

Amendment of the Whole
as divided in Committee
7/14/08

FILE NO. 081030

ORDINANCE NO.

1 [Payroll Expense Tax]

2 Ordinance submitting to the voters an ordinance amending the Business and Tax
3 Regulations Code by (1) amending Section 902.1 and adding Section 902.2 to clarify
4 the tax liability of "pass through entities" under the Payroll Expense Tax Ordinance,
5 including partnerships, Subchapter S corporations, limited liability companies, limited
6 liability partnerships and other persons or entities not subject to federal income tax or
7 which are allowed a deduction in computing such tax for distributions to the owners or
8 beneficiaries of such persons or entities and specifying safe harbor measure of
9 taxable payroll expense for owners of pass through entity (200% of compensation for
10 its most highly paid quartile of employees); and (2) amending Section 905-A to increase
11 the Small Business Tax Exemption to include all taxpayers whose taxable payroll
12 expense is \$250,000 or less.

13 Note: Additions are *single-underline italics Times New Roman*;
14 deletions are *strikethrough italics Times New Roman*.
15 Board amendment additions are double underlined.
Board amendment deletions are ~~strikethrough normal~~.

16 ~~Be it ordained by the People of the City and County of San Francisco:~~

17 ~~Section 4.~~ ORDAINED that Pursuant to Article XIII C of the Constitution of the State
18 of California, the Board of Supervisors hereby submits this ordinance shall be submitted to the
19 qualified electors of the City and County of San Francisco, at the November 4, 2008 general
20 municipal election and that this ordinance shall become operative only if approved by the
21 qualified electors at such election.

22 Be it ordained by the People of the City and County of San Francisco:

23 Section 12. The San Francisco Business and Tax Regulations Code is hereby
24 amended by amending Section 902.1 and adding Section 902.2 to read as follows:
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1 SEC. 902.1. PAYROLL EXPENSE. (a) The term "Payroll Expense" means the
2 compensation paid to, on behalf of, or for the benefit of an individual, including shareholders of
3 a professional corporation or a Limited Liability Company ("LLC"), including salaries, wages,
4 bonuses, commissions, property issued or transferred in exchange for the performance of
5 services (including but not limited to stock options), compensation for services to owners of pass-
6 through entities, and any other form of compensation, who during any tax year, perform work or
7 render services, in whole or in part in the City; and if more than one individual or shareholders
8 of a professional corporation or members of an LLC, during any tax year performs work or renders
9 services in whole or in part in the City, the term "Payroll Expense" means the total
10 compensation paid including salaries, wages, bonuses, commissions, property issued or
11 transferred in exchange for the performance of services (including but not limited to stock
12 options), in addition to any compensation for services to owners of pass-through entities, and any
13 other form of compensation for services, to all such individuals and shareholders of a professional
14 corporation or members of an LLC.

15 (b) Any person that grants a service provider a right to acquire an ownership
16 interest in such person in exchange for the performance of services shall include in its payroll
17 expense for the tax year in which such right is exercised an amount equal to the excess of
18 (i) the fair market value of such ownership interest on the date such right is exercised over
19 (ii) the price paid for such interest.

20 (c) Any individual compensated in his or her capacity as a real estate salesperson
21 or mortgage processor shall be deemed an employee of the real estate broker or mortgage
22 broker for or under whom such individual performs services, and any compensation received
23 by such individual, including compensation by way of commissions, shall be included in the
24 payroll expense of such broker. For purposes of this Section, "real estate broker" and
25 "mortgage broker" refer to any individual licensed as such under the laws of the State of

1 California who engages the services of salespersons or a salesperson, or of mortgage
2 processors or a mortgage processor, to perform services in the business which such broker
3 conducts under the authority of his or her license; a “salesperson” is an individual who is
4 engaged by a real estate broker to perform services, which may be continuous in nature, as a
5 real estate salesperson under an agreement with a real estate broker, regardless of whether
6 the individual is licensed as a real estate broker under the laws of the State of California; a
7 “mortgage processor” is an individual who is engaged by a real estate broker or mortgage
8 broker to perform services, which may be continuous in nature, as a mortgage processor
9 under an agreement with such real estate broker or mortgage broker, regardless of whether
10 the mortgage processor is also licensed as a mortgage broker under the laws of the State of
11 California.

12 (d) All compensation, including all pass-through compensation for services paid to,
13 on behalf of, or for the benefit of owners of a pass-through entity, shall be included in the
14 calculation of such entity’s payroll expense tax base for purposes of determining such entity’s
15 tax liability under this Article. For purposes of this section, the “pass-through compensation for
16 services” of a pass-through entity shall be the aggregate compensation paid by such entity for
17 personal services rendered by all such owners, and shall not include any return on capital
18 investment. The taxpayer may calculate the amount of compensation to owners of the entity
19 subject to the Payroll Expense Tax, or the taxpayer may presume that, in addition to amounts
20 reported on a W-2 form, the amount subject to the payroll expense tax is 90% of the amount
21 of net earnings from self-employment derived from the entity for federal income tax purposes.
22 for each owner, an amount that is two hundred percent (200%) of the average annual
23 compensation paid to, on behalf of, or for the benefit of the employees of the pass-through
24 entity whose compensation is in the top quartile (i.e., 25%) of the entity's employees who are
25

1 based in the City; provided, the total number of employees of the entity based in the City is
2 not less than twenty.

3 SEC. 902.2. PASS-THROUGH ENTITY. The term "pass-through entity" includes a trust,
4 partnership, corporation described in Subchapter S of the Internal Revenue Code of 1986, as amended,
5 limited liability company, limited liability partnership, professional corporation, and any other person
6 or entity (other than a disregarded entity for federal income tax purposes) which is not subject to the
7 income tax imposed by Subtitle A, Chapter 1 of the Internal Revenue Code of 1986, as amended, or
8 which is allowed a deduction in computing such tax for distributions to the owners or beneficiaries of
9 such person or entity. Any person exempt from payment of the Payroll Expense Tax under Section
10 905-A or 906 of this Article shall not be disqualified from or denied such exemption as a result of
11 being a "pass-through entity" under this Section.

12 Section 2. The San Francisco Business and Tax Regulations Code is hereby amended
13 by amending Section 905-A to read as follows:

14 SEC. 905-A. SMALL BUSINESS TAX EXEMPTION.

15 (a) Notwithstanding any other provisions of this Article, "small business enterprises"
16 as hereinafter defined, shall be exempt from payment of the Payroll Expense Tax; provided,
17 however, that small business enterprises shall pay the annual registration fee pursuant to
18 Section 855 of Article 12.

19 (b) The term "small business enterprise" shall mean and include any taxpayer:

20 (1) Whose tax liability-under this Article, but for this exemption provision, would not
21 exceed \$2,500 and or, effective January 1, 2009, whose taxable payroll expense does not exceed
22 \$250,000 and;

23 (2) Who has filed a tax return by the last date of February for the preceding tax year. If
24 the taxpayer fails to file a return by that date, the taxpayer shall be subject to a penalty as
25 specified in subsection (d).

1 (c) For the 2011 tax year, and each second succeeding tax year, the Tax Collector shall
2 increase the ceiling for the Small Business Tax Exemption (rounded to the nearest \$10,000 increment)
3 to reflect increases in the United States Department of Labor's Bureau of Labor Statistics consumer
4 price index for all urban customers for the San Francisco-Oakland-San Jose area for each of the
5 preceding two tax years.

6 (d) In lieu of the penalty specified in Section 6.17-3 of this Article for failing to file a
7 return, any person who otherwise qualifies for the small business exemption set forth in this
8 Section who fails to file a return by the last date of February shall pay a penalty as follows:

9 (1) If the person's Payroll Expense Tax liability under this Article, but for the small
10 business exemption under this section, would be less than \$1,000, the penalty shall be \$100
11 plus 10% of the amount of such liability, for each month, or fraction thereof, that the return is
12 delinquent, up to a maximum amount equal to the person's liability for such tax but for the
13 small business exemption;

14 (2) If the person's Payroll Expense Tax liability under this Article, but for the small
15 business exemption under this section, would be \$1,000 or more, then the penalty shall be
16 \$250 plus 10% of the amount of such liability, for each month, or fraction thereof, that the
17 return is delinquent, up to a maximum amount equal to the person's liability for such tax but
18 for the small business exemption.

19 (e) The Tax Collector may, in his or her discretion, reduce the penalty set forth in
20 subsection (c) to not less than \$100 upon a showing that the late filing of the return was due
21 to reasonable cause and not due to willful neglect.

22 Section 3. This ordinance does not change any of the Payroll Expense Tax rates in
23 Section 903.1 and reaffirms the current rates.

24 APPROVED AS TO FORM:
25 DENNIS J. HERRERA, City Attorney

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By:

Michael Slattery
Deputy City Attorney