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June 24, 2014

Via: Electronic Mail Only

Honorable Wade Harper
& Members of the City Council
City of Antioch
200 H Street
Antioch, CA 94509

Re: Antioch's Proposed Business License Tax for Residential Landlords

Dear Mayor Harper and Members of the City Council:

On behalf of the California Apartment Association ("CAA"), this office urges you to vote no on the proposed resolution to present voters with a measure to impose a business license tax on residential landlords ("Tax"), which is set for vote this evening. As set forth below, some of which was addressed before the issuance of last Wednesday's Staff Report, the proposed Tax runs afoul of the United States Constitution and should fail before the Council. While we recognize that we have sixty days to bring a reverse validation action pursuant to California Code of Civil Procedure Section 863 if you decide to approve the resolution, we are hopeful that such legal action will not be necessary and you will vote no this evening.

On June 18, 2014, the City Manager and City Attorney of Antioch issued a Staff Report to the City Council for Consideration at the Council Meeting of June 24, 2014 ("Staff Report"). The subject of the Staff Report was the Business License Tax Ballot Measure, which would place a measure on the November 2014 Ballot that levies an annual business license tax on only residential landlords in the City of Antioch, levying $250 per unit against residential rental property owners for single family home rentals and $150 per unit for multifamily buildings. The Staff Report also attempts to justify the tax on this isolated segment of the rental industry within the "Proposed Resolution of the City Council of the City of Antioch Calling for and Noticing a Municipal Election on November 4, 2014 to Present Voters a Measure to Update the Existing Business License Tax Ordinance to Include a Residential Landlord Business License Tax and to Confirm the Existing Business License Tax, with an Increase in the Minimum Tax" ("Proposed Resolution").

The Staff Report provides a summary of the Council's arguments for the "fairness" of the Tax. The Tax is argued to be fair on the grounds that "many landlords, especially landlords of single family dwellings, have not been paying any Business License Tax" and "the rental or leasing of residential real estate is a unique business; very different from retail or other commercial endeavors in terms of economic benefits to the property owner and to the City." The Staff Report then attempts to deflect the council from the unfairness of the Tax by stating that "residential landlords benefit financially from depreciation for tax purposes while they historically benefit from asset appreciation . . . which is not subject to the City's Business License Tax." The Staff Report then attempts to distinguish residential landlords from commercial landlords who are not subject to the proposed Tax by arguing that although there are similar benefits, commercial landlords "pay the business license tax based on gross receipts and their tenants pay various taxes to the City, including sales tax, business to business tax, and the existing Business License Tax."

The Proposed Resolution, based on the Staff Report, makes the following findings: (1) "some residential apartment landlords are assessed an annual business license tax based on their gross annual income and others were not assessed any;" (2) renting property is a business and those business owners "should pay a business license tax like other businesses . . . to fund municipal services to those businesses;" (3) "the majority of residential landlords do not pay a business license tax;" (4) residential landlords "benefit financially from tax advantages, including depreciation for tax purposes, while historically enjoying asset appreciation."

Even though the Staff Report and the Proposed Resolution claim the Tax is needed to be "fair," the arguments presented demonstrate the purpose is, and effect of the Tax will be, to unlawfully discriminate against interstate commerce in residential rental real estate. The Tax burdens residential landlords small and large, and affects the ability of developers to initiate new projects for the purpose of renting. The grounds for creating the separate structure are arbitrary and based on a false dichotomy between commercial and residential real estate markets. Further, the rates charged to residential landlords are not fairly apportioned because they are not based on actual use or are otherwise rationally related to the business occurring in the City. These deficiencies contravene the Commerce Clause of the U.S. Constitution and the Equal Protection Clauses of the Fourteenth Amendment to the U.S. Constitution and the California Constitution.

It is clear that the long-term effects of this tax are being ignored in order to obtain a short-term infusion into the City coffers, in violation of the constitutional rights of residential landlords. For the reasons set forth below, we urge you to vote no on the Proposed Resolution.

Arbitrary Basis

The differences between commercial and residential landlords cited in the Staff Report are illusory at best; merely red herrings in an effort to justify an unconstitutional ordinance. The

Staff Report claims that the economic benefits of the residential landlord to the City are different than those of a commercial landlord. This is simply not the case.

The Staff Report attempts to justify the Tax by claiming that a residential landlord benefits financially from "depreciation for tax purposes" while further benefiting from "asset appreciation;" as opposed to commercial landlords, who or which not only pay the current business license tax based on gross receipts, but their tenants also pay various taxes to the City. This claim, in and of itself, contradicts the Staff Report because in these respects residential and commercial landlords are **identical**. Residential landlords, just like commercial landlords, have been paying the business license tax on the **gross receipts** of their business, which means that it is paid prior to receiving any deduction for depreciation and well before there is any benefit from asset appreciation. The appreciation of real estate figures largely into the business model of both the residential landlord and the commercial landlord, making the attempted differentiation of the two that much more attenuated. Moreover, commercial landlords and the businesses that may occupy their properties also receive tax benefits for depreciation of their assets. For example, a construction business that is headquartered in the City will pay the business license tax, but every piece of equipment owned by that company will also have the tax "benefit" of depreciation over time.

In addition, depreciation is not the windfall the Staff Report seems to imply for either a commercial or a residential landlord. The purpose of depreciation is to counter-balance the costs of maintaining the asset being depreciated. Both commercial and residential landlords are placing substantial amounts into the City's economy by hiring local tradespeople to maintain their respective properties, a similar benefit to the City by both segments of the rental property industry.

Further, the "asset appreciation" noted by the Staff Report is not guaranteed, as evidenced by the most recent economic downturn. Even if there is an increase in asset appreciation; however, it will always result in a respective increase of property tax revenue to the City in the same manner as a commercial property.[1] The Staff Report claims that there is no landlord revenue lost when a property is transferred; however, this statement is rebuffed by Antioch Municipal Code Section 3-6.01, *et seq.* which provides for a Real Property Transfer Tax that is directly related to the value of the real property being transferred. Therefore, the City directly benefits from any asset appreciation that may occur upon transfer, making the claims that residential landlords are somehow not paying their fair share fall flat.

Finally, to make a claim that there is no economic value to the City based on the ownership and leasing of residential property is preposterous. The Staff Report states that commercial landlords provide "more support for City services than residential rental real estate." This implies the City does not believe that its citizenry offers value. The City is ignoring the fact that without its citizens, many of whom occupy residential rental units, there would be no one to

[1] Both commercial and residential properties are covered by Proposition 13's limitation on property tax increases.

pay the sales taxes, to work at the businesses, or otherwise give the businesses any gross receipts in the first place. Surely the City Council does not intend to pass a resolution that so easily dismisses the contribution of the one-third of the City's population who live in rental housing.

The foregoing demonstrates the arbitrariness of the Proposed Resolution and Tax and the complete lack of a rational basis for taxing one segment of the rental property industry differently from the other. For these reasons, under the legal doctrines outlined below, the Tax violates both the U.S. and California Constitutions and should fail before Council this evening.

Commerce Clause

The Tax violates the Commerce Clause of the United States Constitution because it is based on false statements, is not related to the actual business of being a residential landlord and harms the interstate market for residential rental housing.

As stated in our letter dated June 18, 2014, the burdens placed on the residential rental market by the Tax run afoul of the Commerce Clause of the United States Constitution. The U.S. Supreme Court "makes clear that **renting and otherwise using housing for commercial purposes implicates the federal commerce power**." Groome Resources Ltd., LLC v. Parish of Jefferson, 234 F.3d 192, 206 (5th Cir. 2000) (citing Jones v. U.S., 529 U.S. 848 (2000) and Russell v. U.S., 471 U.S. 858, 862 (1985)) (finding that a residential rental home is used in interstate or foreign commerce) (emphasis added); See also McLain v. Real Estate Bd. of New Orleans, Inc., 444 U.S. 232, 245 (1980).

A tax, license fee, or other regulation that impacts interstate commerce will not offend the Commerce Clause if it is "applied to an activity with a substantial nexus with the taxing State, **is fairly apportioned, does not discriminate against interstate commerce**, and is fairly related to services provided by the State." Commonwealth Edison Co. v. Montana, 453 U.S. 609, 617 (1981) (citing Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (emphasis added)). "[W]hen the measure of a tax bears no relationship to the taxpayers' presence or activities in a [locality], a court may properly conclude . . . that the [locality] is imposing an undue burden on interstate commerce." Id. at 629. A tax is only proper when it relates the tax liability to the value of the activities within the locality. See id. "By itself, generation of revenue is not a local interest that can justify discrimination against interstate commerce." C & A Carbone, Inc. v. Town of Clarkstown, N.Y., 511 U.S. 383, 393 (1994). The types of tax apportionment approved by courts are generally a percentage of the value of the good or service used or sold within the State or locality. See e.g., Goldberg v. Sweet, 488 U.S. 252, 264 & n.14 (1989) (describing proper taxes).

As mentioned in our June 18, 2014, letter, which was sent just before the Staff Report was issued, since the United States Supreme Court has clearly stated that providing rental housing is participating in interstate commerce, the Tax must comply with the Commerce

Clause. The contents of the Staff Report strengthen our arguments that the Proposed Resolution violates the U.S. Constitution.

In the Staff Report and its attachments, the City has provided multiple iterations of proposals for charging the Tax on a per-unit basis. Not one of these proposals is linked to the amount of income acquired by a residential landlord or by the apportioned cost of services used by residential properties. Unlike Commonwealth Edison, where a tax on coal mined in a state was proportionate to the value of that coal, the Tax being considered by the City is not rationally related to the value of services provided or to the amount of money earned by the property owner renting the residence. 453 U.S. at 629. A flat fee ignores the variances in the value provided by landlords. For example, under the current proposal a fourplex that contained four studio apartments would have the same tax burden as a property that contained four three-bedroom townhouses and a pool, even though the services that each would require are substantially different and the income received by the landlord for each is substantially different.

The current business tax valuation easily meets Constitutional requirements because of the clear relation between the services and the tax, but the City's Proposed Resolution does not. Unlike the claims in the Staff Report that the purpose is to fairly apportion the business license tax burden on residential landlords, the City has not shown that commercial property owners do not receive the same benefits of owning property as residential owners, nor has it shown that those benefits are outweighed by business license taxes charged to the tenants of these commercial properties. The only "evidence" provided in support of the argument that residential landlords do not provide economic benefit to the City is purely anecdotal and has the sole purpose of portraying residential landlords as avoiding their fair share of taxes even though they currently pay a percentage of the value of the services offered like every other business owner.

The Proposed Resolution attempts to paint the Tax as fixing an exemption for certain residential landlords, but the Tax instead discriminates against one type of interstate commerce, residential rentals. There is no express exemption in the City's Municipal Code for residential landlords, nor are there any findings that all commercial landlords pay the proper amount of business tax that would necessitate a tax specifically applied to residential landlords. All of the reasons provided in the Staff Report and its attachments and the reasons outlined in the Proposed Resolution are merely a smokescreen to cover the discriminatory purpose of the Tax. The City's failure to enforce its currently valid business license tax does not provide a basis for enacting a discriminatory ordinance.

The Tax is facially discriminatory against residential landlords, allowing for sales of residential and commercial property and rental of commercial properties to remain taxed at a rational rate based on actual value, but rental of residential property to be taxed on a per unit basis with no such corresponding burden on commercial property. As stated herein both above and below, there is no rational basis for the apportionment of the Tax which bears no relationship to the taxpayers' activities in the City. Further, the Tax has a discriminatory effect by placing an

additional burden on developers who may desire to create further residential rental properties, which burden would not exist for those who may develop commercial properties or residential properties for sale. Developers may have more difficulty obtaining loans because of the Tax and will be discouraged from creating more housing in the City. In short, the Tax would have the effect of disturbing the market for residential rental properties in the City and the State of California.

Because the Tax is not fairly apportioned and discriminates against interstate commerce in the rental housing industry, it is invalid under the Commerce Clause of the U.S. Constitution and you must vote no on the Proposed Resolution.

Equal Protection

The Tax violates the Equal Protection clauses of the Fourteenth Amendment of the United States Constitution and the California Constitution because it treats two segments of the real estate rental industry as though they were in separate industries, even though they are not.

The Tax discriminates between two similarly situated classes on an arbitrary basis. It is a violation of the Fourteenth Amendment of the U.S. Constitution and Article 1, Section 7 of the California Constitution to treat differently those who are similarly situated with respect to the legitimate purpose of a law. City of Cleburne, Texas v. Cleburne Living Center, 473 U.S. 432, 439 (1985); College Area Renters & Landlord Assn. v. City of San Diego, 43 Cal. App. 4th 677, 686 (1996) (College Renters). A statute cannot discriminate against similarly situated persons unless it bears a rational relationship to a legitimate governmental purpose. College Renters, 43 Cal. App. 4th at 686. An ordinance "may not rely on a classification whose relationship to an asserted goal is so attenuated as to render the distinction arbitrary or irrational." Id.

The proposed ordinance implementing the Tax is similar to the one overturned in College Renters. In that case, the City of San Diego enacted an ordinance to control overcrowding of neighborhoods by regulating the number of occupants of rental housing, but not of owner-occupied housing. College Renters, 43 Cal. App. 4th at 681. San Diego's basis for enacting the ordinance was a scientific survey of a random sample of residents who lived in residential neighborhoods. Id. The Court ultimately held that the ordinance violated equal protection precedent because within San Diego's goal of controlling overpopulation, owners and renters (no matter the length of the renter's tenancy) were similarly situated, even assuming the survey provided evidence that renters were the cause of a majority of overcrowding. Id. at 687. Here, the goal is to obtain income for the general fund through a business license tax. Unlike San Diego, the City does not even have a survey on which to base its claims that residential landlords are not paying their "fair share" of the business license tax. Further, the Court's finding was that even if there was proof of a difference between owners and renters and their impact on over-crowding, that was not enough to support treating the similarly situated citizens differently. Such is also the case here. All landlords provide land and improvements for others to use with

the understanding that those improvements and land will be maintained by the landlord. It does not matter whether the rented purpose is commercial or residential, as such you cannot treat the industry segments differently without violating the United States and California Constitutions.

The Proposed Resolution also parallels the situation presented by Elysium Institute, Inc. v. County of Los Angeles, 232 Cal. App. 3d 408, 429-30. In that case, a nudist colony sued the County of Los Angeles for refusing to issue a special use permit to continue operating the colony based on an ordinance that classified nudist camps to a different zoning classification than other recreational clubs. Id. at 421. The Court held that a nudist colony was a similar use of land to any other recreational club, campground, or monastery in terms of the number of people using the area, services required, overnight use, and parking concerns. Id. at 431. As such, the County's conduct was unconstitutional. Here, the City has a business license tax ordinance in place. The City claims that the business license tax does not assure that residential landlords pay it; however, this system seems to function without trouble to tax a variety of businesses that range from restaurants and retail to commercial, industrial, and residential landlords. Like the County in Elysium, the Staff Report attempts to create differences where none exist. The Staff Report concedes residential landlords have been paying the business license tax. It just claims that an undisclosed proportion of residential landlords, who most likely represent only a minority of residential units in the City, do not pay the current business license tax.[2] While we have not been retained to investigate the accuracy of the statement that landlords of single family dwellings have not been paying any business license tax, or whether or not they are required to pay such tax under the current business license ordinance, if there is an issue with non-compliance, the solution is not to enact an unconstitutional ordinance.

For the foregoing reasons, on behalf of the California Apartment Association, we urge you to seek other methods of raising funds for the municipality that are not arbitrary and discriminatory. If you would like to discuss the matter further, please feel free to contact the undersigned or Joshua Howard, CAA's Senior Vice President of Local Government Affairs.

Sincerely,

PAHL & McCAY
A Professional Corporation

Karen K. McCay

Karen K. McCay

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cc: CAA
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[2] The Staff Report states that "many," "some," and a "majority" of residential landlords are not properly paying the current business license tax, a contradiction that further proves there is no real basis for the claims made.