 billion dollars from 36 tax and fee revenue categories paid by Los Angeles residents and businesses. The burden of these taxes and fees was allocated to residents, businesses, or to some combination of the two. This allocation was based on data from the Comptroller's Office, property tax

data, the State Board of equalization, DWP and numerous smaller sources of data. Where no data were available, Dr. Reardon relied on conversations with the relevant departmental officials.

The report found that residents pay about 50% of the city budget, business pay 46% and outsiders (tourism, hotel taxes, etc.) pay the remaining 4%. The caveat is that statutory incidence was assumed, in the absence of hard data on the extent to which businesses pass along their costs to their customers and employees.

These fractions were then compared across local competitor cities. Due to the unavailability of data from the other cities for many of the detailed revenue categories, they focused on three revenue sources which cities tend to rely on and for which the data were of good quality: property taxes, sales taxes, and business taxes. Residents in Los Angeles pay about 55% of these taxes, which is in line with the other cities. However, if this percentage is converted to dollars and compared to median household income, Los Angeles is the third highest. They also found that other cities rely more heavily on taxes and fees raised from outsiders.

The reports by the Milken Institute, UT Strategies, Arthur Andersen, and Landmark Partners included the following interim recommendations, outlined in more detail in their Interim Report (available from Rex Oliff):

Aggressively enforce nexus, which means catching the people who are doing business in Los Angeles and not paying their taxes, especially businesses located outside of city limits.

- Minimize the uncertainty of development fees.
- Shift more taxes to outsiders.
- Develop a new tax form.
- Upgrade the audit department.

The final part of the project is under way at the Milken Institute, whose economists are building a tax simulation model to model the potential revenue and employment effects of changes in the tax code. Data on the business and utility taxes businesses pay will be merged with data on their employment and wages. These will then be linked to an input- output model customized for Los Angeles, that tracks the multiplier effects of growth and decline among industries. The model will be used to examine the effects of such changes as simplifying the code or equalizing rates across categories, on both City revenue and on public and private employment. The tax model should be completed by July, when the Institute and its consortium partners will make recommendations to the City. The City will also be able to use the model to test tax scenarios of their own design.

Commissioner Jimenez asked if Dr. Reardon also researched benefits associated with taxes and fees. Dr. Reardon replied no, she only examined the amount of the tax or fee. Commissioner Jimenez stated that he thought this is an area that also must be addressed in the city and county.

Commissioner Petak stated that the taxes and fees listed in the interim report are an outgrowth of the impacts of Proposition 13 and essentially General Fund money.

Commissioner Padilla asked if Dr. Reardon examined how tax costs are passed on to the consumer. Dr. Reardon said she looked for that information and was unable to find it for Los Angeles City or any other large city.

Commissioner Seidner stated his concern that the study did not examine Los Angeles's data as it relates to that of competitor cities outside of California. Dr. Reardon stated that her study was focused on the cities surrounding Los Angeles, but another report produced by Landmark partners does look at additional competitor cities of Los Angeles.

Commissioner Ojeda-Kimbrough stated that the important factor of average education and how it relates to the business and jobs examined in the Milken Institute should have been explored. Chairman Abel stated he thought that was more a regional issue than a city issue, which was the focus of the Milken report.

Chairman Abel thanked Dr. Reardon for her presentation and invited her back to the Commission when the report is finalized.

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