

File No. 110155

Committee Item No. 6

Board Item No. _____

COMMITTEE/BOARD OF SUPERVISORS

AGENDA PACKET CONTENTS LIST

Committee: Budget and Finance SUB-Committee Date: March 16, 2011

Board of Supervisors Meeting

Date _____

Cmte Board

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<input type="checkbox"/>	<input type="checkbox"/>	Resolution
<input checked="" type="checkbox"/>	<input type="checkbox"/>	Ordinance
<input checked="" type="checkbox"/>	<input type="checkbox"/>	Legislative Digest
<input checked="" type="checkbox"/>	<input type="checkbox"/>	Budget Analyst Report
<input type="checkbox"/>	<input type="checkbox"/>	Legislative Analyst Report
<input type="checkbox"/>	<input type="checkbox"/>	Ethics Form 126
<input type="checkbox"/>	<input type="checkbox"/>	Introduction Form (for hearings)
<input type="checkbox"/>	<input type="checkbox"/>	Department/Agency Cover Letter and/or Report
<input type="checkbox"/>	<input type="checkbox"/>	MOU
<input type="checkbox"/>	<input type="checkbox"/>	Grant Information Form
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OTHER

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Completed by: Victor Young

Date: March 11, 2011

Completed by: Victor Young

Date: _____

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

[Business and Tax Regulations Code - Payroll Expense Tax Exclusion in Central Market Street and Tenderloin Area]

Ordinance amending Article 12-A of the Business and Tax Regulations Code by adding Section 906.3 to establish a payroll expense tax exclusion for businesses located in the Central Market Street and Tenderloin Area.

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

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

Section 1. Findings. The Board of Supervisors hereby finds that:

(a) In January of 2010, Mayor Gavin Newsom announced the Central Market Partnership – a public/private initiative to renew and coordinate efforts to revitalize the Central Market neighborhood (from approximately Fifth Street to Tenth Street) with a focus on cultivating an eclectic, community-serving arts district.

(b) As part of the Central Market Partnership, the City has developed the following tools to assist with this effort:

(1) An \$11.5 million loan fund for low-interest loans to small businesses in the area;

(2) Coordinated incentives, including a renewed effort to generate tax increment financing through a Redevelopment Area;

(3) The Better Market Street initiative, which will overhaul the streetscape and repave the corridor in 2014;

(4) Technical assistance and limited funding for arts groups looking to relocate to Central Market;

1 (5) An NEA grant to undertake visible arts-oriented activities that will
2 generate positive foot traffic; and

3 (6) Partnerships with recently established Community Benefit Districts and
4 other Community Benefit Organizations whose focus is on improving the neighborhood as
5 well as an Interagency Working Group to target City attention and resources to the
6 neighborhood.

7 (c) Therefore, attracting businesses to the Central Market Street neighborhood is a
8 key component in the revitalization of the area.

9 Section 2. The San Francisco Business and Tax Regulations Code is hereby amended
10 by adding Section 906.3, to read as follows:

11 **SEC. 906.3. CENTRAL MARKET STREET AND TENDERLOIN AREA PAYROLL**
12 **EXPENSE TAX EXCLUSION.**

13 (a) The amount of payroll expense tax due under this Section shall be:

14 (1) For any person maintaining a fixed place of business in the Central Market
15 Street and Tenderloin Area on the effective date of this ordinance, such person shall owe the lesser of
16 that person's payroll expense tax liability for 2010 or that person's payroll expense tax liability for the
17 year they are claiming the exclusion, including zero;

18 (2) For any person who commences to maintain a fixed place of business in the
19 Central Market Street and Tenderloin Area after the effective date of this legislation, such person shall
20 owe the lesser of that person's payroll expense tax liability for the tax year prior to the date the person
21 commenced to maintain a fixed place of business in the Central Market Street and Tenderloin Area or
22 that person's payroll expense tax liability for the year they are claiming the exclusion, including zero;
23 or

24 (3) For any person who commences to maintain a fixed place of business in the
25 Central Market Street and Tenderloin Area after relocating to San Francisco, such person shall owe

1 the lesser of the amount that person paid in payroll expense tax for that person's initial year in
2 San Francisco and that person's payroll expense tax liability for the year they are claiming the
3 exclusion, including zero.

4 (b) For purposes of this Section, the following terms shall have the meanings set forth
5 below:

6 (1) "Central Market Street and Tenderloin Area" means the area located in
7 downtown San Francisco, generally including: parcels fronting the south side of Market Street from
8 Eleventh Street to Sixth Street; a portion of the parcels fronting the south side of Market Street from
9 Sixth Street to Fifth Street (odd numbered addresses from 999 to 933 Market Street); parcels fronting
10 the north side of Market Street from Van Ness Avenue to Eighth Street; 875 Stevenson Street; and
11 parcels in the area bordered by: Geary Street, from Polk Street to Taylor Street (south side only);
12 Taylor Street, from Geary Street to Ellis Street (west side only); Ellis Street, from Taylor Street to
13 Mason Street (south side only); Mason Street, from Ellis Street to Market Street (west side only);
14 Market Street, from Mason Street to Charles J. Brenham Place (north side only); Charles J. Brenham
15 Place, from Market Street to McAllister Street (east side only); McAllister Street, from Charles J.
16 Brenham Place to Larkin Street (north side only); Larkin Street, from McAllister Street to Eddy Street
17 (east side only); Eddy Street, from Larkin Street to Polk Street (north side only); and Polk Street, from
18 Eddy Street to Geary Street (east side only). The exclusion applies exclusively to the following
19 Assessor's Lots: the entirety of Blocks 0317, 0318, 0319, 0320, 0321, 0322, 0322A, 0323, 0324, 0331,
20 0332, 0333, 0334, 0335, 0336, 0337, 0338, 0339, 0340, 0342, 0343, 0344, 0345, 0346, 0347, 0348,
21 0349, 0350, 0716, 0717, 0740, and 0835; Block 0813, Lots 7, 8, 9 and 10; Block 3701, Lots 50, 59 and
22 65; Block 3702, Lots 1, 44, 44A, 45, 46, 47, 48, 48A, 53 and 54; Block 3703, Lots 1, 56, 58, 59, 60, 61,
23 62, 63, 64, 65, 66, 67, 68, 70, 74, 75, 76, 78 and 88; Block 3704, Lots 70, 69, 68, 67 and 78; Block
24 3507, Lots 39, 40 and 41; Block 3508, Lots 1 and 39; Block 0355, Lots 3, 4, 5, 6, 7, 8, 9, 10 and 15;
25 and Block 0351, Lots 1, 22, 39, 41, 46, 47, 49 and 51.

1 (2) An employee is a "qualified employee" for purposes of computing this exclusion
2 if the employee spends at least 90% of work time on activities directly related to the conduct of a trade
3 or business located within the Central Market Street and Tenderloin Area and performs at least 90% of
4 work time within the boundaries of the Central Market Street and Tenderloin Area. For purposes of
5 this Section, outside independent contractors shall not be considered employees of the business.

6 (c) In order to be eligible for the payroll expense tax exclusion authorized under this
7 Section, persons wishing to claim the exclusion must:

8 (1) Complete and submit an initial application to the Office of Economic and
9 Workforce Development for review and evaluation. The Office of Economic and Workforce
10 Development will use this application to verify that applicants claiming the payroll expense tax
11 exclusion under this Section meet the eligibility requirements outlined in subsections (b)(1) and (b)(2)
12 of this Section. The Office of Economic and Workforce Development shall have the authority to
13 prescribe the form of the application and, consistent with this ordinance, the rules and regulations
14 regarding eligibility for the Central Market Street and Tenderloin Area payroll expense tax exclusion,
15 which shall include participation in the City's First Source Hiring Program as defined in Section 83.4
16 of the Administrative Code.

17 (2) File an annual affidavit with the Office of Economic and Workforce Development
18 affirming that they continue to meet the eligibility criteria as determined by the Office of Economic and
19 Workforce Development. The affidavit must be filed with the Office of Economic and Workforce
20 Development on or before January 31 of each year subsequent to the Office of Economic and
21 Workforce Development's initial approval of the application.

22 (3) Maintain a reasonable method of documentation that the Tax Collector can
23 review or verify objectively that tracks employees whose compensation qualifies for the Central Market
24 Street and Tenderloin Area exclusion, and provide such documentation to the Tax Collector upon
25 request.

1 (4) File an annual Payroll Expense Tax Return with the Tax Collector regardless of
2 the amount of tax liability, if any, shown on the return after claiming the exclusion provided for in this
3 Section.

4 (d) The Office of Economic and Workforce Development shall:

5 (1) No later than the effective date of this ordinance, adopt rules, regulations and
6 forms regarding eligibility and the application process for the Central Market Street and Tenderloin
7 Area payroll expense tax exclusion. The Office of Economic and Workforce Development may amend
8 such rules, regulations and forms from time to time as necessary.

9 (2) Review all applications for completeness and upon approval, issue a certificate
10 of eligibility to the applicant. The decision of the Office of Economic and Workforce Development
11 regarding eligibility for the exclusion shall be final.

12 (3) Provide the Tax Collector with a list of persons eligible to claim the tax
13 exclusion authorized under this Section for the preceding tax year by March 1 of each year.

14 (e) The Central Market Street and Tenderloin Area exclusion authorized under this Section
15 shall be available to and may be taken by each person for each tax year that person holds a valid
16 certificate of eligibility for a period not to exceed six years from the effective date of this ordinance or
17 the commencement of the person's business in the Central Market Street and Tenderloin Area,
18 whichever is later. The date the Tax Collector first received the person's application for a business
19 registration certificate for the person's Central Market Street and Tenderloin Area business shall be
20 presumed to be the date of commencement of such business unless the person establishes a different
21 commencement date to the satisfaction of the Tax Collector.

22 (f) The Central Market Street and Tenderloin Area exclusion authorized under this Section
23 shall expire on the eighth anniversary date of the effective date of this Section. A person may not use or
24 claim any unused portion of the Central Market Street and Tenderloin Area exclusion after the
25 expiration date of this Section. Unless exempted under Sections 906 of this Article, every person

1 engaging in a business in the Central Market Street and Tenderloin Area in the City shall pay the tax
2 imposed under this Article on the full amount of the person's payroll expense attributable to the City
3 from and after the expiration of this Section.

4 (g) If a person's calculated liability for the Payroll Expense Tax does not exceed the ceiling
5 specified in Section 905-A for the tax year after applying the Central Market Street and Tenderloin
6 Area exclusion under this Section, the person shall be exempt from payment of the Payroll Expense Tax
7 for that tax year as provided in Section 905-A.

8 (h) The Tax Collector shall submit an annual report to the Board of Supervisors for each
9 year for which the Central Market Street and Tenderloin Area exclusion authorized under this Section
10 is available that sets forth aggregate information on the dollar value of the Central Market Street and
11 Tenderloin Area exclusions taken each year, the number of businesses taking the exclusion and the
12 change in the number of businesses located in the Central Market Street and Tenderloin Area of the
13 City.

14 (i) The Assessor-Recorder shall submit an annual report to the Board of Supervisors for
15 each year for which the Central Market Street and Tenderloin Area exclusion authorized under this
16 Section is available that sets forth any identifiable increases in property value resulting from
17 businesses' location, relocation or expansion to or within the Central Market Street and Tenderloin
18 Area.

19 (j) The Controller, not later than after three years after the effective date of this ordinance,
20 shall perform an assessment and review of the effect of the Central Market Street and Tenderloin Area
21 payroll expense tax exclusion on the Central Market Street and Tenderloin Area. Based on such
22 assessment and review the Controller shall prepare and submit an analysis to the Board of Supervisors.
23 The analysis shall be based on factors that the Controller deems relevant, and may include, but shall
24 not be limited to, data contained in the annual reports to the Board of Supervisors as required by
25 subsections (h) and (i) of this Section.

1 (k) The Central Market Street and Tenderloin Area payroll expense tax exclusion set forth
2 in this Section may not be claimed concurrently with any other payroll expense tax exclusion.

3 (l) A misrepresentation or misstatement by any person regarding eligibility for the Central
4 Market Street and Tenderloin Area payroll expense tax exclusion authorized by this Section that results
5 in the underpayment or underreporting of the payroll expense tax shall be subject to penalties as
6 provided in Section 6.17-2 of Article 6 of the San Francisco Business and Tax Regulations Code.

7
8 APPROVED AS TO FORM:
9 DENNIS J. HERRERA, City Attorney

10 By:


STEPHANIE PROFITT
Deputy City Attorney

FILE NO.

LEGISLATIVE DIGEST

[Business and Tax Regulations Code - Payroll Expense Tax Exclusion in Central Market Street and Tenderloin Area]

Ordinance amending Article 12-A of the Business and Tax Regulations Code by adding Section 906.3 to establish a payroll expense tax exclusion for businesses located in the Central Market Street and Tenderloin Area.

Existing Law

San Francisco imposes a payroll expense tax on business entities based on the compensation they pay to employees and others for work or services performed in San Francisco. (Business and Tax Regulations Code Section 901 et seq.) 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 amendment would amend Section 906 to establish a payroll expense tax exclusion for qualified employees employed by businesses in the Central Market Street and Tenderloin Area. For a business located in the Central Market Street and Tenderloin Area, its payroll expense tax liability shall be the lesser of its payroll expense tax liability for 2010 or the year it is claiming the exemption, including zero. For a business that moves to the Central Market Street and Tenderloin Area from another part of San Francisco, its payroll expense tax liability shall be the lesser of its payroll expense tax liability for the tax year prior to its move to the Central Market Street and Tenderloin Area or the year it is claiming the exclusion, including zero. A business that moves to San Francisco, and specifically to the Central Market Street and Tenderloin Area, shall pay the lesser of the amount it paid in payroll expense tax for its initial year in San Francisco and its payroll expense tax liability for the year it is claiming the exclusion, including zero. The exclusion will be available for a period of 8 years from the effective date of this legislation and employers may avail themselves of the exclusion for 6 years. After the legislation expires, no unused portions of the exclusion may be claimed.

Background Information

Under Business and Tax Regulations Code Section 901 et seq., businesses 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) This proposed amendment would amend Section 906 to establish a payroll expense tax exclusion for the purpose of encouraging entities to retain and hire employees to work in the Central Market Street and Tenderloin Area.

Item 6
File 11-0155

Department(s):
Office of Economic and Workforce Development
Treasurer/Tax Collector

EXECUTIVE SUMMARY

Legislative Objective

- The proposed ordinance would amend the Business and Tax Regulation Code to establish a Payroll Expense Tax exclusion for businesses in the Central Market and Tenderloin Area.

Key Points

- Businesses currently pay Payroll Expense Taxes to the City of 1.5 percent of the firm's payroll expenses for work or services performed in San Francisco. Businesses with an annual payroll of \$250,000 or less and certain biotechnology and clean energy technology businesses are currently exempt from the Payroll Expense Tax.
- The proposed Payroll Expense Tax exclusion would be available for a period of eight years from the effective date of the proposed ordinance; however, individual businesses could only claim the Payroll Tax exclusion for a maximum of six years.
- The proposed Payroll Expense Tax exclusion would only apply to net new employees hired by businesses (a) already located in the Central Market and Tenderloin Area, or (b) that relocate to the Central Market and Tenderloin Area from another San Francisco location. The proposed Payroll Expense Tax exclusion would also apply to all employees of businesses that relocate to the Central Market and Tenderloin Area from outside the City.
- Twitter, presently located at 795 Folsom Street, is currently seeking a new headquarters of approximately 150,000 square feet of space with options to expand up to 500,000 square feet in future years. Twitter currently has 350 employees, expects to reach 750 employees by July 2011, and estimates having 1,500 employees by July 2012 and 3,000 employees in 2013. Twitter is considering relocating to the SFMart on Market Street between 9th and 10th Streets.

Fiscal Impacts

- If Twitter relocates to the Central Market and Tenderloin Area, Twitter would still pay its existing base Payroll Expense Tax of approximately \$535,500 (350 employees with an average annual salary of \$102,000) annually to the City. However, Twitter would not pay any additional Payroll Expense Taxes on the estimated 1,150 additional employees (1,500 projected less 350 currently), resulting in forgone City Payroll Tax revenues of \$1,759,500 in 2012; or the estimated 2,650 additional employees (3,000 projected less 350 currently) resulting in forgone City Payroll Tax revenues of \$4,054,500 in 2013.
- The Tax Collector's Office estimates (a) initial one-time General Fund expenditures of approximately \$162,000, and (b) annual General Fund expenditures of \$180,000 would be required to implement and administer the proposed ordinance.

Recommendations

- Amend the proposed ordinance as specified below to reduce the administrative cost for the Tax Collector's Office and to clarify the provisions.

- Approval of the proposed ordinance, as amended, is a policy decision for the Board of Supervisors, given the potential short-term loss of Payroll Expense Tax revenues for the City relative to the potential economic stimulus for the Central Market and Tenderloin Area.

MANDATE STATEMENT / BACKGROUND

Mandate Statement

In accordance with the City's Business and Tax Regulations Code Section 902.1¹, currently, San Francisco businesses pay Payroll Expense Taxes to the City of 1.5 percent of the firm's payroll expenses for work or services performed in San Francisco. Each San Francisco businesses' tax liability is determined annually based on the payroll expenses of the entity. Business and Tax Regulations Code Section 905-A provides an exemption for businesses with a payroll of \$250,000 or less from the Payroll Expense Tax liability. Sections 906.1 and 906.2 of the Business and Tax Regulations Code also provide exclusions for businesses engaged in certain biotechnology enterprises and clean energy technology, respectively.

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

Background

According to Ms. Jennifer Matz, Director of the Office of Economic and Workforce Development (OEWD), the City has faced challenges concerning the Central Market Street Area² and the adjacent Tenderloin for decades. To exemplify the challenges, the OEWD provided the following statistics concerning the Central Market Street and Tenderloin Area: (a) empty and underutilized buildings and storefronts, including a 31 percent storefront vacancy rate in 2010 on Market Street between 5th and 8th, which is the highest rate tracked in the City; (b) poor building conditions with little "leasable" space, such that 33 of the buildings between 5th and 8th Streets are over 100 years old, most with long deferred maintenance; (c) relatively high rents given the downtown location and transit access; (d) lack of retail or services for neighborhood residents and workers (i.e. no full-service grocery store); and (d) negative street activity and lack of foot traffic. Additionally, the OEWD advised that the Tenderloin is one of the most economically disadvantaged neighborhood in the City, with (a) one out of three residents living in poverty, (b) more than half of the residents without a salary or wage income, (c) most of the business activity comprised of low-end convenience or liquor stores, and (d) significant illegal street activity.

¹ Business and Tax Regulations Code Section 902.1(a) specifically defines Payroll Expense as compensation paid to individuals including shareholders of a professional corporation or a Limited Liability Company (LLC), for salaries, wages, bonuses, commissions, property issued or transferred in exchange for the performance of services (including but not limited to stock options), compensation for services to owners of pass-through entities, and any other form of compensation, who during any tax year, perform work or render services, in whole or in part in the City.

² The Central Market Street Area is identified as approximately Fifth Street to Tenth Street, along Market Street.

As a result, Ms. Matz advises that a public-private initiative, called the Central Market Partnership was created in January 2010 with a focus on cultivating an eclectic, community-serving arts district in the Central Market and Tenderloin Area. According to Ms. Matz, other planned components of the Central Market Partnership include (a) \$11,500,000 of Department of Housing and Urban Development Section 108-guaranteed loan proceeds for low-interest loans for small businesses³, (b) coordinated incentives, including a renewed effort to generate tax increment financing through the proposed creation of a Redevelopment Area, (c) the Better Market Street Initiative with a focus on overhauling the streetscape and plans to repave the corridor in 2014, (d) technical assistance from OEWD for arts groups to relocate to the area, (e) a \$250,000 National Endowment of the Arts grant for visible arts-oriented activities to increase foot traffic⁴, (f) partnerships with Community Benefit Districts and other organizations with a focus on improving the neighborhood, (e) establishment of an Interagency Working Group to target City attention and resources to the neighborhood.

DETAILS OF PROPOSED LEGISLATION

The proposed ordinance would amend Article 12-A of the City's Business and Tax Regulation Code by adding Section 906.3 to establish a Payroll Expense Tax exclusion for any (a) new business that is started in or (b) relocates to the Central Market Street and Tenderloin Area. The proposed ordinance would become effective at least 30 days after the Board of Supervisors approves the proposed ordinance, estimated to be approximately May 1, 2011. According to Ms. Matz, the proposed ordinance is intended to encourage entities to retain and hire employees to work in the Central Market and Tenderloin Area, and is considered part of the above-noted Central Market Partnership, a public/private initiative to renew and coordinate efforts to revitalize the Central Market and Tenderloin neighborhoods.

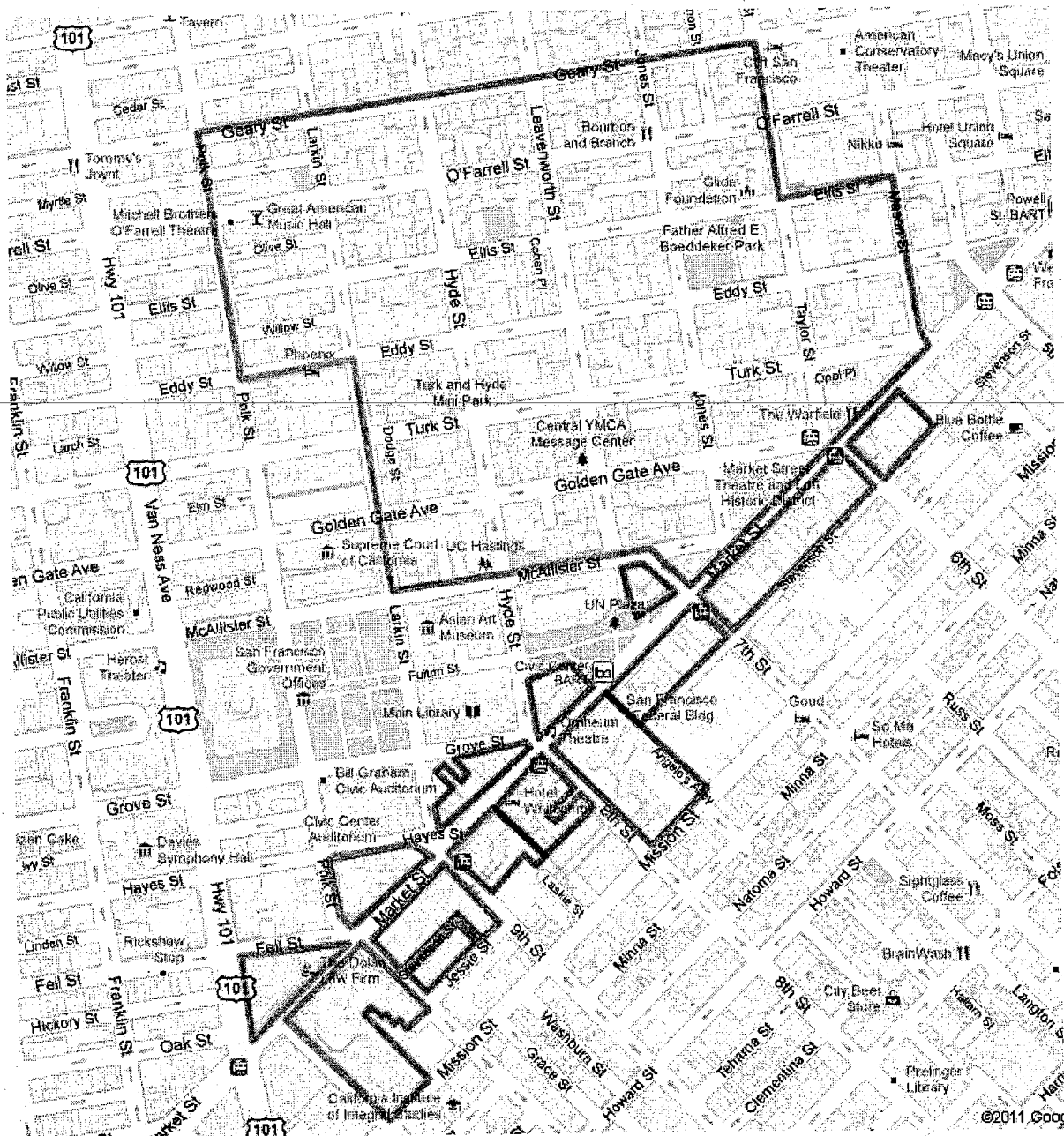
The Central Market Street and Tenderloin Area is specifically defined in the proposed ordinance⁵ and shown in Map 1 below.

³ As of January 2011, the Central Market Cultural District Loan Fund (CDLF) has only announced one loan, Pearl's Deluxe Burgers, 1001 Market Street. Although the Fund aims to assist art programs, many entities do not have the capital or income to meet the loan requirements and the terms of loans are linked to job creation, essentially a new job must be created for every \$50,000 borrowed within five years.

⁴ In July 2010, the National Endowment for the Arts awarded \$250,000 grant to the San Francisco Arts Commission from Mayors' Institute on City Design 25th Anniversary Initiative (MICD25) to support the revitalization of the Mid Market neighborhood.

⁵ According to the Office of Economic and Workforce Development, the "Central Market and Tenderloin" area includes: parcels fronting the south side of Market Street from Eleventh Street to Sixth Street; a portion of the parcels fronting the south side of Market Street from Sixth Street to Fifth Street (odd numbered addresses from 999 – 933 Market St.); parcels fronting the north side of Market Street from Van Ness Avenue to Eighth Street; the area bordered by Geary St., from Polk St. to Taylor St. (south side only), Taylor St., from Geary St. to Ellis St. (west side only), Ellis St., from Taylor St. to Mason St. (south side only), Mason St., from Ellis St. to Market St. (west side only), Market St., from Mason St. to Charles J. Brenham Pl. (north side only), Charles J. Brenham Pl., from Market St. to McAllister St. (east side only), McAllister St., from Charles J. Brenham Pl. to Larkin St. (north side only), Larkin St., from McAllister St. to Eddy St. (east side only), Eddy St., from Larkin St. to Polk St. (north side only), Polk St., from Eddy St. to Geary St. (east side only); and 875 Stevenson Street.

Map 1: The Central Market and Tenderloin Area Payroll Expense Tax Exclusion Boundaries



Source: Office of Economic and Workforce Development (OEWD)

The proposed Payroll Expense Tax exclusion would be applicable to payroll expenses after the effective date of this proposed ordinance for (a) net new employees hired by businesses currently located in the Central Market and Tenderloin Area, (b) net new employees hired by businesses that relocate to the Central Market and Tenderloin Area that are currently located in San Francisco, and (c) existing employees and new hires for businesses that move into the Central Market and Tenderloin Area from outside the City.

In accordance with the proposed ordinance:

- Eligible businesses that are currently paying Payroll Expense Taxes that are located in the Central Market and Tenderloin Area would continue to pay the same base Payroll Expense Taxes for current employees for 2010;
- Eligible businesses that are currently paying Payroll Expense Taxes that are located elsewhere in the City would continue to pay the same Payroll Expense Taxes for current employees until the business relocates into the Central Market and Tenderloin Area; and
- Eligible businesses that are not currently located in San Francisco would be excluded from paying 100 percent of their Payroll Expense Taxes if they relocate into the Central Market and Tenderloin Area.

The proposed Payroll Expense Tax exclusion could not be concurrently claimed by a business that claims any other Payroll Expense Tax exclusion, such as the existing biotechnology or clean energy Payroll Expense Tax exclusions. In addition, the proposed Payroll Expense Tax exclusion would be available for a period of eight years from the effective date of the proposed ordinance, or until approximately May 1, 2019. However, individual businesses could only claim this Payroll Tax exclusion for a maximum of six years. After the proposed ordinance expires in eight years, no unused portions of the exclusion can be claimed.

According to the proposed ordinance, this Payroll Expense Tax exclusion would be restricted to businesses with employees that (a) spend at "least 90 percent of work time on activities directly related to the conduct of trade or business" located within the Central Market and Tenderloin Area, and (b) perform "at least 90 percent of work time within the boundaries" of the Central Market and Tenderloin Area (see Policy Considerations below).

In order to be eligible for the Payroll Expense Tax exclusion, businesses must (a) apply to the OEWD for evaluation and certification of eligibility, and (b) participate in the City's First Source Hiring Program⁶. If eligibility is approved, the individual businesses must (a) file an annual Payroll Expense Tax Return with the Tax Collector's Office regardless of the amount of tax liability shown on the return after claiming the exclusion; (b) file an annual affidavit with OEWD affirming the continued eligibility of the business to receive the exclusion; (c) maintain a reasonable method of documentation that tracks employees whose compensation qualifies for the Payroll Expense Tax exclusion; and (d) provide the documentation to the Tax Collector's Office upon request.

Under the proposed ordinance, the Tax Collector is required to report to the Board of Supervisors each calendar year the amount of payroll excluded from the City's Payroll Expense Tax liability for businesses in the Central Market and Tenderloin Area that are authorized to receive the exclusion, identifying (a) the number of businesses eligible for the exclusion and (b) the change in the number of all businesses within the Central Market and Tenderloin Area. Under the

⁶ The City's First Source Hiring Program, established in Chapter 83 of the City's Administrative Code, connects low-income San Francisco residents with businesses that have entry-level jobs that are generated by the City's investment in contracts or public works, or by business activity subject to approval by the City's Planning Department or the Department of Building Inspection.

proposed ordinance, the Assessor-Recorder would be required to annually report to the Board of Supervisors any "identifiable increases in property value resulting from businesses' location, relocation, or expansion to or within" the Central Market and Tenderloin Area. In addition, no later than three years following the effective date of the proposed ordinance, the Controller would be required to perform an assessment and review of the effect of the Central Market and Tenderloin Area Payroll Expense Tax exclusion, and subsequently submit the analysis to the Board of Supervisors.

FISCAL ANALYSIS

Prospective Businesses and Payroll Tax Impacts

OEWD has identified the following prospective businesses that might benefit from the proposed Payroll Expense Tax exclusion: (a) Twitter, (b) Black Rock LLC (Burning Man), (c) two hotel chains, (d) a new youth hostel, (e) a mixed-use theater project potentially anchored by the American Conservatory Theater, and (f) a full-service grocery store. The Budget and Legislative Analyst notes that both Twitter and Black Rock LLC would be relocating from other locations in the City. The proposed new youth hostel has already received approval from the Planning Department but is currently raising money for this project.

Of all the identified prospective projects for the revitalization of the Central Market and Tenderloin Area, a lot of attention has recently been given to the pending Twitter relocation. Twitter was founded in San Francisco in 2006 and is currently located at 795 Folsom Street. According to Ms. Matz, Twitter is currently selecting a location for a new headquarters of approximately 150,000 square feet of space with options to expand up to 500,000 square feet in future years. Ms. Matz reports that Twitter currently has 350 employees, expects to reach 750 employees by July 2011, and estimates having 1,500 employees by July 2012 and 3,000 employees in 2013. According to Ms. Matz, Twitter is considering two buildings in San Francisco and two buildings south of San Francisco, with the reported leading contenders to be the SF Mart on Market Street between 9th and 10th Streets⁷ and the former Walmart.com building in Brisbane.

If the proposed ordinance is approved, and Twitter decides to relocate to the Central Market and Tenderloin Area, although Twitter would not be required to pay the Payroll Expense Tax on any new hires, Twitter would still pay its existing base Payroll Expense Tax of approximately \$535,500 (350 employees with an average annual salary of \$102,000) annually to the City. However, Twitter would not pay any additional Payroll Expense Taxes on the estimated 1,150 additional employees (1,500 projected less 350 currently) to be hired by 2012 or the estimated 2,650 additional employees (3,000 projected less 350 currently) by 2013.

⁷ The SF Mart, formerly known as the Western Furniture Exchange and Merchandise Mart, was acquired by ADCO in 1968, and offers 890,000 square feet of commercial space, 200,000 square feet of retail space, and 450 underground parking spots. According to media reports, Shorenstein Properties LLC has agreed to buy the property; however, the deal is not confirmed and not yet public.

Assuming Twitter was able to relocate into the Central Market and Tenderloin Area immediately, and there was no change in the average annual Twitter salary of \$102,000, this would result in approximately \$1,759,500 (1,150 additional employees x \$102,000 annual salary x .015 Payroll Expense Tax) of forgone Payroll Expense Taxes to the City in 2012 and approximately \$4,054,500 (2,650 additional employees x \$102,000 x .015) in 2013. However, this assumes that Twitter would remain in the City without the Payroll Expense Tax exclusion. If the number of employees at Twitter remains relatively stable at approximately 3,000 employees, when the Payroll Expense Tax expires, Twitter would pay approximately a total of \$4,590,000 (\$535,500 annual base Payroll Expense Tax plus \$4,054,500 of excluded Payroll Expense Tax) annually to the City.

In 2004, the Board of Supervisors approved Ordinance 26-04 (File 03-1990) amending the definition of "Payroll Expense" to include bonuses and property issued or transferred in exchange for the performance of services, including but not limited to stock options. As a result, San Francisco companies are required to pay a Payroll Expense Tax on gains from employee stock options when companies go public. The inclusion of stock options as payroll expense increases the differential between the City and every other city in the Bay Area for the cost of doing business. Mr. Ted Egan of the Controller's Office advises that Twitter is one of only a few companies in the City that could be going public and at such time could include stock options as a part of their payroll expenses. However, under the proposed ordinance, if Twitter relocated to the Central Market and Tenderloin Area and went public within the six years of their participation in the proposed Payroll Expense Tax exclusion, the value of such stock options would also be excluded, such that Twitter would only pay their base Payroll Tax of approximately \$535,500 annually.

Administrative Impacts and Costs

Mr. Greg Kato, of the Treasurer/Tax Collector's Office reports that their office cannot estimate the number of businesses that may qualify for the proposed Payroll Expense Tax exclusion in the Central Market and Tenderloin Area. Therefore, Mr. Kato cannot accurately determine the administrative costs to implement the proposed ordinance. However, Mr. Kato noted that currently businesses report Payroll Expense Tax liability based on location. In contrast, although the proposed Payroll Expense Tax exclusions would be limited to the Central Market and Tenderloin Area, the proposed ordinance defines eligible employees as employees that spend (a) at least 90 percent of work time within the boundaries of the Central Market and Tenderloin Area, and (b) at least 90 percent of work time on activities directly related to the conduct of trade or business located within the Central Market and Tenderloin Area.

Ms. Tajel Shah of the Treasurer/Tax Collector's Office advises that this proposed 90 percent definition for eligible employees would require businesses to report the proportion of employees work time expended within the boundaries of this Area as well as employees work time directly related to activities within the Area, which would result in a added administrative work for the Tax Collector's staff to verify. As a result, Ms. Shah estimates that initial one-time General Fund expenditures of approximately \$162,000 would be necessary to create the necessary forms and establish procedures to verify each businesses employment and payroll data and provide refunds in the first year. In addition, Ms. Shah estimates that the proposed ordinance would require approximately \$186,000 of General Fund expenditures each year to fund one full-time equivalent

auditor position, plus administrative support to review and audit the proposed Payroll Expense Tax exclusions.

Based on the provisions in the subject ordinance that the OEWD would determine the eligibility of businesses to qualify for the proposed Payroll Expense Tax exclusion, Ms. Matz estimates that OEWD can absorb these additional responsibilities within their existing budget.

Mr. Egan advises that the Controller's Office is preparing an economic analysis of the proposed legislation, which is anticipated to be available prior to the March 16, 2011 Budget and Finance Committee meeting.

POLICY CONSIDERATIONS

Loss of City Payroll Taxes versus Increased Economic Stimulation

The Budget and Legislative Analyst notes that if the proposed Payroll Expense Tax exclusion is not approved, Twitter may not stay and grow their business in San Francisco, such that San Francisco will lose the existing estimated \$535,500 annual Payroll Taxes that Twitter currently pays to the City. On the other hand, if Twitter relocates to the Central Market and Tenderloin Area and grows their business as discussed above, and the proposed Payroll Expense Tax exclusion is approved, the City would potentially forego up to \$4,054,500 of excluded Payroll Expense Tax annually. Over a six-year period, the time period that Twitter could obtain a Payroll Expense Tax exclusion under the proposed ordinance, this could result in up to \$22,032,000 [\$1,759,500 in 2012 + \$20,272,500 (\$4,054,500 in 2013-2017)] of forgone Payroll Taxes to the City, which are General Fund revenues.

Yet, if Twitter relocates to the Central Market and Tenderloin Area and grows their business as discussed above, and the proposed Payroll Expense Tax exclusion is approved, after Twitter receives the Payroll Expense Tax exclusion for six years, the City would begin to receive potentially significantly greater Payroll Taxes from Twitter. As noted above, based on an estimated 3,000 employees, at the current 1.5 percent Payroll Tax rate and assuming a constant \$102,000 average annual salary, the City would receive an estimated \$4,590,000 of annual Payroll Taxes.

In addition, San Francisco could receive other future benefits of having Twitter based in San Francisco, such as the creation of additional jobs and the direct and indirect economic benefits associated with such job growth. According to Ms. Matz, an estimated additional \$1,320,000 would be generated in the first year of Twitter's presence in the Central Market and Tenderloin Area, increasing to \$1,726,585 in the sixth year of direct tax revenues to the City. Although indirect economic impacts are more difficult to project, OEWD expects Twitter to have a significant multiplier effect with the generation of jobs to meet the goods and services needs of Twitter and its employees. However, the Budget and Legislative Analyst notes that if Twitter does not expand at the rate that is being projected, the additional future benefits of having Twitter in the Central Market and Tenderloin Area could be significantly diminished.

While Agreeing to Payroll Tax Exclusions, Additional Potential Costs to the City Are Being Proposed

In negotiations between Twitter and OEWD, the OEWD has agreed to provide additional City services to address Twitter's concerns regarding public safety, transportation, and neighborhood conditions in the Central Market and Tenderloin Area, which could result in additional costs to the City. For example, the Police Department has agreed to expand its Mid-Market foot patrol boundary on Market Street that currently extends from 4th Street to 9th Street to 10th Street. In addition, the San Francisco Municipal Transportation Agency (SFMTA) has been requested to provide a 47A service line, a non-stop express service during prime commuting hours between the Caltrain Station at 4th and King Streets and the Civic Center BART Station at 9th and Market Streets. OEWD advises that these two proposed City improvements, coupled with the actions of the Central Market Partnership discussed previously, are anticipated to address Twitter's concerns regarding neighborhood conditions. However, as the City is experiencing significant budgetary shortfalls, if Twitter does not expand at the rate projected, the Budget and Legislative Analyst questions whether the City will be able to deliver increased levels of services to meet the demands of a large company while potentially reducing Payroll Tax revenues.

Increasing Vacancies in the Central Market and Tenderloin Area

The Budget and Legislative Analyst also notes that in addition to the major challenges already facing the Central Market and Tenderloin Area discussed above in the Background section, there are anticipated to be significant additional vacancies in this area over the next several years, due to the vacating of (a) the State Compensation Building on the corner of Market and 9th Streets, (b) the Bank of America Building on the corner of Market and 11th Streets, and (c) the City's Public Utility Commission Building on Market Street between 7th and 8th Streets. Therefore, there is anticipated to be significantly increased office space available in the Central Market and Tenderloin Area over the next several years, which will likely result in reduced rents from this increasing supply. The combination of increased supply and reduced rents in major office buildings in the Area may encourage new businesses to locate or relocate to this Area, without the added benefit of the proposed Payroll Expense Tax exclusion.

Proposed Amendments

As noted above, Section 906.3(b)(2) of the proposed ordinance defines eligible employees as employees that spend (a) at least 90 percent of work time within the boundaries of the Central Market and Tenderloin Area, and (b) at least 90 percent of work time on activities directly related to the conduct of trade or business located within the Central Market and Tenderloin Area. Based on discussions with Ms. Matz, this language was included in the proposed ordinance to be consistent with language in the City's existing Enterprise Zone legislation. However, as discussed by the Budget and Legislative Analyst, these provisions will result in a significant administrative burden for the Tax Collector's staff to enforce, and may not be necessary to effectively implement the proposed ordinance. Ms. Matz concurs that this language is not necessary to achieve the objectives of the proposed Payroll Expense Tax exclusion. Ms. Shah estimates that if the proposed language is deleted, the Tax Collector's Office estimates that the initial \$162,000 costs would remain the same, but that the annual ongoing costs to implement the proposed ordinance would be reduced from approximately \$186,000 to \$81,000, a reduction of

\$105,000 annually of General Fund expenses. Therefore, the Budget and Legislative Analyst recommends that all of Section 906.3(b)(2) be deleted.

In addition, Section 906.3(a) of the proposed ordinance states that the amount of Payroll Expense Tax due would be available for any business that maintains or establishes a fixed place of business in the Central Market and Tenderloin Area after the effective date of this legislation, but (a) does not specify that the Payroll Expense Tax exclusion is attributable to only the payroll expense at the fixed place of business within the Central Market and Tenderloin Area, and (b) does not specify the base year for determining how existing Payroll Taxes would be owed to the City. To address both of these issues, the Budget and Legislative Analyst recommends amending Section 906.3(a) to state the following:

An exclusion from the payroll expense tax shall be allowed for each person who maintains a fixed place of business within the Central Market Street and Tenderloin Area for payroll expense attributable to that fixed location; provided, however that in no event shall the tax exclusion reduce a person's tax liability to less than the person's Base Year payroll expense tax liability.

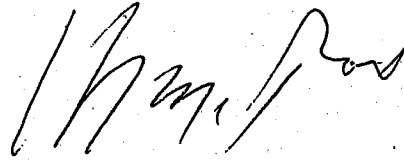
Given this change, the Budget and Legislative Analyst also recommends adding a new Section 906.3(b)(2) to specify

"Base Year" means the 2010 tax year for a person who maintains a fixed place of business in San Francisco on the effective date of this ordinance. For a person who moves to the Central Market Street and Tenderloin Area from another part of San Francisco, Base Year means that person's tax year for the year prior to entering into a lease agreement or buying real property in the Area. For a person who commences to maintain a fixed place of business in San Francisco after the effective date of this ordinance, Base Year means that person's first tax year in the Area.

According to Ms. Stephanie Profitt of the City Attorney's Office, an Amendment of the Whole containing these changes is expected to be introduced.

RECOMMENDATIONS

1. Amend the proposed ordinance as specified above to reduce the administrative cost for the Tax Collector's Office and to clarify the provisions.
2. Approval of the proposed ordinance, as amended, is a policy decision for the Board of Supervisors, given the potential short-term loss of Payroll Expense Tax revenues for the City relative to the potential economic stimulus for the Central Market and Tenderloin Area.

A handwritten signature in black ink, appearing to read 'Harvey M. Rose', written in a cursive style.

Harvey M. Rose

cc: Supervisor Chiu
Supervisor Mirkarimi
Supervisor Kim
Supervisor Wiener
President Chiu
Supervisor Avalos
Supervisor Campos
Supervisor Cohen
Supervisor Elsbernd
Supervisor Farrell
Supervisor Mar
Clerk of the Board
Cheryl Adams
Controller
Greg Wagner