

**CITY AND COUNTY OF SAN FRANCISCO**

**BOARD OF SUPERVISORS**

**BUDGET AND LEGISLATIVE ANALYST**

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June 13, 2023

**TO:** Budget and Appropriations Committee

**FROM:** Budget and Legislative Analyst



**SUBJECT:** June 15, 2023 Special Budget and Appropriations Committee Meeting

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<p><b>Item 5</b> <b>File 23-0660</b></p>	<p><b>Department:</b> Early Childhood (DEC)</p>
<p><b>EXECUTIVE SUMMARY</b></p>	
<p style="text-align: center;"><b>Legislative Objectives</b></p> <ul style="list-style-type: none"> <li>• The proposed ordinance would amend the Commercial Rents Tax provisions to allow a sublessor of commercial space to deduct the rent paid to its lessor from the rent received from its sublessee when calculating its commercial rents tax liability for the tax years 2023 through 2029.</li> </ul> <p style="text-align: center;"><b>Key Points</b></p> <ul style="list-style-type: none"> <li>• The Early Care and Education Commercial Rents Tax applies to businesses leasing commercial space that are subject to the City’s gross receipts tax and is in addition to gross receipts or payroll taxes paid by businesses in the City. The tax equals (a) 1 percent of lease revenues from the lease or sublease of warehouse space, and (b) 3.5 percent of lease revenues from the lease or sublease of other commercial spaces in the City. Currently, commercial landlords with less than \$2.09 million in gross receipts, and rents paid from non-profit, government, arts, industrial use, and non-formula retail tenants are exempt from the tax.</li> <li>• According to the Mayor’s Office, the intent of this proposed ordinance is to suspend the duplicative tax on the same commercial space, as well as to stimulate commercial leasing, especially in the downtown corridor.</li> <li>• The proposed ordinance would reduce the tax liability of an estimated 250-350 taxpayers.</li> </ul> <p style="text-align: center;"><b>Fiscal Impact</b></p> <ul style="list-style-type: none"> <li>• The proposed ordinance would reduce Commercial Rents Tax proceeds by an estimated \$17.0 million annually, of which \$14.45 million would have otherwise been appropriated for early childcare and education programs and \$2.55 million would have been allocated to the General Fund for discretionary use.</li> </ul> <p style="text-align: center;"><b>Recommendation</b></p> <ul style="list-style-type: none"> <li>• Approval of the proposed ordinance is a policy matter for the Board of Supervisors.</li> </ul>	

**MANDATE STATEMENT**

Charter Section 2.105 requires that legislative acts in San Francisco be by ordinance, subject to approval by a majority of the Board of Supervisors.

Business and Tax Regulations Code Section 2113 states that amendments to or repeal of Article 21 of the Business and Tax Regulations Code are subject to Board of Supervisors approval by ordinance without voter approval.

**BACKGROUND**

The Early Care and Education Commercial Rents Tax was authorized by the voters in June 2018 with the passage of Proposition C and went into effect on January 1, 2019. According to the Proposition’s provisions, 85% of the proceeds from the tax are to be used for early childcare and education programs and 15% are to be allocated to the General Fund for discretionary use.

The tax applies to businesses leasing commercial space that are subject to the City’s gross receipts tax and is in addition to gross receipts or payroll taxes paid by businesses in the City. The tax equals (a) 1 percent of lease revenues from the lease or sublease of warehouse space, and (b) 3.5 percent of lease revenues from the lease or sublease of other commercial spaces in the City. For 2022, commercial landlords with less than \$2,090,000 in San Francisco gross receipts, and rents paid from non-profit tenants, government tenants, arts, industrial uses, and non-formula retail uses are exempt from the tax.

**DETAILS OF PROPOSED LEGISLATION**

The proposed ordinance would amend the Commercial Rents Tax provisions to allow a sublessor of commercial space to deduct the rent paid to its lessor from the rent received from its sublessee when calculating its commercial rents tax liability for the tax years 2023 through 2029.

The proposed ordinance also requires the Controller to provide a report to the Board of Supervisors detailing the number of taxpayers that took the deduction and the amount of the resulting forgone tax proceeds.

**FISCAL IMPACT**

The Controller has estimated the proposed ordinance would reduce Commercial Rents Tax proceeds by \$17.0 million annually. Of this amount, 85% or \$14.45 million would otherwise be appropriated for early childcare and education programs and 15% or \$2.55 million would otherwise be allocated to General Fund uses.

This reduction has been factored into the commercial rent tax revenues included in the Mayor’s Proposed Budget of \$172.0 million for FY 2023-34 and \$194.1 million for FY 2024-25, representing a 9.0% and an 8.0% decrease.

According to the Treasurer-Tax Collector, these deductions are estimated to impact 250 to 350 taxpayers. According to the Mayor's Office, the intent of this proposed ordinance is to suspend the duplicative tax on the same commercial space, as well as to stimulate commercial leasing, especially in the downtown corridor.

**RECOMMENDATION**

Approval of the proposed ordinance is a policy matter for the Board of Supervisors.