



San Francisco Needs to Overhaul Its Policy on Business Taxes

By Manuel Fishman, Buchalter law firm

If a City administration wanted to come up with a more byzantine way of taxing an industry that creates thousands of jobs in the City and is directly responsible for so many iconic symbols

and incubators of a thriving economic downtown community, it would be hard pressed to duplicate the various taxes imposed on the commercial real estate industry in San Francisco.

I count six major taxes that the City and County of San Francisco levies on the real estate industry—even without including the community benefit districts where owners of commercial buildings vote to tax themselves to augment City services to maintain our sidewalks, sweep our streets and respond to persistent violations of commonly accepted norms of behavior in front of our buildings. There are (1) the gross receipts tax on all receipts from real estate activities in San Francisco, (2) the payroll tax on qualifying compensation paid to employees of companies in the real estate industry, (3) the commercial rent tax on rents from leasing of commercial space in San Francisco, (4) the supplemental gross receipts tax adopted this past November on companies earning in excess of \$50,000,000 in gross receipts in San Francisco, (5) the annual business registration tax that is linked to a company's gross receipts in San Francisco, and (6) the San Francisco transfer tax imposed on the sale of properties in San Francisco (and the increased fees associated with the recordation of documents evidencing any real estate transaction).

In one form or another, all of these taxes get passed through to the businesses that are the tenants who occupy the buildings, adding to the tax burden of these businesses and reducing the competitiveness of the City. Our industry needs to educate the City on basic real estate accounting principles and practices. Most expenses incurred by a landlord are not expenses attributable to the landlord's business, but are expenses attributable to the tenant's business, and do not affect the income of the landlord (for example, replacement of light bulbs and fixing malfunctioning doors, HVAC, etc. in a tenant's premises; paying contractors for tenant improvements requested by a tenant;

providing for excess janitorial services; or paying utility bills directly attributable to a tenant's consumption of electricity). The City handles the treatment of property taxes differently based on a test of whether the reimbursement is by means of a separately stated charge to a tenant. Why?

Another inconsistency: for purposes of determining the gross receipts tax, rent from all tenants are included in gross receipts, but for purposes of the San Francisco commercial rent tax, rents received from nonprofits or governmental entities are excluded from the revenue on which the tax is included, as are rents from non-formula retail tenants. In addition, the tax is limited to gross receipts from the lease of commercial space in properties in San Francisco, including subleases—but not other gross receipts (so gross receipts from the construction of tenant improvements and certain building amenities may be exempt). In addition, the supplemental gross receipts tax ordinance specifically excludes from the definition of gross receipts any rents subject to the commercial rent tax. Banks and insurance companies are exempt from the gross receipts tax (and the commercial rent tax) if they own their buildings, and large corporate businesses with administrative services offices in San Francisco pay a reduced gross receipts tax, but must pay a supplemental gross receipts tax. And, of course, the Presidio pays no gross receipts tax on the rents it receives, although businesses in the Presidio pay such taxes. Confused? You should be. It creates uncertainty and inconsistent application depending on the nature of a building's ownership, tenants and the services provided.

The goal for BOMA San Francisco in 2019 is to energize its members around a restructuring of the various business taxes and to establish effective lines of communication with the administration to establish industry standard practices for recognition of revenue and expenses. The recent letters received by property managers and owners of commercial buildings from various City departments undermines such communication. Lastly, our industry needs to be at the table to ensure accountability for the hundreds of millions of dollars that our industry is contributing to the City for services that benefit all San Franciscans.

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