

File No. 110337

Committee Item No. _____
Board Item No. 9

COMMITTEE/BOARD OF SUPERVISORS

AGENDA PACKET CONTENTS LIST

Committee _____

Date _____

Board of Supervisors Meeting

Date 5/24/11

Cmte Board

<input type="checkbox"/>	<input type="checkbox"/>	Motion
<input type="checkbox"/>	<input type="checkbox"/>	Resolution
<input type="checkbox"/>	<input checked="" type="checkbox"/>	Ordinance
<input type="checkbox"/>	<input type="checkbox"/>	Legislative Digest
<input type="checkbox"/>	<input type="checkbox"/>	Budget Analyst Report
<input type="checkbox"/>	<input type="checkbox"/>	Legislative Analyst Report
<input type="checkbox"/>	<input type="checkbox"/>	Introduction Form (for hearings)
<input type="checkbox"/>	<input type="checkbox"/>	Department/Agency Cover Letter and/or Report
<input type="checkbox"/>	<input type="checkbox"/>	MOU
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OTHER

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Amended in Board 5/17/11

Completed by: Rene Calouseg
Completed by: _____

Date 5-19-11
Date _____

An asterisked item represents the cover sheet to a document that exceeds 20 pages. The complete document is in the file.

[Business and Tax Regulations Code – Excluding Stock-Based Compensation from Payroll Expense, Tax Years 2011 through 20137]

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 pPayroll eExpense that is attributable to sStock-Based eCompensation.

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 ~~strikethrough 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~~their 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 pPayroll eExpense tax liability associated with stock options appears to be a significant incentive for successful technology

1 companies to relocate outside of San Francisco. As a result, the report suggests that San
2 Francisco consider modifying its pPayroll eExpense tTax oOrdinance to reduce this incentive.

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

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

15 (f) Attracting and retaining growing businesses in San Francisco through thoughtful
16 business tax reform is a key component to maintaining a strong local economy and tax base.
17 Therefore,

18
19 Section 2. The San Francisco Business and Tax Regulations Code is hereby amended
20 by adding Section 906.4, to read as follows:

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

22 (a) Definitions.

23 (1) "Eligible Person" shall mean a person who as of January 1, 2011: (i) is a
24 Technology Business, (ii) employs at least 100 employees in San Francisco, (iii) was
25 founded after 2001, and (iv) undertakes an initial public offering on a public stock exchange.

1 or experiences a change in control prior to any such initial public offering, during the
2 period this exclusion is in effect.

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

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

12 (b) An Eligible Person may exclude from its pPayroll eExpense, as defined in Section
13 902.1, all compensation related to Stock-Based Compensation for the tax years 2011, 2012 and
14 2013 through 2017.

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

1 (1) A person who, in tax year 2010, paid more than \$750,000 in Payroll
2 Expense Tax attributable to Stock-Based Compensation may exclude Payroll Expense
3 attributable to Stock-Based Compensation in excess of that paid in tax year 2010;

4 (2) A person who, in tax year 2010, did not pay more than \$750,000 in
5 Payroll Expense Tax attributable to Stock-Based Compensation may exclude Payroll
6 Expense attributable to Stock-Based Compensation in excess of \$750,000;

7 (d) In order to be eligible for the ~~p~~Payroll ~~e~~Expense ~~t~~Tax exclusion authorized under this
8 Section, persons wishing to claim the exclusion must:

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

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

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

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

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

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

1 (h) A misrepresentation or misstatement by any person regarding eligibility for the
2 exclusion authorized by this Section that results in the underpayment or underreporting of the pPayroll
3 eExpense tTax shall be subject to penalties.

4 (i) The Stock-Based Compensation Exclusion in this Section may not be claimed
5 concurrently with any other pPayroll eExpense tTax exclusion.

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

10 (k) Not later than six months prior to the expiration of this ordinance, the Controller
11 shall perform an assessment and review of the effect of the Stock-Based Compensation
12 Exclusion under this Section. Based on such assessment and review, the Controller shall
13 prepare and submit an analysis to the Board of Supervisors. The analysis shall be based on
14 criteria deemed relevant by the Controller, and may include but is not limited to, data
15 contained in the annual report to the Board of Supervisors as required by subsection (j). In its
16 analysis, the Controller shall recommend to the Board of Supervisors whether the exclusion
17 should be extended for an additional period.

18 (i)(l) This Section 906.4 shall expire by operation of law on December 31, 2013⁷, unless
19 extended by the Board of Supervisors or the voters, and the City Attorney shall cause it to be removed
20 from future editions of the Business and Tax Regulations Code.

21
22 APPROVED AS TO FORM:
23 DENNIS J. HERRERA, City Attorney

24 By: _____
25 STEPHANIE PROFITT
Deputy City Attorney

LEGISLATIVE DIGEST

[Business and Tax Regulations Code – Excluding Stock Compensation from Payroll Expense, Tax Years 2011 through 2017]

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.

Existing Law

San Francisco imposes a Payroll Expense Tax on business entities based on the compensation they pay to employees and others for work or services performed in San Francisco. (Business and Tax Regulations Code Section 901 et seq.) The tax rate is 1.5% of taxable Payroll Expense. This tax is determined each year based on the Payroll Expense of the entity. Stock compensation is subject to the Payroll Expense Tax.

Amendments to Current Law

The proposed amendment would amend Section 906 to establish an exclusion from the Payroll Expense Tax for Stock-Based Compensation of Eligible Persons for six years. Under the exclusion, an Eligible Person is a person who undertakes an initial public offering on a public stock exchange or experiences a change in control prior to any such public offering. The amount of Payroll Expense attributable to Stock-Based Compensation that an Eligible Person may exclude from its Payroll Expense is the excess of what that person paid in 2010 if that person paid more than \$750,000 in Payroll Expense Tax attributable to Stock-Based Compensation; however, if the Eligible Person did not pay more than \$750,000 in Payroll Expense Tax attributable to Stock-Based Compensation in 2010, that person may exclude Payroll Expense attributable to Stock-Based Compensation that is in excess of \$750,000. The exclusion cannot be claimed retroactively.

Background Information

Under Business and Tax Regulations Code Section 901 et seq., businesses pay a Payroll Expense Tax based on the compensation paid to employees and others for work or services rendered in San Francisco. (Section 901.1) This proposed amendment would amend Section 906 to establish a six year Payroll Expense Tax exclusion for the purpose of excluding stock compensation from the Payroll Expense Tax for companies that undergo an initial public offering or change in control prior to an initial public offering.