

File No. 090228

Committee Item No. 6

Board Item No. _____

COMMITTEE/BOARD OF SUPERVISORS

AGENDA PACKET CONTENTS LIST

Committee BUDGET AND FINANCE

Date 2/17/10

Board of Supervisors Meeting

Date _____

Cmte Board

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OTHER

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| <input checked="" type="checkbox"/> | <input type="checkbox"/> | <u>Economic Impact Report</u> |
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Completed by: Gail Johnson

Date 2/12/10

Completed by: _____

Date _____

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

1 [Payroll Expense Tax Revision To Encourage Job Retention And Creation In San Francisco.]

2
3 **Ordinance amending the Payroll Expense Tax Ordinance by adding Section 905 to**
4 **permit the Payroll Expense Tax owed for the year 2010 to be paid at the lower of the**
5 **amount owed for 2009 or 2010 and for the year 2011 to be paid at the lowest of the**
6 **amount owed for 2009, 2010, or 2011.**

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

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

11 Section 1. The San Francisco Business and Taxation Code is hereby amended by
12 adding Section 905, to read as follows:

13 **Sec. 905. Payroll Expense Taxes For the Years 2010 and 2011.**

14 For every person required to pay the payroll expense tax under Section 903, the amount of the
15 payroll expense tax owed in year 2010 shall be the lesser of the amount owed in years 2009 or 2010,
16 including zero, and the amount of payroll expense tax owed in year 2011 shall be the lowest of the
17 amount owed in years 2009, 2010 or 2011, including zero.

18
19 APPROVED AS TO FORM :
20 DENNIS J. HERRERA, City Attorney

21 By: 

22 LINDA ROSS
23 Deputy City Attorney

24
25 Mayor Newsom, Supervisor Duffy
BOARD OF SUPERVISORS

LEGISLATIVE DIGEST

[Temporary Revision of Payroll Expense Tax To Stimulate Job Retention and Creation]

Ordinance amending the Payroll Expense Tax Ordinance by adding Section 905 to permit the Payroll Expense Tax owed for the year 2010 to be paid at the lower of the amount owed for 2009 or 2010 and for the year 2011 to be paid at the lowest of the amount owed for 2009, 2010, or 2011.

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 Professions Tax Code Sections 901 et seq.) The tax rate is 1.5% of taxable payroll expense. This tax is determined each year based on the payroll expenses of the entity.

Amendments to Current Law

The proposed amendments would add a new Section 905 to limit the payroll expense tax owed during 2010 to the lesser of the tax owed in 2009 or 2010, including zero, and would limit the payroll expense tax owed in 2011 to the lowest of the tax owed in 2009, 2010 or 2011, including zero.

Background Information

Under Business and Tax Regulations Code Section 901 et seq., business entities pay a "payroll expense tax" based on the compensation paid to employees and others for work or services rendered in San Francisco. (Section 901.1) The payroll expense tax includes taxes on compensation paid to those with ownership interests in professional corporations, limited liability companies, and limited liability companies among others – called "pass-through entities" under the Code. (Sections 901.1, 902.2)

This proposed amendment would add a new Section 905 for the purpose of encouraging entities to retain or hire employees to work in San Francisco. The proposed amendment would limit the payroll expense tax owed in 2010 to the lower of the tax owed in 2009 or 2010, even if zero, and limit the payroll expense tax owed in 2011 to the lowest of the tax owed in 2009, 2010, or 2011, even if zero.

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Based on this proposed amendment, an employer that increased its payroll expenses in 2010 or in 2011 over its 2009 payroll, would pay payroll expense tax based on its 2009 payroll. This proposed amendment would include employers who paid zero payroll taxes in 2009. Therefore, employers who began to pay compensation in 2010 and/or in 2011 to employees working in San Francisco, would potentially pay zero in payroll taxes for those workers in 2010 and/or 2011.

Item 6**File 09-0228¹****Department:**

Office of the Treasurer and Tax Collector

EXECUTIVE SUMMARY**Legislative Objectives**

- Ordinance amending the San Francisco Business and Tax Regulations Code, by creating a new Section 905 which would limit the amount of Payroll Expense Tax payable to the City by an employer in tax years 2010 and 2011. In 2010 the employer would pay the City the lesser of either (a) the amount paid in 2009, or (b) the amount owed in 2010. In 2011 the employer would pay the lesser of either (a) the amount paid in 2009, (b) the amount paid in 2010, or (c) the amount owed in 2011.

Fiscal Impacts

- The proposed ordinance would result in (a) a net reduction of tax revenues by an estimated \$72,000,000 over two years, 2010 and 2011, and (b) an increase in the administrative costs of the Office of the Treasurer and Tax Collector by an estimated \$709,851 over the two years, for a total net two-year fiscal impact of reduced revenues and increased costs to the City of an estimated \$72,709,851.

Key Points

- The City currently imposes a Payroll Expense Tax of 1.5 percent of compensation paid by private employers to the City. The proposed ordinance would limit the amount of Payroll Expense Taxes payable to the City, such that any growth in payroll occurring in 2010 or 2011 would effectively be exempt from the City's Payroll Expense Tax.
- The Controller's Office of Economic Analysis estimates that the proposed ordinance would create up to 2,900 jobs during the two year period. However, by 2020, only approximately 400 of those jobs would still exist.

Recommendation

- Because the proposed ordinance would result in a net reduction in tax revenues and increased expenses by an estimated total of \$72,709,851 over the years 2010 and 2011, approval of the proposed ordinance is a policy matter for the Board of Supervisors.

¹ This report is based on an amendment of the whole introduced on February 9, 2010.

MANDATE STATEMENT

Mandate Statement

Section 901 of the San Francisco Business and Tax Regulations Code, known as the Payroll Expense Tax Ordinance, imposes a tax on private employers operating businesses in San Francisco of 1.5 percent of the total annual compensation paid to employees for work performed in San Francisco. However, employers, whose compensation payments to its employees total \$250,000 or less annually, are exempt from paying the Payroll Expense Tax to the City.

DETAILS OF PROPOSED LEGISLATION

The proposed ordinance would limit the amount of the Payroll Expense Tax payable to the City by an employer in tax years 2010 and 2011. In 2010 the employer would pay to the City the lesser of either (a) the amount paid in 2009, or (b) the amount owed in 2010. In 2011 the employer would pay the lesser of either (a) the amount paid in 2009, (b) the amount paid in 2010, or (c) the amount owed in 2011.

FISCAL IMPACTS

The proposed ordinance would limit the amount of Payroll Expense Taxes payable to the City of San Francisco for tax years 2010 and 2011.

The Controller's Office of Economic Analysis estimates that the proposed ordinance to limit Payroll Expense Taxes would result in a net tax revenue reduction of approximately \$72,000,000 over the two years of the proposed Payroll Expense Tax limits, as shown in Table 1 below.

Table 1: Fiscal Impact During 2010-2011²

Year	Decrease in Payroll Expense Tax	Increase in Other Taxes ³	Net Decrease
2010	-\$33,000,000	\$5,000,000	-\$28,000,000
2011	-\$52,000,000	8,000,000	-\$44,000,000
Total	-\$85,000,000	\$13,000,000	-\$72,000,000

Mr. Ted Egan, Chief Economist for the Controller's Office of Economic Analysis, stated he would be present at the Budget and Finance Committee meeting on February 17, 2010 to present the details of the economic impact which would result from the proposed ordinance.

² The Controller's Office of Economic Analysis also estimates an increase in Property Tax, Hotel Tax, Sales Tax, and Utility User Tax paid to the City from 2012-2020 totaling approximately \$30,000,000, as a result of the creation of new jobs.

³ The Controller's Office of Economic Analysis estimates increases in Property Tax, Hotel Tax, Sales Tax, and Utility User Tax, would result from the creation of an estimated 2,900 private sector jobs over a two year period.

Ms. Tajel Shah, Director of Budget and Operations for the Office of the Treasurer and Tax Collector, stated that the increased administrative costs to collect the Payroll Expense Tax as a result of the proposed ordinance would be an estimated \$709,851 in total over 2010 and 2011, as shown in Table 2 below.

Table 2: Estimated Increased Administrative Costs of the Office of the Tax Collector in 2010-2011

	FTE	FTE Adjusted Annual Salary	Mandatory Fringe Benefits	Total
Implementation Costs				
Principal Programmer (Class 1064)	1.0	\$109,229	\$36,045	\$145,274
Labor Overhead at 15.9%		-	-	23,099
Adobe Setup Costs		-	-	30,000
Subtotal Implementation (One-Time Costs)	1.0			198,373
Ongoing Costs				
Clerk (Class 1408)	1.0	\$65,546	\$19,664	\$85,210
Senior Account Clerk (Class 1632)	0.8	47,570	15,698	63,268
Collections Supervisor (Class 4310)	0.5	44,148	14,569	58,717
Labor Overhead at 15.9%		-	-	32,944
Adobe Licenses for New Forms		-	-	6,000
Production of New Forms		-	-	9,600
Subtotal First Year of Ongoing Costs	2.3			\$255,739
Second Year of Ongoing Costs	2.3			255,739
Totals	5.6			\$709,851

Therefore, the total General Fund two-year fiscal impact of the proposed ordinance is estimated to be \$72,709,851 in tax years 2010 and 2011, including (a) net reduced taxes payable to the City of \$72,000,000 (including reduced Payroll Expense Taxes of \$85,000,000) as shown in Table 1 above, and (b) increased administrative costs to the City in the amount of \$709,851 as shown in Table 2 above.

As discussed above, the proposed net tax reduction of \$72,000,000 includes (a) approximately \$85,000,000 in reduced Payroll Expense Taxes, and (b) approximately \$13,000,000 in increased other taxes such as Property Tax, Hotel Tax, Sales Tax, and Utility User Tax, resulting from job creation. The Budget Analyst notes that the City's Payroll Expense Taxes are budgeted at \$348,213,000 in the FY 2009-2010 Annual Appropriations Ordinance, as previously approved by the Board of Supervisors, such that the 2011 annual Payroll Expense Tax reduction of \$44,000,000 represents 12.6 percent of the FY 2009-2010 budgeted amount for Payroll Expense Tax of \$348,213,000.

POLICY CONSIDERATIONS

The proposed ordinance would increase the City's overall projected FY 2010-2011 budgetary shortfall of \$522,000,000 by \$28,454,112, or 5.5 percent, to \$550,000,000.

According to a letter provided by the Mayor to the Board of Supervisors on December 17, 2009, the projected budget shortfall for FY 2010-2011 is \$522,000,000. The proposed ordinance would result in a cost to the City of \$28,454,112, including (a) reduced tax revenues of \$28,000,000 (shown in Table 1 above), (b) increased one-time administrative costs of implementation of \$193,373 (shown in Table 2 above), and (c) increased ongoing administrative costs of \$255,739 (shown in table 2 above). Therefore, approval of the proposed ordinance would result in increasing the City's overall estimated \$522,000,000 budgetary shortfall in FY 2010-2011 by \$28,454,112 or 5.5 percent, to \$550,454,112.

According to the estimates from the Controller's Office of Economic Analysis, the proposed ordinance would temporarily create a net increase of up to 2,900 jobs over the two year period of the proposed tax limits. However, by 2020, only approximately 400 of those jobs would still exist.

The economic impact report prepared by the Controller's Office of Economic Analysis states that the proposed ordinance is estimated to temporarily create up to 2,900 new private sector jobs during the two year period of the proposed Payroll Tax limits. The Budget Analyst notes that should the City decide to offset the \$72,000,000 net decrease (see Table 1 above) in tax revenues to the City solely through layoffs, at an average annual cost per job of approximately \$127,832⁴, the City would have to layoff up to an estimated 282 employees for a period of two years based on an average annual compensation and fringe benefits costs of \$127,832 ($\$72,000,000 \div 2 \text{ years} \div \$127,832$)⁵.

The Controller's Office of Economic Analysis estimates that, after the initial two year period of the proposed Payroll Expense Tax limits, the employment effects of the proposed ordinance would diminish, such by 2020, only approximately 400 of those jobs would still exist.

The proposed ordinance is to create an incentive to (a) hire new employees, and (b) increase compensation for existing employees.

The proposed ordinance, titled "Payroll Expense Tax Revision to Encourage Job Retention and Creation in San Francisco", would exempt from Payroll Expense Taxes owed to the City any increase in compensation paid to employees over the amount paid in 2009. However, the Budget Analyst notes that such compensation increases paid to employees could result from either (a) compensation paid to new employees, or (b) increases in compensation paid to existing employees. Therefore, the approval of the proposed ordinance, which would result in estimated General Fund tax revenue reductions to the City of \$72,000,000 (see Table 1 above), does not guarantee that new jobs will be created.

⁴ This calculation was provided by the Controller.

⁵ The Controller's Office of Economic Analysis estimates that if the City's budget was reduced across all spending categories (including salaries and fringe benefits) by \$72,000,000 to offset the reduction in tax revenue, then the resulting proportional reduction in City employment would be 140 jobs. This differs from the Budget Analyst's calculation above which assumes all cost savings are from cuts to City salaries and fringe benefits.

The Budget and Finance Committee is considering two ordinances (File Nos. 09-0228 and 09-1461) regarding reductions to the Payroll Expense Tax. If both ordinances are approved, it is uncertain in how the Payroll Expense Taxes owed to the City should be calculated in 2010 and 2011.

These two ordinances are (a) the subject ordinance to exclude growth in payroll over 2009 from the Payroll Expense Taxes due in 2010 and 2010 (File 09-0228), and (b) a Payroll Expense Tax credit or refund of \$2,000 in 2010 for small businesses (20-49 employees) which comply with the City's Health Care Security Ordinance 2010 (File 09-1461). If both proposed ordinances are approved by the Board of Supervisors, it is uncertain as to what proposed tax reduction, either the \$2,000 credit or refund or the exclusion in taxable payroll growth, would apply first.

For example, assuming both ordinances are approved and an employer is eligible for the Payroll Tax reductions proposed in both ordinances, for the year 2010, the ordinances, in combination, are unclear which of the formulas below would determine the tax owed:

1. Lesser of (a) Taxes owed in 2009 or (b) Taxes owed in 2010. Then reduce that value by \$2,000.
2. Lesser of (a) Taxes owed in 2009, or (b) Taxes owed in 2010 less \$2,000.

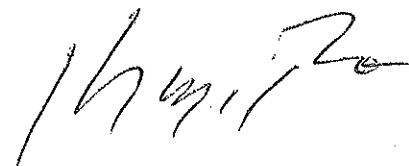
For the year 2011, a similar uncertainty exists regarding formulas below would determine the tax owed:

1. Lesser of (a) Taxes owed in 2010 less \$2,000, or (b) Taxes owed in 2011.
2. Lesser of (a) Taxes owed in 2010 regardless of the \$2,000 credit or refund, or (b) Taxes owed in 2011.

The Budget Analyst notes that the fiscal impact to the City calculated by the Controller's Office and the Treasurer/Tax Collector for each proposed ordinance does not include the final impact to the City which might be caused if both ordinances are approved by the Board of Supervisors.

RECOMMENDATION

Because the proposed ordinance would result in a reduction over tax years 2010 and 2011 in General Fund Tax revenues payable to the City of an estimated \$72,000,000, and would result in an increase of expenditures to be incurred by the City of an estimated \$709,851, or a net cost to the City of an estimated \$72,709,851, approval of the proposed ordinance is a policy matter for the Board of Supervisors.



Harvey M. Rose

cc: Supervisor Avalos
Supervisor Mirkarimi
Supervisor Elsbernd
President Chiu
Supervisor Alioto-Pier
Supervisor Campos
Supervisor Chu
Supervisor Daly
Supervisor Dufty
Supervisor Mar
Supervisor Maxwell
Clerk of the Board
Cheryl Adams
Controller
Greg Wagner



TO: Angela Calvillo, Clerk of the Board of Supervisors
FROM: *for* Mayor Gavin Newsom *G*
RE: Substitute Ordinance to Revise Payroll Expense Tax
DATE: February 9, 2010

Dear Madame Clerk:

Attached for introduction to the Board of Supervisors is substitute legislation for the ordinance pending in File No. 090228, amending the Payroll Expense Tax Ordinance by adding Section 905 to permit the Payroll Expense Tax owed for the year 2010 to be paid at the lower of the amount owed for 2009 or 2010 and for the year 2011 to be paid at the lowest of the amount owed for 2009, 2010, or 2011.

I request that this item be scheduled in the Budget and Finance Committee.

Please note: Supervisor Bevan Dufty is a co-sponsor of this legislation.

Should you have any questions, please contact Starr Terrell at (415) 554-5262.

Cc: Supervisor Bevan Dufty



SMALL BUSINESS COMMISSION
OFFICE OF SMALL BUSINESS



CITY AND COUNTY OF SAN FRANCISCO
GAVIN NEWSOM, MAYOR

February 11, 2010

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

RE: File No. 090228 [Temporary Revision of Payroll Expense Tax to Stimulate Job Retention and Creation.] Ordinance amending the San Francisco Business and Tax Regulations Code, Payroll Expense Tax Ordinance, by adding Section 905 to permit the Payroll Expense Tax owe for the year 2009 to be paid at the lower of the amount owed for 2008 or 2009 and for the year 2010 to be paid at the lower of the amount owed for 2008 or 2010, but not reducing any taxes attributable to payroll expenses for owners or beneficiaries of pass through entities and others.

Small Business Commission Recommendation: **Approval**

Dear Ms. Calvillo:

On March 9, 2009, the Small Business Commission originally heard File No. 090228 and recommended approval to the Board of Supervisors. The Small Business Commission requested to hear it again on February 8, 2009, to reaffirm to the Board of Supervisors a **strong recommendation for approval** for File #090228.

The Small Business Commission supports the Mayor's efforts to stimulate job growth which is critical to improving San Francisco's economy.

Sincerely,

Regina Dick-Endrizzi
Director, Office of Small Business

cc. Supervisor Avalos, Mirkarimi and Elsbernd
Starr Terrell
Gail Johnson, Clerk of the Budget and Finance Committee



Peggy Nevin/BOS/SFGOV

02/10/2010 04:11 PM

To Gail Johnson/BOS/SFGOV@SFGOV

cc

bcc

Subject Fw: Temporary Revision of Payroll Tax Expense: Economic Impact Analysis

From: Controller Reports/CON/SFGOV
To: Angela Calvillo/BOS/SFGOV@SFGOV, BOS-Supervisors/BOS/SFGOV, Steve Kawa/MAYOR/SFGOV@SFGOV, Greg Wagner/MAYOR/SFGOV@SFGOV, Joe Arellano/MAYOR/SFGOV@SFGOV, Starr Terrell/MAYOR/SFGOV@SFGOV, CON-Barometer/CON/SFGOV
Cc: BOS-Legislative Aides/BOS/SFGOV, Ken Bruce/BudgetAnalyst/SFGOV@SFGOV, Debra Newman/BudgetAnalyst/SFGOV@SFGOV, Severin Campbell/BudgetAnalyst/SFGOV@SFGOV, CON-Media Contact/CON/SFGOV, CON-EVERYONE/CON/SFGOV
Date: 02/10/2010 03:20 PM
Subject: Temporary Revision of Payroll Tax Expense: Economic Impact Analysis
Sent by: Maura Lane

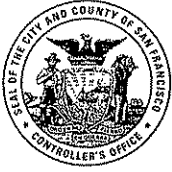
Main Conclusions:

The proposed tax policy would allow San Francisco businesses to pay no tax on any growth in payroll that they experience in 2010 or 2011. Currently, the City levies a 1.5% tax on large and medium sized businesses. Under the policy, growing businesses would be incentivized to add jobs in San Francisco, since net new payroll would be essentially tax-free for the two year period.

The policy is projected to have a significant impact on job creation in San Francisco, offsetting between 5% and 8% of all jobs lost in the City over the past two years, with some employment continuing after the policy expires in 2012. At an average cost of \$16,500 per job during the two year period, the proposed policy is one of the most cost-effective local economic policies available.

However, the job creation would come at a significant cost to the City's General Fund, of \$28 million during the first year, and \$44 million in the second year. This cost is net of the additional tax revenue generated by the jobs created by the policy. The policy can be further tailored to reduce the cost to the City, although reduction in the scope of the incentive will also reduce its impact on unemployment in San Francisco.

<http://co.sfgov.org/webreports/details.aspx?id=1022>



CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

RECEIVED
BOARD OF SUPERVISORS
SAN FRANCISCO

2010 FEB 10 PM 3:06

Ben Rosenfield
Controller
Monique Zmuda
Deputy Controller

BY al

February 10, 2010

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

Re: Office of Economic Analysis Impact Report for File Number ~~090288~~

090228

Dear Madam Clerk:

The Office of Economic Analysis is pleased to present you with its economic impact report on file number 090288, "Temporary Revision of Payroll Tax Expense: Economic Impact Analysis." 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 and Finance Committee

Temporary Revision of Payroll Tax Expense: Economic Impact Analysis

Item #090288

Office of Economic Analysis

February 10, 2010



Introduction

- Proposed policy will allow businesses to pay, in 2010, the lesser of their 2009 or 2010 payroll tax liabilities.
- In 2011, they will be able to pay the lesser of their 2011 or 2009 payroll tax liabilities.
- In effect, the policy gives firms a tax break on net new payroll, effectively encouraging local hiring during the recession.
- The proposed policy will have a strong positive impact on local hiring, albeit at a steep cost to the City's General Fund.
- The policy is a targeted tax cut that mirrors the President's New Jobs Tax Credit, which is supported by a wide range of economists.



Important Aspects of the Policy

- No business affected by the policy will pay less in payroll tax than they did in 2009.
- Reduction in labor costs will stimulate some job creation.
- However, many businesses would add employment even without the tax incentive. The City would lose payroll tax growth that it would otherwise have received for tax years 2010 and 2011.
- Because the City cannot run a fiscal deficit from one year to the next, the lost revenue would necessitate reductions in City staffing and services, like any revenue shortfall.



Economic Context

- As of December 2009, there were 41,700 unemployed residents of San Francisco, 22,900 more than there were in December 2007.
- Approximately 36,000 jobs have been lost in the City during that time.
- During the recession the city's unemployment rate, currently 9.4%, has exceeded any recorded for San Francisco dating back to 1990.
- Seasonally-unadjusted unemployment has declined for several months in San Francisco. However, the President's Budget assumes national unemployment will remain at 8% until 2013.



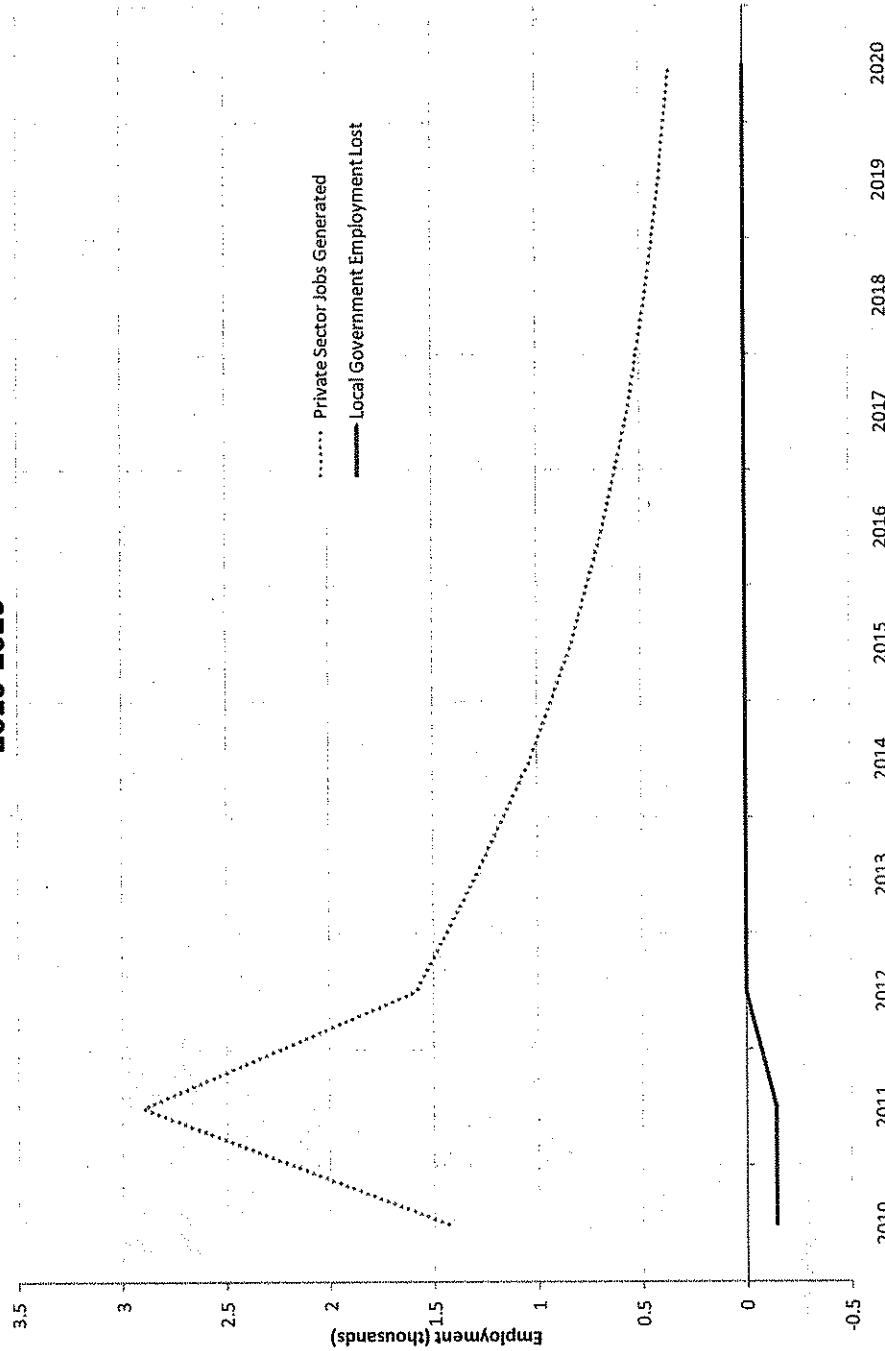
Summary of Impacts

- Policy will create a net 1,430 jobs in 2010 and 2,900 jobs in 2011.
 - Represents 5-8% of total jobs lost in San Francisco since December, 2007.
 - This number includes the projected losses of public sector employment due to the revenue shortfall associated with the policy.
 - Assumes an April 1 2010 start date and no induced employment prior.
 - Will also create an annual average of 890 jobs 2012-2020, after the policy expires.
- Over the next two years, the net revenue impact to the City will be a loss of approximately \$72 million. Over ten years, the cost will fall to \$42 million, because of ongoing tax revenue from new job generation.
- Average cost per job is \$16,500 in 2010 and 2011.
- The potential impacts of the City revenue decline on public services, and indirectly on the economy, is not considered, because the City could adjust to that impact in many ways.



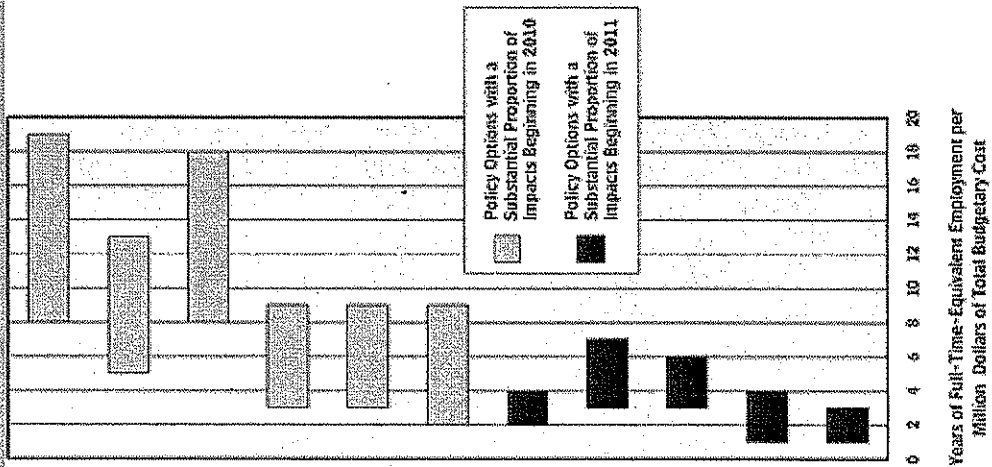
Employment Impacts, 2010-2020

Public and Private Sector Employment Impacts of the Proposed Policy, 2010-2020



CBO Assessment of Federal Stimulus Options

- Increasing Aid to the Unemployed
- Reducing Employers' Payroll Taxes
- Reducing Employers' Payroll Taxes for Firms That Increase Their Payroll
- Reducing Employers' Payroll Taxes
- Providing an Additional One-Time Social Security Payment
- Allowing Full or Partial Expensing of Investment Costs
- Investing in Infrastructure
- Providing Aid to States for Purposes Other Than Infrastructure
- Providing Additional Refundable Tax Credits for Lower- and Middle-Income Households in 2011
- Extending Higher Exemption Amounts for the Alternative Minimum Tax
- Reducing Income Taxes in 2011



Other than direct aid to the unemployed, a recent Congressional Budget Office analysis found that reducing payroll taxes for expanding businesses was the most cost-effective policy to stimulate job growth, ahead of all other types of tax cuts, infrastructure investment, and other non-infrastructure public spending.



Why a Targeted Tax Reduction is a More Effective Policy Than a Simple Tax Cut

- Payroll tax reductions can stimulate employment by reducing the effective cost of labor to businesses.
- However, if the stimulus does not directly incentivize job creation, it may not overcome the loss of public sector employment that the subsidy's revenue would pay for.
- Reducing the tax subsidy to only *new* payroll at expanding ensures that more of the subsidy goes to businesses that actually will increase payroll, and is therefore a more efficient tax policy.



Options to Reduce the Cost of the Policy

- The proposed policy can be re-scaled to reduce its cost. The net employment increase of the policy will be proportionally reduced as well.
- Three ways to scale the policy include:
 - By capping the maximum tax credit per business.
 - By reducing the percentage of new payroll tax excluded.
 - By restricting the policy to small businesses.



Reducing the Policy Cost by Capping the Maximum Tax Credit

Maximum Credit	Two-Year Cost	Net Two-Year Job Gain
Current: no maximum	\$72 million	4,330
\$10,000 per business	\$33 million	1,995
\$5,000 per business	\$21 million	1,300
\$2,500 per business	\$12 million	710
\$1,000 per business	\$5 million	325

This approach favors job creation in small businesses, without explicitly excluding large businesses. It does so by limiting the total size of the credit, which will usually mean more of a small business's new hires would be covered.



Reducing the Policy Cost by Limiting the Total Payroll of Eligible Businesses

Maximum Payroll	Two-Year Cost	Net Two-Year Job Gain
Current: no maximum	\$72 million	4,330
\$50,000,000	\$57 million	3,540
\$25,000,000	\$47 million	2,865
\$10,000,000	\$36 million	2,190
\$5,000,000	\$26 million	1,515

This approach explicitly restricts the program to businesses below a certain level of payroll, but allows these businesses to exclude all new payroll from their tax.



Reducing the Policy Cost By Reducing the Percentage of Tax Exempted

Net New Payroll Exempted	Two-Year Revenue Loss	Net Two-Year Job Gain
Current: 100%	\$72 million	4,330
75%	\$53 million	3,245
50%	\$36 million	2,165
25%	\$18 million	1,080
10%	\$7 million	430

This approach opens the policy to all businesses without a cap, but instead of exempting 100% of new payroll from the payroll tax, it exempts only a fraction. Both the cost of the policy, and the effective reduction in labor costs which generate the job growth, are reduced in proportion.



Conclusion

- The proposed targeted tax cut would have a strong positive impact on job creation in San Francisco.
- The policy would also make the City’s serious current budget deficit worse, and likely lead to significant employment reductions in the City’s workforce.
- At the federal level, the policy is favored by many economists and is among the most efficient tax policies for job generation.
- The incentive has a high cost as proposed, but can be scaled in one of several ways to reduce its cost to the City.



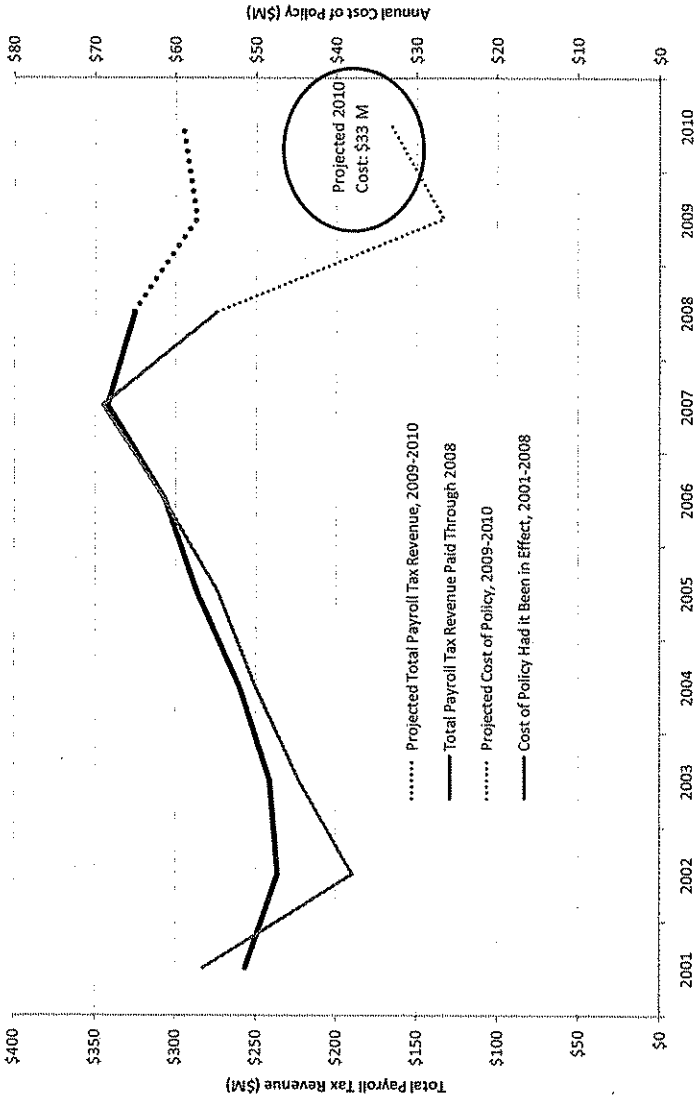
Appendix

- Estimating the Payroll Tax Revenue Loss
- Estimating Job Creation
- Estimating the Revenue Gains of the Jobs Created
- Estimates of Net Revenue



Estimating First-Year Payroll Tax Lost from the Policy

**Projected First-Year Cost of the Proposed Policy, 2010
With What It Would Have Cost in 2001 -2008**
(Total Payroll Tax Revenue Shown to Illustrate Trend)



During the 2001-2004 recession, total payroll tax revenue declined, but the payroll tax from expanding businesses declined 4 times as fast. The total payroll tax paid by expanding businesses is the cost of the proposed policy.

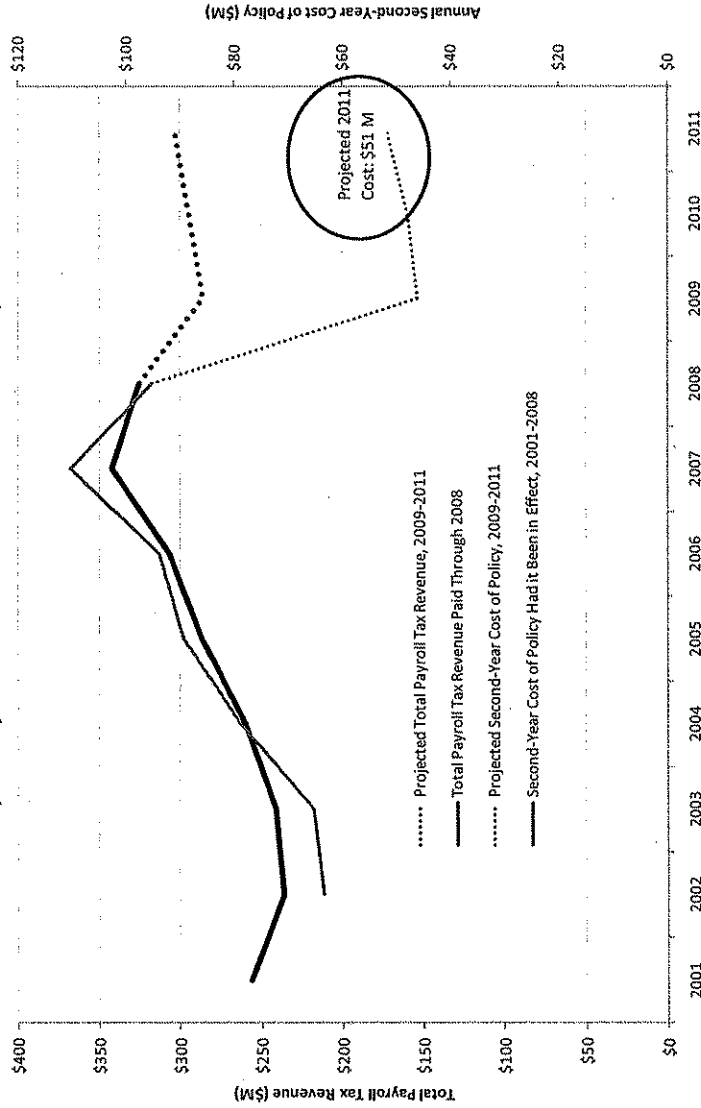
The Controller's Office is projecting a 12% decline in payroll in 2009. If the same relationship holds as the last recession, that would lead to a 51% drop in expanders' payroll in 2009, followed by a 24% gain in 2010.

This would translate into a policy cost of \$33 million in 2010, the first year of the policy.



Estimating the Second-Year Payroll Tax Loss from the Policy

Projected Second-Year Cost of the Proposed Policy, 2011, With What It Would Have Cost in 2001 -2010
(Total Payroll Tax Revenue Shown to Illustrate Trend)



In 2011, businesses will be eligible to pay based on their payroll from 2011 or 2009, whichever is lower.

If the two-year cut had been in effect over the last decade, the second year of the policy would have been significantly more expensive than the first year, because growing businesses would essentially receive two years of new payroll tax free.

If the same pattern of payroll decline and recovery occur in 2011 that we saw in the last recession, the second year of the policy will cost the City \$51 million in payroll tax revenue.



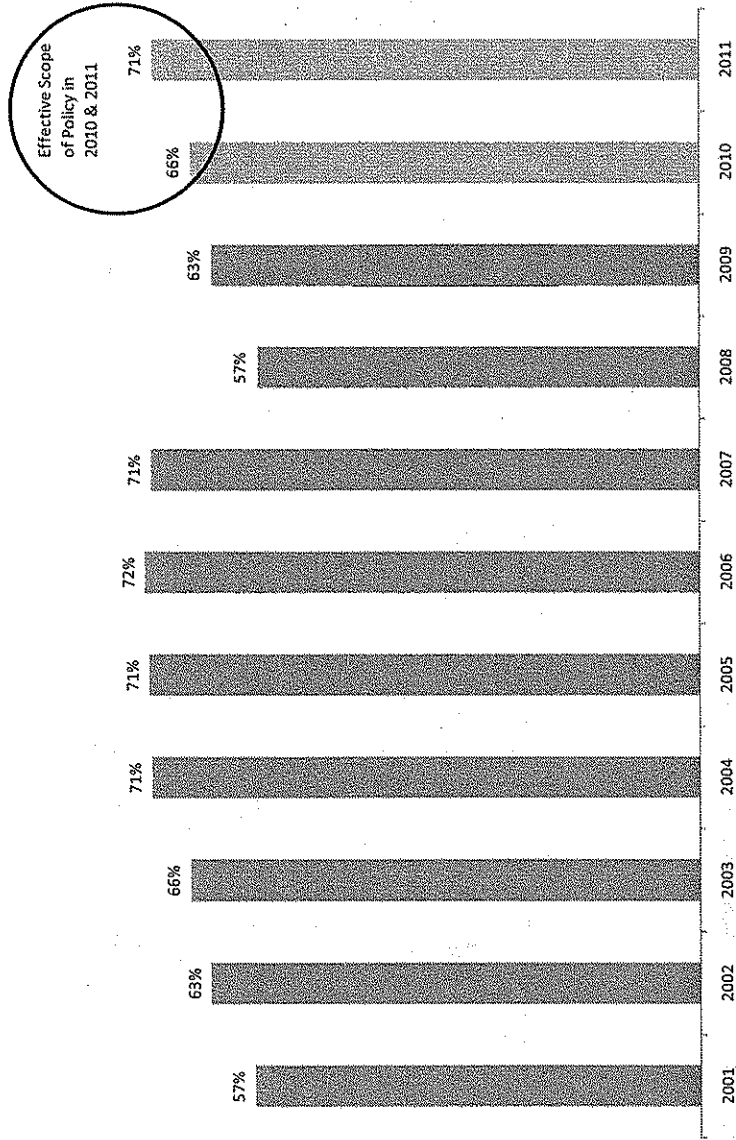
Estimating Job Creation from the Policy

- Estimating job creation involves two questions:
 - What percentage of the payroll tax base can take advantage of the incentive? This leads to an effective city-wide wage reduction?
 - How sensitive are employment changes to changes in wages? This depends on the elasticity of demand for labor in San Francisco, and can be modeled.



Percentage of Affected Businesses

Percentage of Payroll-Tax Paying Businesses Eligible for Exemption Had it Been in Effect, 2001-2011



Businesses whose total payroll is not expanding are not eligible for any payroll tax exemption under the policy. Consequently, the employment impact of the policy is somewhat less than it would be if it were a straight elimination of the payroll tax.

Nevertheless, based on past tax payment information provided by the Treasurer's Office, it is possible to estimate the percentage of businesses that could have benefited had the policy been in effect in the past.

For this report, it is assumed that the 2009, 2010, and 2011 are similar to the experience of 2001, 2002, and 2003.



Effect of Lower Labor Costs on Employment

- The net impact of the policy is an approximately 1% reduction of labor costs to San Francisco payroll-tax paying businesses in 2010 and 2011.
- The OEA's REMI model of the city economy estimates that a 1% reduction in labor costs will generate a .24% increase in private sector employment in 2010, and a 0.4% increase in employment in 2011.
- These elasticities of demand for labor are typical in econometric studies of the job creation impacts of tax credits*.

* See, for example, Timothy J. Bartik and John H. Bishop, "The Job Creation Tax Credit", *EPI Briefing Paper #248*, Economic Policy Institute. October, 2009.



Estimating the Revenue Impact of Employment Induced by the Policy

- Each new job induced by the policy (which is *not* the same as each worker hired created by growing businesses) indirectly generates other tax revenue:
 - Commercial and Residential Property Tax
 - Hotel Tax
 - Sales Tax
 - Utility User Tax
 - Payroll tax for induced employment continuing after 2011.



Summary of Ten-Year Revenue Impacts

	Payroll Tax Lost	Revenue Gain from Additional Employment	Net Revenue
Year 1	-\$33,135,365	\$5,205,186	-\$27,930,179
Year 2	-\$51,984,067	\$7,923,662	-\$44,060,405
Years 3-10	\$0	\$29,817,132	\$29,817,132
Years 1-10	-\$85,119,432	\$42,945,980	-\$42,173,453



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