Postponing Tax Increases and Tax Credits for a New Location: Economic Impact Report

CITY & COUNTY OF SAN FRANCISCO

Office of the Controller

Office of Economic Analysis

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Introduction

- The proposed legislation would change the City's business taxes in two ways:
- First, it would extend temporary reductions in the Gross Receipts Tax rate for certain industries.
- Second, it would provide a temporary tax credit for businesses in certain office-using industries that open a physical location in San Francisco.
- The Office of Economic Analysis has prepared this report after determining that the proposed legislation might have a material effect on the San Francisco economy.

Extended Rate Reductions: Policy Details

- Proposition F in November 2020 raised Gross Receipts Tax rates for most businesses, while eliminating the City's Payroll Expense Tax.
- However, the measure temporarily reduced the tax rates for the Retail Trade, Food Services, Manufacturing, Certain Services, Accommodations, and Arts, Entertainment, and Recreation industries. In general, these industries were most adversely affected by the COVID-19 pandemic. The reductions applied to tax years 2020 and 2021.
- In the measure, 2023 tax rates for those industries were raised back to 2020 levels, and then permanently raised again for tax years 2024 and beyond.
- The proposed measure would delay the planned increases for two years. Instead of rising in 2023 and 2024, the tax rates for these industries will rise in 2025 and 2026. The magnitude of the rate increases are unchanged; the proposed measure only shifts the timing.
- The proposed measure is effectively a tax cut for these industries, for tax years 2023-26.

Temporary Credit for New Locations: Policy Details

- Secondly, the proposed measure provides for a Gross Receipts Tax credit for businesses in certain office-using industries that open a new physical location in San Francisco.
- The credit is available for three years following the opening of the new physical location. The location must be opened January 1, 2023 and December 31, 2027. The credit may not be taken beyond the 2028 tax year.
- To qualify, a business must be opening its first location in the city, or returning to the city after an absence of at least three years. It cannot be a successor-in-interest to, or a member of a combined group containing, another San Francisco business.
- The business must also have Gross Receipts in the Information, Financial Services, Insurance, Professional, Scientific, and Technical Services, or Administrative and Support Services industries.
- The credit is equal to 0.45% of the business's San Francisco Gross Receipts, which is roughly half of the average rate paid by businesses in these industries. The maximum allowable credit each year is set at $1 million.
- Some businesses pay the Administrative Office Tax instead of the Gross Receipts Tax. Such businesses that qualify would receive a credit equal to 0.7% of their San Francisco payroll expense, again subject to the $1 million annual cap.

Economic Impact Factors

- The proposed legislation is projected to have both positive and negative effects on the economy.
- The proposed postponement of tax increases for the COVID-impacted industries would effectively lower their business taxes, which would create an incentive to grow and expand jobs in the city. Similarly, the new location tax credit would lower business taxes for impacted businesses, and this would encourage them to lease space and hire employees within the city. This investment and hiring would create positive multiplier effects throughout the economy.
- However, both the postponed rate increases, and the new location tax credit, would reduce General Fund revenue. This would, in turn, reduce City spending and generate negative multiplier effects on the broader local economy.
- The net economic impact depends on the relative strength of the positive and negative effects.

Revenue Impact of the Rate Postponement

- The table below shows the revenue impact of the proposed postponement of tax increases for the COVID-impact industries, in millions of dollars.

Industry	2023	2024	2025	2026
Retail Trade	$1.4	$4.2	$4.2	$1.4
Food Services	$0.8	$2.3	$2.3	$0.8
Manufacturing	$0.6	$1.7	$1.7	$0.6
Accommodations	$0.4	$1.2	$1.2	$0.4
Arts, Entertainment, and Recreation	$0.2	$0.7	$0.7	$0.2
Certain Services	$0.1	$0.3	$0.3	$0.1
Total	$3.5	$10.4	$10.4	$3.5

Revenue Impact of the New Location Tax Credit

- The table below shows the estimate annual revenue loss associated with the new location tax credit.
- The estimate was determined by calculating what the proposal would have cost in 2021, had it applied to businesses that established a new location in the city in the prior three years.
- The estimate is subject to a high degree of uncertainty, because of the volatility in tax liabilities of new businesses, and difficulties in identifying returning businesses and successors-in-interest with existing City data.

	2023	2024	2025	2026	2027	2028
Total Cost	$1.4	$5.5	$9.1	$9.1	$9.1	$7.7

Economic Impact Assessment

- In 2020 and 2021, venture capital investment in San Francisco and the Bay Area reached record highs. However, relatively few of those new businesses signed office leases, and the office vacancy rate in the city remains at record highs.
- In this context, the new location tax credit is likely to have a moderately stimulative effect on leasing and employment in office industries, although a quantitative estimate of employment would be highly speculative.
- The impact of the incentive is likely to be modest, especially when compared to current office vacancy rates.
- Similarly, the reduced General Fund spending could be managed in a variety of ways, each with their own impact on the economy, and again the impact on City finances would be relatively modest.
- For this reason, a net economic impact estimate is challenging to estimate, likely modest, and highly speculative.

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