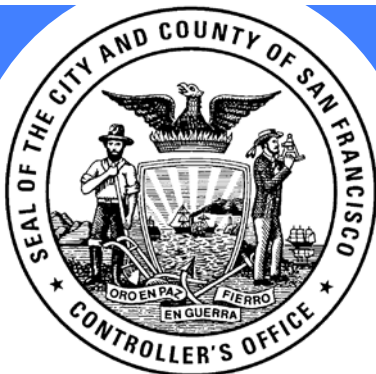


Business Tax Changes: Economic Impact Report

(Revised October 8, 2020)



CITY & COUNTY OF SAN FRANCISCO

Office of the Controller
Office of Economic Analysis

Item #200648

10/08/2020

- The proposed legislation would make a number of changes to San Francisco's system of business taxes. The changes would require voter approval, by a simple majority vote, at the November 2020 election.
- The revenues from two new taxes approved by San Francisco voters in 2018 have been impounded by the City Controller's Office, because of ongoing litigation. The proposed tax changes would permit the City to expend those impounded funds, and replace the tax revenues for 20 years, if the City loses that litigation.
- Additionally, the proposal would eliminate the City's Payroll Expense Tax, reduce business registration fees for small businesses, and make a number of adjustment to the City's Gross Receipts Tax rates.
- The Office of Economic Analysis (OEA) has prepared this economic impact report after determining that the proposed changes could have a material impact on the city's economy.
- The proposed tax is incorporated within a City Charter amendment which also excludes the tax's revenue from budget baselines. Only the tax changes are considered in this report, as the baseline changes do not affect the broader city economy.

- Specifically, the proposed tax would make the following changes:
 1. Providing a new revenue stream (a “backstop”) that would permit the City to expend the impounded revenue now being collected from the Commercial Rents Tax (“Baby C”) and Homelessness Gross Receipts Tax (“Big C”). The backstop is an increase in Gross Receipts Tax rates that mirror Big C and Baby C, and would go into effect for 20 years, only if the City loses the litigation.
 2. A repeal of the Payroll Expense Tax, effective in tax year 2021, funded by an across-the-board increase in Gross Receipts Tax rates, of 40%.
 3. A reduction of business registration fees, for businesses with \$1 million or less in San Francisco gross receipts.
 4. An increase in the small business exemption for the Gross Receipts Tax, to \$2 million. It’s 2019 level is \$1.17 million.
 5. Temporary reductions in Gross Receipts Tax rate for certain industries, and phased, permanent, increases in Gross Receipts Tax rates for other industries, as detailed on the following three pages.

Proposed Temporary Rate Reductions

- The City's Gross Receipts Tax has progressive tax rates, in which a business faces higher tax rates on higher tiers of gross receipts.
- The proposed measure would reduce the tax rates on the lowest three tiers (up to \$25 million in gross receipts), for the following industries: Retail Trade; Certain Services; Manufacturing; Arts, Entertainment, Recreation; Accommodations; and Food Services.
- The rates reductions for all 6 industries would be, in tax years 2021 & 2022, equivalent to 50% of the existing rates below \$25 million, adjusted by the 40% increase to fund the elimination of the Payroll Expense Tax. In tax year 2023, the reduction would be 25% of this adjusted rate, and in tax year 2024 and afterwards, there would be no reduction.
- Rates for all industries and tiers, for each year, are shown in the Appendix.

Proposed Rate Increases

- The proposal would change the rates that apply to the Information industry, beginning in tax year 2021, by raising them to match the rates that apply to the Professional, Scientific, and Technical Services industry.
- Additionally, further stepped increases would apply, to the industries and in the tax years shown on the next page. These increases are shown as a percentage increase of current rates, for all tiers.
- In 2023 and 2024, the increases would be delayed by one year if total San Francisco gross receipts for the proceeding year was below 90% or 95%, respectively, of San Francisco gross receipts total for 2019. This effectively defers tax increases if there is a major decline in the city's economy that continues to 2022 or 2023.
- The detailed rate increases by industry are shown on the next page. Full rate detail is provided in appendix.

Rate Increase Details

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Business Activity	2021	2022	2023	2024
Certain Services	0%	0%	0%	0%
Retail Trade	0%	0%	0%	0%
Wholesale Trade	0%	0%	0%	0%
Biotechnology	0%	5%	10%	15%
Clean Technology	0%	0%	0%	0%
Food Services	0%	0%	0%	0%
Information	0%	10%	15%	20%
Manufacturing	0%	0%	0%	0%
Transportation and Warehousing	0%	0%	0%	0%
Accommodations	0%	0%	0%	0%
Arts, Entertainment, and Recreation	0%	0%	0%	0%
Utilities	0%	5%	10%	15%
Activity Not Listed Above	0%	10%	15%	20%
Administrative and Support Services	0%	5%	10%	15%
Private Education and Health Services	0%	5%	10%	15%
Construction	0%	0%	0%	0%
Financial Services	0%	10%	15%	20%
Insurance	0%	5%	10%	15%
Professional, Scientific, and Technical Services	0%	10%	15%	20%
Real Estate and Rental and Leasing Services	0%	5%	10%	15%
Administrative Office Tax Payers	0%	5%	10%	15%

- An estimate of the revenue changes associated with each of the features of the tax proposal is shown on the table on the next page.
- The table assumes a resolution of the Big C/Baby C tax litigation, in the City's favor, in 2023, and that there is no revenue associated with the backstop in that year or beyond. As stated earlier, if the City loses the litigation, the backstop would replace the revenue of Big C/Baby C, as a general tax, for 20 years.
- The table shows the Big C and Baby C revenues that have been paid, or will be paid between now and 2023. This payment has and will continue to occur, regardless of whether this proposal is adopted. The proposal only permits the City to spend it prior to the final resolution of the litigation.

Revenue Impact of Policy Features, 2020-2025

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Tax Feature	Spending Use	2021	2022	2023	2024	2025
Unlocked Big C Revenue	Affordable Housing	\$197	\$94	\$0	\$0	\$0
	Mental Health	\$98	\$47	\$0	\$0	\$0
	Homelessness Prevention	\$59	\$28	\$0	\$0	\$0
	Shelter & Hygiene	\$40	\$19	\$0	\$0	\$0
	General Fund Re-Payments	\$197	\$0	\$0	\$0	\$0
Unlocked Baby C Revenue	Childcare	\$273	\$160	\$0	\$0	\$0
	General Fund Distributions	\$107	\$28	\$0	\$0	\$0
Replace Payroll Tax with Gross Receipts Tax Increase	General Fund	\$1	\$1	\$1	\$1	\$1
Reduce Business Registration Fees	General Fund	-\$5	-\$5	-\$5	-\$5	-\$5
Raise Gross Receipts Tax Small Business Exemption	General Fund	-\$12	-\$12	-\$12	-\$12	-\$12
Temporary Tax Reductions	General Fund	-\$22	-\$22	-\$11	\$0	\$0
Move Information to Schedule 6 Rates	General Fund	\$30	\$30	\$30	\$30	\$30
Stepped Tax Increases	General Fund	\$0	\$39	\$61	\$83	\$83
Total		\$963	\$407	\$64	\$97	\$97

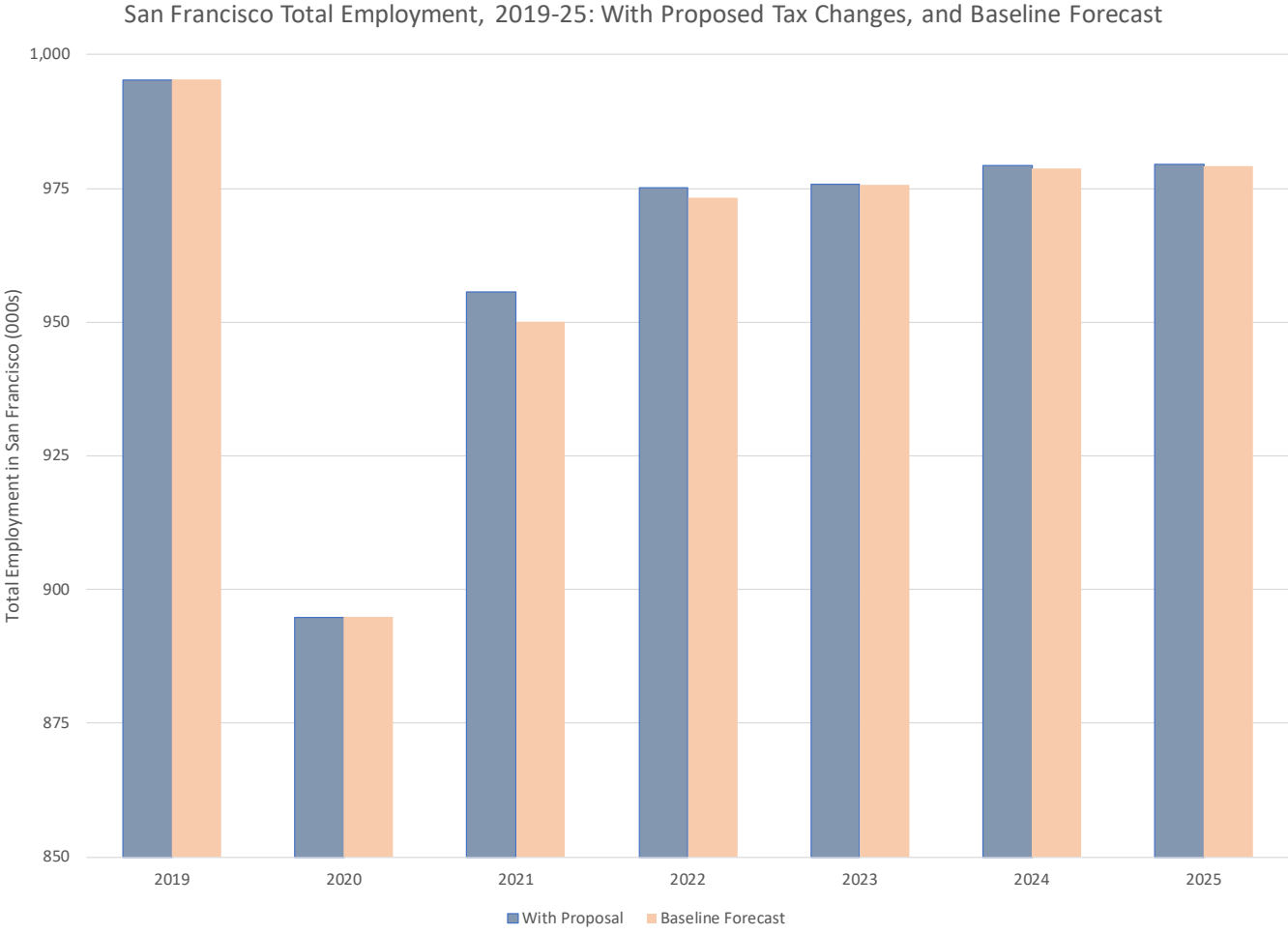
- The proposal will affect the city's economy in three primary ways:
 1. The backstop feature will allow the spending of Big C/Baby C revenue, prior to the resolution of the litigation. This spending will create a positive impact on the city's economy, without any offsetting negative impact on businesses.
 2. Secondly, the proposal fully shifts the City's business tax base away from payroll expense, to gross receipts, which will create an incentive to add payroll and employment in the city.
 3. Thirdly, the proposal changes the Gross Receipts Tax burden, across industries and businesses of different sizes. Since industries in San Francisco differ in their sensitivity to the cost of doing business, and their multiplier effects, these shifts may also impact the city's economy.
- The estimated net impact of the proposal on each industry, for the years 2021-2024, is shown in the table on the next page.

Change in Business Taxes by Industry, 2021-2024

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Industry	2021 (\$M)	2022 (\$M)	2023 (\$M)	2024 (\$M)
Accommodations	-\$1	-\$1	\$0	\$2
Activity Not Listed Above	\$0	\$1	\$2	\$3
Administrative and Support Services	\$0	\$1	\$2	\$3
Arts, Entertainment, and Recreation	-\$2	-\$2	-\$1	\$0
Biotechnology	-\$1	-\$1	\$0	\$0
Certain Services	-\$2	-\$2	-\$1	-\$1
Clean Technology	\$0	\$0	\$0	\$0
Construction	\$3	\$3	\$3	\$3
Financial Services	\$8	\$17	\$21	\$25
Food Services	-\$9	-\$9	-\$5	-\$2
Information	\$16	\$30	\$36	\$43
Insurance	\$0	\$1	\$1	\$1
Manufacturing	-\$3	-\$3	-\$2	\$0
Private Education and Health Services	\$0	\$1	\$1	\$2
Professional, Scientific, and Technical Services	-\$6	\$4	\$10	\$15
Real Estate and Rental and Leasing Services	\$4	\$5	\$7	\$8
Retail Trade	-\$9	-\$9	-\$6	-\$3
Transportation and Warehousing	\$0	\$0	\$0	\$0
Utilities	\$1	\$1	\$2	\$2
Wholesale Trade	-\$2	-\$2	-\$2	-\$2
Administrative Office Tax payers	\$0	\$1	\$3	\$4

Economic Impact Assessment



The OEA used the REMI model to estimate the economic impact of the tax and spending changes summarized on pages 8 and 10.

The chart to the left illustrates a baseline forecast of city employment, prepared since COVID-19 emergency, and the REMI estimate of city employment were the tax proposal to go into effect.

The baseline forecast is for the city to lose approximately 100,000 jobs in 2020. 55,000 would be recovered in 2021.

The tax proposal would raise the number of jobs by about 5,500 in 2021, and 1,900 in 2022, due to the expenditure of the unlocked Big C/Baby C funds. In later years, when no new backstop spending is assumed, the job impacts are much more modest.

*The estimate assumes a resolution of the tax litigation in 2023, and that the triggered tax increases are not deferred and go into effect in 2023 and 2024.

- The COVID-19 emergency has dramatically worsened the near-term economic outlook for the city. The baseline jobs forecast is for the loss of 100,000 jobs in 2020, and no full recovery to 2019 employment levels until after 2025.
- In this context, the tax proposal could improve the economy in the early years; its expected impact of 5,500 jobs in 2021 would account for 10% of all projected job recovery in the city next year.
- After the resolution of the tax litigation, when no new spending from Big C and Baby C is expected, the economic impact would be much more modest. An increase in employment in the City, and in City contractors, would slightly outweigh the job losses in the industries that face tax increases under the proposal.

Appendix: Proposed Tax Rates by Industry

Business Activity	2021				2022				2023				2024			
	\$0-1M	\$1-2.5M	\$2.5-\$25M	\$25M+	\$0-1M	\$1-2.5M	\$2.5-\$25M	\$25M+	\$0-1M	\$1-2.5M	\$2.5-\$25M	\$25M+	\$0-1M	\$1-2.5M	\$2.5-\$25M	\$25M+
Certain Services	0.053%	0.070%	0.095%	0.224%	0.053%	0.070%	0.095%	0.224%	0.079%	0.105%	0.142%	0.224%	0.105%	0.140%	0.189%	0.224%
Retail Trade	0.053%	0.070%	0.095%	0.224%	0.053%	0.070%	0.095%	0.224%	0.079%	0.105%	0.142%	0.224%	0.105%	0.140%	0.189%	0.224%
Wholesale Trade	0.105%	0.140%	0.189%	0.224%	0.105%	0.140%	0.189%	0.224%	0.105%	0.140%	0.189%	0.224%	0.105%	0.140%	0.189%	0.224%
Biotechnology	0.175%	0.287%	0.518%	0.665%	0.181%	0.297%	0.537%	0.689%	0.188%	0.308%	0.555%	0.713%	0.194%	0.318%	0.574%	0.736%
Clean Technology	0.175%	0.287%	0.518%	0.665%	0.175%	0.287%	0.518%	0.665%	0.175%	0.287%	0.518%	0.665%	0.175%	0.287%	0.518%	0.665%
Food Services	0.088%	0.144%	0.259%	0.665%	0.088%	0.144%	0.259%	0.665%	0.131%	0.215%	0.389%	0.665%	0.175%	0.287%	0.518%	0.665%
Information	0.560%	0.644%	0.714%	0.784%	0.573%	0.665%	0.751%	0.832%	0.579%	0.675%	0.770%	0.855%	0.585%	0.685%	0.788%	0.879%
Manufacturing	0.088%	0.144%	0.259%	0.665%	0.088%	0.144%	0.259%	0.665%	0.131%	0.215%	0.389%	0.665%	0.175%	0.287%	0.518%	0.665%
Transportation and Warehousing	0.175%	0.287%	0.518%	0.665%	0.175%	0.287%	0.518%	0.665%	0.175%	0.287%	0.518%	0.665%	0.175%	0.287%	0.518%	0.665%
Accommodations	0.210%	0.228%	0.228%	0.560%	0.210%	0.228%	0.228%	0.560%	0.315%	0.341%	0.341%	0.560%	0.420%	0.455%	0.455%	0.560%
Arts, Entertainment, and Recreation	0.210%	0.228%	0.228%	0.560%	0.210%	0.228%	0.228%	0.560%	0.315%	0.341%	0.341%	0.560%	0.420%	0.455%	0.455%	0.560%
Utilities	0.420%	0.455%	0.455%	0.560%	0.435%	0.471%	0.471%	0.580%	0.450%	0.488%	0.488%	0.600%	0.465%	0.504%	0.504%	0.620%
Activity Not Listed Above	0.735%	0.770%	0.840%	0.910%	0.788%	0.825%	0.900%	0.975%	0.814%	0.853%	0.930%	1.008%	0.840%	0.880%	0.960%	1.040%
Administrative and Support Services	0.735%	0.770%	0.840%	0.910%	0.761%	0.798%	0.870%	0.943%	0.788%	0.825%	0.900%	0.975%	0.814%	0.853%	0.930%	1.008%
Private Education and Health Services	0.735%	0.770%	0.840%	0.910%	0.761%	0.798%	0.870%	0.943%	0.788%	0.825%	0.900%	0.975%	0.814%	0.853%	0.930%	1.008%
Construction	0.420%	0.490%	0.560%	0.630%	0.420%	0.490%	0.560%	0.630%	0.420%	0.490%	0.560%	0.630%	0.420%	0.490%	0.560%	0.630%
Financial Services	0.560%	0.644%	0.714%	0.784%	0.600%	0.690%	0.765%	0.840%	0.620%	0.713%	0.791%	0.868%	0.640%	0.736%	0.816%	0.896%
Insurance	0.560%	0.644%	0.714%	0.784%	0.580%	0.667%	0.740%	0.812%	0.600%	0.690%	0.765%	0.840%	0.620%	0.713%	0.791%	0.868%
Professional, Scientific, and Technical Services	0.560%	0.644%	0.714%	0.784%	0.600%	0.690%	0.765%	0.840%	0.620%	0.713%	0.791%	0.868%	0.640%	0.736%	0.816%	0.896%
Real Estate and Rental and Leasing Services	0.399%	0.399%	0.420%	0.420%	0.413%	0.413%	0.435%	0.435%	0.428%	0.428%	0.450%	0.450%	0.442%	0.442%	0.465%	0.465%
Administrative Office Tax (% of Payroll Expense)	1.400%	1.400%	1.400%	1.400%	1.470%	1.470%	1.470%	1.470%	1.540%	1.540%	1.540%	1.540%	1.610%	1.610%	1.610%	1.610%

Addendum (10/8): Post-Lawsuit Impact Estimate

- On September 9, 2020, the California Supreme Court declined to hear the Big C lawsuit, leaving standing the Appellate Court decision which favored the City.
- Accordingly, the City can begin expending the impounded Big C revenues immediately, and voter approval of the proposed tax would no longer have the effect of unlocking those revenues.
- The OEA has recalculated the measure’s projected job impacts, given its reduced impact on new revenues. The table below shows the original and revised employment impacts: the difference between the baseline jobs forecast, and the forecast with the tax in place.

Year	Original Estimate of Job Creation from Proposed Tax	Revised Estimate of Job Creation from Proposed Tax
2021	5,506	1,599
2022	1,925	797
2023	171	242
2024	378	366
2025	464	440

Staff Contacts

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