



AGENDA REPORT

City Attorney's Office

DATE:	July 2, 2024
TO:	Mayor Martinez and Members of the City Council
FROM:	Dave Aleshire, City Attorney
SUBJECT:	Approval of Settlement Agreement
FINANCIAL IMPACT:	The City Council authorized the City Attorney to negotiate an agreement to create a new Class for automotive businesses to reduce taxes for such businesses by some \$500,000.
PREVIOUS COUNCIL ACTION:	None
STATEMENT OF THE ISSUE:	Under Measure U, auto dealers are included in Category Class C with manufacturing. Hilltop Group have paid taxes under protest but sued the City on October 11, 2023 claiming such tax was confiscatory and unconstitutional. The parties have negotiated to establish a new category for automobile dealers reducing their tax level and which would be enacted by amendment to Measure U adding a new Class Q
RECOMMENDED ACTION:	APPROVE settlement agreement and AUTHORIZE staff to proceed with Ordinance amending Measure U to create Class Q for automobile dealers - City Attorney's Office (Dave Aleshire 510-620-6509).

I. INTRODUCTION

On August 5, 2020, the Richmond City Council held a special meeting and adopted Resolution No. 90-20 to place a gross receipts business license tax before City voters in the November 3, 2020 general election, known as “Measure U.” Measure U proposed to repeal and replace Chapter 7.04 of the Richmond Municipal Code to implement a gross receipts or revenue-based tax on businesses operating within the City. Measure U

differentiated businesses into different classes for the purpose of establishing gross receipts and other tax rates on each business class. Plaintiffs' dealerships were classified as "Automobile Sales, Manufacturing" under "Class C." Voters approved Measure U at the City's general election on November 3, 2020.

Plaintiffs in this litigation are comprised of six automobile retail dealers (collectively, "Hilltop")¹ that operate retail and wholesale automobile dealerships within the City of Richmond. Hilltop has brought suit against the City challenging the City's imposition of business license taxes authorized by the passage of Measure U in November 2020.

In June 2022, Plaintiffs acting through their legal counsel submitted a letter to the City Manager contending that Measure U business license tax on the basis that Measure U, as applied to automobile dealerships, was oppressive, burdensome, confiscatory, and discriminatory, in violation of the Fourteenth Amendment (Equal Protection), Fifth Amendment (Takings) and Commerce Clause of the United States Constitution. On October 11, 2022, Plaintiffs filed a complaint (the "Complaint") against the City in Superior Court of Contra Costa County, California (Case No. C22-02188) challenging the constitutionality of Measure U. The allegations and claims set forth in the Complaint are referred to in this Agreement as the "Action."

II. SUMMARY OF CONCLUSION AND RECOMMENDATION

Generally, challenging the constitutionality of a public agency's taxing framework carries a high burden. Given the City's investigations, City felt the claims were defensible. However, because the alleged violations are Constitutional in nature, if Hilltop was to prevail on one or more of them, it will likely be awarded its attorney's fees. The Hilltop dealers in addition to Measure U taxes, pay significant sales and other assessments to City and have the option to relocate their businesses. The City decided a negotiated outcome was best and also wanted to deal with the whole category of auto dealers.

The City first offered to integrate the "Class C- Auto Dealership/ Manufacturing" into "Class A -Retail Sales." Staff prepared numerous scenarios for the City Council to consider and mediation took place on February 24, 2023. These efforts ultimately lead to the current Settlement Agreement.

The Settlement Agreement provides:

1. The creation of Class Q for Automobile Dealerships;
2. A table ranging from \$1 per \$1,000 of gross receipts for gross receipts below \$1,000,000 to \$2.20 per \$1,000 of gross receipts of \$50M;

¹ The six named plaintiffs are DKD of Hilltop, Inc. dba Hanlees Hilltop Buick GMC; Hanlees Hilltop Inc. dba Hanlees Hilltop Toyota; Leehan, Inc. dba Hanlees Hilltop Nissan; Hanlees Seven, Inc. dba Hanlees Hilltop Hyundai; Michael C. Stead Inc. dba Hilltop Ford/Kia; Michael Stead's Auto Depot Inc. dba Hilltop Chrysler Jeep Dodge.

3. The new rates apply in the future, but the Dealers will receive a credit for the surplus paid in one year, annotated over three years (FY 25, 26, 27).

III. RELEVANT BACKGROUND AND ALLEGATIONS IN HILLTOP'S COMPLAINT

On or around October 11, 2022, Hilltop commenced suit against the City for alleged constitutional violations of the Commerce Clause, Equal Protection Clause, and Taking Clause in Contra Costa County Superior Court, disputing Measure U.

For many years, nearly all businesses operating within the City, including Plaintiffs, paid a business tax at a flat rate to the City. In or around 2020, the City Council of the City desired to repeal and replace the existing tax rate system with a new business tax structure based on the gross receipts the business generates within the City, calculated as the total amount of money received in connection with all sales and services. The staff presentation to the City Council on August 5, 2020 noted that the City Council's formal motion and direction to City staff was to develop a gross-receipts tax structure "based on the Berkeley model, tailored to the economics of the City of Richmond." (Comp., ¶ 19.)

On December 17, 2019, the Mayor brought an item to the City Council, directing the City Manager to explore potential revenue enhancement and cost-recovery measures, based on the City's structurally unbalanced budget. The City partnered with Lift Up Richmond² to explore the feasibility of placing measures on the November 2020 ballot that would increase revenue.

In March 2020, the City Council considered an initial draft of Measure U, which was based on Oakland's ordinance that would also be on the November 2020 ballot. On July 28, 2020, the City Council declared a fiscal emergency due to the City's longstanding structural budget imbalance and the financial impacts of the Coronavirus (COVID-19) Pandemic. Measure U was presented to the Council again on July 28, 2020 which proposed that small businesses, any business generating less than \$250,000 in sales, would only have to pay \$100. Different rates were applicable to different business categories. Within the business categories, the rates were structured on a progressive basis, meaning that the higher the dollars in gross receipts, the higher the tax rate. Again, Measure U provided the City Council with flexibility to: (1) defer implementation, (2) reduce the rates after adoption, and (3) add exemptions.

On August 5, 2020, the City Council adopted a resolution submitting to the voters at the November 3, 2020 General Municipal Election, A Measure to Adopt an Ordinance Repealing and Replacing Richmond Municipal Code 7.04 to Create a Gross Receipts Business Tax Structure. The approved measure read as follows:

"To maintain the quality of life in Richmond by providing essential City services, including 911 emergency response, pothole/street repair, homeless and youth services and other general services, shall an ordinance amending the City business tax structure to use a range from 0.06% to 5.00%, charging the highest

² The Lift Up Richmond coalition consists of SEIU Local 1021, Richmond Police Officers Association (RPOA), IAFF Local 188, IFPTE Local 21, RYSE, Alliance of Californians for Community Empowerment (ACCE), Asian Pacific Environmental Network (APEN), and many more community and labor advocates.

rates on cannabis businesses and those with high gross revenue and the lowest rates for small businesses, providing approximately \$6.2 million annually until ended by voters, be adopted?”

Measure U was approved and passed by voters on November 3, 2020.

Measure U went into effect on January 1, 2022.

IV. Status Of Litigation.

After Hilltop filed suit in October 2022, the parties engaged in early resolution efforts under Contra Costa County Superior Court’s Early ADR Program – which requires a mediation or other settlement conference to be completed within 90 days. The City was prepared to file a Demurrer (i.e. motion to dismiss) to the Takings cause of action and initiated a meet and confer with Hilltop’s counsel. During the course of the discussions, Hilltop and the City agreed to stay the City’s Demurrer filing until mediation was completed. Thereafter the parties engaged in mediation on February 24, 2023 and settlement negotiations. There was an underlying suggestion that Hilltop might relocate its business to another jurisdiction. Moreover, the City Council felt any workout should create a Class, Q, which would apply to all auto dealers in the City.

As the basis for negotiations, the City requested an independent 3rd Party study of the economic claims of the Hilltop Group. This study by JS Held verified many of the claims in terms of industry profitability. Further, negotiations were based on the study.

V. SETTLEMENT SCENARIOS AND RECOMMENDATION

The Settlement Agreement contains the following provisions:

“Class Q — Automobile Dealerships.

Persons engaged in class Q business activities shall pay a business tax as follows:

If annual gross receipts are:	Then the business tax is:
Not over \$1,000,000.00	\$1.00 per \$1,000.00 of annual gross receipts
Over \$1,000,000.00 but not over \$2,500,000.00	\$1,000.00 plus \$1.30 per \$1,000.00 of annual gross receipts over \$1,000,000.00
Over \$2,500,000.00 but not over \$25,000,000.00	\$2,950.00, plus \$1.60 per \$1,000.00 of annual gross receipts over \$2,500,000.00
Over \$25,000,000.00 but not over \$50,000,000.00	\$38,950.00, plus \$1.90 per \$1,000.00 of annual gross receipts over \$25,000,000.00
Over \$50,000,000.00	\$86,450.00, plus \$2.20 per \$1,000.00 of annual gross receipts over \$50,000,000.00

Reconciling Prior Tax Years. City acknowledges that since the enactment of Measure U, Plaintiffs, under protest, have timely paid all taxes due to the City under Measure U except as noted in Subsection D below. The City agrees that each of the

Plaintiffs shall receive credit against Measure U taxes for gross receipts generated in 2024, 2025, and, 2026, which tax shall become due in 2025, 2026, and 2027, as follows:

- A. The amount of each Plaintiff's reimbursement credit shall be calculated by taking the total positive difference between the amount of Measure U business tax each Plaintiff dealership paid under protest in 2023 based upon gross receipts generated in 2022, and subtracting the amount of tax that would have been due in 2023 based upon gross receipts generated in 2022 if the Class Q tax rates had been in effect at the time (the "Total Reimbursement Credit"). For example, if a Plaintiff paid \$200,000 pursuant to Measure U – Class C in 2023, but the amount that would have been due 2023 for that Plaintiff under Measure U – Class Q would have been \$170,000, then the amount of the Total Reimbursement Credit would be \$30,000.
- B. The Total Reimbursement Credit shall be divided by 3 to arrive at the "Annual Reimbursement Credit."
- C. For Measure U taxes based upon gross receipts generated in 2024, 2025, and, 2026 to become due in 2025, 2026, and 2027, each Plaintiff shall be entitled to calculate and to deduct its Annual Reimbursement Credit from the amount due to be paid to the City, and City shall accept such reduced amount as payment in full of such Plaintiff's Measure U tax for that year. Thus, for Plaintiffs' business tax payments to become due on April 1, 2025, 2026, and 2027, the amount due shall be reduced by the amount of each Plaintiff's Annual Reimbursement Credit.
- D. Notwithstanding the formula expressed above, certain of the Plaintiffs did not timely pay their Measure U tax in 2024 for 2023 and are subject to a penalty under Measure U for late payment of approximately \$50,000 (the "Penalty Amount") which shall be the actual amount. That penalty shall be collected against those Plaintiffs by reducing the Annual Reimbursement Credit by the Penalty Amount amortized over the three years the Annual Reimbursement Credit is applicable.

Payments in Lieu of Class Q Business License Tax Rate. If for any reason or no reason at all, the City fails to enact the new Class Q business license tax set forth in Section 1 above, then for each payment of Measure U tax by any Plaintiff, the City agrees to refund within 30 days the amount by which the amount paid exceeds the amount that would have been due under the Measure U – Class Q business license tax rates set forth in Section 1 above if the Class Q business license tax rates set forth in Section 1 had been adopted and were in effect for such tax year.