City & County of San Francisco

Recommended Reforms to the Business Tax System

Prepared by

OFFICE OF THE TREASURER & TAX COLLECTOR

OFFICE OF THE CONTROLLER

February 5, 2024

About the Controller's Office

The Controller is the chief financial officer and auditor for the City and County of San Francisco. We produce regular reports on the City's financial condition, economic condition, and the performance of City government. We are also responsible for key aspects of the City's financial operations, from processing payroll for City employees to processing and monitoring the City's budget.

Our team includes financial, tech, accounting, analytical and other professionals who work hard to secure the City's financial integrity and promote efficient, effective, and accountable government. We strive to be a model for good government and to make the City a better place to live and work.

About the Treasurer & Tax Collector

The Office of the San Francisco Treasurer & Tax Collector serves as the banker, tax collector, collection agent, and investment officer for the City and County of San Francisco. Our mission is to collect and safeguard the City's money and use our expertise to assist low-income San Francisco families build economic security and mobility.

We are committed to providing excellent services for taxpayers, customers, and our community. By promoting diversity, equity, and inclusion, we are a stronger, smarter, and more informed government agency.

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Executive Summary

In response to a request from Mayor London Breed and Board of Supervisors President Aaron Peskin, this memo outlines a series of tax reform recommendations to inform a potential ballot measure for the November 2024 election.

In October 2022, Supervisor Rafael Mandelman asked the Controller and the Treasurer to study the impact of remote and hybrid work on the City s business taxes. In July 2023, the Offices of the Controller (CON) and the Treasurer & Tax Collector (TTX) released a report that pointed to three sources of risk to the City's tax base stemming from remote work, and recent City policy changes:

1. An increasing concentration of the tax base in office industries that are most impacted by remote work.
2. An increasing reliance on large commercial office activities, which have been curtailed in the short term, and are likely to generate lower value in the long term.
3. An increase in revenue volatility stemming from increased reliance on the largest businesses. This is due to both changes to tax policy, and changes in how the City s economy has evolved.

The recommendations in this report are intended to mitigate risks in our current business tax structure in San Francisco, advance broad goals of simplicity and predictability for taxpayers, and promote greater equity for small businesses. This report does not make any recommendation regarding how much revenue the City should seek to generate through business taxes, only the way in which that revenue is collected. All recommendations assume revenue neutrality based on 2022 tax filings, with no significant changes to the City's base of taxpayers.

RECOMMENDATIONS

Tax Reform Goal	Proposals
Reduce risk of tax loss from remote work and business relocation	• Shift away from calculation of taxes based on payroll in San Francisco toward sales in the City through modifications to the tax apportionment formula, reducing the exposure to impacts from remote work and reducing the risk of business relocation out of the City.
Reduce the overall business tax base's reliance on the value of commercial property	• Reduce the Commercial Rents Tax and replace this revenue source with rate and other adjustments in the broader Gross Receipts Tax, reducing the overall reliance on office rents to support City services.

Reduce volatility and other risks stemming from over-concentration of business taxes on a small number of payers	• Merge the Homelessness Gross Receipts Tax and the majority of the Overpaid Executive Tax into the broader Gross Receipts Tax structure, resulting in less volatility in City revenues and less concentration of the tax on a small set of businesses.
Simplify the overall tax structure to achieve greater predictability for both businesses and the City	• Reduce the number of tax schedules to simplify administration of the tax and reduce potential conflicts between the City and taxpayers. • Simplify tax calculations and reduce the need for overpayments and refunds by better aligning local tax filing deadlines with those for federal and state tax filings. • Improve taxpayer tax compliance by codifying Voluntary Disclosure Agreement (VDA) procedures. • Explore process for taxpayers to request and receive guidance regarding material issues affecting the proper calculation of the tax; dedicate resources to publish more guidance for all taxpayers. • Convene an interested parties meeting(s) with stakeholders to solicit feedback about the online filing process. • Reform the process used to place tax proposals before the voters, including conforming the signature count required to qualify an initiative tax proposal for the ballot with other cities in California.
Greater equity for small businesses	• Expand the Small Business Exemption to $2.5 million • Reduce/eliminate license fees • Reduced business registration fees • Progressive tax rates in all categories

As we researched and developed proposals, our offices, with the assistance of the Office of Economic and Workforce Development (OEWD), held more than 30 group meetings with affected businesses, community stakeholders, and three large public roundtable meetings. This report details our recommendations resulting from that work, and concludes with a discussion of key options, decisions, and potential next steps for policymakers.

As we will detail later in this report, policymakers have significant choices to resolve should they wish to proceed with a fully-formed final tax reform proposal:

1. What overall revenue goal they wish to establish for the overall tax structure – a revenue neutral package, as we have modeled, or one that yields either more or less revenue.
2. How and if they want to refine this proposal to address feedback received through this process regarding impacts of our reform concepts.
3. A host of specific definitional, administrative, and other issues that would need resolution to translate the broad reforms outlined in this interim report into the legal text of a tax ordinance that could be considered by the voters.

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Outreach

After releasing the report in July, CON and TTX worked with the Office of Economic and Workforce Development (OEWD) to plan three business roundtable meetings in September, October, and November. A broad cross-section of businesses was invited to participate, and interested people could sign up online to receive information about upcoming meetings. We posted presentation materials online and circulated them via email to all invitees so that people unable to attend could review and provide feedback. Seventy-five different businesses and business groups attended at least one of these roundtable sessions.

CON, TTX, and OEWD also provided individual briefings to several groups of businesses upon request, including SPUR, Hotel Council, Bay Area Council, Small Business Commission, Golden Gate Restaurant Association, construction companies, commercial property owners, retail businesses, the San Francisco Apartment Association, and the Chamber of Commerce.

In addition to business briefings, CON also held regular meetings with other stakeholders including members of the City's employee labor organizations and advocates and providers of healthcare, childcare, and homeless services to update them on the proposals and elicit their feedback.

CALENDAR

- **July 2023**→ release of our report highlighting risks to the tax base.
- **Early September 2023** → first business roundtable meeting.
- **September/October 2023** → meetings with industry groups.
- **October 2023** → presentation of initial concepts for reform.
- **October/November 2023**→ received feedback on initial concepts, continued modeling.
- **November 2023** → roundtable meetings to present refined concepts.
- **November 2023– January 2024**→ Further feedback and refinement leading to this report.

Recommended Changes to the City's Business Tax Structure

The following section outlines our recommendations to reform the City s business tax structure in response to these emerging risks. These recommendations are the result of our research and analysis and have been informed by stakeholder feedback we have received during this project.

Recommendation #1: Consolidate Tax Structure

Our first recommendation is that the City reduce revenue volatility and diminish its over-concentration on a few large payers by consolidating the business tax structure. Currently, the City generates $1.4 billion per year from four business taxes: the Gross Receipts Tax, Homelessness Gross Receipts Tax, Commercial Rents Tax, and Overpaid Executive Tax. Together, these taxes comprise the City's second-largest source of tax revenue, after Property Tax. The Commercial Rents Tax and the Overpaid Executive Tax are highly volatile revenue streams that are vulnerable to remote work. The Commercial Rents Tax is also vulnerable to a potential decline in commercial rents, which is also associated with remote work.

To reduce the risks of volatility and businesses reducing the scale of their operations in the City, we recommend:

- Merging the Homelessness Gross Receipts Tax into the Gross Receipts Tax, while preserving the same dedicated funding for homeless services.
- Reducing the rates of the Overpaid Executive Tax by 90%.
- Reducing the rates of the Commercial Rents Tax by 25%, while preserving the same dedicated funding for early childhood care and education.

To preserve the revenue that the voters approved for these taxes, the revenue shortfalls created by the preceding three changes should be made up with increases to the broader Gross Receipts Tax[1], so that the net changes are revenue-neutral based on 2022 tax filings.

Recommendation #2: Greater Equity for Small Businesses

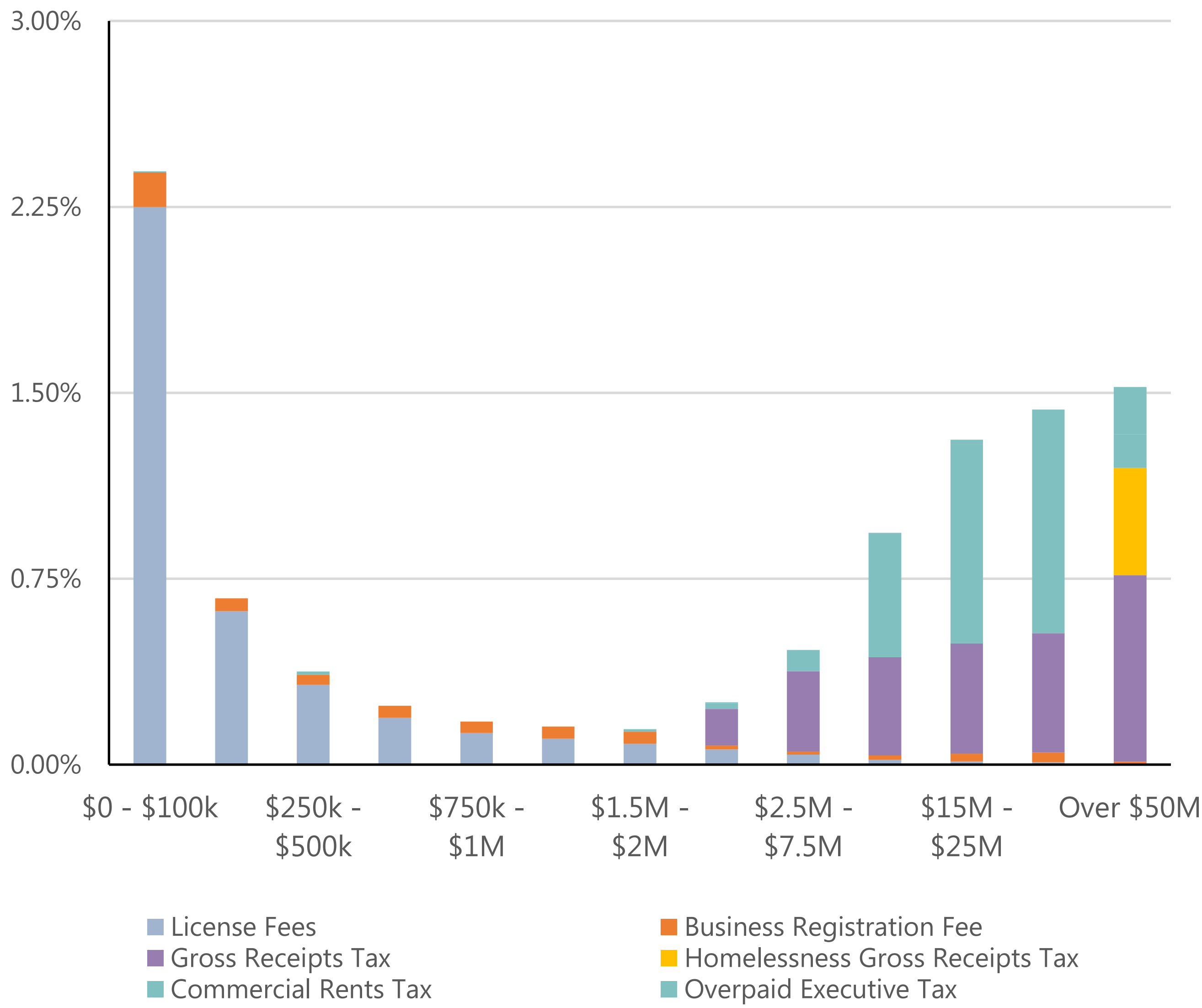
Supporting small businesses continues to be a primary policy goal for the City. The existing tax rates are structured to be progressive – meaning that smaller businesses pay less than larger businesses. Of the 95,000 businesses operating in San Francisco, approximately 85% are currently exempt from gross receipts taxes because they fall under the small business exemption threshold, currently set at $2,190,000**.** We are proposing to increase the small business exemption threshold to $2.5 million and continue to tie this exemption threshold to increase with the consumer price index (CPI).

We are also recommending elimination of $10 million in regulatory license fees that are disproportionately paid by small businesses, particularly restaurants and bars. We'd recoup the funds through the increases to the rates in the broader Gross Receipts Tax. Small businesses are disproportionately impacted by fees for

[1] Note, we are not recommending significant changes to the general structure of the Administrative Office Tax (AOT), which applies to a small number of taxpayers who meet all the criteria for the tax (more than 1,000 U.S. employees, over $1 billion in gross receipts annually, and over 50 percent of the total combined payroll expense within the City of that person and its related entities for the preceding tax year was associated with providing administrative or management services exclusively to that person or related entities). We do recommend implementing a multi-year qualification to reduce volatility when taxpayers fall into / out of the AOT from one year to the next. Additional potential modifications of the AOT should be reviewed by stakeholders in development of a possible business tax reform package.

regulatory licenses charged by City Departments, including Public Health, Fire, Police, Entertainment, Public Works, and Cannabis. Because these fees are generally "one size fits all," the impact of paying $1,500 for annual license fees for a small business is much more pronounced than for a large business. When license fees are added to business tax and registration fees, the City's tax/fee burden falls heavily on the smallest businesses.

Cumulative Tax and Fee Burden by Size of Business, as % of San Francisco Gross Receipts, 2022-23



In response to feedback from taxpayers and City staff, we are recommending simplifying rate schedules wherever feasible. When the City moved from the Payroll Expense Tax to the Gross Receipts Tax upon passage of Proposition E in 2012, the new Gross Receipts Tax was designed to be responsive to differences between industries. Subsequent voter-approved tax policy changes created further distinctions between industries and businesses of different sizes. These changes have led to considerable complexity. While a complex rate schedule has achieved policy goals such as managing the tax's impacts on specific industries, it has also had the undesired effect of making it hard for some businesses to predict their tax liability. We believe that both businesses and the City would benefit from streamlining categories and rates to make the tax structure easier to comply with and administer.

Specifically, we recommend simplifications to the Business Registration Fee, the Gross Receipts Tax rate schedules, and the Gross Receipts Tax apportionment rules, as described below.

Business Registration Fee

We are proposing to simplify the business registration schedule so that the fees are based only on San Francisco Gross Receipts[1]. Currently, business registration fees have two distinct schedules for different groups of business activities. One schedule is used for Certain Services (e.g. Repair/Maintenance, Personal/Laundry, Civic Orgs), Retail Trade, and/or Wholesale Trade; and the other for all other business activities. We recommend reducing this to one schedule, and maintaining the progressivity in the rates, including the increased business registration fee for businesses just about to graduate out of the small business exemption threshold. This limits the "hard edge" when a business grows and starts paying the Gross Receipts Tax for the first time. We also recommend adding additional tiers for businesses above $50 million in gross receipts for both the Business Registration Fee and Gross Receipts Tax. The full table of proposed Business Registration Fees can be found in Appendix 2.

Gross Receipts Tax Rate Schedule

The Gross Receipts Tax is calculated using a business' San Francisco gross receipts and business activities. Businesses must determine what types of business activities apply to them from a list of options provided. For example, a restaurant may select "Food Services" and a clothing store may select "Retail Trade" as their business activity. Gross Receipts Tax rates vary depending on a business' gross receipts and business activity.

At present, the Gross Receipts Tax has 14 different rate schedules for different business activities (such as Retail Trade, Accommodations, or Financial Services). To reduce complexity, we recommend that the 14 rate schedules currently in effect be replaced with five, as illustrated below.

[1] This is only applicable for Gross Receipts Taxpayers, not for Administrative Office Taxpayers.

Proposed Category	Current Business Activities
Advanced Services	Information, Professional Services, Insurance, Administrative and Support Services, Private Education & Health Services, FinTech
Real Property	Real Estate and Accommodations
Financial Services	Financial Services
Wholesale and Retail Trade	Retail Trade, Wholesale Trade
All other	Transportation and Warehousing, Manufacturing, Construction, Utilities, Food Services, Arts, Entertainment & Recreation, Certain Services

Wherever possible, we've collapsed categories to reduce uncertainty for taxpayers. For example, under this proposal, a business's tax would be the same regardless of whether it was classified as Information, Professional, Scientific, and Technical Services or any other business activity in the Advanced Services schedule.

Gross Receipts Tax Apportionment Rules

To calculate the Gross Receipts Tax, businesses with gross receipts within and outside of San Francisco determine their San Francisco gross receipts generally using one or both of their sales in San Francisco[2], and/or payroll apportionment, as dictated by their business activities. In the current Gross Receipts Tax, some business activities use only their sales in San Francisco (e.g., Real Estate and Rental and Leasing Services); some business activities use only apportionment (e.g., Financial Services); and some business activities use 50% sales and 50% apportionment (e.g., Retail Trade).

[2] We are using the shorthand of "sales in San Francisco" vs. the more precise "allocation of receipts" to assist the public and policymakers in understanding these recommendations. Taxpayers should continue to rely on the code to determine how to allocate gross receipts to San Francisco, which has rules specific to allocating gross receipts related to real property, tangible personal property, services, and intangible property.

Sales in San Francisco (Allocation)

Gross receipts generally are allocated to San Francisco if the property sold is shipped or delivered to a purchaser in San Francisco, if the benefit of the services generating the gross receipts is received in San Francisco, if the intangible property generating the gross receipts is used in the City, or if the property generating the gross receipts is in San Francisco.

Apportionment

Gross receipts generally are apportioned to San Francisco by multiplying total gross receipts by the portion of the business's total payroll in San Francisco divided by the business s total payroll.

As discussed in the July 2023 report, San Francisco's 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. It also intensifies the complexity for a business when their activities switch from one activity to another, and the apportionment changes and different rates result in significant tax differences. In our current system, the following industries use 100% payroll apportionment to determine San Francisco Gross Receipts:

- Certain Services
- Arts Entertainment and Recreation
- Private Education and Health Services
- Administrative and Support Services
- Financial Services
- Insurance
- Professional, Scientific and Technical Services

All other industries, except for Accommodations, Real Estate and Rental and Leasing Services calculate San Francisco Gross Receipts 50% based on sales in San Francisco and 50% based on payroll apportionment.

Current Sales in San Francisco / Apportionment Methodologies:

Calculation Method	Business Activity
50% sales in San Francisco and 50% based on payroll apportionment	Retail Trade; Wholesale Trade; Manufacturing; Transportation and Warehousing; Information; Biotechnology; Clean Technology; Food Services; Utilities; Construction
Payroll apportionment	Certain Services; Arts Entertainment and Recreation; Private Education and Health Services; Administrative and Support Services; Miscellaneous Business Activities; Financial Services; Insurance; Professional, Scientific and Technical Services
Receipts derived from or related to properties located or used in the City	Accommodations; Real Estate and Rental and Leasing Services

We are proposing to reduce the current penalty of having employees in San Francisco and create uniformity in apportionment rules across categories. All industries, except Real Estate & Accommodations, would calculate San Francisco Gross Receipts using 75% sales in San Francisco and 25% payroll apportionment. Real Estate & Accommodations will continue to use receipts derived from or related to properties located or used in the City.

Proposed Sales in San Francisco / Apportionment Methodologies

Calculation Method	Business Activity
75% sales in San Francisco and 25% based on payroll apportionment	Every business activity except Real Estate and Accommodations.
Receipts derived from or related to properties located or used in the City	Real Estate and Accommodations

Recommendation #4: Modify Gross Receipts Tax Rates

The following are proposed rates for the Gross Receipts Tax. These rates are revenue neutral based on 2022 filings, and accommodate the shifts in business activity schedules, inclusion of additional rate tiers for businesses with more than $50 million in Gross Receipts, changes to apportionment rules, and the consolidation of taxes into the Gross Receipts Tax.

GROSS RECEIPTS		SCHEDULE				
From	To	Advanced Services	Real Property	Financial Services	Wholesale & Retail	All Other
$0	$2,500,000	1.000%	0.250%	1.500%	0.150%	0.250%
$2,500,001	$25,000,000	1.000%	0.300%	2.500%	0.200%	0.300%
$25,000,001	$50,000,000	1.500%	0.750%	3.500%	0.500%	0.750%
$50,000,001	$100,000,000	2.000%	1.250%	4.500%	1.250%	1.250%
$100,000,001	$250,000,000	2.250%	1.750%	5.000%	1.500%	1.750%
$250,000,001	$1,000,000,000	2.250%	1.500%	5.500%	2.000%	2.000%
$1,000,000,001		2.500%	2.000%	5.500%	2.500%	2.250%

Recommendation #5: Predictability & Tax Administration

We've heard from many taxpayers through this process that aside from the tax calculation itself, taxpayers need more predictability and clarity. We looked for reforms that will improve administration, reduce disputes, allow businesses to more accurately budget, and create more revenue certainty for the City.

First, we propose to move the tax extension deadline from April to November and include a safe harbor for any taxpayer who pays 110% of their prior year obligation by February 28th. This will ensure that businesses have the opportunity to complete federal IRS filings before filing with San Francisco.

We are also proposing to formalize the Voluntary Disclosure Agreement (VDA) procedures for taxpayers who have not previously filed tax returns in San Francisco to come into compliance. TTX has a VDA program now, but recognizes that codifying the program, and reducing the look-back period from 10 years to 6 years to align with the Franchise Tax Board will make this program more effective.

TTX is also exploring a process for taxpayers to request and receive guidance regarding material issues affecting the proper calculation of the tax; and how to dedicate resources to publish more guidance for all taxpayers. And, to improve communication and filing processes, TTX will convene an interested parties meeting(s) with stakeholders to solicit feedback about the online filing process.

Recommendation #6: Align Ballot Rules for Taxes with Other Cities in California

Complicated rate schedules and apportionment rules are not the only features of the City's tax system that create uncertainty for taxpayers. Although all local tax increases must be approved by voters in California, cities have established different rules for how taxes can reach the ballot.

San Francisco is the only city in California with a substantial business tax to allow either a minority of the legislative body (in our case the Board of Supervisors), or a Mayor acting alone, to place tax measures on the ballot. Compared with other cities with substantial business taxes, San Francisco also has a lower signature threshold for citizen-initiated tax measures to be placed on the ballot. Uncertainty about future taxes discourages investment in the City, without providing new tax revenue.

We recommend increasing the voter threshold to place tax measures on the ballot and removing the ability for either a minority of the Board of Supervisors or the Mayor to directly place a tax measure on the ballot outside of the standard legislative process. These changes would require a Charter change, unlike the ordinance changes required to implement other portions of our proposal.

Ballot Rules for Selected California Cities

	Citizen-Initiated			Legislature-Initiated	Mayor-Initiated
Cities	**Required Signature Threshold for Taxes**	**% of What?**	**Threshold as % of Registered Voters**	**% of Legislature Required for Taxes**	**Are Mayor-Initiated Taxes Permitted?**
San Francisco	2%	Registered Voters	2.0%	36%	Yes
Los Angeles	15%	Recent Voters	6.5%	53%	No
Oakland	10%	Registered Voters	10%	63%	No
Mountain View	10%	Registered Voters	10%	57%	No
Santa Monica	10%	Registered Voters	10%	57%	No
Berkeley	5%	Recent Voters	4.1%	63%	No
Richmond	10%	Registered Voters	10%	57%	No

Projected Impacts of Proposed Changes

Although we project that our recommended changes would be revenue-neutral (based on 2022 tax filings), changes in tax policy of this magnitude will inevitably cause some businesses to pay more in tax, and others to pay less. In this section we present our estimates of the impact of these proposed changes by business activity, and by business size. Since the City's highly concentrated tax revenue was identified as a risk in our July report, we also detail how the proposed changes would affect the concentration of business tax revenue.

ADVANCED SERVICES

The table below indicates the projected impacts of the proposed changes on the business activities that would fall under the Advanced Services schedule. "Baseline" refers to 2022 payments for the Business Registration Fee, Gross Receipts Tax, Homelessness Gross Receipts Tax, Overpaid Executive Tax, and Commercial Rents Tax in millions. "Proposed" refers to what payments would have been in 2022 in millions, had the proposed changes to the tax structure, rates, and apportionment rules been in effect for that tax year.

Business Activity	Baseline	Proposed	$ Difference	% Difference
Information	$438.7	$406.5	-$32.2	-7%
Professional, Scientific, and Technical Services	$157.9	$132.7	-$25.1	-16%
Private Education and Health Services	$28.1	$18.8	-$9.3	-33%
Administrative and Support Services	$26.8	$30.2	$3.4	13%
Fintech	$24.7	$4.6	-$20.2	-81%
Activity not listed	$18.1	$13.8	-$4.4	-24%
Biotechnology	$7.6	$12.8	$5.2	68%
Insurance	$7.2	$8.1	$0.9	12%
Clean Technology	$0.4	$0.5	$0.1	36%
Advanced Services Sub-total	$709.5	$627.9	-$81.5	-11%

In general, businesses in these industries export information and knowledge-based services to customers outside of San Francisco. For this reason, they would benefit from the proposed change in apportionment rules, that would shift the tax burden away from having payroll expenses in the City, and towards selling into the City. Consequently, the overall tax burden in the schedule would decline, despite the fact that the proposed Gross Receipts Tax rates are somewhat higher than the current Gross Receipts and Homelessness Gross Receipts Tax rates combined.

Our July report highlighted the wide difference in tax liability that large businesses in advanced services currently face in San Francisco compared to other Bay Area cities. For example, the table below illustrates the impact of the proposed changes on the tax liability of a large Information industry business with $30 billion in total Gross Receipts, $600 million in sales in San Francisco, and incurring 20% of its Payroll Expense locally – either in San Francisco, or the City of San Jose. Under the current tax system, the business would owe $43.7 million in business tax, all to San Francisco, if the jobs earning that 20% of its total payroll were in San Francisco. If it moved those jobs to San Jose, it would only owe $171,301 to San Jose, and its liability to San Francisco would decline to $3.8 million, for a tax savings of $39.8 million.

		Jobs in San Francisco, none in San Jose	Jobs in San Jose, none in San Francisco	Tax Savings of Move
Current (2022 rates)	Amount owed to SF	$43,726,686	$3,766,686	
	Amount owed to SJ	$0	$171,301	
	Total amount owed	$43,726,686	$3,937,987	$39,788,699
Proposal	Amount owed to SF	$21,915,863	$9,540,863	
	Amount owed to SJ	$0	$171,301	
	Total amount owed	$21,915,863	$9,712,164	$12,203,699

Under our proposal, the business would owe $21.9 million in taxes – again, all to San Francisco – if the jobs were in San Francisco, and $9.7 million (the bulk to San Francisco) if the jobs were in San Jose. The tax savings of a move would fall to $12.2 million – a 69% reduction.

For this hypothetical business, as with other exporting businesses in this schedule, changing apportionment rules both reduces the tax created by having payroll and jobs within San Francisco, and increases the tax created by sales into San Francisco.

FINANCIAL SERVICES

The estimated impact for the Financial Services sector is shown below. The sector is expected to pay 17% more than currently, because its Gross Receipts Tax rates would increase, though it would benefit from the change in apportionment rules.

Business Activity	Baseline	Proposed	$ Difference	% Difference
Financial Services	**$148.7**	**$174.4**	**$25.7**	**17%**

REAL PROPERTY

The apportionment rules for the Real Property schedule, whose projected impacts are shown below, do not change, but overall taxes paid by the schedule decline because of the proposed reduction in the Commercial Rents Tax.

Business Activity	Baseline	Proposed	$ Difference	% Difference
Real Estate	$243.1	$203.2	-$40.0	-16%
Accommodations	$12.4	$16.5	$4.1	33%
Real Property Sub-Total	**$255.6**	**$219.7**	**-$35.9**	**-14%**

RETAIL AND WHOLESALE TRADE

The proposed Retail and Wholesale Trade schedule is expected to see the highest overall increase in tax liability. A revenue-neutral shift in apportionment rules away from payroll, towards sales in the City, inevitably puts pressure on businesses that generate a large amount of sales in San Francisco per dollar of payroll. However, most of the increase will fall on larger retailers, and those with less local payroll and employment. As noted earlier, the proposed rates for wholesale and retail trade are the most progressive among the five schedules, with the highest-tier rates more than 10 times the lower tier rates.

Business Activity	Baseline	Proposed	$ Difference	% Difference
Retail Trade	$79.1	$156.0	$76.9	97%
Wholesale Trade	$26.0	$55.0	$29.0	112%
Retail & Wholesale Trade Sub-Total	**$105.1**	**$210.9**	**$105.9**	**101%**

ALL OTHER

The remaining schedule, covering all other business activities, has a mixed set of impacts, with some industries paying more and others paying less. Collectively, the All Other schedule is expected to see a 5% reduction in its business tax liability as a result of the proposed changes.

Business Activity	Baseline	Proposed	$ Difference	% Difference
Transportation and Warehousing	$57.5	$54.5	-$3.1	-5%
Manufacturing	$54.6	$39.2	-$15.4	-28%
Construction	$34.1	$40.5	$6.4	19%
Utilities	$12.0	$19.1	$7.0	59%
Food Services	$10.9	$12.3	$1.3	12%
Arts, Entertainment, and Recreation	$8.5	$3.0	-$5.5	-65%
Certain Services	$0.4	$0.9	$0.5	130%
"All Other" Sub-Total	**$178.1**	**$169.4**	**-$8.7**	**-5%**

IMPACTS BY BUSINESS SIZE

The proposal will also have different impacts for businesses of different sizes. The table below shows the current and projected tax liability from the proposal for smaller ($0 - $25 million), midsized ($25-$100 million), and large businesses (more than $100 million). Businesses with less than $25 million in San Francisco Gross Receipts – by far the vast majority of business taxpayers – could together see a drop in tax liability of $10.4 million, or 4% of what they now pay. The 532 mid-size businesses from $25 - $100 million would collectively pay $14.1 million more, or a 5% increase, while the group of 173 largest businesses, with gross receipts over $100 million, would effectively pay the same amount as it does now. For a breakdown of this data by tiers of San Francisco Gross Receipts as currently defined, see Appendix 3.

Size (Current San Francisco Gross Receipts)	# of Businesses	Overall Change in Tax Liability, Proposal vs. Current	% Change in Tax Liability, Proposal vs. Current
$0 – $25 million	10,831	-$10.4 million	-4%
$25 – $100 million	582	$14.1 million	5%
Over $100 million	173	$1.9 million	0%

The decrease in tax liability for the largest businesses, with San Francisco Gross Receipts exceeding $1 billion, is connected to one of the primary goals of the proposal, to reduce the City's over-reliance on taxes paid by a small number of large businesses. In 2022, five businesses paid $336 million, or 28% of total revenue from Gross Receipts Tax, Homelessness Gross Receipts Tax, and Overpaid Executive Tax combined. The ten largest paid $436 million or 37%, and the 100 largest paid $768 million or 65%.

Under the proposal, because of the reduction in tax liability from the largest businesses, these percentages are expected to decline somewhat. The five largest would pay 23% of the total, instead of 28%, and the top 10 would pay 32%, instead of 37%.

Business Tax Revenue (Gross Receipts Tax, Homelessness Gross Receipts Tax, Overpaid Executive Tax)	Baseline $	Baseline %	Proposed $	Proposed %
From Top 5	$336	28%	$286	23%
From Top 10	$436	37%	$402	32%
From Top 100	$768	65%	$802	63%
Remaining 10,805 businesses	$414	35%	$471	37%

SUMMARY: INTENDED BENEFITS OF PROPOSED CHANGES

The proposed changes accomplish several high-level goals:

Tax Reform Goal	Proposals
Reduce risk of tax loss from remote work and business relocation	• Shift away from calculation of taxes based on payroll in San Francisco toward sales in the City through modifications to the tax apportionment formula, reducing the exposure to impacts from remote work and reducing the risk of business relocation out of the City.
Reduce the overall business tax base's reliance on the value of commercial property	• Reduce the Commercial Rents Tax and replace this revenue source with rate and other adjustments in the broader Gross Receipts Tax, reducing the overall reliance on office rents to support City services.
Reduce volatility and other risks stemming from over-concentration of business taxes on a small number of payers	• Merge the Homelessness Gross Receipts Tax and the majority of the Overpaid Executive Tax into the broader Gross Receipts Tax structure, resulting in less volatility in City revenues and less concentration of the tax on a small set of businesses.
Simplify the overall tax structure to achieve greater predictability for both businesses and the City	• Reduce the number of tax schedules to simplify administration of the tax and reduce potential conflicts between the City and taxpayers. • Simplify tax calculations and reduce the need for overpayments and refunds by better aligning local tax filing deadlines with those for federal and state tax filings. • Improve taxpayer tax compliance by codifying Voluntary Disclosure Agreement (VDA) procedures. • Explore process for taxpayers to request and receive guidance regarding material issues affecting the proper calculation of the tax; dedicate resources to publish more guidance for all taxpayers. • Convene an interested parties meeting(s) with stakeholders to solicit feedback about the online filing process. • Reform the process used to place tax proposals before the voters, including conforming the signature count required to qualify an initiative tax proposal for the ballot with other cities in California.
Greater equity for small businesses	• Expand the Small Business Exemption to $2.5 million • Reduce/eliminate license fees • Reduced business registration fees • Progressive tax rates in all categories

Open Policy Decisions, Feedback, and Next Steps

The tax reform proposal outlined in this report reflects our proposed structural changes to the business tax structure in San Francisco. We believe it makes substantial positive progress to address the key risks and challenges identified at the beginning of this process and summarized at the beginning of this report. This proposal should be considered an interim one, however, as policymakers have significant choices to resolve should they wish to proceed with a fully formed final tax reform proposal:

1. What overall revenue goal they wish to establish for the overall tax structure – a revenue neutral package, as we have modeled, or one that yields either more or less revenue.

2. How and if they want to refine this proposal to address feedback, we have received through this process regarding impacts of our reform concepts.

3. A host of specific definitional, administrative, and other issues that would need resolution to translate the broad reforms outlined in this interim report into the legal text of a tax ordinance that could be considered by the voters.

In the sections below, we briefly outline these open issues and summary feedback we have received on them from various stakeholders during our research and development process.

OPEN ISSUES AND FEEDBACK: GLOBAL REVENUE TARGET

Our offices are not making any recommendation regarding the revenue target of an ultimate proposal, and rates can be adjusted to achieve different outcomes. Based on our modeling, the rates outlined in this interim report would have yielded an equivalent amount of revenue to what was owed to the City in 2022 for the taxes considered in this report. The recommendations in this report do not significantly alter the number of businesses paying the taxes.

A revenue-negative package could be developed with a series of rate or other changes that would result in lower overall taxes paid by businesses and available for City services. A 5% reduction in rates would reduce City revenues by $70 million annually. A number of businesses and business advocacy organizations we've met with believe policymakers should pursue a revenue-negative package.

Alternatively, a revenue-positive package could be developed with a series of rate or other changes that would result in higher overall taxes paid by businesses and available for City services. For a point of comparison, an overall 5% increase in rates versus those outlined in this report would yield an additional $70 million annually. Some stakeholders we've met with, including representatives from organized labor and organizations representing non-profit service providers, believe policymakers should pursue a revenue-positive package.

In establishing a revenue goal for an ultimate tax package, policymakers should consider both initial goals and longer-term goals. We note that a tax package that is revenue neutral in 2022 will change over time versus the current status quo system given (1) future rate adjustments scheduled under current law to go into effect in the coming several years and (2) the projected increase in revenue generated by our proposed system versus the current one, driven by the reduction in reliance on certain taxes that are likely to grow at slower rates absent a change.

OPEN ISSUES AND FEEDBACK: TAX STRUCTURE MODIFICATIONS

The modifications to the City's business tax structure outlined in this report represent a significant change, and in a revenue-neutral frame. As a result, while the package as a whole represents significant progress against the risks we have outlined, it does result in significant changes in tax liabilities across individual businesses and sectors.

We have received feedback from various businesses and sectors during our development and vetting process that policymakers may wish to consider in development of a more refined final reform package. We note that any change to minimize one set of impacts will require other trade-offs. In a revenue-neutral framework, a reduction in taxes benefiting one sector would necessarily be paid for by other sectors or the package as a whole. Alternatively, a revenue-negative package would result in a reduction in global revenues available to support City services.

We recommend that policy makers, if they wish to proceed towards a reform package, develop a clear process to (1) receive and vet additional feedback from affected stakeholders and (2) vet and consider amendments to this base recommendation package, including both positive and negative impacts that would result from possible changes.

The following summarizes industry-specific feedback we have received to date through this process.

- **Small business.** While our proposal reduces the overall taxes and fees paid by smaller businesses as a whole, we have received feedback that the small business exemption threshold should be increased further from the levels we have suggested, and that additional reductions should be considered to offset current economic conditions. The Small Business Commission was very appreciative of the proposal to eliminate license fees. Small businesses have also communicated their desire to see an extension of the temporary tax relief afforded to smaller businesses during the pandemic (Prop F 2020 and subsequent relief extension approved by the Mayor and Board of Supervisors).

- **Retailers.** We have recommended apportionment and other changes that we believe will have positive overall economic benefits to the City and its businesses, but they result in a significant shift of tax burden to retailers and wholesalers. We have received significant feedback that the overall rates increase for retail and wholesale trade is too high, from:

    - Larger national retailers
    - Grocery stores and their national association
    - Major retailers and wholesalers headquartered in San Francisco; and
    - Certain legacy retail businesses, such as auto dealers

- **Mid-size businesses.** We have recommended changes to minimize risks outlined in our report, including addressing current disproportionate impacts on small businesses and an overconcentration of our tax burden in several large taxpayers. In a revenue-neutral construct, this results in a shift of tax liability to midsized businesses (those with revenues between $50 million-$100 million). Several business organizations, including the Chamber of Commerce, Advance SF, Golden Gate Restaurant Association and Building Owners and Managers Association, commented that increased taxes on these businesses is not warranted.

- **Larger businesses.** We have recommended changes that reduce the City's reliance on tax payments from the largest payers and distributes the impact of this change among approximately 100 large companies with San Francisco receipts in excess of $100 million. Our recommended changes result in less concentration in the largest 0.2% of taxpayers but do not change the overall tax burden of the largest 2.0% of taxpayers. We have received feedback from several large businesses that this redistribution of tax among the group of larger businesses results in impacts that should be mitigated with further rate reductions. Conversely, we have received feedback from City labor organizations that our proposed shift of revenue generated by the Overpaid Executive Tax into the broader tax base is not warranted, and that reductions in the overall taxes paid by larger companies is not warranted.

OPEN ISSUES AND FEEDBACK: OTHER PROPOSED CONCEPTS

We have offered recommendations on several areas beyond the business tax structure itself, including how portions of this tax base is dedicated to specific homeless and early childhood education services. We have received feedback from a set of stakeholders in each service area that, while open to the concept of change, such changes should ensure a comparable amount of legally dedicated funds remain for those purposes and that no changes to the specific eligible expenses or oversight structure should be pursued in an ultimate measure.

Additionally, we have offered recommendations to modify how tax increases in the future are considered and placed before the voters, including conforming the signature count required to qualify a measure for the ballot to the norms for other local governments in California. We have received feedback from labor organizations and other budget stakeholders opposing these recommended changes.

Translation of the concepts we have outlined in this report into a final tax proposal for consideration of the voters requires additional consideration and work by our offices and policymakers to resolve a number of detailed definitional issues that would need to be detailed in such a proposal or subsequent administrative determinations. We have received detailed feedback from some taxpayers with proposals on these issues, which we have not evaluated to date and would need to if policymakers want to proceed towards a final proposal.

We highlight that working through this litany of issues – including policy, administrative, and legal analysis of each – will require significant time and resources to complete should policymakers establish a goal of completing this work in time for consideration by the voters on the November 2024 ballot.

Formal feedback we receive regarding this report is available on the project website at sf.gov/businesstaxreform.

Closing and Summary

We offer these recommendations to reform the City's business tax structure in response to new risks and challenges that face the City, its business community, and residents.

We believe these changes would significantly mitigate those risks, while acknowledging that significant issues require additional policymaker evaluation and decisions should the City proceed towards a November 2024 ballot measure.

The Treasurer's Office and Controller's Office are available to assist with next steps and assistance, at the direction of the Mayor and Board of Supervisors.

Appendix

APPENDIX 1: SAMPLE PRO-FORMA MODELS

To help illustrate the impacts of our recommendations, the following tables illustrate how the proposed rates would affect hypothetical businesses in a variety of industries. The tables compare what they would owe under 2022 rates, under rates that are currently scheduled to be in place in 2026, and what they would owe in 2026 under this proposal. The last column shows the percentage difference in liabilities under the currently-scheduled 2026 rates, and under this proposal.

Impacts: Small Business

- The first two hypothetical examples represent small businesses with less than $1 million in San Francisco gross receipts.
- Under current rules, both are exempt from the Gross Receipts Tax, and this would continue to be true under this proposal.
- Both businesses would receive a modest reduction in business registration fees.

Artist

San Francisco only gross receipts: $150,000

	2022 Baseline	**2026 Baseline**	**2026 Proposed**	**% Change vs. 2026 Baseline**
Business Registration Fee	$93	$93	$86	-8%
Gross Receipts Tax	$0	$0	$0	--
TOTAL	**$93**	**$93**	**$86**	**-8%**

Nail Salon

San Francisco only gross receipts: $750,000

	2022 Baseline	2026 Baseline	2026 Proposed	% Change vs. 2026 Baseline
Business Registration Fee	$314	$314	$282	-10%
Gross Receipts Tax	$0	$0	$0	--
TOTAL	**$314**	**$314**	**$282**	**-10%**

Impacts: Financial Services

- A hypothetical small investment bank, with 5% of gross receipts derived from San Francisco, and 10% of its payroll expense incurred here, would see its overall business tax liability rise.
- Despite the shift away from payroll-only apportionment, which currently applies to Financial Services business activity, the proposed Financial Services schedule features higher tax rates.

Small Investment Bank

Total gross receipts: $100 million
10% SF payroll factor and $5 million in gross receipts attributable to SF

	2022 Baseline	2026 Baseline	2026 Proposed	% Change vs. 2026 Baseline
Business Registration Fee	$1,885	$1,885	$565	-70%
Gross Receipts Tax	$73,725	$78,640	$131,250	67%
Homelessness Gross Receipts Tax	$0	$0	$0	--
Commercial Rents Tax	$0	$0	$0	--
Overpaid Executive Tax	$0	$0	$0	--
TOTAL	**$75,610**	**$80,525**	**$131,815**	**64%**

Impacts: Commercial Real Estate

- Reducing the City's reliance on tax revenue from commercial real estate activity is a key goal of this reform effort.
- In this example, a medium-sized commercial office building would see its overall business tax liability fall, mainly because of the proposed 25% reduction in the Commercial Rents Tax.

Medium-Sized Commercial Office Building

San Francisco gross receipts: $25 million
Apportionment is 100% sales

	2022 Baseline	2026 Baseline	2026 Proposed	% Change vs. 2026 Baseline
Business Registration Fee	$6,285	$6,285	$5,500	-12%
Gross Receipts Tax	$108,200	$115,675	$73,750	-36%
Homelessness Gross Receipts Tax	$0	$0	$0	--
Commercial Rents Tax	$875,000	$875,000	$656,250	-25%
Overpaid Executive Tax	$0	$0	$0	--
TOTAL	**$989,485**	**$996,960**	**$735,500**	**-26%**

- As noted earlier, business taxes paid by the Wholesale and Retail Trade sectors are expected to roughly double under the proposal. However, there are important nuances within this schedule, which these examples can help illustrate.
- The first example represents a small clothing store with $3 million in gross receipts. This business is just above the proposed $2.5 million small business exemption, and would experience a slight increase in business registration fees and Gross Receipts Tax. Its license fees would decline.
- The second, a medium-sized wholesale market that largely does business within the city, would see a larger increase.

- The second, a medium-sized wholesale market that largely does business within the city, would see a larger increase.
- The largest increases would be experienced by larger firms, particularly those with little employment in the city. Such a retailer would see the largest increase, at 133%. In this case, the business is subject to the Overpaid Executive tax, and the reduction in OET rates softens its tax increase somewhat.
- The final example is a large retailer that is identical to the previous example, except it is headquartered in the city. Because of its higher payroll factor, it benefits from the change of apportionment rules, and its increase is only 54%.

Small Clothing Store

San Francisco only gross receipts: $3 million

	2022 Baseline	2026 Baseline	2026 Proposed	% Change vs. 2026 Baseline
Business Registration Fee	$502	$502	$565	13%
Gross Receipts Tax	$2,055	$4,095	$4,750	16%
Homelessness Gross Receipts Tax	$0	$0	$0	--
Commercial Rents Tax	$0	$0	$0	--
Overpaid Executive Tax	$0	$0	$0	--
License Fees	$103	$103	$0	-100%
TOTAL	**$2,660**	**$4,700**	**$5,315**	**13%**

Medium-Sized Wholesale Market

Total gross receipts: $50 million
65% SF payroll factor and $40 million in gross receipts attributable to SF

	2022 Baseline	2026 Baseline	2026 Proposed	% Change vs. 2026 Baseline
Business Registration Fee	$9,429	$9,429	$12,573	33%
Gross Receipts Tax	$70,875	$70,875	$114,375	61%
Homelessness Gross Receipts Tax	$0	$0	$0	--
Commercial Rents Tax	$0	$0	$0	--
Overpaid Executive Tax	$0	$0	$0	--
TOTAL	**$38,577**	**$80,304**	**$126,948**	**58%**

Larger Retailer That Ships Goods to SF, but Has No Jobs Here

Total gross receipts: $10 billion
0% SF payroll factor and $75 million in gross receipts attributable to SF

Subject to Overpaid Executive Tax

	2022 Baseline	2026 Baseline	2026 Proposed	% Change vs. 2026 Baseline
Business Registration Fee	$9,429	$9,429	$23,575	150%
Gross Receipts Tax	$50,955	$73,675	$251,875	242%
Homelessness Gross Receipts Tax	$0	$0	$0	--
Commercial Rents Tax	$0	$0	$0	--
Overpaid Executive Tax	$37,500	$37,500	$5,625	-85%
TOTAL	**$97,884**	**$120,604**	**$281,075**	**133%**

Large Retailer Headquartered in SF

Total gross receipts: $10 billion
1.5% SF payroll factor and $75 million in gross receipts attributable to SF

Subject to Overpaid Executive Tax

	2022 Baseline	2026 Baseline	2026 Proposed	% Change vs. 2026 Baseline
Business Registration Fee	$25,146	$25,146	$23,575	-6%
Gross Receipts Tax	$218,955	$241,675	$720,625	198%
Homelessness Gross Receipts Tax	$109,375	$109,375	$0	-100%
Commercial Rents Tax	$0	$0	$0	--
Overpaid Executive Tax	$112,500	$112,500	$9,375	-92%
TOTAL	**$465,976**	**$488,696**	**$753,575**	**54%**

Impacts: Food Services

- The final example illustrates the impact of the proposal on a restaurant with $6 million in gross receipts, all generated within San Francisco.
- Although the industry-wide results shown on page X indicate that Food Services as a whole is expecting to pay more in this revenue-neutral framework, it is important to realize this is based on rates as they existed in 2022. This industry's rates are due to increase because of policy changes made in the 2020 Proposition F changes to the Gross Receipts Tax.
- As shown on the next page, by 2026, if this proposal is not adopted, this hypothetical business would see its taxes rise from $14,854 to $26,934.
- Under this proposal, its taxes would be $17,315 in 2026. Thus, while proposal would represent a slight increase from 2022 rates, it would represent a 36% decrease from rates that are already scheduled to take effect by 2026.

Mid-Size Restaurant

San Francisco only gross receipts: $6 million Subject to Overpaid Executive Tax

	2022 Baseline	2026 Baseline	2026 Proposed	% Change vs. 2026 Baseline
Business Registration Fee	$628	$628	$565	-10%
Gross Receipts Tax	$12,105	$24,185	$16,750	-31%
Homelessness Gross Receipts Tax	$0	$0	$0	--
Commercial Rents Tax	$0	$0	$0	--
Overpaid Executive Tax	$0	$0	$0	--
License Fees	$2,121	$2,121	$0	-100%
TOTAL	**$14,854**	**$26,934**	**$17,315**	**-36%**

APPENDIX 2: PROPOSED BUSINESS REGISTRATION FEES (FOR NON-ADMINISTRATIVE OFFICE TAXPAYERS)

		Baseline		Policy
From	**To**	**Schedule A**	**Schedule B**	
$0	$100,000	$56	$46	$51
$100,000	$250,000	$93	$78	$86
$250,000	$500,000	$157	$124	$141
$500,000	$750,000	$314	$250	$282
$750,000	$1,000,000	$439	$376	$408
$1,000,000	$1,500,000	$628	$518	$573
$1,500,000	$2,000,000	$879	$725	$802
$2,000,000	$2,500,000	$376	$250	$1,035
$2,500,000	$7,500,000	$628	$502	$565
$7,500,000	$15,000,000	$1,885	$1,414	$1,650
$15,000,000	$25,000,000	$6,285	$4,714	$5,500
$25,000,000	$50,000,000	$15,716	$9,429	$12,573
$50,000,000	$100,000,000	$28,290	$18,859	$23,575
$100,000,000	$200,000,000	$37,720	$25,146	$31,433
$200,000,000	$9,999,999,999	$44,006	$37,720	$40,863

APPENDIX 3: IMPACTS BY BUSINESS SIZE

From	To	$ Difference (in millions)	% Difference
$0	$2,500,000	-$8.9	-37%
$2,500,001	$25,000,000	-$1.4	-1%
$25,000,001	$50,000,000	$11.3	9%
$50,000,001	$100,000,000	$2.8	2%
$100,000,001	$250,000,000	$23.3	13%
$250,000,001	$1,000,000,000	$31.6	11%
$1,000,000,001		-$52.9	-13%