

File No. 100756

Committee Item No. 3

Board Item No. \_\_\_\_\_

### COMMITTEE/BOARD OF SUPERVISORS

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Committee BUDGET AND FINANCE

Date 7/14/10

Board of Supervisors Meeting

Date \_\_\_\_\_

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Improving San Francisco's Business Tax:  
An Analysis of Two Alternatives\*

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Completed by: Gail Johnson

Date 7/12/10

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

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

7  
8           MOVED, That the Board of Supervisors hereby submits the following ordinance to the  
9 voters of the City and County of San Francisco, at an election to be held on November 2,  
10 2010.

11  
12 **Ordinance to be submitted to the voters amending the San Francisco Business and Tax**  
13 **Regulations Code by: (1) adding Article 12-E, Sections 1300-1307, to impose a**  
14 **commercial rent tax on the gross receipts from the rental of commercial real property;**  
15 **(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**  
16 **common administrative provisions to the commercial rent tax and adding Section 6.9-8**  
17 **to provide a limitation to the amount of tax credits claimed by related entities;**  
18 **(3) amending Article 12-A, Section 903.1 and adding Sections 902.7 and 906F, to**  
19 **establish a progressive payroll expense tax rate structure and a standard payroll**  
20 **expense tax credit; and (4) providing a savings clause.**

21  
22           NOTE:           Additions are single-underline italics Times New Roman;  
23                               deletions are ~~strike-through italics Times New Roman~~.

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

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

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

4 **Section 1. Findings and purpose.**

5 The voters hereby find and declare as follows:

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

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

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

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

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

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

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

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

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

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

15 **ARTICLE 12-E: COMMERCIAL RENT TAX**

16 **SEC. 1300. SHORT TITLE.**

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

19 **SEC. 1301. PURPOSE.**

20 *The City and County of San Francisco (the "City") imposes the Commercial Rent Tax for*  
21 *general governmental purposes and in order to require all segments of the commercial and the*  
22 *business community to carry their fair share of the costs of local government in return for the benefits,*  
23 *opportunities and protections that the City affords. The Controller shall cause proceeds from the tax to*  
24 *be deposited in the City's general fund, and the City may expend them for any City purposes.*  
25

1 **SEC. 1302. DEFINITIONS.**

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

4 **SEC. 1303.1. COMMERCIAL PURPOSES.**

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

9 **SEC. 1303.2. GROSS RECEIPTS.**

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

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

20 **SEC. 1304. IMPOSITION OF COMMERCIAL RENT TAX.**

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

1 used for commercial purposes.

2 **SEC. 1305. RATE OF COMMERCIAL RENT TAX.**

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

<u>Tax Year</u>	<u>Rate</u>
<u>2011</u>	<u>0.665%</u>
<u>2012</u>	<u>1.330%</u>
<u>2013 and subsequent years</u>	<u>1.995%</u>

8 **SEC. 1306. SMALL COMMERCIAL TENANT EXCLUSION.**

9 A person subject to the tax may exclude from gross receipts in a tax year the total amount  
10 received from a group of related entities if the total amount received by or on behalf of a person subject  
11 to tax from the group of related entities for the rental of real property from any location in the City and  
12 used for commercial purposes is less than \$65,000 in a tax year.

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

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

18 Section 3. Article 6 of the San Francisco Business and Tax Regulations Code is  
19 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  
20 adding Section 6.9-8, to read as follows:

21 **SEC. 6.1-1. COMMON ADMINISTRATIVE PROVISIONS.**

22 (a) Except where the specific language of the Business and Tax Regulations Code or  
23 context otherwise requires, these common administrative provisions shall apply to Articles 6,  
24 7, 9, 10, 10B, 11, 12, 12-A, ~~and~~ 12-B and 12-E of such Code and to Chapter 105 of the  
25 San Francisco Administrative Code. Any provision of this Article 6 that references or applies

1 to Article 10 shall be deemed to reference or apply to Article 10B. Any provision of this  
2 Article 6 that references or applies to a tax shall be deemed to also reference or apply to a fee  
3 administered pursuant to this Article.

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

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

#### 10 **SEC. 6.2-17. RETURN.**

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

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

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

16 (1) The City;

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

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

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



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

2             Except for jeopardy determinations under Section 6.12-2, and subject to prepayments  
3 required under Section 6.9-2, all amounts of taxes and fees imposed by Articles 6, 7, 9, 10,  
4 10A, 11, ~~and 12-A~~, and 12-E are due and payable, and shall be delinquent if not paid to the Tax  
5 Collector on or before the following dates.

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

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

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

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

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

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

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

22             (1) **Hotel and Parking Taxes.** The Hotel Tax (Article 7) and the Parking Tax  
23 (Article 9) shall be paid in monthly installments. Such monthly installments shall be due and  
24 payable to the Tax Collector on or before the last day of the month immediately following the  
25 month for which the prepayment is due. Taxes paid in the first two monthly installments of

1 any quarterly period shall be a credit against the total liability for such third-party taxes for the  
2 quarterly period. Estimated tax prepayments shall be computed based on the estimated tax  
3 accrued during the month in question, but in no instance shall a prepayment be equal to a  
4 sum less than 30 percent of the tax collected in the immediately preceding quarterly period. If  
5 the taxpayer can establish by clear and convincing evidence that the amount of any  
6 prepayment will exceed the total tax liability for the quarterly period for which the tax  
7 prepayment becomes due, the Tax Collector may, in writing, adjust the amount of the tax  
8 prepayment. The third monthly installment of any quarterly period shall be in an amount equal  
9 to the total tax liability for the quarterly period, less the amount of any tax prepayments  
10 actually paid.

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

14 (A) **Small Firm Prepayments**. Every person liable for payment of a total  
15 Payroll Expense Tax in excess of \$3,750, and/or a Commercial Rent Tax in excess of \$2,500 but  
16 less than \$50,000 for any tax year shall pay such tax for the following each tax year in two  
17 installments. The first installment shall be due and payable, and shall be delinquent if not paid  
18 on or before, August 1st. The first installment shall be a credit against the person's total  
19 Payroll Expense Tax and Commercial Rent Tax for the tax year in which the first installment is  
20 due. The first installment shall be in an amount equal to one-half (1/2) of the person's  
21 estimated Payroll Expense Tax and Commercial Rent Tax for such tax year. The estimated  
22 liability shall be computed by using 52% of the person's taxable payroll expense (as defined in  
23 Section 902.2 of Article 12-A) for the preceding tax year, and 52% of the person's estimated  
24 taxable gross receipts (as defined in Section 1303.2 of Article 12-E for the preceding tax year), and  
25 the rates of taxes applicable to the tax year in which the first installment is due. The second

1 installment shall be reported and paid on or before the last day of February of the following  
2 year. The second installment shall be in an amount equal to the person's total Payroll  
3 Expense Tax and Commercial Rent Tax for the subject tax year, less the amount of the first  
4 installment and other tax prepayments for such tax year, if any, actually paid.

5 (B) **Large Firm Prepayments.** Every person liable for payment of a total  
6 Payroll Expense Tax and a Commercial Rent Tax in excess of \$50,000 for any tax year shall pay  
7 such tax for ~~the following~~each tax year in four quarterly installments. The first, second and third  
8 quarterly installments shall be due and payable, and shall be delinquent if not paid on or  
9 before, May 1st, August 1st and November 1st, respectively. The first, second and third  
10 quarterly installments shall be a credit against the person's total Payroll Expense Tax and total  
11 Commercial Rent Tax for the tax year in which such first, second and third quarterly installments  
12 are due. Such quarterly installments each shall be in an amount equal to one-quarter (1/4) of  
13 the person's estimated Payroll Expense Tax liability and Commercial Rent Tax liability for such  
14 tax year. The estimated liability for such tax year shall be computed by using 104% of the  
15 person's taxable payroll expense (as defined in Section 902.1 of Article 12-A) and 104% of the  
16 person's taxable gross receipts (as defined in Section 1303.2 of Article 12-E) for the preceding tax  
17 year, and the rates of taxes applicable to the tax year in which the first, second and third  
18 quarterly installments are due. The fourth quarterly installment shall be reported and paid on  
19 or before the last day of February of the following year. The fourth quarterly installment shall  
20 be in an amount equal to the person's total Payroll Expense Tax liability and total Commercial  
21 Rent Tax liability for the subject tax year, less the amount of the first, second and third  
22 quarterly installments and other tax prepayments, if any, actually paid.

23 (b) **Tax Prepayment Penalties.** Every person who fails to pay any tax prepayment  
24 required under this Section before the relevant delinquency date shall pay a penalty in the  
25 amount of five percent (5%) of the amount of the delinquent tax prepayment per month, or

1 fraction thereof, up to twenty percent (20%) in the aggregate, and shall also pay interest on  
2 the amount of the delinquent tax prepayment from the date of delinquency at the rate of one  
3 percent (1%) per month, or fraction thereof, for each month the prepayment is delinquent, until  
4 paid.

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

12 In no instance shall an estimated prepayment of hotel or parking taxes be less than  
13 30 percent of such tax collected in the immediately preceding quarterly period. If such  
14 estimated prepayment is less than 30 percent of the tax collected in such preceding quarterly  
15 period, the operator shall be subject to penalties and interest for the deficiency pursuant to  
16 Section 6.17-1. If a prepayment based on actual tax owed is less than 90 percent of the  
17 actual liability for the month, the operator shall be subject to penalties and interest for the  
18 deficiency pursuant to Section 6.17-1.

19 (d) **Forms and Adjustments.** Tax prepayments required under this Section shall be  
20 accompanied by a tax prepayment form prepared by the Tax ~~Collector~~ Collector, but failure of  
21 the Tax Collector to furnish the taxpayer with a tax prepayment form shall not relieve the  
22 taxpayer from any tax prepayment obligation. The Tax Collector may, in writing, adjust the  
23 amount of a tax prepayment if the taxpayer can establish by clear and convincing evidence  
24 that the first installment of biannual tax prepayments, or first, second or third monthly  
25 installments of a quarterly tax prepayment, will amount to more than one half or one quarter,

1 respectively, of the person's total tax liability for the tax year in which the installment is due.

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

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

11 **SEC. 6.9-8. LIMITATION ON TAX BENEFITS.**

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

15 (b) A group of related entities means:

16 (1) husband and wife;

17 (2) grantor and fiduciary;

18 (3) grantor and beneficiary;

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

20 (5) decedent and decedent's estate;

21 (6) partners, or partner and partnership; or

22 (7) one or more persons related by common ownership, direct or indirect, of more than  
23 50 percent.

24  
25 Section 4. Article 12-A of the San Francisco Business and Tax Regulation Code is

1 hereby amended by amending Section 903.1 and adding Sections 902.7 and 906F, to read as  
2 follows:

3 **SEC. 902.7. LOWER BRACKET PAYROLL FACTOR.**

4 (a) The term "lower bracket payroll factor" means a multiplier that the Controller will use to  
5 calculate the Payroll Expense Tax rate applicable to the compensation paid to certain individuals for  
6 tax years 2012-2014, according to a formula described in this Section. The Controller shall compute  
7 the lower bracket payroll factor for tax years 2012 through 2014 according to a formula in which a  
8 fraction is subtracted from the number one. If the fraction is ever less than zero, the lower bracket  
9 payroll factor shall equal one. If the fraction is ever greater than one, the lower bracket payroll factor  
10 shall be zero. The fraction shall consist of a numerator of CRT minus SPETC with the resulting  
11 difference multiplied by .55 and a denominator of LBPT, all as expressed in numerical form as:

$$(1-((CRT-SPETC)*.55)/LBPT)$$

12  
13 Where: CRT = the actual amount of Commercial Rent Tax revenue received by the Tax  
14 Collector for the previous tax year as of the first business day of July, minus the actual  
15 amount of Commercial Rent Tax revenue received by the Tax Collector for the tax year  
16 two years prior, as of the first business day of July of the previous year, if any. For  
17 example, CRT for tax year 2013 shall be the Commercial Rent Tax revenue received for  
18 tax year 2012 as of the first business day of July 2013, minus the Commercial Rent Tax  
19 revenue received by the Tax Collector for tax year 2011 as of the first business day of  
20 July 2012;

21 SPETC = the total amount of standard payroll expense tax credit that, based on  
22 information provided by the Tax Collector, the Controller determines that persons  
23 subject to the payroll expense tax claimed for the previous tax year as of the first  
24 business day of July, minus the total amount of standard payroll expense tax credit that  
25 the Controller determines that persons subject to the payroll expense tax claimed for the

1 tax year two years prior, as of the first business day of July of the previous year, if any.  
2 For example, SPETC for tax year 2013 shall be the total amount of standard payroll  
3 expense tax credit claimed for tax year 2012 as of the first business day of July 2013,  
4 minus the total amount of standard payroll expense tax credit claimed for tax year 2011  
5 as of the first business day of July 2012; and  
6 LBPT = the total amount of payroll expense taxes that the Controller determines the  
7 City received as of the first business day of July with respect to individuals receiving  
8 compensation at or below the payroll tax cut off amount for the previous tax year.

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

### 13 **SEC. 903.1. RATE OF PAYROLL EXPENSE TAX.**

14 ~~The rate of the payroll expense tax shall be 1½ percent. The amount of a person's liability for~~  
15 ~~the payroll expense tax shall be the product of such person's taxable payroll expense multiplied by~~  
16 ~~0.015. The amount of such tax for Associations shall be 1½ percent of the payroll expense of such~~  
17 ~~Association, plus 1½ percent of the total distributions made by such Association by way of salary to~~  
18 ~~those having an ownership interest in such Association. Amounts paid or credited to those having an~~  
19 ~~ownership interest in such Association prior and in addition to the distribution of ownership profit or~~  
20 ~~loss shall be presumed to be distributions "by way of salary" and for personal services rendered, unless~~  
21 ~~the taxpayer proves otherwise by clear and convincing evidence.~~

22 (a) The term "payroll expense tax cut off amount" shall mean a dollar value used to separate  
23 payroll expense tax brackets. The payroll expense tax cut off amount will change to reflect changes in  
24 the consumer price index as dictated in Subsection (f).

25 (b) The term "upper bracket payroll expense tax rate" shall mean the payroll tax expense tax

1 rate applicable to a portion of payroll expense of a person subject to this tax consisting of the total  
2 amount of compensation paid to each individual during the tax year where that total amount of  
3 compensation exceeds the payroll expense tax cut off amount applicable for that tax year.

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

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

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

20 (f) For purposes of this Section the payroll expense tax cut off amount shall be \$85,000 as  
21 adjusted for a taxable year, commencing with tax year 2012, by the year-over-year percentage  
22 increase in the United States Department of Labor's Bureau of Labor Statistics annual average  
23 consumer price index for all urban customers for the San Francisco – Oakland – San Jose area from  
24 the previous tax year. The Controller shall compute, certify and publish the applicable and adjusted  
25 payroll expense tax cut off amount on or before February 1 of each year following the previous tax



1 year.

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

9 **SEC. 906F. STANDARD PAYROLL EXPENSE TAX CREDIT.**

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

<u>Tax Year</u>	<u>Tax Credit</u>
<u>2011</u>	<u>\$250</u>
<u>2012</u>	<u>\$500</u>
<u>2013 and subsequent years</u>	<u>\$750</u>

14  
15  
16  
17  
18 (b) Commencing with tax year 2014 the credit allowed by this Section shall be adjusted by the  
19 year-over-year percentage increase in the United States Department of Labor's Bureau of Labor  
20 Statistics annual average consumer price index for all urban customers for the San Francisco –  
21 Oakland – San Jose area from the previous tax year. The Controller shall compute, certify and publish  
22 the applicable standard payroll tax credit on or before February 1 of each year following the previous  
23 tax year, commencing on or before February 1, 2015.

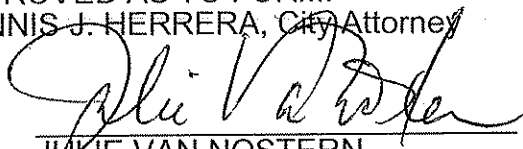
1           Section 5. **Savings Clause.**

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

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

13  
14 APPROVED AS TO FORM:  
15 DENNIS J. HERRERA, City Attorney

16 By:

  
17 JULIE VAN NOSTERN  
18 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 \$250 in tax year 2011, \$500 in tax year 2012, and \$750 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 0.665 percent for tax year 2011, and would increase over three years to 1.995 percent, which would be the rate for subsequent tax years. The ordinance allows a commercial landlord to exclude from gross receipts amounts received from any tenant if the amount received from that tenant (or a related group of entities) is less than \$65,000.

#### 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**

**Ben Rosenfield**  
**Controller**

**Monique Zmuda**  
**Deputy Controller**

July 9, 2010

Mr. John Arntz  
Department of Elections  
City Hall, Room 48  
Dr. Carlton B. Goodlett Place  
San Francisco, CA 94102-4689

RE: Ordinance revising the payroll expense tax to establish a progressive tax rate structure and reducing selection payroll expense tax rates and imposing a gross receipts tax on the rental of commercial real property

Dear Mr. Arntz,

Should the proposed ordinance be approved by the voters, in my opinion, it would result in an annual revenue increase ranging from approximately \$20 million in 2011, rising to \$54 million in 2013, and \$34 million by 2016 and thereafter. The ordinance would create three major changes in San Francisco's payroll expense 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 to all businesses phased in from \$500 in 2011, \$1,000 in 2012, \$1,500 in 2013, and adjusted for inflation thereafter. Currently, all businesses with less than \$250,000 in taxable payroll are exempt from the tax, while those with more than \$250,000 in taxable payroll are liable.
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. The revenue estimates above assume a lower bracket rate of 1.3% in 2013 and subsequent years. The upper bracket rate is 1.5%, the same as the current payroll tax rate.

Sincerely,

Ben Rosenfield  
Controller

This analysis reflects our current understanding of the proposal. We will update this analysis as additional information becomes available. Should this item be placed on the November 2, 2010 ballot, we will prepare a fiscal impact statement for the Voter Information Pamphlet.

# City and County of San Francisco

Office of the Controller - Office of Economic Analysis

## Improving San Francisco's Business Tax: An Analysis of Two Alternatives

### Final Report



June 7, 2010

Amended June 10, 2010



SMALL BUSINESS COMMISSION  
OFFICE OF SMALL BUSINESS



CITY AND COUNTY OF SAN FRANCISCO  
GAVIN NEWSOM, MAYOR

July 2, 2010

Honorable David Chiu, President  
Board of Supervisors  
City Hall room 244  
1 Carlton B. Goodlett Place  
San Francisco, CA 94102-4694

**RE: File No. 100756** [Establishing a progressive payroll expense tax rate structure and reducing selected payroll expenses tax rates; imposing a gross receipts tax on the rental of commercial real property.]

Dear President Chiu:

On behalf of the Small Business Commission, I would like to thank you for your presentation Monday on your proposed business tax revisions. The Commission also appreciates you taking time to listen to the public comment and participate in the discussion that followed.

The Commission recognizes that there are benefits to spreading out the business tax burden to a higher number of businesses, many of whom are exempt from the payroll tax. The Commission also recognizes that the current payroll tax structure disincentives job creation and we appreciate any effort to shift taxes towards a model that does not discourage the creation of jobs. At this time however, the Commission was not prepared to make a formal recommendation to the Board of Supervisors. Instead, the Commission requests that your office and the Office of Economic Analysis review several options which the Commission feels may further reduce the tax burden on small businesses.

- **Increase the gross receipts tax exemption amount for small commercial property owners.** The Commission is concerned that the commercial gross receipts taxes, after being passed on to tenants, will in many cases raise the overall burden to a number of small businesses. Of particular concern are those businesses which are currently exempt from payroll taxes since they will be ineligible for the proposed payroll tax credit. As a means to address this concern, the Commission asks you to consider raising the exemption amount from the current \$200,000 to either \$400,000 or \$500,000.
- **Replace the \$200,000 gross receipts tax exemption amount for small commercial property owners with a "soft cap" exemption which will exempt the first \$200,000 for all properties.** The Commission also feels that implementing a soft cap, exempting the first \$200,000 or higher amount from all properties may be another option to reduce the amount of rent pass through to small businesses. This soft cap will still exempt small property owners and will mitigate the impact to small businesses located in buildings owned by property owners whose commercial rental income is over the current exemption amount.



SMALL BUSINESS COMMISSION  
OFFICE OF SMALL BUSINESS



CITY AND COUNTY OF SAN FRANCISCO  
GAVIN NEWSOM, MAYOR

- **Create an additional incentive for hiring employees earning less than \$40,000 per year.** The Commission appreciates efforts to reduce the payroll tax, which will stimulate hiring. The Commission asks you to consider further reducing the payroll tax for employees earning less than \$40,000. Having a third payroll tax bracket will allow for further job creation for low wage workers who are struggling to find jobs.
- **Decrease the gross receipts rent tax rate.** The Commission asks you to consider reducing the gross receipt tax rate similar to the rate of Oakland at 1.395%. The Commission believes that the proposed 1.89% rate puts San Francisco at a competitive disadvantage to cities such as Oakland, where an increasing number of our brightest entrepreneurs are choosing to open or relocate their businesses.
- **Reduce the net income goals.** The Commission asks you to consider reducing the net income goals projected in this proposal, by either reducing the rent tax or returning more of the income generated from that tax back to small businesses through further reductions in the payroll tax. The Commission is interested in the proposals outcome will great more jobs in the private sector than in the public sector.

The Commission thanks you for your interest and efforts to bring about reform to the business payroll tax and understands that this is not an easy task. The Commission also thanks you taking its recommendations under consideration and looks forward to rehearing the changes made to the legislation at the July 12, 2010 Small Business Commission meeting.

Sincerely,

Regina Dick-Endrizzi  
Director, Office of Small Business

cc. Starr Terrell, Mayor's Office  
Todd Rufo, Office of Economic and Workforce Development  
Angela Calvillo, Clerk of the Board of Supervisors  
Ted Egan, Controllers Office