Buchalter

CLIENT ALERT

November 10, 2020

2020 Election Results Confirm California's Cautious Approach to Sweeping Ballot Provisions, While the Bay Area Remains Progressive and Ready to Tax

By Manuel Fishman and Jonathan August

The 2020 election in California as pertains to national politics was never in doubt, but despite being a deeply blue state, Californians continued to show their divide on taxing businesses and making major changes to the statewide tax code. Several ballot initiatives, both at the state and municipal level, would have radically altered how businesses and executives are taxed. After the dust settled, the majority of businesses throughout the state were spared the effects of the most sweeping proposals, but Bay Area businesses and highly compensated executives can expect significant changes beginning in 2021.

One of the most discussed and contested statewide ballot initiatives in 2020 was Proposition 15. Following the passage of Proposition 13 in 1978, California has taxed both residential and commercial properties at their as-purchased value, not on their current market value. Thereafter, increases in property taxes are generally limited by statute to a maximum annual 2% increase or reassessment upon change in ownership or new construction. Proposition 15, backed by Governor Gavin Newsom, President-elect Joe Biden, and Facebook founder Mark Zuckerberg, sought to eliminate that protection solely for commercial properties worth more than $3 million. Although the vote is not officially certified as of today, it appears that Proposition 15 will fail, having received just over 48% of the vote statewide. Notwithstanding that fact, Proposition 15 received overwhelming support in San Francisco at over 70% of the vote and a majority of the vote in Santa Clara at just over 55%.

Unlike Proposition 15 with respect to commercial properties, voters statewide look set to approve a constitutional amendment in the form of Proposition 19, which would alter how inherited residential properties are taxed and how many times eligible individuals could transfer their tax assessments when purchasing a new home. Proposition 19 proposed eliminating the inheritance tax break for property passed on to the next generation unless the heir makes the home their primary residence. In addition, seniors and disabled individuals will be permitted to keep their current property tax assessment if they choose to move to a home with equal or lesser value. The intended effect of this proposition is to incentivize older Californians to move from their homes to free up inventory for younger generations, while allowing them to not get taxed at a significantly higher rate for a home of lesser value. Even if the replacement home has a higher value, only that portion of the purchase price in excess of the sale price of the sold property is reassessed at market value. Bay Area voters passed the Proposition with at least 55% of the vote, a higher rate than the rest of the state.

Perhaps the most controversial ballot initiative this year was Proposition 22, which would classify app-based drivers as independent contractors rather than employees. Classifying drivers as independent contractors rather than as employees exempts these individuals from a 2019 California employment law that would require these workers to be paid and given benefits like other full-time employees. Following an overwhelming media campaign funded by app-based driving companies, California voters passed the measure with over 58% of the vote. Critics of Proposition 22 claim that the protections added for workers are insufficient and that the "poison pill" language requiring any future legislative modification to obtain more than a supermajority in both the State Assembly and State Senate will be nearly impossible to overcome. Those arguments succeeded in San Francisco, where nearly 60% of voters voted "no".

The discrepancy between Bay Area voters and the remainder of the state is even more apparent when looking at local ballot initiatives. Following a shortfall in funding for the regional Caltrain network, San Francisco, San Mateo and Santa Clara Counties passed Proposition RR, which raises sales tax in those three counties by 0.125%. This tax increase over the next 30 years will generate an extra $100 million annually to fund Caltrain. Prop RR is also unique in that it required a collective supermajority of voters within all three counties and even with such a high hurdle, voters passed the tax with 70% of the vote.

In San Francisco itself, multiple ballot measures increasing taxes on businesses and highly compensated executives passed with large margins. Proposition F, with nearly 70% of the vote, eliminates the payroll expense tax, increases business registration fees, increases gross receipt tax rates by 40% across all industries, and increases the administrative office tax. Proposition I, although passing with only 57% of the total vote, doubles the real estate transfer tax for all property valued at over $10 million. Lastly, with over 65% of the vote, Proposition L places an increased gross receipts tax, or an increased payroll tax on administrative offices, on businesses when executive wages for managerial employees exceed more than 100 times the median compensation of employees in San Francisco.

The practical effect that each of these tax increases will have is unknown, but they are important for companies to consider when seeking to do business in San Francisco. Moving corporate executives to the city may become less attractive if the move comes with an additional tax solely due to the salary and benefits received by that executive. Large real estate transactions for both high-priced residences and commercial office buildings may become less appealing with a doubled transfer tax. In addition, in order to consider opening a new business or maintaining a current business, companies will need to adjust their expense models in order to incorporate higher tax burdens related to major increases in gross receipts, sales, and administrative office taxes.[1] These increases may have the potential effect of limiting growth of businesses in San Francisco or causing them to relocate to areas that are more tax friendly.[2]

---

[1] Litigation concerning the effectiveness of special taxes enacted through the initiative process by less than a supermajority vote, including the San Francisco Commercial Rent Tax, is still ongoing. The revenue obtained as part of the 2018 voter initiative (commonly known as the commercial rent tax) has been impounded pending conclusion of this litigation, and Proposition F allows the funds to be released, thereby creating new revenue for the City. Proposition F authorizes a 20-year "backstop" tax that only gets triggered in the event a final judgment holds the commercial rent tax invalid. This "backstop" tax will provide the City with an equivalent amount of revenue necessary to reimburse businesses for any taxes previously paid and that the City may be ordered to refund in connection with the 2018 initiative.

[2] The Office of Economic Analysis for the City of San Francisco has estimated that Proposition I alone may result in the loss of hundreds of jobs and residents, over $50 million in City gross domestic product, and a reduction in per capita disposable income.

The results of the 2020 election in California reflect the ongoing struggle between progressives and conservatives throughout the state with respect to their approach on how to encourage and attract future business – a battle that will continue into the future.

Manuel Fishman
Real Estate, San Francisco
(415) 227-3504
mfishman@buchalter.com

Jonathan August
Real Estate, San Francisco
(415) 227-3558
jaugust@buchalter.com