

# Business License Tax Helps Housing

*Increase the business license tax for owners of residential rental units in order to prevent displacement and fund affordable housing*



*(Photo courtesy of Berkeleyside.org)*

## The Impact

An increase in the business license tax on gross receipts for owners of residential rental properties in Berkeley, Calif., has raised more than \$5 million annually for affordable housing and homelessness prevention in the city. A similar increase in East Palo Alto, Calif., raised about \$600,000 annually.

## Description

Proposals approved by voters in Berkeley and East Palo Alto, Measures U1 and O, apply to landlords with more than five residential units and increase the business license tax by 1.8% and 1.5% of gross receipts, respectively. These are general taxes with funds committed to preventing homelessness and funding affordable housing developments. These taxes cannot be passed on to tenants.

## Where It's Been Implemented

Voters in the City of Berkeley passed Measure U1 in 2016 with a 75% approval rate, raising the business license tax on residential rental properties from 1.081% to 2.88% of gross receipts. This measure generates about \$4 million yearly for affordable housing and homelessness prevention.

Despite having significantly fewer rental properties and a much smaller population than Berkeley, East Palo Alto passed Measure O in 2016 that set the business license tax on residential rental properties at 1.5% of gross rental revenue. It was estimated to generate \$600,000 per year.

### **Key Drivers**

In San Mateo County, as of 2021, the average rent for a two-bedroom apartment was \$3,533 per month, compared to \$1,833 in 2011, a significant increase for tenants. The rising value of housing was due primarily to a shortage of units in comparison to the number of new jobs, not improvements made by owners and landlords.

Taxing these windfall profits is a way to create funding for affordable housing without discrediting any of the hard work of the property owner. The tax increase acknowledges that it is the members of the community and their contributions that help make the location desirable to live in, and puts some of the profit toward building lasting, diverse communities.

### **Key Factors for Success**

Raising the business license tax in California requires a simple majority vote by local voters, or a two-thirds majority vote if it is deemed a “special tax,” meaning that it must be used for a specific purpose. In Berkeley, the Housing Advisory Commission, a committee of affordable housing and homelessness prevention experts, advises the city on how to spend the tax and tracks how it is spent, ensuring that this “general tax” is used for its promised purposes. Recent changes in California law allow a special tax to be passed by majority vote, rather than requiring a two-thirds vote, if it is placed on the ballot through the initiative process and not by the city council.

Measure U1 in Berkeley exempts small landlords with less than five units, units with historically low rents and units reserved for low-income tenants at an affordable rent. New construction is exempt from the tax for 12 years after construction is completed in order to encourage new building.

### **Key Obstacles**

Cities can expect business and property owners to strongly oppose an increase in the business license tax. For example, in the case of Berkeley's Measure DD, businesses proposed raising taxes by a smaller amount than Measure U1. Some people have expressed concern about the tax being passed on to residents, but rents can be raised without a tax increase as long as there is local demand for housing. The tax does not change California's rent stabilization law, which limits rent increases to increases in the consumer price index plus 5% each year.

### **Timeline to Implementation**

In July 2015, the idea to raise the business license tax was introduced by the Measure U1 campaign to the Berkeley City Council. In March-May 2016, the city did community polling to gauge what the community thought and valued, then placed U1 on the ballot. The public approved the measure on November 8, 2016.

### **Background**

The idea of taxing unearned “windfall” profits is not new. Adam Smith's *The Wealth of Nations*, often called the “Bible of Capitalism” and the foundation of market economics, distinguishes between “building rent” and “ground rent.” Building rent is the amount necessary to operate the building and still turn a profit. The amount above this amount is ground rent, which is driven by the desirability of the location. Smith suggests that ground rent be taxed for the benefit of the community that made the location valuable in the first place. An increase in the business license tax does so.

## References and Resources

- Dr. Stephen Barton, retired Berkeley Housing Director and Co-Chair of the Measure U1 campaign, [stephenbarton@live.com](mailto:stephenbarton@live.com), 510-215-9773
- [East Palo Alto Measure O](#)
- [Berkeley Measure DD](#)
- [Berkeley Measure U1](#)
- [Economic & Policy Analysis of Tax](#)

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