

1 [Business and Tax Regulations Code – Payroll Expense Tax Exclusion for Stock-Based
2 Compensation]

3 **Ordinance amending the San Francisco Business and Tax Regulations Code, Article**
4 **12-A, by adding Section 906.5 to establish a payroll expense tax exclusion for stock-**
5 **based compensation and amending Section 902.1 to exclude stock options from the**
6 **definition of Payroll Expense.**

7 NOTE: Additions are *single-underline italics Times New Roman*;
8 deletions are ~~*strike-through italics Times New Roman*~~.
9 Board amendment additions are double-underlined;
Board amendment deletions are ~~strikethrough normal~~.

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

11 Section 1. Findings. The Board of Supervisors hereby finds that:

12 (a) The technology industry is a vital element to San Francisco's long-term future.

13 (b) Issuing stock-based compensation has become an important vehicle in the
14 technology industry to attract and retain valuable employees.

15 (c) San Francisco is the only city in the United States of America that taxes
16 employers on stock-based compensation.

17 (d) Continuing to tax stock-based compensation threatens San Francisco's ability to
18 retain existing technology companies and attract new ones.

19 (e) Excluding stock-based compensation from San Francisco's payroll expense tax
20 is a critical step towards creating a competitive economic environment in San Francisco that
21 entices companies that utilize stock-based compensation to attract and retain employees to
22 stay in San Francisco or to move to San Francisco.

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24 Section 2. The San Francisco Business and Tax Regulations Code is hereby amended
25 by adding Section 906.5, to read as follows:

1 **SEC. 906.5 STOCK-BASED COMPENSATION EXCLUSION.**

2 (a) Any person who does not qualify as a Small Business Enterprise under the provisions of
3 Section 905-A (Small Business Tax Exemption), shall be allowed an exclusion from its Payroll Expense,
4 as defined in Section 902.1, for that portion of its Payroll Expense that is attributable to Stock-Based
5 Compensation.

6 (b) No exclusion shall be allowed under this Section to the extent that such exclusion
7 reduces a person's payroll expense tax liability below \$1,500 for any individual employee. In such
8 case, the person's payroll expense tax liability shall be fixed for such individual employee at \$1,500.

9 (c) Stock-Based Compensation includes, but is not limited to, all incentive and non-statutory
10 stock options, including all underlying stock relating to such options, restricted stock, restricted stock
11 units, and stock acquired as a result of employee stock purchase plans.

12 (d) A person wishing to claim this exclusion must:

13 (1) File with the Tax Collector by the last day in January of each year, on a form
14 prescribed by the Tax Collector, an affidavit attesting to the facts establishing entitlement to the
15 exclusion. Any person who fails to timely file an affidavit under this subsection is prohibited from
16 claiming the Stock-Based Compensation Exclusion.

17 (2) Maintain records and documents in a manner acceptable to the Tax Collector.
18 Such records and documents must objectively substantiate any exclusion claimed under this Section
19 and be provided to the Tax Collector upon request.

20 (3) File an annual payroll expense tax return with the Tax Collector regardless of
21 the amount of tax liability shown on the return after claiming the exclusion provided for in this Section.

22 (e) The Office of the Treasurer and Tax Collector may adopt rules and regulations
23 regarding the exclusion provided under this Section.

24 (f) The Tax Collector shall verify that any exclusion claimed pursuant to this Section is
25 appropriate.

1 (g) The Stock-Based Compensation Exclusion under this Section may not be claimed
2 concurrently with any other payroll expense tax exclusion.

3 (h) The Stock-Based Compensation Exclusion under this Section may not be claimed
4 retroactively.

5 (i) A misrepresentation or misstatement by any person regarding eligibility for the
6 exclusion set forth under this Section that results in the underpayment or underreporting of the payroll
7 expense tax shall be subject to penalties.

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9 Section 3. The San Francisco Business and Tax Regulations Code is hereby amended
10 by amending Section 902.1, to read as follows:

11 **SEC. 902.1 Payroll Expense.**

12 (a) The term "Payroll Expense" means the compensation paid to, on behalf of, or for
13 the benefit of an individual, including shareholders of a professional corporation or a Limited
14 Liability Company ("LLC"), including salaries, wages, bonuses, commissions, property issued
15 or transferred in exchange for the performance of services ~~(including but not limited to stock~~
16 ~~options)~~, compensation for services to owners of pass-through entities, and any other form of
17 compensation, who during any tax year, perform work or render services, in whole or in part in
18 the City; and if more than one individual or shareholders of a professional corporation or
19 members of an LLC, during any tax year performs work or renders services in whole or in part
20 in the City, the term "Payroll Expense" means the total compensation paid including salaries,
21 wages, bonuses, commissions, property issued or transferred in exchange for the
22 performance of services ~~(including but not limited to stock options)~~, in addition to any
23 compensation for services to owners of pass-through entities, and any other form of
24 compensation for services, to all such individuals and shareholders of a professional
25 corporation or members of an LLC.

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

5 ~~(e)~~(b) Any individual compensated in his or her capacity as a real estate salesperson
6 or mortgage processor shall be deemed an employee of the real estate broker or mortgage
7 broker for or under whom such individual performs services, and any compensation received
8 by such individual, including compensation by way of commissions, shall be included in the
9 payroll expense of such broker. For purposes of this Section, "real estate broker" and
10 "mortgage broker" refer to any individual licensed as such under the laws of the State of
11 California who engages the services of salespersons or a salesperson, or of mortgage
12 processors or a mortgage processor, to perform services in the business which such broker
13 conducts under the authority of his or her license; a "salesperson" is an individual who is
14 engaged by a real estate broker to perform services, which may be continuous in nature, as a
15 real estate salesperson under an agreement with a real estate broker, regardless of whether
16 the individual is licensed as a real estate broker under the law of the State of California, a
17 "mortgage processor" is an individual who is engaged by a real estate broker or mortgage
18 broker to perform services which may be continuous in nature, as a mortgage processor
19 under an agreement with such real estate broker or mortgage broker, regardless of whether
20 the mortgage processor is also licensed as a mortgage broker under the laws of the State of
21 California.

22 ~~(d)~~(c) All compensation, including all pass-through compensation for services paid to,
23 on behalf of, or for the benefit of owners of a pass through entity, shall be included in the
24 calculation of such entity's payroll expense tax base for purposes of determining such entity's
25 tax liability under this Article. For purposes of this section, the "pass-through compensation for

1 services" of a pass-through entity shall be the aggregate compensation paid by such entity for
2 personal services rendered by all such owners, and shall not include any return on capital
3 investment. The taxpayer may calculate the amount of compensation to owners of the entity
4 subject to the Payroll Expense Tax, or the taxpayer may presume that, in addition to amounts
5 reported on a W-2 form, the amount subject to the payroll expense tax is, for each owner, an
6 amount that is two hundred percent (200%) of the average annual compensation paid to, on
7 behalf of, or for the benefit of the employees of the pass-through entity whose compensation
8 is in the top quartile (i.e., 25%) of the entity's employees who are based in the City; provided,
9 the total number of employees of the entity based in the City is not less than four.

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11 APPROVED AS TO FORM:
12 DENNIS J. HERRERA, City Attorney

13 By: _____
14 STEPHANIE PROFITT
15 Deputy City Attorney
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