File No. 100756 | Committee Item No. 6
Board Item No. ____

COMMITTEE/BOARD OF SUPERVISORS

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Completed by: Andrea S. Ausberry | Date Friday, July 2, 2010
Completed by: ____ | Date ____

An asterisked item represents the cover sheet to a document that exceeds 25 pages. The complete document is in the file.

[Establishing a progressive payroll expense tax rate structure and reducing selected payroll expense tax rates; imposing a gross receipts tax on the rental of commercial real property.]

Motion ordering submitted to the voters an ordinance revising the payroll expense tax to establish a progressive tax rate structure and reducing selected payroll expense tax rates and imposing a gross receipts tax on the rental of commercial real property, at an election to be held on November 2, 2010.

MOVED, That the Board of Supervisors hereby submits the following ordinance to the voters of the City and County of San Francisco, at an election to be held on November 2, 2010.

Ordinance to be submitted to the voters amending the San Francisco Business and Tax Regulations Code by: (1) adding Article 12-E, Sections 1300-1307, to impose a commercial rent tax on the gross receipts from the rental of commercial real property; (2) amending Article 6, Sections 6.1-1, 6.2-17, 6.8-1, 6.9-1, 6.9-3 and 6.9-5, to apply the common administrative provisions to the commercial rent tax and adding Section 6.9-8 to provide a limitation to the amount of tax credits claimed by related entities; (3) amending Article 12-A, Section 903.1 and adding Sections 902.7 and 906F, to establish a progressive payroll expense tax rate structure and a standard payroll expense tax credit; and (4) providing a savings clause.

NOTE: Additions are *single-underline italics Times New Roman*;
deletions are ~~*strike-through italics Times New Roman*~~.

Be it ordained that pursuant to Article XIII C of the Constitution of the State of California, this ordinance shall be submitted to the qualified electors of the City and County of

San Francisco at the November 2, 2010 general municipal election and shall become operative only if approved by the qualified electors at such election.

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

Section 1. **Findings and purpose.**

The voters hereby find and declare as follows:

1. San Francisco is the only major city in California that levies its entire business tax on payroll expense. This exclusive payroll-based tax discourages job creation and economic growth, lowers wages, and provides an unstable revenue stream.

2. San Francisco currently charges a flat rate on its payroll expense tax base. Instituting a progressive rate structure, in which amounts paid to higher-paid workers are taxed to the employer at a higher rate, will better distribute the tax burden according to a business's ability to pay. It will also help promote a more balanced distribution of jobs within San Francisco.

3. Gross receipts is the most common business tax base among California's largest cities.

4. Amending San Francisco's business tax system to include a gross receipts tax on commercial rents would promote revenue stability by diversifying the tax base.

5. Introducing a new standard payroll expense tax credit will reduce the payroll expense tax of all businesses, and provide particular tax relief to small businesses, which create the most jobs.

6. The legislation will gradually phase in the new commercial rent tax over a three-year period, beginning in tax year 2011, to allow the market time to adjust to the change.

7. Also beginning in tax year 2011, the standard payroll expense tax credit will phase in, starting at $500 in 2011 and rise by $500 increments per year until it reaches $1,500 in tax year 2013.

8. Also beginning in tax year 2011, a person required to pay payroll expense tax will report payroll expense in two brackets: payroll expense attributable to employees whose compensation is above a cut-off level of $85,000, and payroll expense attributable to employees whose compensation is below that cut-off. Beginning in tax year 2012, and each tax year until 2014, the payroll expense tax rate for the lower bracket will be reduced. The cut-off level will change each tax year to reflect changes in the consumer price index.

9. The Controller will calculate reductions in the payroll expense tax rate by applying a formula specified in this legislation. Each year during the phase-in period, the formula dictates a reduction in the payroll expense tax rate for the lower bracket that would reduce payroll expense tax revenue in the next tax year by a portion of the amount the City generated in commercial rent tax, less its tax credit cost, in that tax year.

Section 2. The San Francisco Business and Tax Regulations Code is hereby amended by adding Article 12-E, Sections 1300 through 1307, to read as follows:

ARTICLE 12-E: COMMERCIAL RENT TAX

SEC. 1300. SHORT TITLE.

This Article shall be known as the "Commercial Rent Tax Ordinance" and the tax imposed herein shall be known as the "Commercial Rent Tax."

SEC. 1301. PURPOSE.

The City and County of San Francisco (the "City") imposes the Commercial Rent Tax for general governmental purposes and in order to require all segments of the commercial and the business community to carry their fair share of the costs of local government in return for the benefits, opportunities and protections that the City affords. The Controller shall cause proceeds from the tax to be deposited in the City's general fund, and the City may expend them for any City purposes.

SEC. 1302. DEFINITIONS.

Except where the context otherwise requires, terms this Article does not define that Article 6 does define shall have the same meaning as Article 6 gives them.

SEC. 1303.1. COMMERCIAL PURPOSES.

The term "commercial purposes" means the use of real property for a purpose other than dwelling, sleeping or lodging by an individual or individuals and includes the use of real property where the primary purpose of the real property or the primary use or right to use the property is for a purpose of the renter other than dwelling, sleeping or lodging.

SEC. 1303.2. GROSS RECEIPTS.

(a) The term "gross receipts" means the total amount of cash, credits, property of any kind or nature or any other form of consideration that a person subject to the tax received or is entitled to receive from the rental of real property for commercial purposes.

(b) In addition to the amounts described in (a) of this Section, gross receipts includes all payments made to a person subject to the tax, and/or paid to third parties on behalf of a person subject to the tax as part of a rental arrangement or agreement, including, but not limited to, all insurance, mortgage payments, taxes, expenses, and the cash value of all services rendered to or on behalf of a commercial landlord in lieu of rental payments. If the Commercial Rent Tax is paid on behalf of a person subject to the tax, such tax payment, including any penalty and interest payment, shall be included as gross receipts.

SEC. 1304. IMPOSITION OF COMMERCIAL RENT TAX.

The City hereby imposes an excise tax on the privilege of engaging in the business of renting to others land, buildings, structures, improvements, fixtures, or any other form or component of real property located in the City and used for commercial purposes. The amount of a person's liability for the Commercial Rent Tax shall be the product of the applicable tax rate in Section 1305 multiplied by the gross receipts from the rental of real property or the portion of real property located in the City and *used for commercial purposes.*

SEC. 1305. RATE OF COMMERCIAL RENT TAX.

The Commercial Rent Tax shall be computed at the rates and for the taxable years as follows:

Tax Year	***Rate***
2011	*0.632%*
2012	*1.263%*
2013 and subsequent years	*1.895%*

SEC. 1306. SMALL COMMERCIAL RENT TAX EXEMPTION.

(a) Notwithstanding any other provisions of this Article "small commercial taxpayer" as hereinafter defined, shall be exempt from payment of the Commercial Rent Tax; provided, however, that such taxpayers shall pay the annual registration fee pursuant to Section 855 of Article 12.

(b) The term "small commercial taxpayer" shall mean and include any taxpayer whose gross receipts under this Article, but for this exemption provision, would not exceed $200,000 for that tax year.

SEC. 1307. PAYMENTS, RETURNS, PREPAYMENTS AND EXTENSIONS.

The common administrative provisions of Article 6 shall govern payments, returns, prepayments and extensions for persons subject to this Article. The first tax year for which the Commercial Rent Tax is imposed is the 2011 calendar year. The return and tax for the 2011 tax year is due and payable on the last day of February, 2012.

Section 3. Article 6 of the San Francisco Business and Tax Regulations Code is hereby amended by amending Sections 6.1-1, 6.2-17, 6.8-1, 6.9-1, 6.9-3, and 6.9-5 and adding Section 6.9-8, to read as follows:

SEC. 6.1-1. COMMON ADMINISTRATIVE PROVISIONS.

(a) Except where the specific language of the Business and Tax Regulations Code or context otherwise requires, these common administrative provisions shall apply to Articles 6, 7, 9, 10, 10B, 11, 12, 12-A, ~~and~~ 12-B *and 12-E* of such Code and to Chapter 105 of the San Francisco Administrative Code. Any provision of this Article 6 that references or applies to Article 10 shall be deemed to reference or apply to Article 10B. Any provision of this Article 6 that references or applies to a tax shall be deemed to also reference or apply to a fee administered pursuant to this Article.

(b) Unless expressly provided otherwise, all statutory references in this Article and the Articles set forth in ~~Subsection~~ (a) *of this Section* shall refer to such statutes as amended from time to time and shall include successor provisions.

(c) For purposes of this Article, a domestic partnership established pursuant to Chapter 62 of the San Francisco Administrative Code shall be treated the same as a married couple.

SEC. 6.2-17. RETURN.

The term "return" means any written statement required to be filed pursuant to Articles 6, 7, 9, 10, 10A, 11, 12, ~~or~~ 12-A, *or 12-E*.

SEC. 6.8-1. CITY, PUBLIC ENTITY AND CONSTITUTIONAL EXEMPTIONS.

Nothing in Articles 6, 7, 10, 10A, 11, 12, ~~or~~ 12-A, *or 12-E* shall be construed as imposing a tax upon:

(1) The City;

(2) The State of California, or any county, municipal corporation, district or other political sub-division of the State, except where any constitutional or statutory immunity from taxation is waived or is not applicable;

(3) The United States of America, or any of its agencies or ~~subdivisions~~*sub-divisions*, except where any constitutional or statutory immunity from taxation is waived or is not applicable; or

(4) Any person exempted from the particular tax by the Constitution or ~~statutes~~ *a statute* of the United States or the Constitution or ~~statutes~~ *a statute* of the State of California.

SEC. 6.9-1. DETERMINATIONS, RETURNS AND PAYMENTS; DUE DATE OF TAXES.

Except for jeopardy determinations under Section 6.12-2, and subject to prepayments required under Section 6.9-2, all amounts of taxes and fees imposed by Articles 6, 7, 9, 10, 10A, 11, ~~and~~ 12-A*, and 12-E* are due and payable, and shall be delinquent if not paid to the Tax Collector on or before the following dates.

(a) For the transient hotel occupancy tax (Article 7) and the parking space occupancy tax (Article 9), for each calendar quarter, on or before the last day of the month following each respective quarterly period;

(b) For the payroll expense tax (Article 12-A), on or before the last day of February of each year;

(c) For the utility users taxes (Article 10) and the *access line tax (Article 10B)* ~~emergency response fee (Article 10A)~~, for each monthly period, on or before the last day of the following month; ~~and~~

(d) For the stadium operator admission tax (Article 11), within five days after the event, subject to the provisions of Article 11, Section 804~~.~~*; and*

(e) For the Commercial Rent Tax (Article 12-E), on or before the last day of February of each year.

SEC. 6.9-3. DETERMINATIONS, RETURNS AND PAYMENTS; PREPAYMENTS.

(a) **Prepayments.** Notwithstanding the due dates otherwise provided in Section 6.9-1, taxpayers shall make prepayments of taxes and third-party taxes ("tax payments") to the Tax Collector as follows:

(1) **Hotel and Parking Taxes.** The Hotel Tax (Article 7) and the Parking Tax (Article 9) shall be paid in monthly installments. Such monthly installments shall be due and

payable to the Tax Collector on or before the last day of the month immediately following the month for which the prepayment is due. Taxes paid in the first two monthly installments of any quarterly period shall be a credit against the total liability *for* such third-party taxes for the quarterly period. Estimated tax prepayments shall be computed based on the estimated tax accrued during the month in question, but in no instance shall a prepayment be equal to a sum less than 30 percent of the tax collected in the immediately preceding quarterly period. If the taxpayer can establish by clear and convincing evidence that the amount of any prepayment will exceed the total tax liability for the quarterly period for which the tax prepayment becomes due, the Tax Collector may, in writing, adjust the amount of the tax prepayment. The third monthly installment of any quarterly period shall be in an amount equal to the total tax liability for the quarterly period, less the amount of any tax prepayments actually paid.

(2) **Payroll Expense Tax** ***and Commercial Rent Tax*****.** The Payroll Expense Tax (Article 12-A) *and the Commercial Rent Tax (Article 12-E)* shall be paid in biannual or quarterly installments as follows:

(A) **Small Firm Prepayments.** Every person liable for payment of a total Payroll Expense Tax *in excess of $3,750, and/or a Commercial Rent Tax* in excess of $2,500 but less than $50,000 for any tax year shall pay such tax for ~~the following~~*each* tax year in two installments. The first installment shall be due and payable, and shall be delinquent if not paid on or before, August 1st. The first installment shall be a credit against the person's total Payroll Expense *Tax and Commercial Rent Tax* for the tax year in which the first installment is due. The first installment shall be in an amount equal to one-half (½) of the person's estimated Payroll Expense *Tax and Commercial Rent Tax* for such tax year. The estimated liability shall be computed by using 52% of the person's taxable payroll expense (as defined in Section 902.2 of Article 12-A) for the preceding tax year, *and 52% of the person's estimated* *taxable gross receipts (as defined in Section 1303.2 of Article 12-E for the preceding tax year),* and the rate*s* of tax*es* applicable to the tax year in which the first installment is due. The second installment shall be reported and paid on or before the last day of February of the following year. The second installment shall be in an amount equal to the person's total Payroll Expense Tax *and Commercial Rent Tax* for the subject tax year, less the amount of the first installment and other tax prepayments for such tax year, if any, actually paid.

(B) **Large Firm Prepayments.** Every person liable for payment of a total Payroll Expense Tax *and a Commercial Rent Tax* in excess of $50,000 for any tax year shall pay such tax for ~~the following~~*each* tax year in four quarterly installments. The first, second and third quarterly installments shall be due and payable, and shall be delinquent if not paid on or before, May 1st, August 1st and November 1st, respectively. The first, second and third quarterly installments shall be a credit against the person's total Payroll Expense Tax *and total Commercial Rent Tax* for the tax year in which such first, second and third quarterly installments are due. Such quarterly installments each shall be in an amount equal to one-quarter (¼) of the person's estimated Payroll Expense Tax liability *and Commercial Rent Tax liability* for such tax year. The estimated liability for such tax year shall be computed by using 104% of the person's taxable payroll expense (as defined in Section 902.1 of Article 12-A) *and 104% of the person's taxable gross receipts (as defined in Section 1303.2 of Article 12-E)* for the preceding tax year, and the rate*s* of tax*es* applicable to the tax year in which the first, second and third quarterly installments are due. The fourth *quarterly* installment shall be reported and paid on or before the last day of February of the following year. The fourth quarterly installment shall be in an amount equal to the person's total Payroll Expense Tax liability *and total Commercial Rent Tax liability* for the subject tax year, less the amount of the first, second and third quarterly installments and other tax prepayments, if any, actually paid.

(b) **Tax Prepayment Penalties.** Every person who fails to pay any tax prepayment required under this Section before the relevant delinquency date shall pay a penalty in the amount of five percent (5%) of the amount of the delinquent tax prepayment per month, or fraction thereof, up to twenty percent (20%) in the aggregate, and shall also pay interest on the amount of the delinquent tax prepayment from the date of delinquency at the rate of one percent (1%) per month, or fraction thereof, for each month the prepayment is delinquent, until paid.

(c) **Hotel and Parking Taxes.** Upon commencing business, an operator subject to the Hotel Tax (Article 7) or the Parking Tax (Article 9) shall have the option of making prepayments in the amount of the actual tax owed or making an estimate of the prepayment for the month based on the estimated tax accrued during the month in question. Once the operator has selected an option, the operator must continue to follow that procedure unless prior written permission to use the alternative procedure has been obtained from the Tax Collector.

In no instance shall an estimated prepayment of hotel or parking taxes be less than 30 percent of such tax collected in the immediately preceding quarterly period. If such estimated prepayment is less than 30 percent of the tax collected in such preceding quarterly period, the operator shall be subject to penalties and interest for the deficiency pursuant to Section 6.17-1.. If a prepayment based on actual tax owed is less than 90 percent of the actual liability for the month, the operator shall be subject to penalties and interest for the deficiency pursuant to Section 6.17-1.

(d) **Forms and Adjustments.** Tax prepayments required under this Section shall be accompanied by a tax prepayment form prepared by the Tax ~~*Col-lector*~~ *Collector*, but failure of the Tax Collector to furnish the taxpayer with a tax prepayment form shall not relieve the taxpayer from any tax prepayment obligation. The Tax Collector may, in writing, adjust the amount of a tax prepayment if the taxpayer can establish by clear and convincing evidence that the first installment of biannual tax prepayments, or first, second or third monthly installments of a quarterly tax prepayment, will amount to more than one half or one quarter, respectively, of the person's total tax liability for the tax year in which the installment is due.

SEC. 6.9-5. DETERMINATIONS, RETURNS AND PAYMENTS; CREDITS AND EXEMPTIONS.

The credits and exemptions set forth in Articles 7, 9, 10, 10A, 11, 12, ~~and~~12A, *and 12E* are provided on the assumption that the City has the power to offer such credits and exemptions. If a credit or exemption is invalidated by a court of competent jurisdiction, the taxpayer must pay any additional amount that the taxpayer would have owed but for such invalid credit or exemption. Amounts owed as a result of the invalidation of a credit or exemption that are paid within three years after the decision of the court becomes final shall not be subject to interest or penalties.

SEC. 6.9-8. LIMITATION ON TAX BENEFITS.

(a) A group of related entities may claim one and only one of each of the following enumerated tax benefits: (i) Small Business Tax Exemption (Article 12-A, Section 905-A), (ii) Small Commercial Rent Tax Exemption (Article 12-E, Section 1306), or (iii) Standard Payroll Expense Tax Credit (Article 12-A, Section 906F).

(b) A group of related entities means:

(1) husband and wife;

(2) grantor and fiduciary;

(3) grantor and beneficiary;

(4) fiduciary and beneficiary, legatee, or heir;

(5) decedent and decedent's estate;

(6) partners, or partner and partnership; or

(7) one or more persons related by common ownership, direct or indirect, of more than

50 percent.

Section 4. Article 12-A of the San Francisco Business and Tax Regulation Code is hereby amended by amending Section 903.1 and adding Sections 902.7 and 906F, to read as follows:

SEC. 902.7. LOWER BRACKET PAYROLL FACTOR.

(a) The term "lower bracket payroll factor" means a multiplier that the Controller will use to calculate the Payroll Expense Tax rate applicable to the compensation paid to certain individuals for tax years 2012-2014, according to a formula described in this Section. The Controller shall compute the lower bracket payroll factor for tax years 2012 through 2014 according to a formula in which a fraction is subtracted from the number one. If the fraction is ever less than zero, the lower bracket payroll factor shall equal one. If the fraction is ever greater than one, the lower bracket payroll factor shall be zero. The fraction shall consist of a numerator of CRT minus SPETC with the resulting difference multiplied by .45 and a denominator of LBPT, all as expressed in numerical form as:

(1-((CRT-SPETC).45)/LBPT)*

Where: *CRT = the actual amount of Commercial Rent Tax revenue received by the Tax Collector for the previous tax year as of the first business day of July, minus the actual amount of Commercial Rent Tax revenue received by the Tax Collector for the tax year two years prior, as of the first business day of July of the previous year, if any. For example, CRT for tax year 2013 shall be the Commercial Rent Tax revenue received for tax year 2012 as of the first business day of July 2013, minus the Commercial Rent Tax revenue received by the Tax Collector for tax year 2011 as of the first business day of July 2012;*

SPETC = the total amount of standard payroll expense tax credit that, based on information provided by the Tax Collector, the Controller determines that persons *subject to the payroll expense tax claimed for the previous tax year as of the first business day of July, minus the total amount of standard payroll expense tax credit that the Controller determines that persons subject to the payroll expense tax claimed for the tax year two years prior, as of the first business day of July of the previous year, if any. For example, SPETC for tax year 2013 shall be the total amount of standard payroll expense tax credit claimed for tax year 2012 as of the first business day of July 2013, minus the total amount of standard payroll expense tax credit claimed for tax year 2011 as of the first business day of July 2012; and*

LBPT = the total amount of payroll expense taxes that the Controller determines the City received as of the first business day of July with respect to individuals receiving compensation at or below the payroll tax cut off amount for the previous tax year.

(b) The Controller shall compute, certify and publish the lower bracket payroll factor for 2012 through 2014 on or before September 1 of each year commencing September 1, 2012 using the formula described in the previous clause. The lower bracket payroll factor for each tax year after 2014 shall be the factor established as of December 31, 2014.

SEC. 903.1. RATE OF PAYROLL EXPENSE TAX.

~~*The rate of the payroll expense tax shall be 1½ percent. The amount of a person's liability for the payroll expense tax shall be the product of such person's taxable payroll expense multiplied by 0.015. The amount of such tax for Associations shall be 1½ percent of the payroll expense of such Association, plus 1½ percent of the total distributions made by such Association by way of salary to those having an ownership interest in such Association. Amounts paid or credited to those having an ownership interest in such Association prior and in addition to the distribution of ownership profit or loss shall be presumed to be distributions "by way of salary" and for personal services rendered, unless the taxpayer proves otherwise by clear and convincing evidence.*~~

(a) The term "payroll expense tax cut off amount" shall mean a dollar value used to separate

payroll expense tax brackets. The payroll expense tax cut off amount will change to reflect changes in the consumer price index as dictated in Subsection (f).

(b) The term "upper bracket payroll expense tax rate" shall mean the payroll tax expense tax rate applicable to a portion of payroll expense of a person subject to this tax consisting of the total amount of compensation paid to each individual during the tax year where that total amount of compensation exceeds the payroll expense tax cut off amount applicable for that tax year.

(c) The term "lower bracket payroll expense tax rate" shall mean the payroll tax expense tax rate applicable to a portion of payroll expense of a person subject to this tax consisting of the total amount of compensation paid to each individual during the tax year where that total amount of compensation is less than or equal to the payroll expense tax cut off amount applicable for that tax year.

(d) The rates of the payroll expense tax shall be determined as provided in this Section. The amount of a person's liability for the payroll expense tax shall be the product of such person's taxable payroll expense multiplied by the rates determined in this Section. The amount of such tax for Associations shall be the applicable tax rates determined in this Section multiplied by the applicable portions of the payroll expense of such Association, plus 1½ percent of the applicable tax rates determined in this Section multiplied by the applicable portion of total distributions made by such Association by way of salary to those having an ownership interest in such Association. Amounts paid or credited to those having an ownership interest in such Association prior and in addition to the distribution of ownership profit or loss shall be presumed to be distributions "by way of salary" and for personal services rendered, unless the taxpayer proves otherwise by clear and convincing evidence.

(e) The upper bracket payroll expense tax rate shall be 1½ percent.

(f) For purposes of this Section the payroll expense tax cut off amount shall be $85,000 as adjusted for a taxable year, commencing with tax year 2012, by the year-over-year percentage increase in the United States Department of Labor's Bureau of Labor Statistics annual average

consumer price index for all urban customers for the San Francisco – Oakland – San Jose area from the previous tax year. The Controller shall compute, certify and publish the applicable and adjusted payroll expense tax cut off amount on or before February 1 of each year following the previous tax year.

(g) For tax year 2011, the lower bracket payroll expense tax rate shall be 1½ percent. For tax years 2012-2014, the Controller shall calculate, certify and publish on or before February 1 of each year following tax years 2012-2014, the lower bracket payroll expense tax rate by multiplying the lower bracket payroll factor for that tax year, by the lower bracket payroll expense tax rate that was in effect the previous tax year. For tax year 2015 and subsequent tax years the lower bracket payroll expense tax rate shall be the lower bracket payroll expense tax rate for tax year 2014. The lower bracket payroll expense tax rate shall never exceed 1½ percent.

SEC. 906F. STANDARD PAYROLL EXPENSE TAX CREDIT.

(a) A person subject to the tax imposed by this Article shall be allowed a credit against the person's total tax liability in the following amounts and for the following tax years (as adjusted in accordance with this Section), except that in no event shall the tax credit reduce a person's tax liability to less than zero:

Tax Year	***Tax Credit***
2011	*$500*
2012	*$1,000*
2013 and subsequent years	*$1,500*

(b) Commencing with tax year 2014 the credit allowed by this Section shall be adjusted by the year-over-year percentage increase in the United States Department of Labor's Bureau of Labor Statistics annual average consumer price index for all urban customers for the San Francisco – Oakland – San Jose area from the previous tax year. The Controller shall compute, certify and publish the applicable standard payroll tax credit on or before February 1 of each year following the previous

tax year, commencing on or before February 1, 2015.

Section 5. **Savings Clause.**

(a) No section, clause, part or provision of this ordinance shall be construed as requiring the payment of any tax that would be in violation of the Constitution or a statute of the United States or of the Constitution or a statute of the State of California. Except as provided in (b) of this Section, if any section, clause, part or provision of this ordinance, or the application thereof to any person or circumstance, is held invalid or unconstitutional, the remainder of this ordinance, including the application of such part or provision to other persons or circumstances, shall not be affected thereby and shall continue in full force and effect. To this end, the provisions of this ordinance are severable.

(b) If the imposition of Commercial Rent Tax in Section 2 of this ordinance is held invalid or unconstitutional in a final court determination, the remainder of this ordinance shall be null and void and of no force and effect.

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

By: Julie Van Nostern
JULIE VAN NOSTERN
Deputy City Attorney

LEGISLATIVE DIGEST

[Establishing a progressive payroll expense tax rate structure and reducing selected payroll expense tax rates; imposing a gross receipts tax on the rental of commercial real property.]

Motion ordering submitted to the voters an ordinance revising the payroll expense tax to establish a progressive tax rate structure and reducing selected payroll expense tax rates and imposing a gross receipts tax on the rental of commercial real property, at an election to be held on November 2, 2010.

Existing Law

The City currently imposes a payroll expense tax on every person engaging in business in San Francisco, although businesses below a certain size do not have to pay the tax. The current tax rate is 1.5 percent of the taxpayer's total payroll.

The City does not currently impose a tax on the money a person or company receives for renting out commercial real estate

Amendments to Current Law

The proposal is a motion that would submit an ordinance to the voters for the November 2, 2010 election, entitled "Ordinance to be submitted to the voters amending the San Francisco Business and Tax Regulations Code by: (1) adding Article 12E, Sections 1300-1307, to impose a commercial rent tax on the gross receipts from the rental of commercial real property; (2) amending Article 6, Sections 6.1-1, 6.2-17, 6.8-1, 6.9-1, 6.9-3 and 6.9-5, to apply the common administrative provisions to the commercial rent tax and adding Section 6.9-8 to provide a limitation to the amount of tax credits claimed by related entities; (3) amending Article 12-A, Section 903.1 and adding Sections 902.7 and 906F, to establish a progressive payroll expense tax rate structure and a standard payroll expense tax credit; and, (4) providing a savings clause."

If adopted by the voters, the ordinance would reduce the City's payroll expense tax in two ways. First, it would give each taxpayer a credit against the payroll expense tax. The credit would be $500 in tax year 2011, $1000 in tax year 2012, and $1500 in tax year 2013 and subsequent tax years.

Second, between now and tax year 2014, the ordinance would lower the tax rate an employer pays on compensation for employees earning less than $85,000 a year. The Controller would determine the amount of the reduction, based in part on how much the City collected under the new commercial rent gross receipts tax.

If adopted, the ordinance would also impose a new gross receipts tax on commercial rents, to be phased in over a three-year period beginning with the 2011 tax year. The City would collect a tax on the rent that anyone received for renting out land, buildings, or any other forms of real property located in the City and used for commercial purposes as defined in the ordinance. The tax rate would be 0.632 percent for tax year 2011, and would increase over three years to 1.895 percent, which would be the rate for subsequent tax years. The ordinance would exempt small commercial landlords—those collecting less than $200,000 in rents for the year—from the tax.

Background Information

The payroll expense tax is imposed for general governmental purposes and in order to require commerce and the business community to carry a fair share of the costs of local government in return for the benefits, opportunities and protections provided by the City. While businesses engaged in the activity of renting commercial real estate also receive those benefits, opportunities and protections, they generally pay relatively little payroll expense tax.

In order to better distribute the tax burden according to a business's ability to pay and spread the tax burden among all businesses receiving the benefits, opportunities and protections provided by the City, the ordinance would introduce a new commercial rent tax. The revenue generated by this tax would be used in part to provide a credit against the payroll expense tax for all businesses. In addition, the revenue generated by the commercial rent tax would be used to lower the rate of the payroll expense tax imposed on compensation paid to individuals receiving less than $85,000 per year in compensation.

CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

RECEIVED
BOARD OF SUPERVISORS
SAN FRANCISCO

2010 JUN 28 AM 11:31

BY af

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

June 28, 2010

The Honorable Board of Supervisors
City and County of San Francisco
Room 244, City Hall

Angela Calvillo
Clerk of the Board of Supervisors
Room 244, City Hall

Re: Office of Economic Analysis Impact Report for File Number 100756

Dear Madam Clerk and Members of the Board:

The Office of Economic Analysis is pleased to present you with its economic impact report on file number 100756, "Establishing a Progressive Payroll Expense Tax: Economic Impact Report." If you have any questions about this report, please contact me at (415) 554-5268.

Best Regards,

Ted Egan
Chief Economist

cc Gail Johnson, Committee Clerk, Budget & Finance Committee

City and County of San Francisco

Office of the Controller – Office of Economic Analysis

Establishing a Progressive Payroll Expense Tax: Economic Impact Report

Item #100756

Office of Economic Analysis

June 28, 2010

Outline

- Overview
- Background
- Fiscal Impact
- Impact on Specific Businesses
- Overall Economic Impact
- Economic Impact Compared to Other Tax Measures
- Conclusions & Recommended Amendments

Overview

- The proposed legislation creates three major changes in San Francisco's business tax:
  1. a new tax on gross receipts from commercial rent, phased in from 2011 to 2013, to a final rate of 1.895%. Commercial landlords with gross receipts under $200,000 per year would be exempt from the commercial rent tax.
  2. a standard tax credit of $1,500 to all businesses. The credit does not reduce tax liability to less than zero.
  3. the creation of a progressive payroll tax structure, with a reduced tax rate on payroll for workers earning less than $85,000 per year.
- The lower-bracket rate is phased-in by formula, based on the revenue raised by the rent tax. This analysis is based on a lower bracket rate of 1.3% in 2013 and subsequent years.
- The upper bracket rate is 1.5%, the same as the current rate.

Background

- San Francisco's 1.5% payroll tax has been the subject of economic policy debate for many years.
- A recent Controller's Office study found that progressive payroll / commercial rent tax hybrid would be more efficient, equitable, and stable than the current payroll-only tax.
- This legislation is based on that study, although the commercial rent tax rate, and the revenue gain for the City, are both higher than the progressive payroll option detailed in the report.

Estimated Fiscal Impact: Key Points

- The rent tax is expected to generate approximately $73 million per year. This estimate is uncertain, as the City has not charged a commercial rent tax in the past.
- The standard payroll tax credit is expected to cost the City approximately $12 million per year.
- The legislation uses a formula to allocate 45% of this net revenue gain (rent tax less tax credit cost) to reducing the lower bracket payroll rate in the following year. The remaining 55% is kept for the General Fund.
- The General Fund increase is estimated at approximately $34 million per year, but this is uncertain and depends on the value of the rent tax.
- The Controller's Office estimates the resulting lower-bracket rate would be approximately 1.3%.

Estimated Fiscal Impact: Budget Basis

Tax Year	Rent tax rate	Rent Tax Revenue	Tax Credit	Tax Credit Revenue	Cumulative Change in Payroll Tax Revenue	Net Budget Impact
2010	0.000%	$0.0	$0	$0.0	$0.0	$0.0
2011	0.632%	$24.5	$500	-$4.1	$0.0	$20.4
2012	1.263%	$49.0	$1,000	-$8.1	-$9.2	$42.9
2013	1.895%	$73.5	$1,500	-$12.2	-$18.4	$54.1
2014	1.895%	$73.5	$1,500	-$12.2	-$27.6	$44.9
2015	1.895%	$73.5	$1,500	-$12.2	-$27.6	$33.7
2016	1.895%	$73.5	$1,500	-$12.2	-$27.6	$33.7

Impact on Specific Businesses: Small Graphic Design Firm

Graphic Design Firm
NAICS: 54143
Sector: Business & Professional Services

Information about the company:		
Number of Employees:	2	
Annual Gross Receipts:	$575,000	
Total Annual Payroll	$175,000	
Payroll for Workers Over $85,000	$95,000	
Payroll for Workers Under $85,000	$80,000	
Annual Rent	$18,000	
Current Tax	Tax Paid	
Tax on Total Payroll, @1.5%	**$0**	(exempt)
Progressive Payroll Tax Option	Tax Paid	
Payroll tax on workers > $85,000, taxed at 1.5%	$0	(exempt)
+ Payroll tax on workers < $85,000, taxed at 1.3%	$0	(exempt)
- Deduction	$1,500	
Progressive Payroll Tax	$0	
+ 90% of Rent tax passed through, @1.895%	$307	
Total Progressive Payroll Tax + Rent Increase	**$307**	
Gain (Loss) vs. Current Tax	**($307)**	

A small graphic design firm, with two employees, is exempt from the current payroll tax, and would be exempt from the progressive payroll tax as well.

However, they would likely see their occupancy costs rise, as commercial landlords will likely pass through the bulk of the rent tax. The firm's rents might rise by about $300 per year, or 0.05% of gross receipts.

Impact on Specific Businesses: Dentist's Office

Dentist's Office
NAICS: 6212
Sector: Education & Health Services

Assumptions about the business:	
Number of Employees:	10
Annual Gross Receipts:	$1,200,000
Total Annual Payroll	$450,000
Payroll for Workers Over $85,000	$225,000
Payroll for Workers Under $85,000	$225,000
Annual Rent	$105,000
Current Tax	Tax Paid
Tax on Total Payroll, @1.5%	**$6,750**
Progressive Payroll Tax Option	Tax Paid
Payroll tax on workers > $85,000, taxed at 1.5%	$3,375
+ Payroll tax on workers < $85,000, taxed at 1.3%	$2,925
- Tax Credit	$1,500
Progressive Payroll Tax	$4,800
+ 90% of Rent tax passed through, @1.895%	$1,791
Total Progressive Payroll Tax + Rent Increase	**$6,591**
Gain (Loss) vs. Current Tax	**$159**

A dental office with ten employees would now pay the payroll tax, and, like all current business payers, would pass less in tax, because of the standard credit and the lower rate on payroll below $85,000.

Although the dental office's rents would rise, the net impact would be a slight savings of about $150, or 0.01% of gross receipts.

Impact on Specific Businesses: Hardware Store

Hardware Store
NAICS: 4441
Sector: Retail Trade

Assumptions about the business:	
Number of Employees:	18
Annual Gross Receipts:	$6,500,000
Total Annual Payroll	$750,000
Payroll for Workers Over $85,000	$90,000
Payroll for Workers Under $85,000	$660,000
Annual Rent	$225,000
Current Tax	Tax Paid
Tax on Total Payroll, @1.5%	**$11,250**
Progressive Payroll Tax Option	Tax Paid
Payroll tax on workers > $85,000, taxed at 1.5%	$1,350
+ Payroll tax on workers < $85,000, taxed at 1.3%	$8,580
- Tax Credit	$1,500
Progressive Payroll Tax	$8,430
+ 90% of Rent tax passed through, @1.895%	$3,837
Total Progressive Payroll Tax + Rent Increase	**$12,267**
Gain (Loss) vs. Current Tax	**($1,017)**

A hardware store with 18 employees would pay significantly less tax directly, but could expect a rent increase that offsets their tax savings about approximately $1,000 per year, or 0.01% of gross receipts.

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Impact on Specific Businesses: Restaurant

Restaurant
NAICS: 7221
Sector: Leisure & Hospitality

Assumptions about the business:	
Number of Employees:	30
Annual Gross Receipts:	$2,750,000
Total Annual Payroll	$900,000
Payroll for Workers Over $85,000	$90,000
Payroll for Workers Under $85,000	$810,000
Annual Rent	$250,000
Current Tax	Tax Paid
Tax on Total Payroll, @1.5%	**$13,500**
Progressive Payroll Tax Option	Tax Paid
Payroll tax on workers > $85,000, taxed at 1.5%	$1,350
+ Payroll tax on workers < $85,000, taxed at 1.3%	$10,530
- Tax Credit	$1,500
Progressive Payroll Tax	$10,380
+ 90% of Rent tax passed through, @1.895%	$4,264
Total Progressive Payroll Tax + Rent Increase	**$14,644**
Gain (Loss) vs. Current Tax	**($1,144)**

A restaurant with 30 employees would pay significantly less in taxes, since nearly all of its payroll would fall into the lower bracket.

However, restaurants tend to be in higher-rent space, and their higher rent costs could lead to a net cost increase of approximately $1,100 per year, or 0.04% of gross receipts.

Impact on Specific Businesses: Grocery Wholesaler

Grocery Wholesaler
NAICS: 4244
Sector: Wholesale Trade

Assumptions about the business:	
Number of Employees:	58
Annual Gross Receipts:	$61,000,000
Total Annual Payroll	$3,100,000
Payroll for Workers Over $85,000	$620,000
Payroll for Workers Under $85,000	$2,480,000
Annual Rent	$350,000
Current Tax	Tax Paid
Tax on Total Payroll, @1.5%	**$46,500**
Progressive Payroll Tax Option	Tax Paid
Payroll tax on workers > $85,000, taxed at 1.5%	$9,300
+ Payroll tax on workers < $85,000, taxed at 1.3%	$32,240
- Tax Credit	$1,500
Progressive Payroll Tax	$40,040
+ 90% of Rent tax passed through, @1.895%	$5,969
Total Progressive Payroll Tax + Rent Increase	**$46,009**
Gain (Loss) vs. Current Tax	**$491**

Because wholesalers tend to have lower-paid employees, and low rent costs, these firms stand to benefit from the proposed legislation.

However, the gain is extremely small in the context of the size of the business: approximately $500 per year, or 0.0008% of gross receipts.

Impact on Specific Businesses: Software Company

Software company
NAICS: 5112
Sector: Information

Assumptions about the business:	
Number of Employees:	75
Annual Gross Receipts:	$30,000,000
Total Annual Payroll	$9,000,000
Payroll for Workers Over $85,000	$6,750,000
Payroll for Workers Under $85,000	$2,250,000
Annual Rent	$900,000

Current Tax	Tax Paid
Tax on Total Payroll, @1.5%	**$135,000**

Progressive Payroll Tax Option	Tax Paid
Payroll tax on workers > $85,000, taxed at 1.5%	$101,250
+ Payroll tax on workers < $85,000, taxed at 1.3%	$29,250
- Tax Credit	$1,500
Progressive Payroll Tax	$129,000
+ 90% of Rent tax passed through, @1.895%	$15,350
Total Progressive Payroll Tax + Rent Increase	**$144,350**
Gain (Loss) vs. Current Tax	**($9,350)**

A software company with 75 employees would be somewhat more under the progressive payroll tax proposal. Most of its payroll is in the upper bracket and would be taxed at the present rate of 1.5%, and it would also pay higher rent as the commercial rent tax is largely passed-through to them.

The net increase in costs could total $9,350, or about 0.03% of gross receipts.

Impact on Specific Businesses: Hotel

Hotel	
NAICS: 7221	
Sector: Leisure & Hospitality	
Assumptions about the business:	
Number of Employees:	350
Annual Gross Receipts:	$52,750,000
Total Annual Payroll	$13,500,000
Payroll for Workers Over $85,000	$945,000
Payroll for Workers Under $85,000	$12,555,000
Annual Rent	$0
Current Tax	Tax Paid
Tax on Total Payroll, @1.5%	**$202,500**
Progressive Payroll Tax Option	Tax Paid
Payroll tax on workers > $85,000, taxed at 1.5%	$14,175
+ Payroll tax on workers < $85,000, taxed at 1.3%	$163,215
- Tax Credit	$1,500
Progressive Payroll Tax	$175,890
+ 90% of Rent tax passed through, @1.895%	$0
Total Progressive Payroll Tax + Rent Increase	**$175,890**
Gain (Loss) vs. Current Tax	**$26,610**

Most hotels in San Francisco own rather than rent their space, and would be significant winners under the progressive payroll tax proposal.

A large, 350 employee hotel would pay over $25,000 less, saving approximately 0.05% of gross receipts.

Impact on Specific Businesses: Commercial Bank

Commercial Bank
NAICS: 52211
Sector: Financial Services

Assumptions about the business:

Number of Employees:	700	
Annual Gross Receipts:	$560,000,000	
Total Annual Payroll	$90,000,000	
Payroll for Workers Over $85,000	$50,000,000	
Payroll for Workers Under $85,000	$40,000,000	
Annual Rent	$6,125,000	
Current Tax	Tax Paid	
Tax on Total Payroll, @1.5%	**$0**	(exempt)
Progressive Payroll Tax Option	Tax Paid	
Payroll tax on workers > $85,000, taxed at 1.5%	$0	(exempt)
+ Payroll tax on workers < $85,000, taxed at 1.3%	$0	(exempt)
- Tax Credit	$1,500	
Progressive Payroll Tax	$0	
+ 90% of Rent tax passed through, @1.895%	$104,462	
Total Progressive Payroll Tax + Rent Increase	**$104,462**	
Gain (Loss) vs. Current Tax	**($104,462)**	

Commercial banks are exempt from all local taxation, and would continue to be exempt under the progressive payroll legislation.

However, they would pay higher rents, likely exceeding $100,000 per year, or 0.02% of gross receipts.

Economic Impact Factors

- Lower payroll costs: Lowering the payroll tax on workers below $85,000 will reduce the cost of hiring in San Francisco, creating jobs and boosting local spending.
- Higher occupancy costs: Commercial rent tax will raise occupancy costs and make San Francisco a less competitively-priced office location.
- Government spending: Increased City revenue will generate multiplier effects and maintain City services.
- The aggregate economic impact of the legislation is the combination of these individual effects.

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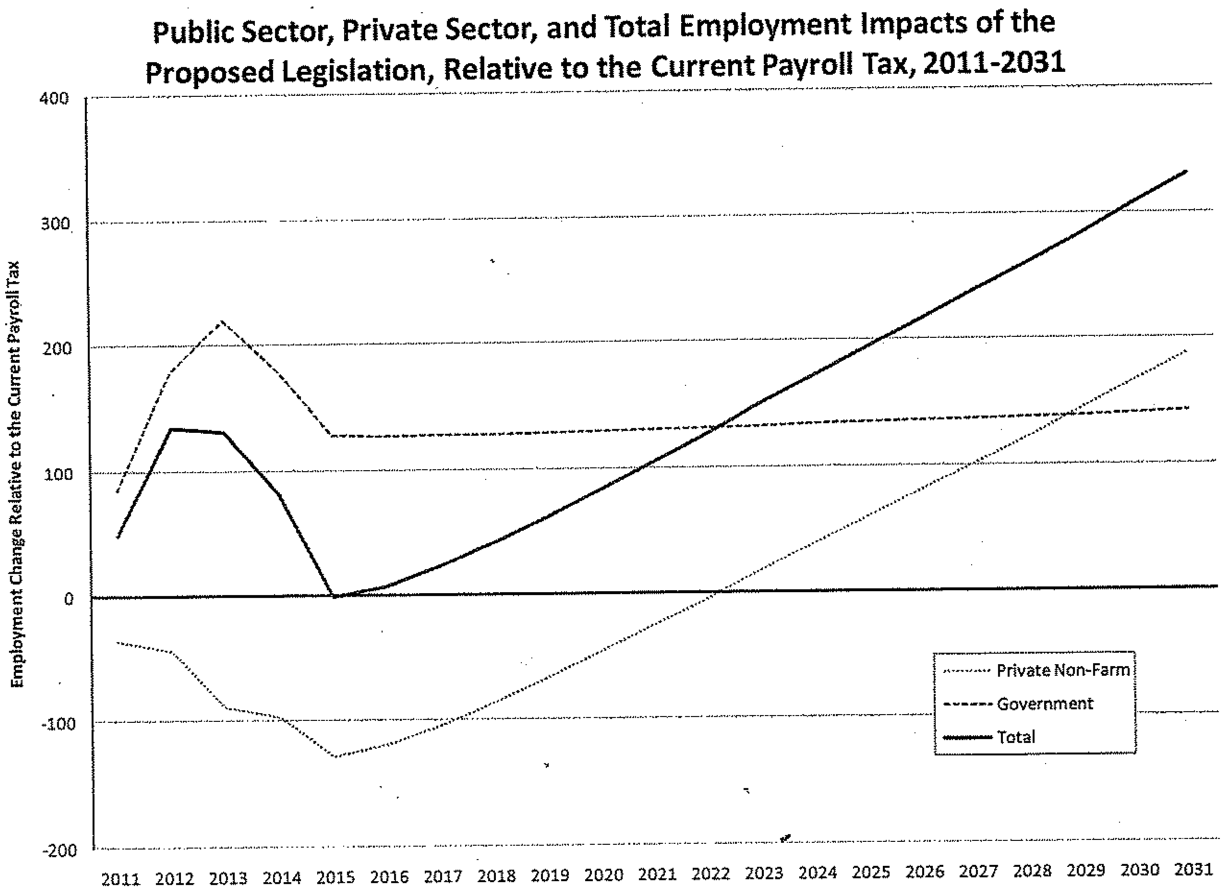
Economic Impact Assessment: Twenty-Year Employment Impacts

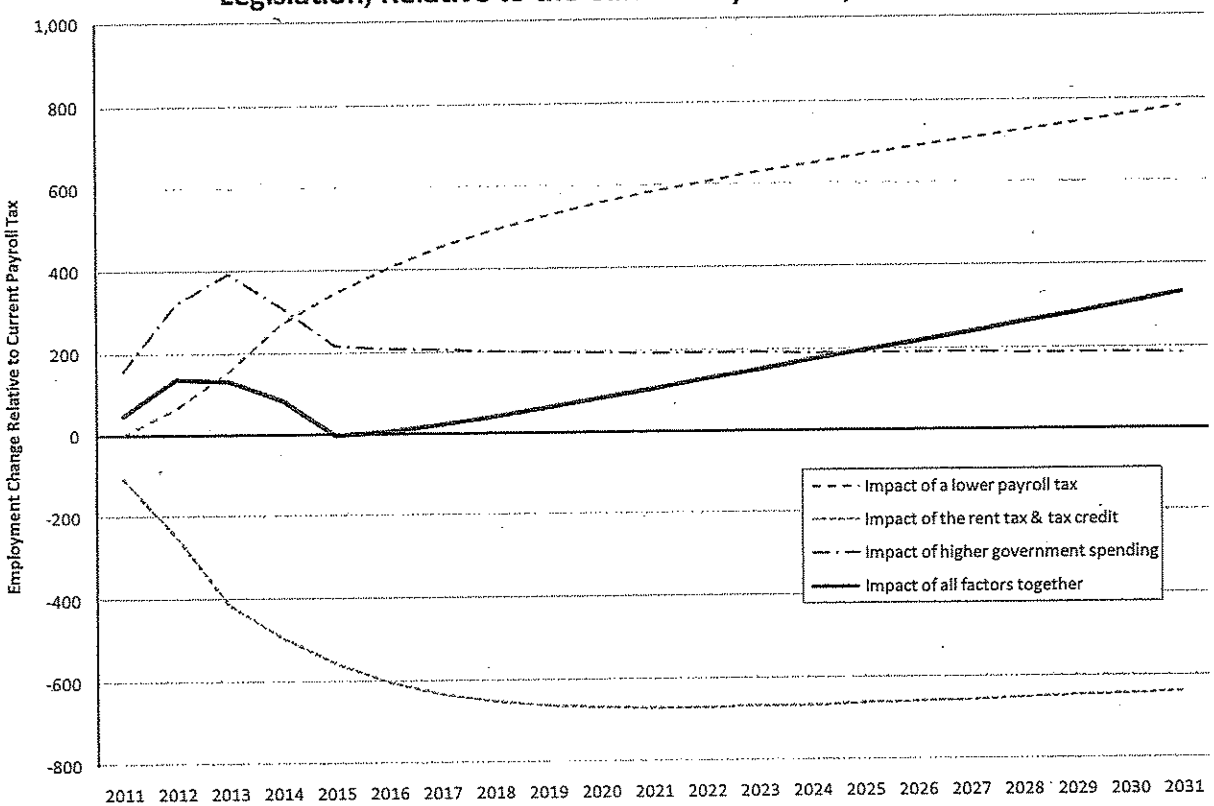


The legislation will cause private sector employment will to decline, relative to the current payroll tax, until 2022, and then rise. The average private sector job impact is 6 jobs, or essentially zero, over twenty years.

However, the tax revenue raised by the legislation supports public sector employment. The total (public + private) job impact is projected to be positive every year except 2015, at the end of the phase-in.

Economic Impact Assessment: Employment Effects by Factor

Employment Effects of Individual Tax Changes in the Proposed Legislation, Relative to the Current Payroll Tax, 2011-2031



The overall job impacts of the legislation can be broken down by its individual tax and revenue items.

While the new rent tax & tax credit package would cost between 600-700 jobs per year, the lower payroll tax would create more jobs in the long run, after 2025.

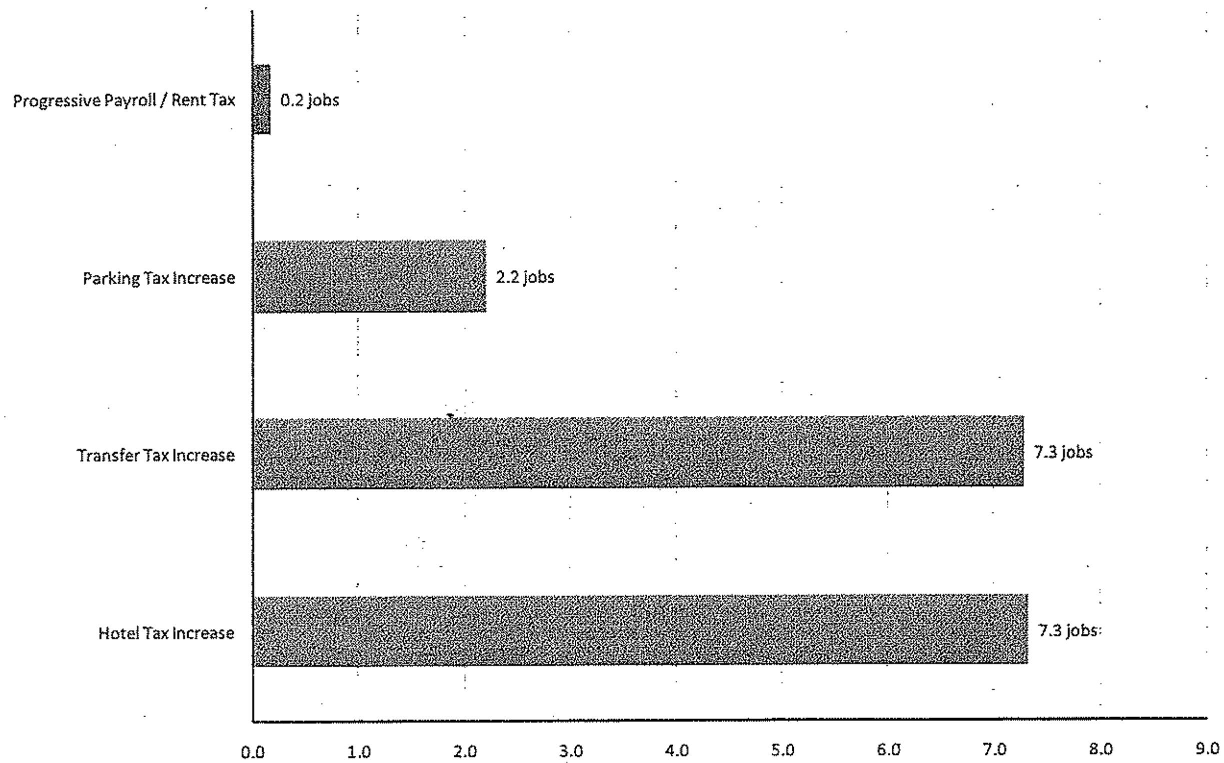
In addition, the higher government spending will sustain about 200 jobs each year, in the public and private sectors, with more coming in the early years.

Economic Efficiency Relative to Other Tax Measures

- The private sector job cost of the proposed legislation can be compared to that of other tax proposals that have been introduced:
  - Real Property Transfer Tax Increase (100750)– will raise housing & occupancy costs, leading to wage inflation and reduced job growth in all industries.
  - 2% increase in the Hotel Tax – will be partly passed on to visitors, lowering occupancy, tourism spending, and tourism industry employment
  - Increase in the Parking Tax (100759)– will reduce consumer spending in San Francisco, reducing employment, mainly in retail trade.
- Detailed economic impact reports on transfer and parking tax measures are underway, and will be released shortly.

Estimated Private Sector Job Loss per $1 million in City Revenue Gained

Average Private-Sector Jobs Cost, per $1 Million Revenue Gain: Proposed Legislation and Three Pending Revenue Measures



The proposed legislation generates $35 million in revenue, at a net average cost of 6 private sector jobs over the next twenty years.

Given the precision of the OEA's REMI model, this is essentially a zero impact.

In comparison with the other tax measures that have been or may be introduced this year, the proposed legislation has by far the lowest negative private sector job impact.

Conclusions and Recommended Amendments

- The proposed legislation modifies the Progressive Payroll option in the Controller's report, to achieve greater revenue growth while minimizing private sector job growth.
- It is less damaging to the economy than other tax measures that have been introduced or discussed in 2010.
- Rent tax revenue estimates are highly uncertain. If the legislation is intended to raise $35 million in revenue, it might be advisable to modify the phase-in formula to ensure precisely that amount is generated.