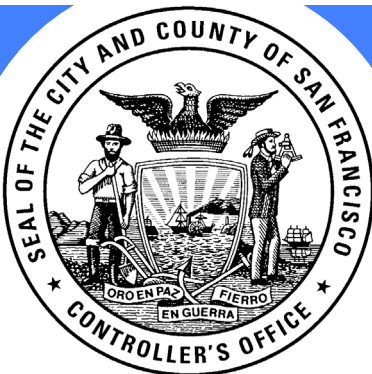


Business Tax Project Overview: Gross Receipts Roundtable Meeting #2



CITY & COUNTY OF SAN FRANCISCO

Office of the Controller

Office of Treasurer & Tax Collector

October 12, 2023

Business Tax Risks, and Other Reform Goals

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- Reduce risk of tax loss from remote work / relocation
- Reduce reliance on commercial property
- Reduce volatility stemming from over-concentration
- Also a need for:
 - Greater simplicity
 - Greater predictability for taxpayers
 - Greater equity for small business

Where We Are in the Process

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- July – release of our report highlighting risks to the tax base.
- Early September – first business roundtable meeting.
- September / October – meetings with industry groups.
- This meeting – presentation of *initial concepts* for reform. These initial concepts will change.
- October/November – receive feedback on initial concepts, continue modeling.
- November roundtable meeting – present *refined concepts*.
- Further feedback and refinement leading to *final concepts* in December.

Initial Concepts for Reform

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- Simplifying Rate Schedules
- Harmonizing apportionment
- Reduce flight risk by de-emphasizing the Payroll Factor
- Reduce volatility and dependence on commercial property, by basing other business taxes on the Gross Receipts Tax
- Eliminate concept of multiple business activities
- Reduce license fees

Rate Schedules – How it Works Now

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- 14 rate schedules, with sometimes significant tax differences between business activities and schedules:

Business Activity	0-\$1m	\$1-\$2.5m	\$2.5-\$25m	\$25m +
Retail Trade; and Certain Services	0.053%	0.070%	0.095%	0.224%
Wholesale Trade	0.105%	0.140%	0.189%	0.224%
Manufacturing; and Food Services	0.088%	0.144%	0.259%	0.665%
Transportation and Warehousing; and Clean Technology	0.175%	0.287%	0.518%	0.665%
Biotechnology	0.181%	0.297%	0.537%	0.689%
Information	0.573%	0.665%	0.751%	0.832%
Accommodations; and Arts, Entertainment, and Recreation	0.210%	0.228%	0.228%	0.560%
Utilities	0.435%	0.471%	0.471%	0.580%
Private Education and Health Services; and Administrative and Support Services	0.761%	0.798%	0.870%	0.943%
Miscellaneous Business Activities	0.788%	0.825%	0.900%	0.975%
Construction	0.420%	0.490%	0.560%	0.630%
Insurance	0.580%	0.667%	0.740%	0.812%
Financial Services; and Professional, Scientific, and Technical Services	0.600%	0.690%	0.765%	0.840%
	0-\$1m	\$1-\$5m	\$5-\$25m	\$25m +
Real Estate and Rental and Leasing Services	0.413%	0.413%	0.435%	0.435%

Rate Schedules – Initial Concept for Reform

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- From 14 to 3 rate schedules:
 1. “Advanced Services” – Financial Services, Information, Professional Services, Insurance, Administrative and Support Services, Private Education & Health Services.
 2. “Real Property” – Real Estate/Rental & Leasing, and Accommodations.
 3. All other business activities

- Rates will be adjusted across the three schedules to achieve revenue neutrality.

Apportionment – How it Works Now

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- 4 methods; sometimes multiple methods are used within a given rate schedule, further creating significant tax differences

Business Activity	Calculation Method
Retail Trade; Wholesale Trade; Manufacturing; Transportation and Warehousing; Information; Bio-Technology; Clean Technology; and Food Services	50% Sale/Use Location and 50% based on payroll
Construction; Utilities	50% Real, Personal, Tangible and Intangible Property and 50% based on payroll
Accommodations; Real Estate and Rental and Leasing Services	Receipts derived from or related to properties located or used in the City
Financial Services; Insurance; and Professional, Scientific and Technical Services; Private Education and Health Services; Administrative and Support Services; Miscellaneous Business Activities; Arts Entertainment and Recreation; and Certain Services	Based on payroll

Apportionment – Initial Concept for Reform

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- All industries (except Real Estate & Accommodations) use two-factor sales + payroll apportionment.
- No difference in factor weighting among industries using the two factors.

Business Activity	Calculation Method
Accommodations; Real Estate	Receipts derived from or related to properties located or used in the City
All Other Industries	Combination of Sales and Payroll

How It Works Now:

- 50% payroll factor for industries using sales & payroll calculation method
- 100% for industries using payroll-only apportionment
- Heavy reliance on payroll-based apportionment drives our tax loss from remote work, and the City's tax competitiveness problem against other Bay Area cities.

Initial Concept for Reform:

- For the industries that will be sales & payroll-based apportionment, reduce reliance on the payroll factor (for example, to 25% payroll / 75% sales, or 33% payroll / 67% sales).
- Rates will be adjusted to achieve revenue-neutrality, given the change in apportionment methods.

How It Works Now:

- The City levies a Homelessness Gross Receipts Tax, Commercial Rents Tax, and Overpaid Executives Tax on small sets of the business tax base.
- The Commercial Rents Tax deepens the City's reliance on the value of commercial property, which is likely to decline.
- The Homelessness Gross Receipts Tax, and Overpaid Executives Tax, are narrowly-based, highly volatile tax streams.

Initial Concepts for Reform:

- Replace the Homelessness Gross Receipts Tax and replace the revenue with a new dedicated tax based on the primary Gross Receipts Tax.
- Make a significant (such as 90%) reduction in the rate of the Overpaid Executives Tax, and replace the revenue with the primary Gross Receipts Tax.
- Make a major (such as 50%) reduction in the Commercial Rents Tax, and replace the revenue with the primary Gross Receipts Tax.
- Gross Receipts Tax rates will be adjusted to make up the revenue.

How It Works Now:

- Businesses may be required to report and pay gross receipts for multiple business activities, unless an 80% rule or a 20% rule applies.
- These rules are complex, and computing the tax for multiple business activities when these rules don't apply is also complex.

Initial Concept for Reform:

- Businesses are assigned to a single business activity, based on the activity from which it derives a plurality of its receipts.

How It Works Now:

- The City charges several permit and license fees to businesses.
- These fees do not vary with the size of the business, and result in a high burden for very small businesses.

Initial Concepts for Reform:

- Reduce or eliminate these fees and recoup the funds in the Gross Receipts Tax.
- Rates will be adjusted to make up the difference.

Intended Benefits of These Initial Concepts

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- We believe these initial concepts will help mitigate the risks identified in the report, and provide greater simplicity and predictability for taxpayers

Tax Reform Goal	Initial Concept
Reduce risk of tax loss from remote work / relocation	Shift away from payroll-only apportionment; reduced payroll factor
Reduce reliance on commercial property	Merge portion of Commercial Rents Tax into the Gross Receipts Tax.
Reduce volatility stemming from over-concentration	Merge Homelessness Gross Receipts Tax, and most of Overpaid Executives Tax, into the Gross Receipts Tax.
Greater simplicity and predictability	Reduced number of schedules; elimination of multiple business activities.
Greater equity for small businesses	Reduce/eliminate license fees

- Although we believe these changes would be effective at mitigating some of the risks identified in our report, they will likely disadvantage some taxpayers.
- A shift away from apportionment based on payroll will lead to a greater weight on the sales factor. Businesses and industries with little payroll, but large sales in the city, would likely face an increased burden.
- Consolidation of rate schedules will lead to greater simplicity and predictability but increase the likelihood of significant changes in tax burdens, for industries as well as individual businesses.
- A shift to sales-based apportionment will likely raise prices faced by businesses and consumers in the city. On the other hand, a reduction in payroll apportionment will stimulate job creation. On balance, it is highly likely that the net impact will be positive.

Other Feedback on Volatility and Predictability

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- Our meetings led to other ideas about reducing volatility, and increasing certainty for taxpayers, which we have not developed into recommendations at this time.
- How best to minimize volatility and unpredictability from future tax policy changes?
- Advance determinations or taxpayer guidance – what are the priorities?

Businesses share their feedback on these Initial Concepts

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| November 9 | Third Meeting of This Group
3:30 – 5pm, City Hall Room 305
Topic –Presentation of Refined Concepts |
| December | Final recommendations to Mayor and Board |

Contact Information

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Please contact us with your questions, concerns, and ideas:

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