File No. 120965

Committee Item No. 4
Board Item No. 2

COMMITTEE/BOARD OF SUPERVISORS

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Board of Supervisors Meeting **Date** November 20, 2012

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Completed by: Victor Young **Date** October 29, 2012
Completed by: Victor Young **Date** 11-2-12

Amendment of the Whole
in Committee. 11/1/12

FILE NO. 120965 ORDINANCE NO.

6

[Business and Tax Regulations Code - Prevent Termination of Payroll Expense Tax Exclusion for Small Business Net New Payroll if Voters Adopt Gross Receipts Tax]

Ordinance amending the San Francisco Business and Tax Regulations Code Article 12-A by amending section 906.5 to prevent the Payroll Expense Tax Exclusion for Small Business Net New Payroll for years 2012 through 2015 from terminating in the event the voters of the City and County of San Francisco pass a gross receipts tax.

NOTE: Additions are *single-underline italics Times New Roman*; deletions are ~~*strike-through italics Times New Roman*~~. Board amendment additions are double-underlined; Board amendment deletions are ~~strikethrough normal~~.

Be it ordained by the People of the City and County of San Francisco:

Section 1. The San Francisco Business and Tax Regulations Code is hereby amended by amending Section 906.5, to read as follows:

SEC. 906.5. NET NEW PAYROLL EXCLUSION.

(a) The purpose of this Section is to increase the number of jobs within the City and County of San Francisco by providing an incentive for Small Businesses to create new jobs or to relocate existing jobs to the City and County of San Francisco.

(b) Notwithstanding any other provisions of this Article, for purposes of this Section the following terms shall have the meaning set forth below:

(1) "Small Business" means a person whose Base Year Payroll Expense is between $1 and $500,000.

(2) "Base Year" means the 2011 tax year for a person who had Payroll Expense in 2011. If a person did not have Payroll Expense in the 2011 tax year, then the first year that the person incurs Payroll Expense shall be that person's Base Year. If a person is exempt

from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the ~~first year that the person incurs Payroll Expense~~Base Year, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion.

(3) "San Francisco Labor Law" means the Health Care Security Ordinance, codified at San Francisco Administrative Code Chapter 14; the Minimum Wage Ordinance, codified at San Francisco Administrative Code Chapter 12R; the Paid Sick Leave Ordinance, codified at San Francisco Administrative Code Chapter 12W; the Minimum Compensation Ordinance, codified at San Francisco Administrative Code Chapter 12P; the Health Care Accountability Ordinance, codified at San Francisco Administrative Code Chapter 12Q; and the prevailing wage requirements, codified at San Francisco Administrative Code Chapter 6.22.

(c) A Small Business may exclude from its Payroll Expense the lesser of $250,000 or the amount of Payroll Expense that is greater than its Base Year Payroll Expense for the 2012, 2013, 2014 and 2015 tax years; provided, however, that in no event shall this exclusion reduce a person's Payroll Expense Tax liability for ~~2012, 2013, 2014 or 2015 to less than the person's Base Year Payroll Expense Tax liability~~any year 2012, 2013, 2014, or 2015 to less than the following: the person's Base Year Payroll Expense Tax liability, multiplied by the Payroll Expense Tax rate in effect for the year being reported, divided by 1.5 percent.

(d) In order to be eligible for the Payroll Expense Tax exclusion authorized under this Section, persons wishing to claim the exclusion must:

(1) Maintain records and documents in a manner acceptable to the Tax Collector. Such records and documents must objectively substantiate any exclusion claimed under this Section and be provided to the Tax Collector upon request.

(2) Timely file with the Tax Collector an annual Payroll Expense Tax return claiming the exclusion provided for in this Section, regardless of the amount of tax liability

shown on the return after claiming the exclusion provided for in this Section. All returns shall be filed by the due date set forth in Article 6 of the San Francisco Business and Tax Regulations Code.

(3) If, after the timely filing of a person's Payroll Expense Tax return, it is determined that the person was delinquent in remitting any taxes, fees or penalties owed to the City and County of San Francisco at the time of filing, that person shall be ineligible to claim the exclusion under this Section for the period covered by the return.

(4) If, prior to or after the timely filing of a person's Payroll Expense Tax return, the San Francisco Office of Labor Standards Enforcement determines that a person violated a San Francisco Labor Law during the period covered by the return, or, in response to an investigation by the San Francisco Office of Labor Standards Enforcement, a person paid, or was required to pay, restitution to former or current employees during the period covered by the return, then such person shall be ineligible to claim the exclusion provided by this Section for the period covered by the return.

(e) A person may not use or claim any unused portion of the exclusion available under this Section after the expiration of this Section.

(f) The San Francisco Office of Labor Standards Enforcement shall, no later than the first of December of each year that the exclusion under this Section is in effect, provide to the Tax Collector a list of all persons it determined to have violated a San Francisco Labor Law, including the year the violation occurred.

(g) The Tax Collector shall verify that any exclusion claimed pursuant to this Section is appropriate.

(h) A misrepresentation or misstatement by any person regarding eligibility for the exclusion authorized under this Section that results in the underpayment or underreporting of the Payroll Expense Tax shall be subject to penalties and interest.

(i) The Office of the Treasurer and Tax Collector may adopt rules and regulations regarding the exclusion provided under this Section.

(j) The exclusion provided by this Section may not be claimed concurrently with any other Payroll Expense Tax exclusion.

(k) The Tax Collector shall submit an annual report to the Board of Supervisors for each year for which the exclusion authorized under this Section is available. The report shall set forth aggregate information on the dollar value of the exclusions taken each year and the number of persons claiming this exclusion.

(l) The exclusion set forth in this Section shall expire by operation of law on December 31, 2015, and the City Attorney shall cause it to be removed from future editions of the Business and Tax Regulations Code unless the Board of Supervisors or the voters extend the exclusion prior to December 31, 2015. ~~*Alternatively, should the voters of the City and County of San Francisco pass a gross receipts tax prior to December 31, 2015, the exclusion under this Section shall terminate upon the effective date of such gross receipts tax.*~~

(m) The exclusion provided for under this Section may be applied only in calculating a person's Payroll Expense Tax liability according to the Payroll Expense Tax rate in effect for each of the years the exclusion provided for under this Section applies. The preceding sentence applies notwithstanding whether the voters of the City and County of San Francisco pass any form of gross receipts tax.

(n) The Controller's Office of Economic Analysis shall issue a report to the Budget and Finance Committee of the Board of Supervisors at the end of the four-year term of the Net New Payroll Exclusion, assessing the effects of the Exclusion on incentivizing job creation and payroll growth among small businesses that applied for the Net New Payroll Exclusion.

Section 2. Effective Date. This ordinance shall become effective 30 days from the date of passage.

Section 3. This section is uncodified. In enacting this Ordinance, the Board intends to amend only those words, phrases, paragraphs, subsections, sections, articles, numbers, punctuation, charts, diagrams, or any other constituent part of the Business and Tax Regulations Code that are explicitly shown in this legislation as additions, deletions, Board amendment additions, and Board amendment deletions in accordance with the "Note" that appears under the official title of the legislation.

APPROVED AS TO FORM:
DENNIS J. HERRERA, City Attorney

By: _____
STEPHANIE PROFITT
Deputy City Attorney

LEGISLATIVE DIGEST

[Business and Tax Regulations Code – Prevent Termination of Payroll Expense Tax Exclusion for Small Business Net New Payroll if Voters Adopt Gross Receipts Tax]

Ordinance amending the San Francisco Business and Tax Regulations Code Article 12-A by amending Section 906.5 to prevent the Payroll Expense Tax Exclusion for Small Business Net New Payroll for years 2012 through 2015 from terminating in the event the voters of the City and County of San Francisco pass a gross receipts tax.

Existing Law

San Francisco imposes a Payroll Expense Tax on business entities based on the compensation they pay to employees and others for work or services performed in San Francisco. (Business and Tax Regulations Code Section 901 et seq.) This tax is determined each year based on the Payroll Expense of the entity.

In July 2012, the Board of Supervisors passed an ordinance establishing an exclusion for net new Payroll Expense incurred by a Small Business in years 2012 through 2015. Under the exclusion, a Small Business may exclude the lesser of $250,000 or the amount of Payroll Expense that is greater than the Small Business' Base Year Payroll Expense. The exclusion cannot reduce a person's Payroll Expense Tax liability to less than the person's Base Year Payroll Expense Tax liability. Persons delinquent in remitting any taxes, fees or penalties to the City, or who have violated labor laws are ineligible to claim the exclusion. The Net New Payroll Expense Tax exclusion is available for years 2012 through 2015, unless the voters pass a gross receipts tax prior to the end of 2012. Should that occur, this exclusion will terminate upon passage of the gross receipts tax.

Amendments to Current Law

The proposed amendment to the Payroll Expense Tax Exclusion for Small Business Net New Payroll prevents the exclusion from terminating if voters pass a gross receipts tax. As a result, the exclusion will remain in effect through 2015.

Background Information

The purpose of the Payroll Expense Tax Exclusion for Small Business Net New Payroll is to increase the number of jobs within the City and County of San Francisco by providing an incentive for Small Businesses to create new jobs or to relocate existing jobs to the City and County of San Francisco.

CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

1390 Market Street, Suite 1150, San Francisco, CA 94102 (415) 552-9292
FAX (415) 252-0461

October 25, 2012

TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst

SUBJECT: October 31, 2012 Budget and Finance Committee Meeting

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Item 4 File 12-0965	Department(s): Treasurer/Tax Collector

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed ordinance would amend Section 906.5 of the City's Business and Tax Regulations Code to prevent the Payroll Expense Tax Exclusion for Small Business Net New Payroll from terminating in the event the voters of the City and County of San Francisco approve a Gross Receipts Tax. The existing Small Business Net New Payroll Exclusion would terminate if the voters approve a Gross Receipts Tax. The intent of the proposed ordinance is to encourage small businesses to create new jobs in San Francisco or relocate existing jobs to San Francisco.

Key Points

- Businesses that have annual payroll expenses of more than $250,000 currently pay Payroll Expense Taxes to the City of 1.5 percent of total annual payroll expenses. On July 10, 2012, the Board of Supervisors approved an ordinance establishing the Payroll Expense Tax Exclusion for Small Business Net New Payroll, an Exclusion for net new payroll expenses up to $250,000 incurred by small businesses.
- Under the existing ordinance, the Small Business Net New Payroll Exclusion is available to eligible businesses in Tax Years 2012 through 2015[1] and the Exclusion will terminate if the voters approve a Gross Receipts Tax within 30 days after the passage of the Gross Receipts Tax. The proposed ordinance would amend the Small Business Net New Payroll Exclusion such that the Exclusion would no longer terminate if the voters approve a Gross Receipts Tax. Instead, the Exclusion would remain in effect for Tax Years 2012 through 2015 so long as the Payroll Expense Tax is in effect during that time.
- If the voters approve the Gross Receipts Tax under Proposition E, the City's Payroll Expense Tax would phase out from Tax Years 2014 to 2018. Therefore, the Small Business Net New Payroll Exclusion, if the proposed ordinance is approved, would be in effect during the phase-out of the Payroll Expense Tax in Tax Years 2014 and 2015.

Fiscal Impact

- Based on the current Payroll Expense Tax rate of 1.5 percent, the Controller's Office previously estimated reduced Payroll Expense Tax revenues of $2,000,000 annually resulting from the Net New Payroll Exclusion, or a total reduction in City revenues of approximately $8,000,000 over the four-year term of the Net New Payroll Exclusion. According to Mr. Ted Egan of the Controller's Office of Economic Analysis, if the voters approve Proposition E, which would phase out the Payroll Expense Tax from Tax Years 2014 to 2018, the estimated annual reduction in City revenues in Tax Years 2014 and 2015 would be less than the previously estimated $2,000,000 due to reductions in the Payroll Expense Tax rates in Tax Years 2014 and 2015, resulting in $1,800,000 in foregone revenues to the City in Tax Year 2014 based on a scheduled Payroll Expense Tax rate of 1.35 percent, and $1,500,000 in foregone revenues to the City in Tax Year 2015, based on an expected Payroll Expense Tax rate of 1.125 percent. Under the proposed ordinance, Payroll Expense Tax revenues to the City would be reduced by an estimated $7,300,000

[1] A "Tax Year" is a calendar year.

over the four-year term of the Net New Payroll Exclusion if the voters approve Proposition E, rather than the Controller's previous estimate of $8,000,000 over the four-year term of the Net New Payroll Exclusion.

Policy Considerations

- In defining "Base Year Payroll Expense," Article 12-A Section 906.5(b)(2) states: *"If a person is exempt from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the first year that the person incurs Payroll Expense, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion."* According to City Attorney's Office, the intent of this provision is to establish a minimum Base Year Payroll Expense of $150,000 for the purposes of calculating the Exclusion for businesses that have payroll expenses of less than $150,000 and therefore do not file Payroll Expense Tax returns.

  In order to clarify the intent of Section 906.5(b)(2), the proposed ordinance should be amended to state: *"If a person is exempt from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the Base Year, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion."*
- Given the estimated reduced Payroll Expense Tax revenues to the City of $7,300,000 over the four-year term of the Net New Payroll Exclusion, and given the City's interest in promoting job creation in San Francisco, the Budget and Legislative Analyst recommends that the proposed ordinance be amended to require the Controller's Office of Economic Analysis to issue a report to the Budget and Finance Committee of the Board of Supervisors at the end of four-year term of the Net New Payroll Exclusion, assessing the effects of the Exclusion on incentivizing job creation and payroll growth among small businesses that applied for the Net New Payroll Exclusion.

Recommendations

- Amend the proposed ordinance to state: *"If a person is exempt from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the Base Year, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion."*
- Amend the proposed ordinance to require the Controller's Office of Economic Analysis to issue a report to the Budget and Finance Committee of the Board of Supervisors at the end of four-year term of the Net New Payroll Exclusion, assessing the effects of the Exclusion on incentivizing job creation and payroll growth among small businesses that applied for the Net New Payroll Exclusion.
- Approval of the proposed ordinance, as amended, is a policy matter for the Board of Supervisors.

MANDATE STATEMENT / BACKGROUND

Mandate Statement

Charter Section 2.105 provides that all legislative acts in San Francisco be by ordinance, and be subject to approval by a majority of the Board of Supervisors.

Background

In accordance with the City's Business and Tax Regulations Code Section 902, every business entity, including sole proprietors with no employees, that conducts business in San Francisco must obtain a valid annual business registration certificate and pay business registration fees to the Office of the Treasurer and Tax Collector. In addition, the City's Business and Tax Regulations Code provides that (a) businesses that have annual payroll expenses of $150,000 or more are required to file annual Payroll Expense Tax statements with the Office of the Treasurer and Tax Collector, and (b) businesses that have over $250,000 in annual payroll expenses are subject to the City's Payroll Expense Tax, which is currently 1.5 percent of total annual payroll expenses. Under Business and Tax Regulations Code Section 905-A, San Francisco businesses with annual payroll expenses of $250,000 or less are exempt from paying the City's Payroll Expense Tax.

Business and Tax Regulations Code Section 902.1(a) specifically defines Payroll Expense as compensation paid to individuals including shareholders of a professional corporation or a Limited Liability Company (LLC), for salaries, wages, bonuses, commissions, property issued or transferred in exchange for the performance of services (including but not limited to stock options), compensation for services to owners of pass-through entities, and any other form of compensation, who during any Tax Year, perform work or render services, in whole or in part in the City. The City's FY 2012-13 Budget includes $454,305,800 in Business Registration and Payroll Expense Tax revenues.

According to Mr. Greg Kato, Policy and Legislative Manager in the Office of the Treasurer and Tax Collector, there are approximately 80,000 business entities with current business registration certificates in San Francisco, including sole proprietors and businesses that have no payroll expenses. Of the approximately 80,000 businesses currently registered with the City, 11,864 or 14.8 percent of all registered businesses submitted Payroll Expense Tax statements for Tax Year 2011 indicating annual payroll expenses of $150,000 or more, as shown in Table 1 below.

Table 1
Payroll Expense Tax Statement Filings for Tax Year 2011

Annual Payroll Expenses	Number of Businesses
$150,000 to $250,000	4,570
$250,001 to $500,000	2,314
Subtotal, Small Businesses	6,884
Greater than $500,000	4,980
Total	**11,864**

Source: Treasurer and Tax Collector

The Small Business Net New Payroll Exclusion

On July 10, 2012, the Board of Supervisors approved Ordinance No. 160-12 adding Section 906.5 to Article 12-A of the City's Business and Tax Regulations Code to establish a four-year Payroll Expense Tax Exclusion for net new payroll expenses up to $250,000 incurred by small businesses doing business in San Francisco. Section 906.5(b)(1) defines a "small business" as a

business with annual payroll expenses between $1 and $500,000 in the Base Year. The Base Year is 2011 for those businesses that had payroll expenses in 2011. For those businesses that did not have payroll expenses in 2011, the Base Year is the first year a business incurs payroll expenses. If the business is exempt from filing a Payroll Expense Tax return in the first year that the business incurs payroll expenses, the business' Base Year payroll expense is considered to be $150,000 for the purposes of calculating the Exclusion.

The Small Business Net New Payroll Exclusion provides that a small business may exclude (a) annual payroll expenses that are greater than the business' Base Year Payroll Expense, or (b) $250,000, whichever is less. Effectively, the maximum annual Exclusion is $250,000, and the Exclusion for each Tax Year is calculated using the Base Year Payroll Expense rather than the previous year's Payroll Expense. Based on the City's current Payroll Expense Tax rate of 1.5 percent of annual payroll expenses, the maximum annual savings to an eligible business is $3,750 (.015 x $250,000).

Under Section 906.5(l), the Small Business Net New Payroll Exclusion is available to eligible businesses in Tax Years 2012 through 2015 and the Exclusion will terminate if the voters approve a Gross Receipts Tax, on the effective date of the Gross Receipts Tax. Proposition E, which is on the City and County of San Francisco's ballot for the November 6, 2012 election, proposes to phase in a Gross Receipts Tax from Tax Years 2014 to 2018 and phase out the City's Payroll Expense Tax over the same period. Although the Gross Receipts Tax would begin to phase in in Tax Year 2014, it will be considered effective when the Board of Supervisors certifies the election, or within 30 days after the election. Therefore, under current law, if the voters approve Proposition E, the Small Business Net New Payroll Exclusion would terminate before it takes effect. The proposed ordinance would amend the Net New Payroll Exclusion to remain in effect through Tax Year 2015 so long as the City's Payroll Expense Tax is in effect.[2]

According to Section 906.5(a), the purpose of the Small Business Net New Payroll Exclusion is to provide small businesses with an incentive to create new jobs in San Francisco or relocate existing jobs to San Francisco.

DETAILS OF PROPOSED LEGISLATION

The proposed ordinance would amend the City's Business and Tax Regulations Code Article 12-A Section 906.5 to prevent the Small Business Net New Payroll Exclusion from terminating in the event the voters of the City and County of San Francisco approve a Gross Receipts Tax. Under the proposed ordinance, the Small Business Net New Payroll Exclusion would remain in effect for the full four-year term from Tax Year 2012 to Tax Year 2015 in the event that voters approve a Gross Receipts Tax. If the Board of Supervisors does not approve the proposed ordinance, the Net New Payroll Exclusion would terminate in the event that the voters approve a Gross Receipts Tax.

[2] As noted below, under Proposition E the Payroll Expense Tax would be phased out over a four-year period as the gross receipts tax is phased in.

The proposed ordinance specifies that the Small Business Net New Payroll Exclusion may be used only in calculating a business' Payroll Expense Tax liability and no other tax liability. Therefore, the Small Business Net New Payroll Exclusion would remain in effect for the full four-year term only so long as the Payroll Expense Tax is in effect. Under Proposition E, the Payroll Expense Tax is scheduled to phase out from Tax Years 2014 to 2018.

Proposition E, which is on the City and County of San Francisco's ballot for the November 6, 2012 election, proposes to phase in a Gross Receipts Tax and phase out the City's Payroll Expense Tax from Tax Years 2014 to 2018. Therefore, if the proposed ordinance is approved, the Small Business Net New Payroll Exclusion would be in effect during the phase-out of the Payroll Expense Tax in Tax Years 2014 and 2015, if the voters approve Proposition E. Under Proposition E, the Payroll Expense Tax rate in Tax Year 2014 would be 1.35 percent (a 10 percent decrease from 1.5 percent), and the Payroll Expense Tax rate in Tax Year 2015 is expected to be 1.125 percent (a 25 percent decrease from 1.5 percent), although the Controller may adjust the rate using a pre-established formula to ensure a revenue-neutral transition from the existing Payroll Expense Tax to the proposed Gross Receipts Tax.

The maximum annual savings to eligible businesses from the Small Business Net New Payroll Exclusion is $3,750 (.015 x $250,000), based on the maximum exclusion of $250,000 in net new payroll expenses and the City's current Payroll Expense Tax rate of 1.5 percent. If the voters approve Proposition E and the Payroll Expense Tax rate decreases to 1.35 percent in Tax Year 2014 and to 1.125 percent in Tax Year 2015, under the proposed ordinance, the maximum annual savings to eligible businesses would be $3,375 in Tax Year 2014 (.0135 x $250,000) and $2,813 in Tax Year 2015 (.01125 x $250,000).

The Likely Number of Eligible Businesses

Under the existing Small Business Net New Payroll Exclusion, an estimated 29,589 San Francisco business entities with payroll expenses between $1 and $500,000 in Tax Year 2011 may be eligible to claim the Small Business Net New Payroll Exclusion if their payroll expenses in Tax Years 2012 through 2015 increase beyond their 2011 Payroll Expense. This includes an estimated 22,705 registered businesses with annual payroll expenses between $1 and $149,999 that were not required to file Payroll Expense Tax returns in Tax Year 2011; and 6,884 businesses with annual payroll expenses between $150,000 and $500,000 that filed Payroll Expense Tax returns in Tax Year 2011, as shown in Table 1 above.[3]

In addition, up to an estimated 45,431 businesses that have current business registration certificates in San Francisco, but had no payroll expenses in Tax Year 2011, will potentially be eligible for the Net New Payroll Exclusion starting the year after these businesses incur payroll expenses for the first time and establish a Base Year Payroll Expense.[4] Businesses that did not

[3] Mr. Ted Egan, Chief Economist in the Controller's Office of Economic Analysis, estimates that 29,589 registered businesses had payroll expenses between $1 and $500,000 in Tax Year 2010. If the number of businesses with payroll expenses between $1 and $500,000 in Tax Year 2011 is comparable to Tax Year 2010, then approximately 22,705 registered businesses (29,589 minus 6,884) with payroll expenses between $1 and $149,999 in Tax Year 2011 will be eligible for the Net New Payroll Exclusion starting in Tax Year 2012.

[4] Of the approximately 80,000 registered businesses in San Francisco, an estimated 34,569 have payroll expenses of at least $1, resulting in an estimated 45,431 registered small businesses with no payroll expense.

exist in Tax Year 2011 can also become eligible for the Net New Payroll Exclusion starting the year after these new businesses incur payroll expenses and establish a Base Year Payroll Expense.

Although an estimated 29,589 businesses will potentially be eligible for the Net New Payroll Exclusion based on having a Base Year Payroll Expense of $500,000 or less, to apply for the Net New Payroll Exclusion, a business must have payroll expenses greater than $250,000 in the current Tax Year and must have annual payroll expenses greater than their Base Year Payroll Expense. Based on the number of businesses that had payroll expenses between $250,000 and $500,000 in Tax Year 2011, as shown in Table 1 above, the number of businesses that apply for the Net New Payroll Exclusion during the proposed four-year effective term of the Exclusion is unlikely to exceed 2,000 in a given year.

FISCAL IMPACT

Payroll Expense Tax Revenue Impact

Based on the current Payroll Expense Tax rate of 1.5 percent, the Controller's Office previously estimated reduced Payroll Expense Tax revenues of $2,000,000 annually resulting from the Net New Payroll Exclusion, or a total reduction in City revenues of approximately $8,000,000 over the four-year term of the Net New Payroll Exclusion. The reduction in Payroll Expense Tax revenues for the first two years of the Net New Payroll Exclusion was incorporated into the City's Budget through the Budget and Finance Committee's Budget Adjustments, allocating $1,500,000 in FY 2012-13 and $2,500,000 in FY 2013-14.

Mr. Ted Egan, Chief Economist in the Controller's Office of Economic Analysis, advises that the estimated annual reduction in City revenues in Tax Years 2014 and 2015 would be less than the previously estimated $2,000,000 if the Payroll Expense Tax rate decreases in Tax Years 2014 and 2015 as proposed under Proposition E, which is on the City and County of San Francisco's ballot for the November 6, 2012 election. According to Mr. Egan, the estimated amount of the annual reduction in City revenues in Tax Years 2014 and 2015 would decrease proportionately to the scheduled decrease in the Payroll Expense Tax rate. Therefore, assuming a Payroll Expense Tax rate of 1.35 percent in Tax Year 2014 (which is 10 percent less than the current Payroll Expense Tax rate of 1.5 percent), the estimated reduction in City revenues would be $1,800,000 (10 percent less than the previously estimated $2,000,000). Assuming a Payroll Expense Tax rate of 1.125 in Tax Year 2015 (which is 25 percent less than the Payroll Expense Tax rate of 1.5 percent), the estimated reduction in City revenues would be $1,500,000 (25 percent less than the previously estimated $2,000,000). Under the proposed ordinance, the estimated reduction in City revenues would total $7,300,000 over the four-year term of the Exclusion if the voters approve the Gross Receipts Tax proposed under Proposition E.

Administrative Costs

According to Mr. Kato, the Office of the Treasurer and Tax Collector is in the process of revising the Treasurer/Tax Collector's existing Payroll Expense Tax documents and programming the Treasurer/Tax Collector's computer system to be ready when businesses start

filing Tax Year 2012 Payroll Expense Tax returns in January 2013. The cost of professional services needed to make these revisions represents a one-time General Fund cost of approximately $55,000. This one-time General Fund cost of $55,000 was not included in the City's FY 2012-13 Budget because the Board of Supervisors approved the Net New Payroll Exclusion after approving the City's FY 2012-13 Budget. Therefore, the Office of the Treasurer and Tax Collector is working with the Mayor and the Controller to identify funds to pay for these costs.

POLICY CONSIDERATIONS

"Base Year Payroll Expense" is Open to Misinterpretation

In defining "Base Year Payroll Expense," Article 12-A Section 906.5(b)(2) states:

"If a person is exempt from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the first year that the person incurs Payroll Expense, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion."

According to the City Attorney's Office, the intent of this provision is to establish a minimum Base Year Payroll Expense of $150,000 for the purposes of calculating the Exclusion for businesses that have payroll expenses of less than $150,000 and therefore do not file Payroll Expense Tax returns. This provision is intended to apply to business that (a) had payroll expenses of less than $150,000 in Tax Year 2011 and previous years; (b) incurred payroll expenses of less than $150,000 for the first time in Tax Year 2011; or (c) incur payroll expenses of less than $150,000 for the first time in Tax Years 2012 through 2014.

In order to clarify that that the intent of Section 906.5(b)(2) is to establish a minimum Base Year Payroll Expense of $150,000 to be used in calculating the Exclusion for all business with payroll expenses of less than $150,000 in the Base Year, the proposed ordinance should be amended to state:

"If a person is exempt from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the Base Year, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion."

Report on the Effects of the Net New Payroll Exclusion

Business and Tax Regulations Code Section 906.5 states that the purpose of the Small Business Net New Payroll Exclusion is to "increase the number of jobs within the City... by providing an incentive for small businesses to create new jobs or to relocate existing jobs to the City..." Because the Net New Payroll Exclusion is based on net increases in payroll expenses rather than new jobs, it may also incentivize (a) increasing hours for existing employees, and (b) increasing wages for existing employees.

However, because businesses routinely increase and decrease their payrolls from year to year, the net increase in payroll expenses that businesses exclude from their Payroll Expense under

the Net New Payroll Exclusion will not serve as a clear indicator of the increase in business payrolls that occurred as a result of the Net New Payroll Exclusion. An unknown portion of the increase in business payrolls would have occurred without the Net New Payroll Exclusion, thus making it difficult to determine what portion of the increase in business payrolls was caused by the incentivizing effects of the Net New Payroll Exclusion.

Given the estimated reduced Payroll Expense Tax revenues to the City of $7,300,000 over the four-year term of the Net New Payroll Exclusion, and given the City's interest in promoting job creation in San Francisco, the Budget and Legislative Analyst recommends that the proposed ordinance be amended to require the Controller's Office of Economic Analysis to issue a report to the Budget and Finance Committee of the Board of Supervisors at the end of four-year term of the Net New Payroll Exclusion, assessing the effects of the Exclusion on incentivizing job creation and payroll growth among small businesses that applied for the Net New Payroll Exclusion.

RECOMMENDATIONS

- Amend the proposed ordinance to state: *"If a person is exempt from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the Base Year, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion."*
- Amend the proposed ordinance to require the Controller's Office of Economic Analysis to issue a report to the Budget and Finance Committee of the Board of Supervisors at the end of four-year term of the Net New Payroll Exclusion, assessing the effects of the Exclusion on incentivizing job creation and payroll growth among small businesses that applied for the Net New Payroll Exclusion.
- Approval of the proposed ordinance, as amended, is a policy matter for the Board of Supervisors.

SMALL BUSINESS COMMISSION
OFFICE OF SMALL BUSINESS

CITY AND COUNTY OF SAN FRANCISCO
EDWIN M. LEE, MAYOR

October 23, 2012

Ms. Angela Calvillo, Clerk of the Board
Board of Supervisors
City Hall room 244
1 Carlton B. Goodlett Place
San Francisco, CA 94102-4694

File No. 120965 [Business and Tax Regulations Code - Prevent Termination of Payroll Expense Tax Exclusion for Small Business Net New Payroll if Voters Adopt Gross Receipts Tax]

Small Business Commission Recommendation: **Approval**

Dear Ms. Calvillo:

On October 22, 2012 the Small Business Commission (SBC) held a hearing on Board of Supervisors File No. 120965 and voted 6-0 to recommend approval.

The Commission heard the original legislation that created the payroll expense tax exclusion for small business net new payroll at our May 7, 2012 meeting and voted 6-0 to recommend approval of BOS File No. 120377. The Commission found that small businesses benefitting from the exclusion will be diverse and that positive job creation will be seen in all areas of the economy.

During the August legislative recess it became apparent that follow-up legislation to BOS File No. 120377 was necessary in order to prevent expiration of this exclusion on the potential passage date of proposition E. The Commission thanks Supervisor Farrell for working with our office to introduce this legislative fix in time for it to take full effect prior to the gross receipts tax sunset provision potentially becoming effective.

Ensuring that this tax exclusion remains in effect through the entire originally proposed term is a priority of the Commission and the SBC thanks Supervisor Farrell for bringing this follow-up legislation forward.

Sincerely,

Regina Dick-Endrizzi
Director, Office of Small Business

Cc: Jason Elliott, Mayor's Office
Supervisor Farrell

SMALL BUSINESS ASSISTANCE CENTER/ SMALL BUSINESS COMMISSION
1 DR. CARLTON B. GOODLETT PLACE, ROOM 110 SAN FRANCISCO, CALIFORNIA 94102-4681
(415) 554-6408

Re: 30 Day Rule Waiver Request - File No. 120965 [Business and Tax Regulations Code - Prevent Termination of Payroll Expense Tax Exclusion for Small Business Net New Payroll if Voters Adopt Gross Receipts Tax]

Judson True to: Margaux Kelly, Victor Young, Katy Tang 10/03/2012 06:16 PM

Cc: Angela Calvillo, Catherine Stefani

Victor - please waive the 30 day rule per the below request.

Thank you,
Judson