

[Business and Tax Regulations Code - Excluding Stock-Based Compensation from Payroll Expense, Tax Years 2011 through 2013]

Ordinance amending Article 12-A of the San Francisco Business and Tax Regulations Code by adding Section 906.4 to establish a payroll expense tax exclusion for that portion of an Eligible Person's Payroll Expense that is attributable to Stock-Based Compensation.

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

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

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

(a) San Francisco is the only city in California to levy a payroll expense tax. The San Francisco Payroll Expense Tax is levied against businesses on its annual compensation expense, to which stock compensation can be subject.

(b) According to the California Employment Development Department, at the beginning of 2011 the City and County of San Francisco had an estimated 32,000 non-government technology jobs. Stated differently, about 17.4 percent of non-government office workers in San Francisco are employed in the technology sector.

(c) In a March 15, 2011 report issued by the Office of the Controller, its Office of Economic Analysis found that it is common practice in the technology industry to compensate employees with stock options. It also found that future payroll expense tax liability associated with stock options appears to be a significant incentive for successful technology companies to relocate outside of San Francisco. As a result, the report suggests that San Francisco consider modifying its payroll expense tax ordinance to reduce this incentive.

1 (d) It is widely believed that several local technology companies will undertake an
2 initial public offering within the next few years. If so, shares of these companies will trade on
3 a public stock exchange and potentially subject the companies to greater payroll expense tax
4 liabilities. City leaders are concerned that faced with potentially greater payroll expense tax
5 liabilities, these companies may move out of San Francisco as the Office of Economic
6 Analysis suggested.

7 (e) San Francisco leaders currently are undertaking a comprehensive review of the
8 San Francisco business tax code. Excluding stock compensation from the payroll expense
9 tax through 2013⁷ will allow the City time to complete its assessment. Also, it will provide a
10 level of certainty regarding future tax liability for the technology companies who take their
11 companies public so that such companies will not feel compelled to relocate outside San
12 Francisco.

13 (f) Attracting and retaining growing businesses in San Francisco through thoughtful
14 business tax reform is a key component to maintaining a strong local economy and tax base.
15 Therefore,
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17 Section 2. The San Francisco Business and Tax Regulations Code is hereby amended
18 by adding Section 906.4, to read as follows:

19 **SEC. 906.4. STOCK-BASED COMPENSATION EXCLUSION.**

20 **(a) Definitions.**

21 **(1) "Eligible Person" shall mean a person who as of January 1, 2011: (i) is a**
22 **Technology Business, (ii) employs at least 100 employees in San Francisco, (iii) was**
23 **founded after 2001, and (iv) undertakes an initial public offering on a public stock exchange,**
24 **or experiences a change in control prior to any such public offering, during the period**
25 **this exclusion is in effect.**

1 (2) ~~"Technology Business"~~ shall mean a Web-based company whose core
2 mission, business plan and revenues are developed through services or goods
3 accessed by way of the Internet.

4 (3)(2) "Stock-Based Compensation" shall mean any stock option granted prior to
5 the person's date of initial public offeringincludes, but is not limited to, all incentive and
6 non-statutory stock options granted prior to the date a person makes an initial public
7 offering or undergoes a change in control, including all underlying stock relating to such
8 options, restricted stock, restricted stock units, and stock acquired as a result of
9 employee stock purchase plans.

10 (b) An Eligible Person may exclude from its pPayroll eExpense, as defined in Section
11 902.1, all compensation related to Stock-Based Compensation for the tax years 2011, 2012 and
12 2013 through 2017.

13 (c) ~~No exclusion shall be allowed under this Section to the extent that such~~
14 ~~exclusion reduces an Eligible Person's payroll expense tax liability below \$1,500 for any~~
15 ~~individual employee. In such case, the Eligible Person's payroll expense tax liability shall be~~
16 ~~fixed for such individual employees at \$1,500~~The amount of Stock-Based Compensation a
17 person may exclude from its Payroll Expense is that amount of Stock-Based Compensation
18 that creates a Payroll Expense Tax liability attributable to Stock-Based Compensation in
19 excess of \$750,000 or the company's 2010 Stock-Compensation related tax liability,
20 whichever is greater.

21 (d) In order to be eligible for the payroll expense tax exclusion authorized under this
22 Section, persons wishing to claim the exclusion must:

23 (1) File with the Tax Collector, on a form prescribed by the Tax Collector, an
24 affidavit attesting to the facts establishing entitlement to the tax exclusion. The affidavit shall
25 be supported by such other documentation as the Tax Collector shall prescribe.

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

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

7 (e) A person may not use or claim any unused portion of the exclusion available under this
8 Section after the expiration date of this Section.

9 (f) The Office of the Treasurer and Tax Collector may adopt rules and regulations
10 regarding the exclusion provided under this Section.

11 (g) The Tax Collector shall verify that any exclusion claimed pursuant to this Section is
12 appropriate.

13 (h) A misrepresentation or misstatement by any person regarding eligibility for the
14 exclusion authorized by this Section that results in the underpayment or underreporting of the payroll
15 expense tax shall be subject to penalties.

16 (i) The ~~Stock-Based~~ Compensation Exclusion in this Section may not be claimed
17 concurrently with any other payroll expense tax exclusion.

18 (j) The Tax Collector shall submit an annual report to the Board of Supervisors for
19 each year for which the exclusion authorized under this Section is available that sets forth
20 aggregate information on the dollar value of the exclusions taken each year, and the number
21 of persons claiming the exclusion.

22 (k) Not later than six months prior to the expiration of this ordinance, the Controller
23 shall perform an assessment and review of the effect of the Stock-Based Compensation
24 Exclusion under this Section. Based on such assessment and review, the Controller shall
25 prepare and submit an analysis to the Board of Supervisors. The analysis shall be based on

1 criteria deemed relevant by the Controller, and may include but is not limited to, data
2 contained in the annual report to the Board of Supervisors as required by subsection (j). In its
3 analysis, the Controller shall recommend to the Board of Supervisors whether the exclusion
4 should be extended for an additional period.

5 ~~(j)(l)~~ This Section 906.4 shall expire by operation of law on December 31, 2013~~7~~, unless
6 extended by the Board of Supervisors or the voters, and the City Attorney shall cause it to be removed
7 from future editions of the Business and Tax Regulations Code.

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9 APPROVED AS TO FORM:
10 DENNIS J. HERRERA, City Attorney

11 By: _____
12 STEPHANIE PROFITT
13 Deputy City Attorney
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