

LEGISLATIVE DIGEST

(Amended in Committee June 25 and July 16, 2020)

[Charter Amendment and Business and Tax Regulations Code - Adjustment of Baseline Funding and Business Tax Changes]

Describing and setting forth a proposal to the voters at an election to be held on November 3, 2020, to amend the Charter of the City and County of San Francisco to provide that future annual adjustments in baseline funding for the following Charter-mandated funds will not take into account certain changes in City revenue resulting from voter-approved business taxes on the November 3, 2020 ballot: the Municipal Transportation Fund, the Park, Recreation and Open Space Fund, the Children and Youth Fund, the Library Preservation Fund, the Housing Trust Fund, the Public Education Enrichment Fund, the Dignity Fund, and the Street Tree Maintenance Fund; to amend the Business and Tax Regulations Code to: 1) reduce the annual Business Registration Fee for businesses with \$1,000,000 or less in San Francisco gross receipts, 2) increase the small business exemption ceiling for the Gross Receipts Tax to \$2,000,000 and increase the annual Business Registration Fee on businesses benefiting from this increased exemption ceiling, 3) modify the Gross Receipts Tax rates, 4) repeal the Payroll Expense Tax, 5) increase the Gross Receipts Tax on certain taxpayers for 20 years if a final judicial decision has the effect of invalidating the Homelessness Gross Receipts Tax Ordinance, 6) impose a new general tax on the gross receipts from the lease of certain commercial space for 20 years if a final judicial decision has the effect of invalidating the Early Care and Education Commercial Rents Tax Ordinance, and 7) make other changes to the City's business taxes; and to increase the City's appropriations limit by the total revenues collected under Articles 12-A-1 and 36 of the Business and Tax Regulations Code for four years from November 3, 2020.

Existing Law

The Charter provides for guaranteed annual funding in a number of special funds, including: the Municipal Transportation Fund; the Park, Recreation and Open Space Fund; the Children and Youth Fund; the Library Preservation Fund; the Housing Trust Fund; the Public Education Enrichment Fund; the Dignity Fund; and the Street Tree Maintenance Fund. These funding requirements are commonly known as "baselines," where the Charter sets a base amount of funding for a particular purpose. In adopting the annual budget, the Board of Supervisors and the Mayor have no discretion to provide lower amounts of funding than the Charter-mandated baselines require.

Under the Charter, the amount of each of these baselines may increase or decrease each year depending on the amount of discretionary revenue the City receives that year. In this calculation, discretionary revenue includes any money received by the City that is unrestricted

and may be used at the option of the Mayor and the Board of Supervisors for any lawful City purpose.

The City imposes a number of taxes under the Business and Tax Regulations Code on businesses engaged in business within the City. Among these taxes, the registration fee (Article 12), the payroll expense tax (Article 12-A), and the gross receipts tax (Article 12-A-1) are general taxes, the revenues from which go to the General Fund and may be used at the option of the Mayor and the Board of Supervisors for any lawful City purpose:

- The registration fee ranges between \$75 and \$35,000 (adjusted for inflation), depending on the type of business and the amount of gross receipts attributable to the City. For businesses engaged in business as an administrative office, the registration fee ranges between \$15,000 and \$35,000 (adjusted for inflation), depending on the business's payroll expense attributable to the City.
- The payroll expense tax rate is 0.38% of payroll expense attributable to the City, except for businesses that pay the administrative office tax. Small businesses with payroll expense attributable to the City not exceeding \$320,000 are exempt from this tax in tax years 2019 and 2020, and this amount is adjusted for inflation every two years.
- The gross receipts tax rate ranges from 0.075% to 0.65% of gross receipts attributable to the City, depending on the business's type of business activities and amount of taxable gross receipts, except for businesses that pay the administrative office tax. Small businesses with gross receipts attributable to the City not exceeding \$1,170,000 generally are exempt from this tax in tax year 2019, and this amount is adjusted for inflation annually.
- In lieu of payroll expense and gross receipts taxes, businesses engaged in business as an administrative office pay the administrative office tax equal to 1.4% of payroll expense attributable to the City.

Certain businesses engaged in business within the City also pay special taxes, the revenues from which are dedicated to specific purposes:

- Businesses that receive gross receipts from the lease of commercial space in properties in the City pay the Early Care and Education Commercial Rents Tax (Article 21) at a rate of 1% or 3.5% of those receipts, depending on the type of property. This tax is dedicated 15% to the General Fund and 85% to fund early care and education for young children.
- The Homelessness Gross Receipts Tax (Article 28) is imposed on (1) businesses that pay the administrative office tax, at a rate of 1.5% of payroll expense attributable to the City and (2) businesses with gross receipts attributable to the City exceeding \$50,000,000, at a rate that ranges from 0.175% to 0.69% of gross receipts attributable to the City in excess of \$50,000,000, depending on the business's type of business activities. This tax is dedicated to fund services for homeless people and to prevent homelessness.

Commencing in 2021, Article 30 will impose an additional tax on businesses engaged in cannabis business activities in the City equal to 1% to 5% of the gross receipts from those cannabis business activities in excess of \$500,000, depending on the type of cannabis business activities and the amount of gross receipts from those activities attributable to the City. This tax will be deposited into the General Fund.

Amendments to Current Law

The proposed Charter amendment would modify the way the City calculates increases or decreases in the baseline funds described above each year. The amount of each of the baselines would still increase or decrease each year depending on the amount of discretionary revenue the City receives that year. But the Charter amendment would exclude from that calculation any revenues the City receives from taxes approved by the voters on the November 2020 ballot that would become effective only if a court strikes down the Homelessness Gross Receipts Tax or the Early Care and Education Commercial Rents Tax (the "Backstop Taxes").

Effective beginning in the 2021-2022 fiscal year, the proposed measure would reduce the registration fee of most businesses with \$1,000,000 or less in gross receipts attributable to the City by approximately 50%, and increase the registration fee of businesses who would benefit from the proposed increase in the small business exemption ceiling for the gross receipts tax (described below). For most businesses with \$1,000,000.01 to \$1,500,000 in gross receipts attributable to the City, the increase would be either \$230 or \$245, depending on the business's activities. For most businesses with \$1,500,000.01 to \$2,000,000 in gross receipts attributable to the City, the increase would be either \$435 or \$460, depending on the business's activities.

This measure would repeal the payroll expense tax beginning in the 2021 tax year. This measure would change the gross receipts tax rates, and would incrementally increase the gross receipts tax rates for certain business activities, beginning with the 2021 tax year through the 2024 or 2025 tax year, as shown in the table immediately below. For those business activities denoted with a double asterisk (**) in the table, the increased rates scheduled to take effect for the 2023 and 2024 tax years would be delayed by one year if the total gross receipts attributable to the City for the 2021 and 2022 tax years, respectively, do not equal or exceed 90% and 95%, respectively, of the total gross receipts attributable to the City for the 2019 tax year. For the 2025 and subsequent tax years, the tax rates shown in the column "Tax Years 2024 & After" would apply irrespective of whether either of the above gross receipts thresholds was met.

Business Activity	Current Gross Receipts Tax Rates*	Proposed Gross Receipts Tax Rates*			
		Tax Year 2021	Tax Year 2022	Tax Year 2023	Tax Years 2024 & After
Retail Trade; Certain Services	0.075% to 0.160%	0.053% to 0.224%	0.053% to 0.224%	0.079% to 0.224%	0.105% to 0.224%
Wholesale Trade	0.075% to 0.160%	0.105% to 0.224%	0.105% to 0.224%	0.105% to 0.224%	0.105% to 0.224%
Manufacturing; Food Services	0.125% to 0.475%	0.088% to 0.665%	0.088% to 0.665%	0.131% to 0.665%	0.175% to 0.665%
Transportation and Warehousing; Clean Technology	0.125% to 0.475%	0.175% to 0.665%	0.175% to 0.665%	0.175% to 0.665%	0.175% to 0.665%
Biotechnology**	0.125% to 0.475%	0.175% to 0.665%	0.181% to 0.689%	0.188% to 0.713%	0.194% to 0.736%
Information**	0.125% to 0.475%	0.560% to 0.784%	0.573% to 0.832%	0.579% to 0.855%	0.585% to 0.879%
Accommodations; Arts, Entertainment and Recreation	0.300% to 0.400%	0.210% to 0.560%	0.210% to 0.560%	0.315% to 0.560%	0.420% to 0.560%
Utilities**	0.300% to 0.400%	0.420% to 0.560%	0.435% to 0.580%	0.450% to 0.600%	0.465% to 0.620%
Private Education and Health Services**; Administrative and Support Services**	0.525% to 0.650%	0.735% to 0.910%	0.761% to 0.943%	0.788% to 0.975%	0.814% to 1.008%
Miscellaneous Business Activities**	0.525% to 0.650%	0.735% to 0.910%	0.788% to 0.975%	0.814% to 1.008%	0.840% to 1.040%
Construction	0.300% to 0.450%	0.420% to 0.630%	0.420% to 0.630%	0.420% to 0.630%	0.420% to 0.630%
Insurance**	0.400% to 0.560%	0.560% to 0.784%	0.580% to 0.812%	0.600% to 0.840%	0.620% to 0.868%
Financial Services**; Professional, Scientific and Technical Services**	0.400% to 0.560%	0.560% to 0.784%	0.600% to 0.840%	0.620% to 0.868%	0.640% to 0.896%
Real Estate**; Rental and Leasing Services**	0.285% to 0.300%***	0.399% to 0.420%	0.413% to 0.435%	0.428% to 0.450%	0.442% to 0.465%

* The gross receipts tax is generally progressive, with rates that increase by tiers, depending on the amount of gross receipts attributable to the City. This table shows the range of gross receipts tax rates from the lowest tier to the highest tier within each business activity.

** If the gross receipts threshold for the 2023 tax year is not met, the rates shown in the "Tax Year 2022" column also would apply to the 2023 tax year. If the gross receipts threshold for the 2024 tax year is not met, the rates shown in the "Tax Year

2023" column would apply to the 2024 tax year (in addition to the 2023 tax year, if the gross receipts threshold for the 2023 tax year was met).

*** The gross receipts tax rate applicable to taxable gross receipts in excess of \$25,000,000 for the business activities of real estate and rental and leasing services will increase to 0.325% beginning in tax year 2021 if this measure does not pass.

This measure would increase the ceiling for the small business exemption from the gross receipts tax to \$2,000,000 of gross receipts attributable to the City, adjusted annually for inflation. This measure would eliminate the credit for taxpayers that have paid a substantially-similar tax to any other taxing jurisdiction on any gross receipts attributed to the City and taxed under Article 12-A-1. Beginning with the 2021 tax year, this measure would adjust the required quarterly payments of gross receipts taxes and administrative office taxes to equal the lesser of (1) 25% of the gross receipts tax liability (or administrative office tax liability) shown on the business's return for the tax year or (2) 25% of the gross receipts tax liability as determined by applying the applicable gross receipts tax rates and small business exemption for the current tax year to the taxable gross receipts shown on the business's return for the preceding tax year (or, if subject to the administrative office tax for the preceding year, 25% of the administrative office tax liability as determined by applying the applicable administrative office tax rate for the current tax year to the total payroll expense attributable to the City shown on the business's return for the preceding tax year).

This measure would incrementally increase the administrative office tax rate beginning in the 2022 tax year as shown in the table immediately below. The increased rate scheduled to take effect for the 2023 and 2024 tax years would be delayed by one year if the total gross receipts attributable to the City for the 2021 and 2022 tax years, respectively, do not equal or exceed 90% and 95%, respectively, of the total gross receipts attributable to the City for the 2019 tax year. For the 2025 and subsequent tax years, the administrative office tax rate would be 1.61% of payroll expense attributable to the City irrespective of whether either of the above gross receipts thresholds was met.

Current Administrative Office Tax Rate*	Proposed Administrative Office Tax Rate*			
	Tax Year 2021	Tax Year 2022	Tax Year 2023	Tax Years 2024 & After
1.4%	1.4%	1.47%	1.54%	1.61%

* The rates shown are in addition to the 1.5% rate currently imposed under the Homelessness Gross Receipts Tax.

If a final judicial decision has the effect of invalidating the Homelessness Gross Receipts Tax, this measure would increase the gross receipts tax on certain businesses for 20 years, beginning with the tax year following the date on which the court's decision becomes final. For businesses that pay the administrative office tax, 1.5% of payroll expense attributable to the City would be added to the applicable administrative office tax rate. For other businesses, there would be added to the gross receipts tax rate tiers an additional rate tier for taxable gross receipts over \$50,000,000 at the rate indicated in the following table for each business activity, plus the applicable rate for taxable gross receipts between \$25,000,000.01 and \$50,000,000:

Business Activity	Tax Rate*
Retail Trade; Certain Services; Wholesale Trade	0.175%
Manufacturing; Food Services; Transportation and Warehousing; Clean Technology; Biotechnology; Information	0.500%
Accommodations; Arts, Entertainment and Recreation; Utilities	0.425%
Private Education and Health Services; Administrative and Support Services; Miscellaneous Business Activities	0.690%
Construction	0.475%
Insurance; Financial Services; Professional, Scientific and Technical Services	0.600%
Real Estate; Rental and Leasing Services	0.325%

* This rate would be added to the applicable rate for taxable gross receipts between \$25,000,000.01 and \$50,000,000.

If a final judicial decision has the effect of invalidating the Early Care and Education Commercial Rents Tax, this measure would add Article 36 to impose a new general tax for 20 years on the gross receipts from the lease of certain commercial space in the City, substantially similar to the existing Early Care and Education Commercial Rents Tax, except that all revenues from the new tax would go to the General Fund.

This measure would increase the City's appropriations limit under Article XIII B of the California Constitution by the total revenues collected under Articles 12-A-1 and 36 of the Business and Tax Regulations Code, for four years from November 3, 2020.

This measure also would remove provisions that are no longer in effect, update the existing code language to current formatting standards, and make other changes to the City's business taxes.

Background Information

In June 2018, San Francisco voters by simple majority vote approved Proposition C, which imposes the Early Care and Education Commercial Rents Tax. In November 2018, San Francisco voters, also by simple majority vote, approved Proposition C, which imposes the Homelessness Gross Receipts Tax. Separate lawsuits regarding the validity of the Early Care and Education Commercial Rents Tax and the Homelessness Gross Receipts Tax are pending at the Court of Appeal. Pending resolution of those suits, the Controller has impounded the revenues from both the Early Care and Education Commercial Rents Tax and the Homelessness Gross Receipts Tax.

This legislative digest reflects amendments made in committee on June 25, 2020, specifying that the baseline calculations in the Charter would only exclude revenues the City receives from the Backstop Taxes.

This legislative digest also reflects amendments made in committee on July 16, 2020, which combined a proposed charter measure originally in BOS File No. 200507 with the tax measure in BOS File No. 200648, made non-substantive edits to the sections of the Charter proposed to be amended, and made the following amendments to the tax provisions originally introduced in BOS File No. 200648, among others:

- Revises the proposed gross receipts tax rates for certain business activities and the administrative office tax rates, and phases in some of the new gross receipts tax rates and administrative office tax rates between 2021 and 2024 or 2025, in some cases depending on whether certain gross receipts thresholds are met;
- Increases the small business exemption threshold to \$2,000,000, adjusted annually for inflation;
- Increases the registration fee for businesses with \$1,500,000.01 to \$2,000,000 in gross receipts who would benefit from the increased small business exemption threshold;
- Revises the required quarterly estimated payments of gross receipts taxes and administrative office taxes; and
- Increases the number of tax years for which the Backstop Taxes would be effective from 10 years to 20 years.

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