Gross Receipts Tax on Transportation Network Company and Private Transit Vehicle Services:

Economic Impact Report

CITY & COUNTY OF SAN FRANCISCO

Office of the Controller

Office of Economic Analysis

Item #180373

05.17.2018

180373

Introduction

- The proposed legislation would place a business tax measure on the November, 2018 ballot in San Francisco. All local tax increases in California must be approved by the voters. In this case, the measure would require a 50% + 1 majority to pass.
- The tax would amend the City's Gross Receipts tax by creating new category of business activity, Transportation Network Services and Private Transit Vehicle Services. Businesses in this category would pay a higher tax rate than they currently do.
- The legislation would also bring forward the expiration of the Central Market and Tenderloin Area Payroll Tax Exclusion that was enacted in 2011, change the taxation rules for businesses operating in more than one industry category, and raise the appropriation limit.
- The Office of Economic Analysis (OEA) has prepared this report after determining that the proposed tax increase might have a material impact on the City's economy. The other provisions of the legislation would not have a significant impact, and are not considered in this report.

Definitions

- The proposed tax would apply to companies doing business in San Francisco, and providing Transportation Network Company Services, or Private Transit Vehicle Services.

- *Transportation Network Company Services* refers to the use of an online-enabled application or platform to connect passengers within drivers using a personal vehicle. This definition is based on the definition of Transportation Network Company (TNC) in the California Public Utilities Code.

- *Private Transit Vehicle Services* means any services provided by a Private Transit Vehicle, which is defined in the City's Transportation Code. Essentially, it is a private, passenger-carrying, road-going vehicle that provides transit services to the public while charging individual fares, which is not regulated by the California Public Utilities Commission (as TNCs are), not a taxi or ambulance, and accepts passengers on a non-pre-arranged basis.

San Francisco Gross Receipts

- A State or local government may not tax all of a business's gross receipts, but only the amount that can be fairly apportioned to the jurisdiction.
- San Francisco's Gross Receipts Tax uses three ways to apportion a business's total gross receipts. Different rules apply to different industries:
  - Payroll: the percentage of total gross receipts that is taxable by the City is equal to the percentage of its total payroll that is based in the city.
  - Sales: only sales from within San Francisco are taxable by the City.
  - Sales + Payroll: half of the taxable receipts are based on the Sales method, and half based on the Payroll method.
- In the proposed legislation, Private Transit Vehicle Services would use the Sales method. For Transportation Network Company Services, the Sales + Payroll method would be used.

Gross Receipts Tax Rates

- The City's Gross Receipts Tax levies different rates for businesses in different industries. Within a given industry, higher rates are charged at higher gross receipts tiers.
- Based on the definitions in the proposed legislation, it is likely that many of the affected businesses are currently paying taxes as Information and/or Transportation. Under the proposed tax, they would be reclassified.
- Consequently, their tax rates will rise at each tier by 0.5%, as shown on the next page. At the highest tier, for gross receipts above $25 million, the tax rate would rise from 0.475% to 0.975%.

Current and Proposed Tax Rates

	Gross Receipts Tier			
	$0-1M	$1-2.5M	$2.5-$25M	$25M+
Retail Trade, Wholesale Trade, Certain Services	0.075%	0.100%	0.135%	0.160%
Manufacturing, Transportation/Warehousing, Information, Biotechnology, Clean Technology, Food Services	0.125%	0.205%	0.370%	0.475%
Accommodations, Utilities, Arts/Entertainment/Recreation	0.300%	0.325%	0.325%	0.400%
Private Education/Health Services, Administrative/Support Services, Miscellaneous Business Activities	0.525%	0.550%	0.600%	0.650%
Construction	0.300%	0.350%	0.400%	0.450%
Financial Services, Insurance, Professional/Scientific/Technical Services	0.400%	0.460%	0.510%	0.560%
Real Estate/Rental/Leasing Services	0.285%	0.285%	0.300%	0.300%
Transportation Network Company/Private Transit Vehicle Services	**0.625%**	**0.705%**	**0.870%**	**0.975%**

New Tax Category

Economic Impact Factors

- On one hand, the proposed tax would raise the cost to affected businesses of operating and generating gross receipts in San Francisco. Because San Francisco gross receipts are generated by maintaining payroll and incurring sales in the city, as well as overall business growth, the proposed tax would create a disincentive to locate jobs and do business in the city.
- To the extent that affected businesses reduce employment and operations in San Francisco, this would generate negative multiplier effects in the city's economy, and tend to contract it.
- As a General Tax, the revenue from the proposed tax would be deposited in the General Fund for any government purpose. The additional local government spending would generate positive multiplier effects throughout the local economy, creating an economic stimulus.
- The net economic impact of the proposed tax results from the relative strength of these positive and negative multiplier effects.

Revenue Estimates

- TNCs and Private Transit Vehicle services revenues cannot be determined from standard economic statistics. Because of this, the revenue estimate in this report is subject to considerable uncertainty.
- However, Uber and Lyft are large businesses in San Francisco which are known to be regulated as Transportation Network Companies as defined by the CPUC, and thus would be subject to the tax.
- Based on the current state of the industry, Uber and Lyft would likely be the source of the vast majority of the tax's new revenue.
- Based on publicly-reported information from these business activities, we estimate the proposed tax would generate $32 million in revenue each year. However, because of the uncertainty, actual revenues could vary substantially from this estimate.
- As global companies headquarters in the city, both companies reportedly have a higher share of their payroll in the city than sales. Given the proposed apportionment rules discussed earlier, this means their employment base in the city would have a major impact on their tax obligation.

General Fund Spending

- San Francisco's $5.1 billion General Fund can be broken down by uses as follows, according to the FY 2017-18 adopted budget:
  - Personnel 45.4%
  - Non-Personnel Operating Costs 15.8%
  - Aid Assistance 7.4%
  - Grants 6.4%
  - Transfers from General Fund 20.8%
  - Capital & Equipment 4.3%
- Excluding transfers, and accounting for 50% of City employees who live outside of San Francisco, a $32 million increase to the General Fund would generate approximately $9 million in direct economic benefits from employee compensation in San Francisco, and $14 million in additional spending on Social Services, Construction, and Professional Services.

Economic Impact Assessment

- Using REMI, we modeled the economic costs of the tax against the benefits of the increased spending through the City's General Fund.
- Overall, on average over a 20-year period, the impact was slightly negative, with an average loss of 150 jobs. About 70 jobs are projected to be lost in the Information sector, with remainder distributed across other sectors. The Health Care and Social Services sector is projected to add jobs, given the City's General Fund support of those activities.
- To put these figures into context, the tax would result in about a 0.1% to 0.2% average reduction in employment and value added for the Information sector as a whole, with much smaller impacts on the other sectors of the local economy. Of course, the impacts on the individual companies affected by the tax would be greater.

Conclusions

- Our analysis suggests the economic impact of the tax is negative, but small in the context of the overall city economy, with the contracting effects of limiting employment and compensation in the Information sector slightly outweighing the benefits of increased spending.
- Relatively few businesses are likely to be affected. Only one business, Uber, would likely account for the vast majority of the tax revenue, at least at present.
- Future tax revenue will be sensitive to the overall trends of an emerging industry. Growth has been rapid in recent years, and with continued growth, revenue could far exceed the estimate in this report. On the hand, changes in technology or regulation could make the categories in the proposed tax less relevant, leading to less-than-expected revenue in the future.
- Furthermore, the tax burden of large TNCs under the proposed tax would be highly sensitive to where their employees work. If businesses react to the tax by relocating more jobs out of San Francisco than anticipated, the City could experience a greater negative economic impact, and an erosion of its business tax base.

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