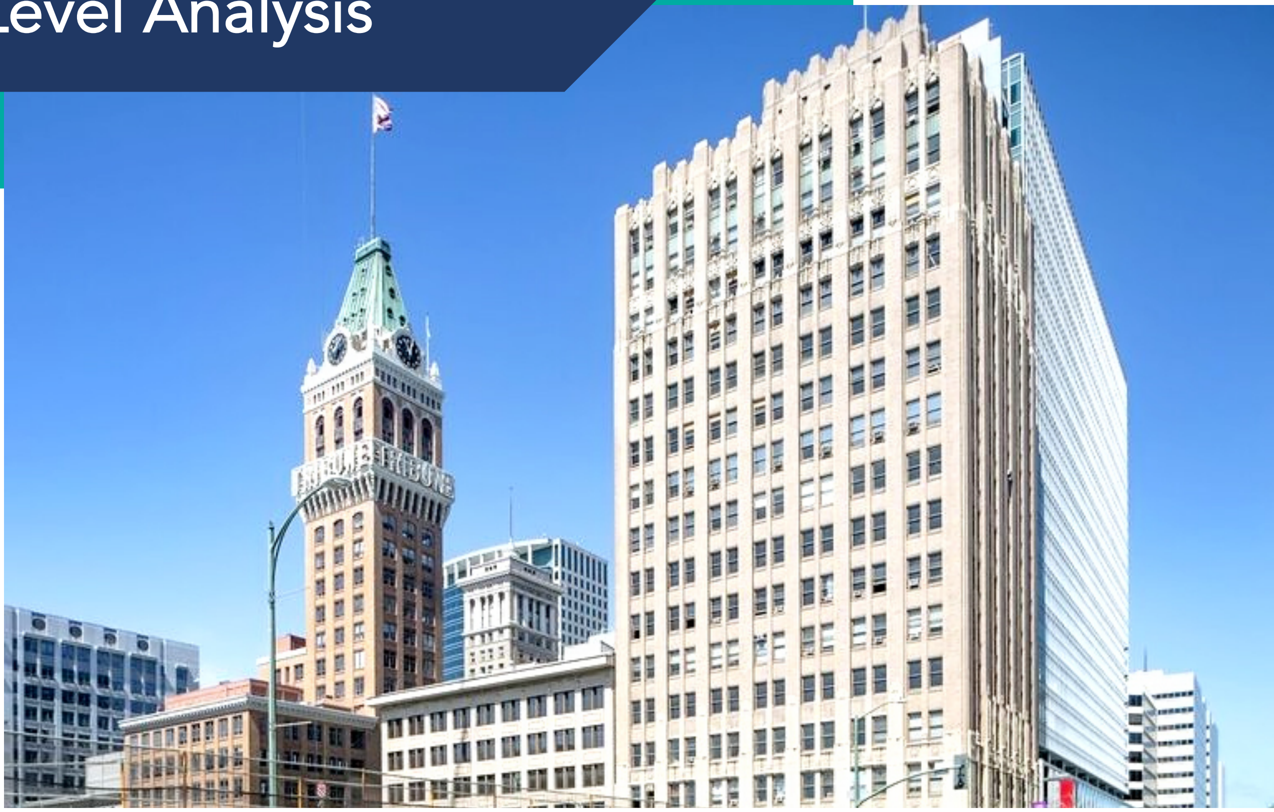
Business Taxes in the Bay Area:

A City Level Analysis



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BAY AREA COUNCIL
ECONOMIC INSTITUTE

INTRODUCTION

In the decade following the Great Recession, the nine-county Bay Area produced job growth that was faster than nearly all other metropolitan areas in the U.S. Much of that growth, approximately 40%, came from employers in two office-based industries: professional services and information. A significant portion of this employment growth was concentrated in San Francisco as some of the city's technology start-ups grew rapidly and Silicon Valley companies opened satellite offices to attract talent from a broader geography.

However, the Bay Area's rapid-growth trajectory has since reversed. While the U.S. economy had fully recovered its pandemic job losses by mid-2022, the Bay Area entered 2023 still down approximately 50,000 jobs from its pre-pandemic employment peak. Much of the region's jobs deficit is associated with the leisure, hospitality, and tourism industries. Despite headlines hypothesizing the death of Silicon Valley, office-based industries – such as professional services and information/tech – have actually increased their employment levels in the region compared to pre-pandemic levels, albeit at slower rates than in other similar metro areas.

The Bay Area's relatively slow economic recovery in the last three years can be traced back to remote work trends in the region. As downtown areas now host a fraction of the office workers they once had, the services (e.g., restaurants, gyms, dry cleaners, etc.) connected to those workers are experiencing reduced demand. Remote work has also allowed many companies to reduce or eliminate their real estate footprints. This shift has been acutely felt in the region's three central business districts: San Francisco's commercial vacancy rate hit 27.6% in the fourth quarter of 2022, downtown Oakland's vacancy rate was 25.3%, and the San Jose core had a 17.4% vacancy rate.

Beyond remote work preferences, numerous factors go into business location decisions for companies large and small – access to talent, labor costs, proximity to customers, cost of real estate, regional amenities, and local taxes, just to name a few. In recent years, many cities across the Bay Area have enacted new or increased business taxes – in the form of a tax on gross receipts, a per employee tax, or a tax based on commercial real estate square footage. These new taxes have added to the cost of doing business – on top of high real estate costs and high labor costs in the region. These variable tax rates across the region have created an economic incentive for companies to explore relocations within the region, while others have looked to move more operations outside of the Bay Area to lower-cost geographies.

While it is impossible to pinpoint a single determining factor in relocations and other corporate real estate decisions, we can analyze business taxes across the region to better understand the cost-benefit calculations that businesses are making as they determine how to locate their real estate and labor force needs. The analysis that follows summarizes business tax structures and rates across the region using three hypothetical companies.

METHODOLOGY

To investigate the business tax landscape across the Bay Area, we analyzed the 20 largest job centers across the southern five counties (Alameda, Contra Costa, San Francisco, San Mateo, and Santa Clara). These counties were chosen as they are most likely to experience intra-regional movement of corporate office locations. The 20 cities analyzed are catalogued below:

- Oakland, Alameda County
- Fremont, Alameda County
- Dublin, Alameda County
- Pleasanton, Alameda County
- Emeryville, Alameda County
- Berkeley, Alameda County
- Walnut Creek, Contra Costa County
- San Ramon, Contra Costa County
- San Francisco, San Francisco County
- Menlo Park, San Mateo County
- Redwood City, San Mateo County
- South San Francisco, San Mateo County
- San Mateo, San Mateo County
- Burlingame, San Mateo County
- San Jose, Santa Clara County
- Santa Clara, Santa Clara County
- Sunnyvale, Santa Clara County
- Mountain View, Santa Clara County
- Cupertino, Santa Clara County
- Palo Alto, Santa Clara County

Across these 20 jurisdictions, business taxes are calculated in very different ways. For simplicity, we have organized business tax structures into three broad groups: (1) Gross annual receipts taxes calculate business taxes based upon the total revenues an organization received from all sources without subtracting any costs or expenses; (2) Employee headcount taxes calculate business taxes based upon the total number of employees within a tax-paying entity; (3) Real estate based business taxes use the total amount of square footage utilized by a company to calculate taxes due. Some jurisdictions use a combination of these methods.

Another key factor in business tax structures is whether or not they are flat or progressive in their taxing methods. In a flat tax structure, all businesses pay the same rate (i.e., a percentage of gross receipts or a taxable amount per employee). Under these structures, larger businesses do pay more than smaller businesses, but their tax burdens are equivalent to their size. In a progressive business tax structure, larger businesses will pay a significantly greater percentage of the overall tax receipts, as they are taxed at higher rates than smaller businesses. Many jurisdictions in the region have moved to progressive structures with the goal of making their tax systems more equitable and to reduce tax burdens on small businesses.

Out of the 20 investigated cities, only 15 were chosen for further analysis. Palo Alto and Cupertino calculate taxes based on commercial square footage, which makes comparisons to other jurisdictions difficult. In Burlingame, San Ramon, and Dublin, flat business license taxes have been implemented that make business tax burdens very low for all businesses in these jurisdictions. The remaining 15 cities are categorized in the below chart by the type of business tax they utilize:

Type of Business Tax	Flat or Progressive	Cities
Gross Annual Receipts	Flat	Fremont, Berkeley, Emeryville
Gross Annual Receipts	Progressive	San Francisco, Oakland, Menlo Park, San Mateo, Walnut Creek, Pleasanton
Employee Headcount	Progressive	San Jose, Santa Clara, Mountain View
Employee Headcount	Flat	South San Francisco, Redwood City, Sunnyvale

The manner in which business taxes are calculated varies substantially by geography. Some jurisdictions simply tax all gross receipts at a flat percentage, while others place varying tax rates on companies based on their industry and/or employment size. Because no two tax structures are exactly alike, comparing tax structures across municipalities is very difficult. As such, we have chosen to analyze annual tax burdens on hypothetical companies within each of the 15 jurisdictions. The below table outlines each of the three example companies:

Company	Industry	Annual Gross Receipts	Employee Headcount
Law Firm	Professional Services	$100 million	75
Payment Processing	Financial Services	$500 million	1,000
Cloud Storage	Information	$750 million	250

The three hypothetical companies are very large as they fall toward the top of the gross receipts range. For example, San Francisco is home to 300-400 companies with more than $50 million in annual gross receipts. In Oakland, there are just 52 companies exceeding $50 million in gross receipts. We have strategically chosen to focus on these larger office-based corporations because they allow us a better ability to highlight tax burden differences across the region. Additionally, in many locations these large companies are contributing significantly to the tax base; but those same expenses also make these companies more likely to relocate or close locations in high-tax jurisdictions.

BUSINESS TAXES ON THE 2022 BALLOT

Santa Clara, Oakland, Palo Alto, and Los Gatos voters approved business tax proposals in the 2022 election. Previously, Oakland's business tax rates were structured as a flat tax rate per $1,000 of earnings, meaning all companies paid the same base rate regardless of earnings. Under its new structure, the tax rate scales up as earnings scale up, with the highest tax bracket set for companies with annual gross receipts over $50 million. Oakland's highest business tax rate is 0.550%, which applies to administrative headquarters with over $50 million in taxable gross receipts.

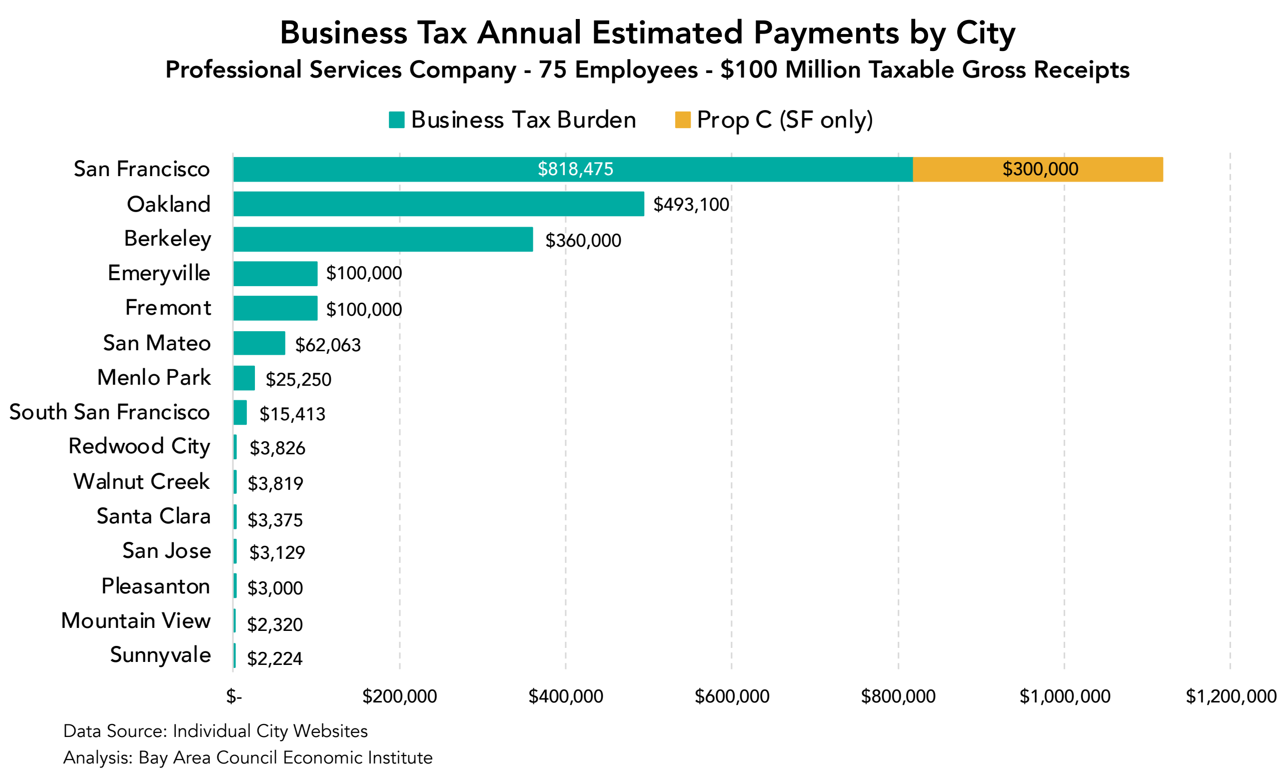
The city of Santa Clara's ballot measure restructures the tax code so that large companies with many employees pay more than small businesses with few employees. Previously, Santa Clara charged anywhere between $15 to $500 in business taxes based on employee headcount. Thus, even the largest businesses by employee size were paying just $500 annually in business tax. The new proposal charges businesses a flat rate of $45 per employee with the total amount capped at $350,000.

RESULTS

The following charts present the estimated annual business tax burdens for the three hypothetical companies for each city. All figures use tax rates for the 2022 tax year (the newly enacted tax rates for Oakland[1] and Santa Clara, which will go into effect in 2023, are included).

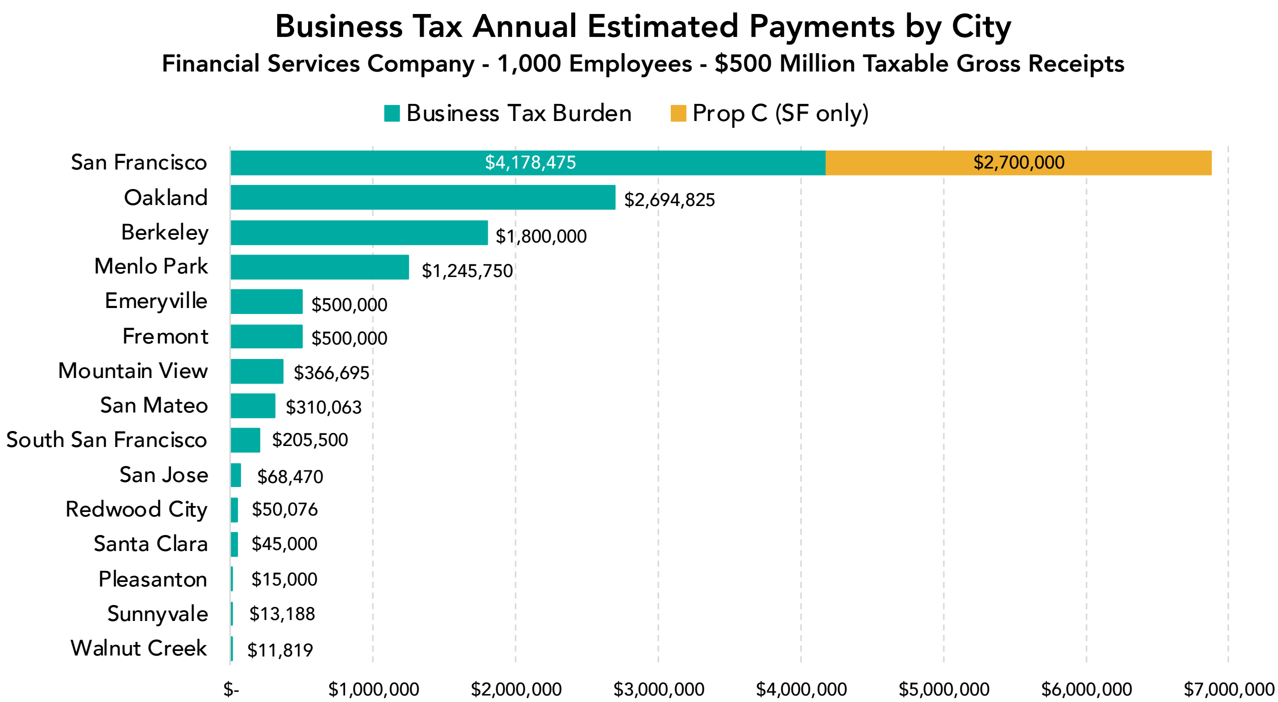
For the purposes of this analysis, we have chosen to separate San Francisco's 2018 Proposition C business tax to fund homelessness services from the city's standard gross receipts tax. Proposition C targets companies with more than $50 million in gross receipts by substantially raising their gross receipts tax rate. For example, the top tier tax rate for companies in the information sector producing more than $25 million in gross receipts was 0.832% in 2022. Proposition C adds on an additional 0.500% marginal tax on receipts over $50 million. At the time of passage, the San Francisco Controller estimated that 67% of all future business tax revenues would come from businesses subject to Proposition C. To understand the city's true business tax burden, Proposition C taxes should be combined with the traditional tax burden in the charts that follow.

***Figure 1.* For a large professional services firm – a law firm, for example – business tax rates are highest in San Francisco, Berkeley, and Oakland, while seven cities would impose minimal taxes under $5,000 annually.**



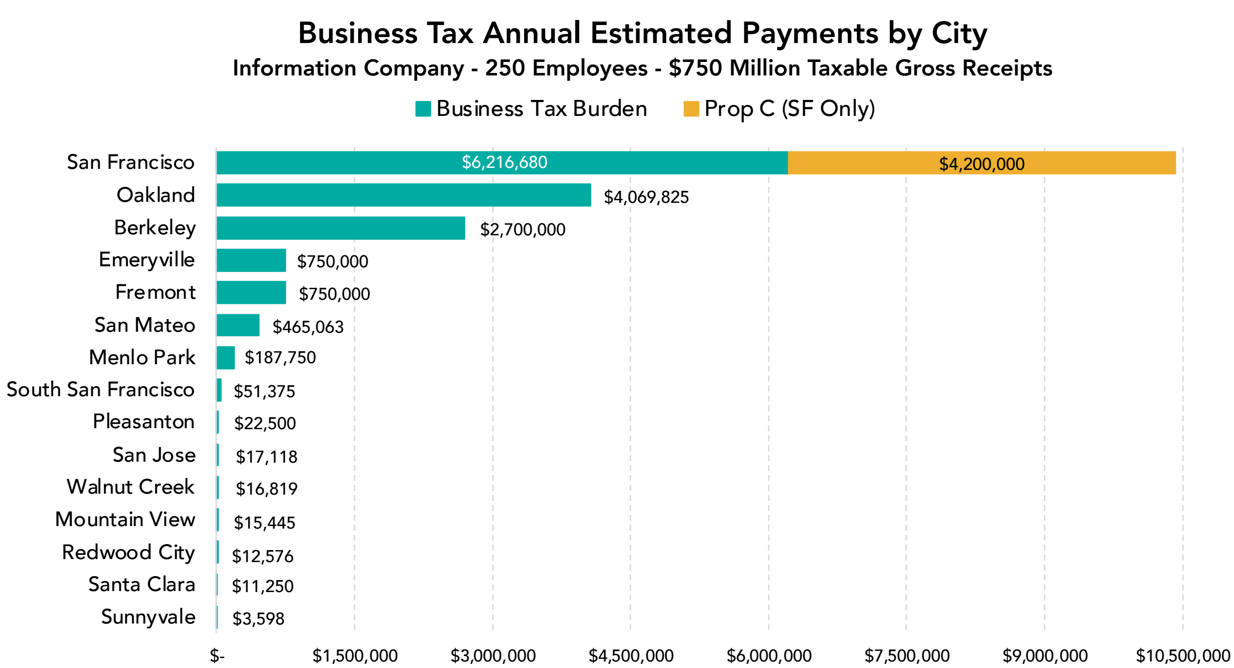
[1] Oakland's new tax structure uses industries to determine tax rates; however, financial services and information are not included in the listing of industries. For the purposes of this analysis, we have applied the tax rates for administrative offices for these two categories. This is the highest tax rate of any industry grouping in Oakland at high revenue levels.

***Figure 2.* For a large financial services firm – such as a fintech firm that processes payments – business tax rates could range as high as $7 million per year in San Francisco (when including Proposition C) to under $50,000 per year in more suburban locations.**



Data Source: Individual City Websites
Analysis: Bay Area Council Economic Institute

***Figure 3.* For a large information company – such as a cloud-based storage provider – business tax rates show the widest variation. Locations that tax progressively based on gross receipts have the highest tax burden, while flat headcount tax locations have relatively small taxes.**



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SUMMARY

In the Bay Area, cities that utilize a progressive gross receipts tax create a significantly higher tax burden for large corporations compared to counterpart cities that tax based on employee headcount. The gap is wide enough that it likely impacts corporate location decisions.

This is particularly true in San Francisco, where tax burdens are multiple times higher than the next closest high-tax cities (Oakland and Berkeley). Compared to jurisdictions in San Mateo and Santa Clara counties, business taxes in San Francisco can be multiple orders of magnitude higher depending on the company's size. When including Proposition C taxes, office-based businesses in San Francisco with more than $50 million in gross receipts can pay tax rates as high as 1.440%. On the other end of the spectrum, the largest job hub in the South Bay – San Jose – caps its headcount tax at $171,300 per year per company.

With such significant variability in business tax liabilities across jurisdictions, there are clear economic incentives for relocation or closure of offices in high-tax municipalities. These tax differences have not been created overnight, though they have been widened by recent tax increases in multiple cities. While it is true that tax rates alone cannot explain corporate location decisions, more employers appear to be taking a closer look at the costs and benefits of where they locate their operations. With remote work taking hold across almost all office-based industries, the benefits of real estate investments appear to be waning, while costs via taxes continue to grow in the region.

About the Bay Area Council Economic Institute

Since 1990, the Bay Area Council Economic Institute has been a leading think tank focused on the economic and policy issues facing the San Francisco Bay Area. The Economic Institute is housed at and supported by the Bay Area Council, a public policy organization that includes hundreds of the region's largest employers and is committed to keeping the Bay Area the world's most competitive economy and best place to live.

The Economic Institute serves a dual purpose as both an economic think tank and public policy analysis consultancy. We utilize publicly available data, our connections to the private and public sector, and the Bay Area Council's policy advocacy team to inform our public policy recommendations. We are also differentiated from other think tanks and consultancies by our unique board, made up academics, business executives, elected officials, and non-profit leaders.

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