Ballot initiatives may shift the San Francisco tax landscape

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In brief

San Francisco elections to be held June 5 will include two competing commercial rent tax measures that would modify the San Francisco gross receipts tax regime for commercial landlords. The two measures on the ballot are:

- The Commercial Rents Gross Receipts Tax (also known as ‘Housing for All’), which would impose a new 1.7% tax on commercial rents in San Francisco to fund low- and middle-income housing and homelessness services. [Commercial Rents Gross Receipts Tax, Dept of Elections, filed Jan. 16, 2018]

- The Early Care and Education Commercial Rents Tax (also known as ‘Universal Childcare for San Francisco’), which would impose a new 3.5% tax on commercial rents (1% tax on rents from warehouses) in San Francisco to fund early care and education for children under specified ages and for families below certain state median income thresholds. [Universal Childcare for San Francisco Families Initiatives, Dept. of Elections, filed Jan. 9, 2018]

Under the existing gross receipts tax regime, the tax rate imposed on commercial rents is approximately 0.3%. (For more information on the San Francisco gross receipts tax, please visit our recent Insight San Francisco Payroll Expense and Gross Receipts Taxes - Filings due February 28, 2018.) Passage of either of these stand-alone additional commercial rent tax regimes would significantly increase tax liabilities for commercial landlords. This effectively means increased rents for those living in the city since such new taxes likely would be passed on to renters and lessees. However, should either measure pass, there could be an additional state measure introduced in time for the November 2018 ballot that could impact the results of the June 5 ballot.

In detail

San Francisco payroll and gross receipts taxes - Background

Historically, San Francisco imposed a flat 1.5% payroll tax on businesses operating in the city. In November 2012, San Francisco voters approved Proposition E, phasing in a new gross receipts tax over a five-year period, while attempting to phase out the payroll tax over the same five-year period, starting on January 1, 2014. However, the gross receipts tax regime has not generated the revenues initially projected on enactment. As a result, the city’s payroll expense tax will remain in existence at a published provisional rate of 0.448%, until such time as corrective legislation is passed.

Proposal - Commercial Rents Gross Receipts Tax

The Commercial Rents Gross Receipts Tax (also known as
‘Housing for All’) would impose an additional 1.7% tax on gross receipts from the lease of ‘commercial space’ in the city to fund low- and middle-income housing and homelessness services, effective January 1, 2019. The tax would not apply to tenants and lessees for residential use, distribution and repair uses, retail use, and entertainment, arts, and recreational uses. Nonprofit organizations and small landlords currently exempt from the gross receipts tax would continue to be exempt from this additional tax.

By imposing an additional 1.7% tax on top of the current 0.3% rate, it is estimated that an additional $65 million would be collected annually under this tax from the commercial real estate industry. Because this measure was placed on the June 2018 ballot by at least four members of the San Francisco Board of Supervisors, this special tax was introduced by legislative action and requires a two-thirds approval by the San Francisco electorate under California Proposition 218 (see below).

Proposal - Early Care and Education Commercial Rents Tax

The Early Care and Education Commercial Rents Tax (also known as ‘Universal Childcare for San Francisco’) would impose an additional 3.5% tax on rentals of ‘commercial space’ in the city, with a reduced 1% tax on rentals of warehouse space, effective January, 2019. The revenues raised by this tax would be dedicated to fund early care and education for the children under specified ages in families whose income is below certain state median thresholds. The tax would not apply to tenants and lessees for residential use, industrial use, retail use, and arts activities. Nonprofit organizations and small landlords currently exempt from the gross receipts tax would continue to be exempt from this additional tax.

By imposing an additional 3.5% tax on commercial rents, it is estimated that an increase of $150 million would be collected annually under this tax from the commercial real estate industry. This measure was placed on the June 2018 ballot by garnering the signatures of at least 9,485 valid San Francisco voters, and, at this time, would require a simple majority of the San Francisco electorate during the November ballot to pass.

Both measures specify that only one of the two commercial rents tax measures described here can be adopted; and, if both measures secure sufficient votes for passage, the measure with the most votes will prevail. Based on polling numbers, one of these two measures could pass on the June 2018 ballot.

Constitutional requirements for special taxes – a possible shifting landscape

Unlike a ‘general tax,’ where revenues are placed into the general fund of the local government and are available for expenditure for any governmental purpose, a ‘special tax’ is a tax where revenues are legally dedicated for one or more specific purposes. The Commercial Rents Gross Receipts Tax and Early Care and Education Commercial Rents Tax are considered a ‘special tax.’

This is significant because in 1996, California voters adopted Proposition 218, a state constitutional requirement that a local government may not impose, extend, or increase any special tax unless the tax first is submitted to the electorate and approved by a two-thirds vote. (Cal. Const., art. XIII C, § 2). However, a recent California Supreme Court decision, California Cannabis Coalition v. City of Upland, 3 Cal. 5th 924 (2017), held that if a special tax proposal is placed on the ballot by voter initiative, it requires only majority voter approval, as opposed to two-thirds approval.

Critics of this decision are seeking litigation, legislation, and statewide ballot measures to amend the state constitution to reverse this holding. However, until then, the City of San Francisco has interpreted this court decision to mean voters can propose tax initiatives that would submit either general or special taxes to the electorate and be subject only to a majority vote, not a two-thirds requirement. Memorandum: Voting Threshold for Initiative Tax Measures Following California Cannabis Coalition v. City of Upland, Office of the City Attorney, (Oct. 17, 2017)

The Commercial Rents Gross Receipts Tax, as indicated above, was placed on the June 2018 ballot by the San Francisco Board of Supervisors, and requires two-thirds (67%) vote by the San Francisco electorate in order to become law. The Early Care and Education Commercial Rents Tax, which was placed on the June 2018 ballot by voter initiative, only requires a simple (50.1%) majority vote. As a result, should the Commercial Rents Gross Receipts Tax receive a 66% vote, and the Early Care and Education Commercial Rents Tax receive a 55% vote, due to the current interpretation of the California constitutional requirements, the Early Care and Education Commercial Rents Tax would become law, even though it garnered fewer votes.

Potential November 2018 State Ballot Initiative – Retroactive Repeal Possibility

A current initiative is underway to obtain enough signatures to legislatively repeal the effect of the California Supreme Court decision in Upland. The ‘California Two-Thirds
Vote for State and Local Revenue Increases Initiative’ may appear on the November 6, 2018 ballot in California as an initiated constitutional amendment (Cal. Initiative 17-0050). Among other things, if passed, this initiative would amend Section 2 of Article XIII C of the California constitution to require that local general and special taxes need to be approved at the ballot box by a two-thirds vote of the local electorate for all taxes, including those put on the ballot through an initiative. This measure also would invalidate any local taxes passed in 2018 that did not meet the criteria of this amendment. As a result, should Initiative 17-0050 be placed on the November 2018 ballot and pass, then unless either of the above-mentioned San Francisco ballot measures pass with at least a two-thirds majority vote, they would effectively be repealed.

The takeaway
Under the existing gross receipts tax regime, the tax rate imposed on commercial rents is approximately 0.3%. Passage of either the Commercial Rents Gross Receipts Tax or the Early Care and Education Commercial Rents Tax would be in addition to the current gross receipts tax regime and, as a result, would significantly increase tax liabilities for commercial landlords and, possibly, the rents of commercial tenants and lessees. While these initiatives should be closely watched, the potential November statewide initiative to require a two-thirds majority approval for all new local tax measures may negate their impact, if passed.

We will continue to monitor the legislative landscape and provide updates as further developments occur.

Let’s talk
For a deeper discussion on how this issue might affect your business, please contact:

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