



**TOWN OF LOS GATOS
COUNCIL AGENDA REPORT**

MEETING DATE: 09/16/2025

ITEM NO: 12

DATE: September 11, 2025
TO: Mayor and Town Council
FROM: Chris Constantin, Town Manager
SUBJECT: **Authorize the Town Manager to Execute a Fourth Amendment with HdL Companies for Business License Discovery and Compliance Audit Services, Sales and Use Tax Management and Audit Services, and Transient Occupancy Tax (TOT) Audit Services with a Total Contract Not to Exceed of \$451,500 plus CPI; and Approve a Resolution Granting a Waiver of Business License Late Fee Penalties for Businesses Undergoing the Business License Discovery and Compliance Audit Process.**

RECOMMENDATION: Authorize the Town Manager to execute a Fourth Amendment with HdL Companies for Business License Discovery and Compliance Audit Services, Sales and Use Tax Management and Audit Services, and Transient Occupancy Tax (TOT) Audit Services with a Total Contract Not to Exceed of \$451,500 plus CPI; and approve a resolution granting a waiver of Business License late fee penalties for businesses undergoing the Business License Discovery and Compliance Audit process.

FISCAL IMPACT:

There are sufficient funds in the Fiscal Year (FY) 2025-26 adopted budget to cover the cost of this fourth amendment, which increases the not to exceed amount by \$178,500 plus CPI to continue existing business license processing services and add Transient Occupancy Tax (TOT) Audit and Sales and Use Tax management services. The amendment also includes a Sales and Use Tax Audit, a Business License Discovery and Compliance Audit, and Business License Tax collection for already licensed delinquent accounts. These services will not be included in the not-to-exceed amount since they are determined as a percentage of the recovered revenue. The FY 2025-26 adopted budget already includes \$50,000 to account for additional Business

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Finance Director

Reviewed by: Town Manager, Assistant Town Manager, Town Attorney, and Finance Director

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License Tax revenue. Staff will monitor the recovered Sales Tax and Business License revenue and return to the Council if a budget adjustment is needed.

STRATEGIC PRIORITY:

The audit services through HdL for Business License, Sale and Use Tax, and TOT supports the strategic priority of *“leveraging the Town’s assets, efficiencies, partnerships, and revenue streams.”*

BACKGROUND:

The Town requires all businesses located within Los Gatos and/or those that operate within Los Gatos to obtain a business license.

In November 2022, Los Gatos voters approved Measure J, which modernized the Town’s business license tax program. This was the first update to the program since 1991 and included adjustments to flat rate fees, retailing gross receipts, e-commerce, manufacturing, wholesaling, and jobbing gross receipts. HdL Companies (HdL) assisted the Town with the business license modernization process (Attachment 5).

Once those services were completed, the Town executed a first amendment to the original agreement for business license tax and fee administration services until December 31, 2023 (Attachment 4). With the second amendment, the Town continued its partnership with HdL through December 31, 2025, to provide dedicated business license support to Los Gatos businesses.

Through this partnership, the Town’s business license application and renewal process has been streamlined by offering online business license applications and renewals. HdL is assisting with a variety of business license related tasks, including new applications, annual renewals, payments, compliance inquiries, and other general support. Staff is continuously monitoring and fine-tuning the business license application and renewal process to improve the customer experience. The current agreement does not include business license delinquency and compliance audits.

During the 2024 business license renewal cycle, one significant business license tax generated reached out to Town staff to memorialize the business license tax payment methodology in a draft written Agreed Upon Procedure. Staff engaged HdL to guide the process. HdL, outside legal counsel, and Town staff worked with this business license tax payer to verify the apportionment methodology. Staff originally increased the agreement (Amendment 3) for these services by \$40,000. However, since the scope of the work performed by HdL has

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decreased, staff is requesting a decrease of \$20,000, which is reflected in the Fourth Amendment.

Annual renewal payments are due on January 2 of each year. According to the Town Code Section 14.10.075, a 25% late fee penalty is assessed monthly, up to 100% on unpaid balances. From March 2020 until December 31, 2023, the Town Council took proactive steps to support and adapt to the needs of the community's businesses during the COVID-19 pandemic. One of the steps taken to support businesses during the pandemic emergency proclamation was the suspension of late fee penalties. The Town Council extended the late fee penalty waiver into 2023 to provide adequate time for businesses to adjust to the new process and fee structure. The Council discontinued the late fee penalty waiver in 2024, which enabled the Town to resume the enforcement of business license compliance.

DISCUSSION:

With the FY 2025-26 adopted budget, the Town Council directed staff to conduct business license and TOT audits to ensure compliance and recovery of all the appropriate taxes. Staff recommends engaging HdL to perform these additional services. HdL is uniquely positioned to provide these services efficiently due to its existing role in administering the Town's business license program. Including the TOT audit as part of their scope of service, supports standardization, promotes efficiency, and results in overall cost savings.

With the Fourth Amendment, staff is requesting the following:

- Extend the Agreement Term from 12/31/2025 until 6/30/2027
- Continue the business license administration services
- Add the following Services:
 - Business License Tax Discovery and Compliance Audits
 - Business License Tax Collection
 - TOT Audits
 - Sales and Use Tax Audit Services
 - Sales and Use Tax Management Services

The table below illustrates the agreement authority change based on the remaining term. The Fourth Amendment, Items 5, 6, and 7, are not included in the not-to-exceed amount since they are determined as a percentage of the recovered revenue. Staff will periodically report to Council on the audit efforts and the estimated additional revenue collected.

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Agreement/Amendments	Services	Term	Compensation
Original Agreement	Business License Tax Ordinance	05/22/2022 - 01/31/2023	\$ 20,000.00
1st Amendment	Business License Managment Services	09/30/2022 - 12/31/2023	\$ 73,000.00
2nd Amendment	Business License Managment Services	12/19/2023 - 12/31/2025	\$ 140,000.00
3rd Amendment	Additional Services - Agreed Upon Agreement Drafting	12/19/2023 - 12/31/2025	\$ 40,000.00
4th Amendment - 1	Reducing compensation for additional services (3rd Amendment)	12/19/2023 - 12/31/2025	\$ (20,000.00)
4th Amendment - 2	Extending Business License Processing Services	12/19/2023 - 06/30/2027	\$ 160,000.00 +CPI
4th Amendment - 3	Sales and Use Tax Management Services	09/16/2025 - 06/30/2027	\$ 13,500.00 +CPI
4th Amendment - 4	TOT Audit	09/16/2025 - 06/30/2027	\$ 25,000.00 +CPI
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			\$ 451,500.00 +CPI
4th Amendment - 5	Sales and Use Tax Audit Services	09/16/2025 - 06/30/2027	15% of One-time revenue collected
4th Amendment - 6	Business License Tax Discovery /Compliance Audits	09/16/2025 - 06/30/2027	35% of One-time revenue collected
4th Amendment - 7	Business License Tax Collections	09/16/2025 - 06/30/2027	25% of One-time revenue collected

Business License Discovery and Compliance Audit Program

The purpose of the Audit is to:

- Ensure equitable enforcement of the Town's business license ordinance.
- Identify unlicensed or underreported businesses.
- Improve the accuracy of business license data.
- Educate the business community on compliance requirements.
- Enhance General Fund revenue through fair and consistent application of the Municipal Code.

Amnesty Program:

To help business achieve compliance, staff recommends that the Town develop an amnesty program where penalty fees are waived if the full amount of back taxes owed over the last three years are paid within 90 days of notification. It is considered best practice to allow each business 90 days to achieve compliance without penalties. This approach provides flexibility for the community and the Town. HdL will notify businesses using multiple communications such as phone, email, and mail. Each business will receive at least a monthly follow-up by one or more of these communication mediums. HdL will attempt to rectify any delinquent accounts in the Town and reach out to any unlicensed business on a regular basis. The first part of the process, characterized as the "working phase," during which HdL is actively sending out notices and receiving heavy responses, may last approximately two years. Then, HdL will enter the "maintenance phase," striving to maintain a healthy level of compliance and activity. HdL has successfully assisted nearby cities with similar programs, including East Palo Alto, San Mateo, Benecia, and Gilroy.

To proceed with such a program, staff recommends that Council approve a resolution to waive late fee penalties during the first phase of the audit, allowing each business 90 days to achieve compliance from the start of identifying the business as non-compliant.

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Potential Concerns:

The Town anticipates several potential concerns from the business community regarding business license enforcement and audits, as HdL preliminarily estimates potentially 1,000 businesses may be contacted through this process. These include a lack of awareness about licensing requirements, frustration over retroactive billing or potential penalties, and disputes about revenue reporting or business classification. Many businesses may also express frustration over the administrative burden, citing time constraints and paperwork as barriers to compliance.

As the Town of Los Gatos implements its Audit Programs, several business types may raise questions or concerns due to past enforcement practices or perceived exemptions. Some common business types are described as follows.

- Commercial rental properties are fully taxable under the Town's business license code, despite historical gaps in enforcement, and should be treated as such to ensure consistency and fairness.
- Home-based businesses, while often small in scale, are also subject to taxation unless they qualify for exemptions based on gross receipts, as outlined in the Town Code Section 14.10.030.
- Lastly, transient businesses that operate in a temporary location in the Town, do not have a permanent physical presence, or do business for a short period of time, are required to obtain a business license and comply with the local tax ordinance, even if their operations are brief. The goal is to ensure fairness and regulatory compliance among all businesses, whether permanent or temporary.

To address these concerns and promote voluntary compliance, the Town recommends a series of mitigation strategies. These include providing information on the Town's website, reaching out to the Chamber of Commerce, and providing personalized support through HdL to improve awareness. The 90-day amnesty program will help ease financial strain by waiving penalties for timely payment. Staff will begin the outreach effort after the Council authorizes the start of the audit process.

Business License is not Authorization to Operate:

Issuance of a business license does not constitute land use approval or legal authorization to operate. The Town of Los Gatos business license tax is a revenue measure and is not regulatory in nature. It is intended solely to generate revenue for municipal services and does not imply that a business is in compliance with zoning, building, or other applicable regulations. All businesses are responsible for ensuring they meet the Town's planning, zoning, and permitting requirements before commencing operations. Possession of a business license does not exempt a business from enforcement actions if it is found to be operating in violation of Town codes.

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Town is taking a balanced approach with businesses to encourage compliance

When businesses are identified as operating without a business license during the discovery process, HdL will work with them within a 90-day period to ensure compliance with past business license taxes. After the business license taxes are paid, the Town will also validate the use and the zoning requirements. If the Town identifies that the business is operating without proper planning approvals or in violation of zoning regulations, the business owner will be notified through the HdL business license portal, clearly outlining the specific planning or zoning requirements that are not being met. This communication will include guidance on how to bring the business into compliance, such as applying for the appropriate permits, modifying operations, or relocating if necessary. At that time, the businesses also have to pay all applicable planning fees. The Town will also offer access to planning staff or resources to help the business understand the process and requirements. In cases where the business is unaware of the violation, education and support can go a long way in fostering cooperation. However, if a business is unwilling to comply after being given a reasonable time and assistance, the Town may need to pursue enforcement actions in accordance with the municipal code. Throughout the process, maintaining transparency, fairness, and open communication will help ensure that planning regulations are upheld while minimizing disruption to the business community.

Transient Occupancy Tax (TOT) Audit Program

Staff is proposing to start its Transient Occupancy Tax (TOT) Audit Program in collaboration with HdL Companies to ensure that all lodging providers are accurately reporting and remitting TOT in accordance with local regulations. This initiative is designed not only to enforce compliance but also to educate businesses, promote fairness, and recover any underreported revenues through a transparent and supportive process.

At the heart of the program is a commitment to fairness and education. HdL will begin by reviewing the Town's existing TOT ordinance and administrative procedures to identify areas for improvement. This may include updating filing forms, clarifying ordinance language, and adopting best practices to enhance enforcement and ease of compliance. Following this, HdL will conduct a detailed analysis of the past 36 months of TOT filings, cross-referencing reported data with operational indicators such as room counts and occupancy rates to identify any discrepancies or anomalies.

Based on this analysis, HdL will present a report to the Town recommending specific lodging providers for audit, using risk-based criteria. Once the Town approves the audit list, selected providers will be notified and given clear instructions, access to support resources, and flexible scheduling options. The audits themselves will involve a thorough review of financial records, including gross receipts, exemptions, and bank statements, to verify compliance.

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After the audits are completed, HdL will prepare a comprehensive Compliance Report for the Town, outlining findings and recommended actions. Lodging providers found to be non-compliant will receive detailed deficiency notices and instructions for payment or appeal, while those in full compliance will be recognized with commendation letters. HdL will also assist the Town in issuing invoices and managing collections for any underreported taxes.

CONCLUSION:

Staff recommends that the Town Council authorize the Town Manager to execute the Fourth Amendment with HdL, and approve a resolution waiving business license late fee penalties for businesses undergoing the business license discovery and compliance audit process, with the approval of both items initiating proposed audit efforts.

ENVIRONMENTAL ASSESSMENT:

This is not a project defined under CEQA, and no further action is required.

Attachments:

1. Fourth Amendment with HdL Companies
2. Third Amendment with HdL Companies
3. Second Amendment with HdL Companies
4. First Amendment with HdL Companies
5. Original Agreement with HdL Companies
6. Draft Resolution