FILE NO.

LEGISLATIVE DIGEST

[Business and Tax Regulations Code – Enact Gross Receipts Tax and Phase Out Payroll Expense Tax]

Ordinance amending the Business and Tax Regulations Code to: 1) enact a new Article 12-A-1 (Gross Receipts Tax Ordinance) to impose a gross receipts tax and a gross expense tax on persons engaging in business activities in San Francisco; 2) amend Article 12-A (Payroll Expense Tax Ordinance) to reduce business payroll expense tax rates based on the amount of gross receipts tax collected under Article 12-A-1 (Gross Receipts Tax Ordinance); 3) amend Article 12 (Business Registration Ordinance) to establish business registration fees based on gross receipts and gross expenses and amend the current business registration fees to generate $40 million in additional revenue; 4) amend Article 12-A (Payroll Expense Tax Ordinance) to add a sunset date to the surplus business tax revenue credit; and 5) amend Article 6 (Common Administrative Provisions) to establish requirements for filing a tax return under Article 12-A-1 (Gross Receipts Tax Ordinance) and establish penalties for non-filing, amend the requirements for filing payroll expense tax returns and penalties for non-filing to conform to the new gross receipts tax.

Existing Law

The City and County of San Francisco currently imposes a tax on the payroll expense of persons who conduct business in the City. The tax is levied at a rate of 1.5 percent against a business's taxable payroll expense, which includes all compensation a person pays to individuals for services performed in the City. The City exempts small businesses with less than $250,000 in payroll expense.

Amendments to Current Law

The legislation phases in a gross receipts tax gradually, over a five-year period that commences with tax year 2014. The phase-in period allows businesses time to adjust to the gross receipts tax. It also minimizes risk of revenue uncertainty to the City, and to business taxpayers as a whole. Also beginning in tax year 2014, the payroll expense tax will be phased-out in increments consistent with the phase-in of the gross receipts tax. If the gross receipts tax generates revenue in excess of current payroll expense tax revenue during the phase-in process, the phase-in stops and final gross receipts tax rates will be permanently established at less than the maximum rates authorized by this Ordinance. If, on the other hand, gross receipts tax revenues do not fully replace current payroll expense tax revenues, then the payroll expense tax will not be fully phased-out, and a reduced payroll expense tax rate will remain at the end of the process. A business that is engaged only in providing administrative services for itself or a related entity will continue to pay a tax based on its payroll expense.

Section 2 identifies the sections of the Ordinance that will be submitted to qualified electors at the November 6, 2012 general election, and provides that Sections 3 and 4 will become operative only if approved by the voters. Section 2 also provides that Sections 5, 6 and 7 of the Ordinance will become operative on the same date as Sections 3 and 4.

Section 3 enacts new Article 12-A-1, the Gross Receipts Tax Ordinance, as specified. The proposed Gross Receipts Tax Ordinance would impose a tax for the privilege of engaging in a business in the City that is measured by the taxpayer's gross receipts or gross expenses from business activities that are attributable to the City. The rate of the tax is tiered and dependent upon a business's industry. The gross receipts tax is to be phased-in over a five year period and during that period, the City's payroll expense tax will be phased-out.

Section 4 sets forth the operative date of the Ordinance. The Gross Receipts Tax would become operative in tax year 2014.

Section 5 amends the Business Registration Ordinance under Article 12 to establish business registration fees based on the gross receipts tax to generate an additional $40 million in revenue. It also amends current business registration fees to add a penalty for failure to register business locations and fictitious business names with the Tax Collector and to add a new fee for registering more than 15 fictitious business names.

Section 6 amends the Payroll Expense Tax Ordinance under Article 12-A to conform to the phase-in of the Gross Receipts Tax Ordinance. The amendments to Article 12-A change the rate of the payroll expense tax to phase the tax out over a period of 5 years.

Section 7 amends the Common Administrative Provisions set forth in Article 6 of the Business and Tax Regulations Code. The amendments to Article 6 amend return and payment requirements and otherwise conform the administrative provisions with the enactment of the Gross Receipts Tax Ordinance.

Background Information

San Francisco is the only major city in California that levies its entire business tax on payroll expense. This payroll-based tax raises an affected business's cost of hiring a worker in San Francisco, and thereby discourages job creation. Instituting a tiered rate structure under which a business is taxed based on its gross receipts or gross expense will better distribute the tax burden among the City's businesses.

A gross receipts tax is the most common business tax base among California’s largest cities. Replacing the payroll expense tax in San Francisco can be expected to stimulate employment in the City, as well as broadening and stabilizing the tax base.