

San Francisco updates – superior court rejects challenges to Commercial Rents and Homelessness Gross Receipts Taxes and other developments

Overview

The City and County of San Francisco's (City) enactment of the Homelessness Gross Receipts Tax¹ (Homelessness GRT) and the Commercial Rents Gross Receipts Tax² (Commercial Rents GRT) are two in a series of taxes that the City has recently enacted. These new taxes, which were placed on the ballot by citizen signature gathering, were passed by a simple majority (over 50% voter approval) but fell short of the super-majority (greater than 2/3rds voter approval) required under California Propositions 13 and 218.

Recently, a San Francisco superior court judge upheld the validity of these taxes, which, if upheld on appeal, would represent an exception to the super-majority requirement for new taxes generally required. The superior court's upholding of the Homelessness and Commercial Rents GRTs is a continuing trend in local tax ballot initiatives that have passed by a simple majority of the vote.³

This Tax Alert summarizes the recent superior court decisions on the constitutionality of the Homelessness and Commercial Rents GRTs. In addition, the alert highlights certain considerations for taxpayers, including the potential ability to elect to claim credits related to the Homelessness GRT. Lastly, the Tax Alert discusses other recent developments in City tax legislation.

Background on the Homelessness and Commercial Rents GRTs

The Homelessness GRT is imposed on gross receipts from business attributable to the City above \$50,000,000.⁴ The Homelessness GRT requires quarterly estimated tax payments and taxpayers are subject to an estimated tax penalty of 5% of the amount of any underpayment.⁵ However, the estimated tax penalty does not apply to the 2019 tax year.⁶

The Commercial Rents GRT is imposed on the gross receipts earned from a lease or sublease in the City, at a rate of 3.5% for commercial space and 1% for warehouse or industrial space.⁷ The Commercial Rents GRT also requires estimated tax payments.⁸ Failure to timely remit payments are subject to an estimated tax penalty of 5% of the amount of the underpayment.⁹ However, like the Homelessness GRT, this penalty does not apply to tax years beginning on or before December 31, 2019.¹⁰ The Commercial

¹ Proposition C, Homelessness Gross Receipts Tax Ordinance, Article 28, Sec. 2804 (appearing on the ballot Nov. 6, 2018).

² Proposition C, The Early Care and Education Commercial Rents Tax Ordinance, Article 21, Sec. 2104 (appearing on the ballot June 5, 2018).

³ See, e.g., Proposition G (San Francisco June 5, 2018 Ballot) (School parcel tax initiative that passed with 60.76% of the vote); Measure AA (Oakland November 6, 2018) (Parcel tax increase that passed with 62.47% of the vote); Measure P (Fresno November 6, 2018) (0.375% sales tax increase that passed with 52.17% of the vote).

⁴ For a more in-depth discussion of the Homelessness Gross Receipts Tax, please see Deloitte's External Multistate Tax Alert, [San Francisco Tax Update](#) (Dec. 13, 2018).

⁵ San Francisco, Cal., Ordinance 69-19 (Apr. 9, 2019), available [here](#).

⁶ *Id.*

⁷ For a more in-depth discussion of the Commercial Rents Gross Receipts Tax, please see Deloitte's External Multistate Tax Alert, [San Francisco Tax Update](#) (Dec. 13, 2018).

⁸ San Francisco, Cal., Ordinance 69-19 (Apr. 9, 2019), available [here](#).

⁹ *Id.*

¹⁰ *Id.*

Rents and Homelessness GRTs were both part of a local ballot initiative, Proposition C, which passed with 61.34% of the vote.¹¹

San Francisco superior court upholds City's Homelessness and Commercial Rents GRTs

On July 5, 2019, San Francisco superior court judge Ethan Schulman, in two separate cases, upheld the constitutionality of the Homelessness GRT and the Commercial Rents GRT.¹² The taxes were both enacted by a simple majority as part of a local ballot initiative, Proposition C.¹³ In the matter of the Homelessness GRT, the City filed a petition for certification with the San Francisco superior court seeking validation of the tax. In the matter involving the Commercial Rents GRT, three business interest groups and an anti-tax group filed a petition seeking to invalidate the tax. The parties' arguments in both matters were generally the same.

The City argued that both taxes were constitutional under the Supreme Court's rationale in *California Cannabis Coalition v. City of Upland*,¹⁴ in which in dicta the Court explained that local ballot initiatives with the required number of signatures only require a simple majority of the vote as opposed to a super-majority of the vote.¹⁵ The California Business Roundtable, the Howard Jarvis Taxpayers Association, the California Business Properties Association, and the Building Owners and Managers Association of California¹⁶ argued that the taxes were unconstitutional because they did not comply with Propositions 218 and 13 of the California Constitution. Propositions 218 and 13 of the California Constitution provide that to impose a special tax at the local level a super-majority of the vote is required.¹⁷

In upholding the constitutionality of both taxes, the superior court judge agreed with the City's interpretation of *Upland*.¹⁸ In both orders the judge explained the California Constitution requires approval by a two-thirds vote before a local government can impose, extend, or increase any special tax.¹⁹ However judge Schulman pointed out that the *Upland* Court explained this constitutional requirement does not extend to voter initiatives.²⁰ The Howard Jarvis Taxpayers Association has filed a notice of appeal in the matter involving the Commercial Rents GRT.²¹ According to multiple legal commentators an appeal will also be filed in the Homelessness GRT matter.²²

Homelessness GRT considerations

The City has announced that it will not spend the current collected revenue from the Homelessness GRT during the pending litigation.²³ To fund homeless services, the City enacted City Ordinance 73-19 on April 26, 2019 which, effective May 26, 2019, provides a tax credit to taxpayers who pay the tax and waive their right to file a future refund claim.²⁴ City Ordinance 73-19 specifies that a taxpayer will be

¹¹ See Ballotpedia, San Francisco, California Proposition C, Gross Receipts Tax for Homelessness Services (November 2018), available at [https://ballotpedia.org/San_Francisco,_California,_Proposition_C,_Gross_Receipts_Tax_for_Homelessness_Services_\(November_2018\)](https://ballotpedia.org/San_Francisco,_California,_Proposition_C,_Gross_Receipts_Tax_for_Homelessness_Services_(November_2018)).

¹² See *City and County of San Francisco v. All Persons Interested in the Matter of Proposition C on the November 6, 2018 San Francisco Ballot*, No. CGC-19-573230 (Cal. Sup. Ct. S.F. County Jul. 5, 2019); see also *Howard Jarvis Taxpayers Association, Building Owners and Managers of California, California Business Properties Association, and California Business Roundtable v. City and County of San Francisco and All Persons Interested in the Matter of Proposition C of the June 5, 2018 San Francisco Ballot*, No. CGC-18-568657, (Cal. Sup. Ct. S.F. County Jul. 5, 2019).

¹³ See Proposition C, The Early Care and Education Commercial Rents Tax Ordinance, Article 21, Sec. 2104 (appearing on the ballot June 5, 2018); see also Proposition C, Homelessness Gross Receipts Tax Ordinance, Article 28, Sec. 2804 (appearing on the ballot Nov. 6, 2018).

¹⁴ *California Cannabis Coalition v. City of Upland*, 3 Cal. 5th 924 (2017).

¹⁵ *Upland*, 3 Cal. 5th at 948.

¹⁶ The Building Owners and Managers Associations of California was a plaintiff in the Commercial Rents GRT matter only.

¹⁷ Cal. Const. art. XIII C, § 2(d).

¹⁸ See *City and County of San Francisco*, at 9-10; see also *Howard Jarvis Taxpayers Association, et. al.*, at 7-8.

¹⁹ See *City and County of San Francisco*, at 9-10; see also *Howard Jarvis Taxpayers Association, et. al.*, at 7-8.

²⁰ See *Upland*, 3 Cal. 5th at 948.

²¹ See *Howard Jarvis Taxpayers Association, Building Owners and Managers of California, California Business Properties Association, and California Business Roundtable v. City and County of San Francisco and All Persons Interested in the Matter of Proposition C of the June 5, 2018 San Francisco Ballot*, No. CGC-18-568657, (Cal. Sup. Ct. S.F. County Jul. 5, 2019) (On July 8, 2019, the Howard Jarvis Taxpayers Association filed a notice of appeal.).

²² See, e.g., Adam Brinklow, *Prop C Court rules SF can businesses for homeless funds*, Curbed SF, Jul. 8, 2019, <https://sf.curbed.com/2019/7/8/20686450/prop-c-lawsuit-homeless-san-francisco-howard-jarvis-herrera-upholds>; Joel Fox, *Supreme Court Needs to Decide Tax Vote Requirements for Initiatives*, Fox & Hounds, Jul. 10, 2019, <http://www.foxandhoundsdaily.com/2019/07/supreme-court-needs-to-decide-tax-vote-requirements-for-initiatives/>; Eversheds Sutherland (US) LLP, *Legal Alert Court holds California local taxes not subject to supermajority voting requirement*, Jul. 9, 2018, <https://us.eversheds-sutherland.com/NewsCommentary/Legal-Alerts/222342/Legal-Alert-Court-holds-California-local-taxes-not-subject-to-supermajority-voting-requirement>.

²³ See San Francisco Treasurer & Tax Collector, Homelessness Gross Receipts Tax, <https://sftreasurer.org/homelessness-gross-receipts-tax-ordinance> (last visited Aug. 1, 2019); see also San Francisco Treasurer & Tax Collector, Homelessness Gross Receipts Tax Notice, available [here](#).

²⁴ San Francisco, Cal., Ordinance 73-19 (Apr. 26, 2019), available at <https://sfgov.legistar.com/LegislationDetail.aspx?ID=3849975&GUID=D76E6A4E-5FF7-4211-928E-D19B08803F9A&Options=ID%7CText%7C&Search=190092>.

entitled to a tax credit if it either: (1) pays the tax and waives the right to a refund of the Homelessness GRT due to the pending litigation or (2) makes an irrevocable gift in the amount of the tax owed.²⁵ If a taxpayer chooses to waive its right to a refund, the City will grant the taxpayer a credit equal to 10% of the Homelessness GRT refund waived.²⁶ If a taxpayer is willing to make an irrevocable gift to be used for the same purposes, the City will grant the taxpayer a credit against their Homelessness GRT liability equal to 110% of the gift amount.²⁷

Taxpayers should consider the impact of the Homelessness GRT credits and whether it is more beneficial for them to waive their right to a refund in the event the tax is ultimately invalidated by a court, in exchange for the certainty of a 10% credit. Per City Ordinance 73-19, taxpayers have until the sooner of either the resolution of the pending litigation or January 1, 2024 to make the choice.²⁸

Commercial Rents GRT considerations

Taxpayers are also facing some level of uncertainty related to the Commercial Rents GRT due to the recent court decision. However, unlike the Homelessness GRT, the City is not offering taxpayers a tax credit for the Commercial Rents GRT to waive the potential refund or gift the amounts. Accordingly, taxpayers, including landlords that may face business decisions due to the tax, should evaluate the potential impact of the Commercial Rents GRT and this decision.²⁹

Other tax ballot measures

On July 17, 2019, Supervisor³⁰ Gordan Mar withdrew his proposal for a stock-based compensation tax from the November 2019 ballot.³¹ Supervisor Mar's stock-based compensation tax would have been imposed on stock-based compensation attributable to the City and would have been paid by the business.³² Supervisor Mar has deferred this tax proposal to the November 2020 ballot in order to gain time to work with community and labor leaders to present comprehensive solutions to economic inequality in the City.³³

Supervisor Mar stated that his decision to defer consideration of the stock-based compensation tax was due in part to the pending Transportation Network Company Tax (TNCT).³⁴ The TNCT imposes a 1.5% tax on ride sharing services and a 3.25% tax on all other rides.³⁵ According to Supervisor Mar, "[b]y focusing this November on the \$600 million Affordable Housing Bond and [Transportation Network Company] Tax, we will continue to build momentum for longer term solutions to the biggest problem facing our City [economic inequality]."³⁶

Supervisors Hillary Ronen and Matt Haney have also withdrawn their proposal to impose the so-called "CEO Tax," which would increase the gross receipts tax on businesses if the median compensation paid to employees in the City is 1% or less than the highest paid employee or officer.³⁷ Supervisors Mar, Ronen and Haney are looking to reintroduce their tax proposals on the November 2020 and March 2020 ballots, respectively.³⁸

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ The Board of Supervisors, which responds to the needs of the people of the City and County of San Francisco, establishes city policies, and adopts ordinances and resolutions. A Supervisor is elected to represent one of the 11 districts of the City and County of San Francisco.

³¹ See Joshua Sabatini, *Proposed "IPO Tax" pulled from November ballot*, San Francisco Examiner, Jul. 17, 2019, <https://www.sfxaminer.com/the-city/proposed-ipo-tax-pulled-from-november-ballot/>.

³² *See id.*

³³ *See id.*

³⁴ *Id.*

³⁵ *See id.*

³⁶ *Id.*

³⁷ *See id.*

³⁸ *See id.*

Contacts:

If you have questions about the San Francisco superior court's decision or other gross receipts tax matters, please contact any of the following Deloitte professionals:

Mark Faulkner
Partner

Deloitte Tax LLP, San Francisco
+1 415 783 5191
mafaulkner@deloitte.com

Hal Kessler
Managing Director

Deloitte Tax LLP, San Francisco
+1 415 783 6368
hkessler@deloitte.com

Scott Schiefelbein
Managing Director,
Washington National Tax
Deloitte Tax LLP, Portland
+1 503 727 5382
sschiefelbein@deloitte.com

Robert Wood
Senior Manager

Deloitte Tax LLP, Seattle
+1 206 716 7076
robwood@deloitte.com

Michael Spencer
Manager,
Washington National Tax

Deloitte Tax LLP, Washington DC
+1 202 220 2661
mispencer@deloitte.com

For further information, visit our website at www.deloitte.com/us/multistatetax

Follow [@DeloitteTax](https://twitter.com/DeloitteTax)

This alert contains general information only and Deloitte is not, by means of this alert, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This alert is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional adviser. Deloitte shall not be responsible for any loss sustained by any person who relies on this alert.

About Deloitte

As used in this document, "Deloitte" means Deloitte Tax LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2019 Deloitte Development LLC. All rights reserved.