City and County of San Francisco

Office of the Controller – Office of Economic Analysis

San Francisco Business Tax Reform: Summary of Gross Receipts Tax Legislation Introduced on June 12, 2012

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Background

- At the request of the Mayor and Board President, the Controller's Office has been working with the Treasurer's Office, the City Attorney's Office, and local businesses on a redesign of the City's business tax system.
- On May 10th, the Controller's Office published a status report that outlined a replacement to the payroll expense tax with a gross receipts tax.
- On June 12th, the Mayor and President Chiu jointly introduced gross receipts tax legislation based on this ongoing work. Their proposal would generate an additional $13 million in new revenue from business license fees.
- Supervisor Avalos also introduced gross receipts tax legislation on that date that was substantially similar in most respects, although it was designed to generate $40 million in additional revenue from business license fees.
- This report provides an overview of key features of both pieces of legislation. It is not intended to be a legal summary and interested persons should consult the draft legislation for exact wording.
- In addition, several areas of the legislation are subject to amendment during the legislative process.

Key Features of Both Ordinances

- Exclusions from Gross Receipts
- Small Business and Other Exemptions
- Schedules of Maximum Gross Receipts Tax Rates
- Combined Filing Issues
- Apportionment
- Handling of Multiple Business Activities
- Treatment of Administrative Offices
- Phase-In of Gross Receipts Tax Rates
- Phase-Out of Payroll Expense Tax Rate
- Existing Payroll Expense Tax Exclusions
- Cancellation of Existing Registration Fees, Establishment of New Registration Fees

Exclusions from Gross Receipts

- Taxes 952.3(c): Gross Receipts excludes taxes if and only if the taxes are:
  - on retail sales, or
  - on a business, but reimbursed by the customer through a separately-stated charge, or
  - a third-party tax collected by a business on behalf of a governmental entity.
- Related entities 952.3(d): All gross receipts received from related entities are excluded.
  - Two taxpayers are defined as related entities (952.5) if they are required under the California Revenue and Taxation code to reflect their income on the same combined report.
  - Two taxpayers, each only doing business in California, are considered to be related entities if they would have been required to file a combined report had they been doing business both within and outside California.
- Financial Services 952.3(e): Gross Receipts excludes the cost to acquire financial instruments.
  - In addition, a business whose sole activity is the receipt of interest and/or dividends from passive investments in financial instruments is not subject to the tax.
- Construction 953.5(c): Gross Receipts excludes payments to construction subcontractors.
- Rent-Controlled Housing 954(d): Gross Receipts excludes 50% of receipts from rent-controlled buildings.
- Sales of Real Estate 954(e): Gross Receipts excludes sales of real property that are subject to the Transfer Tax.

Small Business and Other Exemptions (Sec. 954.1)

- Except for residential real estate lessors, all businesses with San Francisco gross receipts of less than $1 million are exempt from the gross receipts tax.
- Residential real estate lessors are exempt from the tax associated with any building having less than four units. Residential real estate lessors can also report and pay the tax on a building-by-building basis.
- As is currently the case, non-profit organizations are exempt from the gross receipts tax and the business license fee.
- In addition, existing State constitutional exemptions, for banks, insurers, and others will continue to apply.
- The rates on the following pages do not apply to these businesses.

Schedule 1 Maximum Gross Receipts Tax Rates (Sec. 953.1) Applicable to Businesses with Over $1 million in Gross Receipts

Gross Receipts Level	Required Payment
$0 - $1,000,000	0.075% of Gross Receipts
$1,000,001 - $2.5 million	0.100% of Gross Receipts
$2.5 million - $25 million	0.150% of Gross Receipts
$25 million +	0.175% of Gross Receipts

- Schedule 1 applies to Retail Trade, Wholesale Trade, and "Certain Services" (NAICS 81)

Schedule 2 Maximum Gross Receipts Tax Rates (Sec. 953.2) Applicable to Businesses with Over $1 million in Gross Receipts

Gross Receipts Level	Required Payment
$0 - $1,000,000	0.125% of Gross Receipts
$1,000,001 - $2.5 million	0.200% of Gross Receipts
$2.5 million - $25 million	0.350% of Gross Receipts
$25 million +	0.450% of Gross Receipts

- Schedule 2 applies to Manufacturing; Transportation & Warehousing; Information; Biotechnology; Clean Technology; and Food Services.

Schedule 3 Maximum Gross Receipts Tax Rates (Sec. 953.3) Applicable to Businesses with Over $1 million in Gross Receipts

Gross Receipts Level	Required Payment
$0 - $1,000,000	0.300% of Gross Receipts
$1,000,001 - $2.5 million	0.325% of Gross Receipts (Mayor/Chiu) 0.350% of Gross Receipts (Avalos)
$2.5 million - $25 million	0.325% of Gross Receipts (Mayor/Chiu) 0.375% of Gross Receipts (Avalos)
$25 million +	0.400% of Gross Receipts

- Schedule 3 applies to: Real Estate & Rental and Leasing Services; Accommodations; Arts, Entertainment, and Recreation.

Schedule 4 Maximum Gross Receipts Tax Rates (Sec. 953.4) Applicable to Businesses with Over $1 million in Gross Receipts

Gross Receipts Level	Required Payment
$0 - $1,000,000	0.525% of Gross Receipts
$1,000,001 - $2.5 million	0.550% of Gross Receipts
$2.5 million - $25 million	0.600% of Gross Receipts
$25 million +	0.650% of Gross Receipts

- Schedule 4 applies to: Private Education and Health Services, and Administrative and Support Services.

Schedule 5 Maximum Gross Receipts Tax Rates (Sec. 953.5) Applicable to Businesses with Over $1 million in Gross Receipts

Gross Receipts Level	Required Payment
$0 - $1,000,000	0.300% of Gross Receipts
$1,000,001 - $2.5 million	0.350% of Gross Receipts
$2.5 million - $25 million	0.400% of Gross Receipts
$25 million +	0.450% of Gross Receipts

- Schedule 5 applies to Construction.

Schedule 6 Maximum Gross Receipts Tax Rates (Sec. 953.6) Applicable to Businesses with Over $1 million in Gross Receipts

Gross Receipts Level	Required Payment
$0 - $1,000,000	0.400% of Gross Receipts
$1,000,001 - $2.5 million	0.450% of Gross Receipts
$2.5 million - $25 million	0.500% of Gross Receipts
$25 million +	0.550% of Gross Receipts

- Schedule 6 applies to Financial Services, Insurance, and Professional, Scientific, and Technical Services.

Combined Filing Requirement (Sect. 956.3)

- Businesses are required to file returns on a combined basis with all related entities, as defined in Section 952.5.
- Certain California business taxpayers may make a *water's edge election*, under which they combine only those entities earning income that is taxable by the U.S. government. If they do not make such an election, they report on a worldwide combined basis.
- The same grouping used for State tax reporting is required by this legislation. In other words, the *combined gross receipts* and *combined payroll* of the filing group is either water's edge or worldwide, depending on the State filing.

Apportionment (Sec. 956.1 and 956.2)

- The gross receipts of Real Estate, Rental and Leasing Services, and Accommodations industries is taxable if the property is rented or used within San Francisco. Sec. 953.3(f).
- Section 956.2 defines the allocation of gross receipts based on payroll. San Francisco gross receipts equal combined gross receipts, times San Francisco payroll, divided by combined payroll.
- The following industries apportion gross receipts entirely using 952.2: Certain Services (Schedule 1); Arts, Entertainment, and Recreation (Schedule 3); Education and Health Services, and Administrative and Support Services (Schedule 4); Financial Services, Insurance, and Professional, Technical, and Scientific Services (Schedule 6).
- Section 956.1 defines the allocation of gross receipts from tangible and intangible property sales into San Francisco based on the customer location.
- The following industries apportion 50% of their gross receipts using 956.1, and 50% using 956.2: Wholesale and Retail Trade (Schedule 1); Manufacturing, Transportation and Warehousing, Information, Biotechnology, Clean Technology, and Food Services (Schedule 2); Construction (Schedule 5).

Rules for Multiple Business Activities (Sec. 953.7)

- If a business conducts multiple lines of business in San Francisco that cross multiple rate schedules, the following rules apply.
- If one activity accounts for more than 80% of the business's total gross receipts, then the business will use that activity's schedule for all of its gross receipts.
- If no activity accounts for more than 80% of the total, businesses must compute gross receipts for each line of business separately.
- However, any set of activities comprising less than 20% of gross receipts together may be combined, using the highest rate within the group.

Treatment of Administrative Offices (Sec. 953.8)

- Any business having over 50% of its San Francisco payroll associated with administrative and management services is classified as an *Administrative Office*.
- Administrative and management services include activities that do not directly generate gross receipts, but involving managing or providing services to the rest of the enterprise: executive management, record-keeping, legal, accounting, personnel, etc.
- Such a business will not be subject to the Gross Receipts tax that applies to other businesses.
- The sponsors' intent is not to change the tax currently paid by Administrative Offices, but for them to continue to pay a 1.5% tax on payroll expense, as it is currently defined.
- The sponsors' intent is not that the tax will be paid on occupancy or other expenses other than payroll.
- **Note: the language in the introduced legislation is incorrect, and will need to be amended to reflect this intent.**

Phase-In of Gross Receipts Rates (Sec. 959)

- The Gross Receipts tax rates listed on the schedules are maximum rates.
- From 2014 to 2018, Gross Receipts rates will be set by a Controller calculation, involving multiplying the maximum rates by the following phase-in factors:
- 2014: 10%
- 2015: 25%
- 2016: 50%
- 2017: 75%
- 2018: 100%
- If, in any year between 2015 and 2018, the payroll expense tax rate is phased-out to 0%, then the phase-in factor for Gross Receipts rates will be less than indicated above, and will remain at that reduced level for all future years.

Phase-Out of Payroll Expense Tax Rates (Sec. 903.1)

- As the Gross Receipts tax rates are phased-in, the Payroll Expense tax rate will be phased-out, on the following schedule:
- 2014: 1.35%
- 2015: 1.125% +/- ADJ
- 2016: 0.75% +/- ADJ
- 2017: 0.375% +/- ADJ
- 2018: 0% + ADJ
- In each year 2015 – 2018, the Controller will calculate an adjustment (ADJ) equaling the payroll expense tax rate required to achieve the specified revenue target, depending on the previous year's actual gross receipts collections.
- In any year that the calculation above would lead to a payroll expense tax rate less than 0%, the rate would be set at 0% for that year and all future years.
- If that does not happen, the payroll tax will remain at the rate established in 2018 for all future years.
- **Note: the phase-out and phase-in formulas in the current version of the legislation will require amendment.**

Existing Payroll Tax Exclusions

- The City currently maintains five payroll tax exclusions: for biotechnology, clean technology, the local enterprise zone, the Central Market area, and pre-IPO stock compensation.
- In the Mayor and President Chiu's legislation, biotechnology, clean technology, and enterprise zone exclusions would convert to a gross receipts tax credit equal to what the exclusion would be worth with a 1.5% payroll tax rate. (Sec. 960).
- In this legislation, the Central Market exclusion would convert to one in which an affected business's combined business tax payment would never exceed their base year level. (Sec. 961).
- In this legislation, the Pre-IPO stock compensation exclusion is not changed, and the existing expiration dates of the exclusions are retained.
- Supervisor Avalos's legislation does not specify any change to any of the payroll tax exclusions, and they would continue to apply to the payroll tax as it is phased-out.

Business License Fees to Replace Existing Fees and Generate $13 million: Mayor/ President Chiu (Sec. 855)

Gross Receipts Level	Required Payment
$0 - $100,000	$75
$100,001 - $250,000	$150
$250,001 - $500,000	$250
$500,001 - $750,000	$500
$750,001 - $1,000,000	$700
$1,000,000 - $2.5 million	$100
$2.5 million - $7.5 million	$250
$7.5 million - $15 million	$750
$15 million - $25 million	$1,000
$25 million - $50 million	$5,000
$50 million - $100 million	$10,000
$100 million and over	$20,000

Business License Fees to Replace Existing Fees and Generate $40 million: Sup. Avalos (Sec. 855)

Gross Receipts Level	Required Payment
$0 - $100,000	$50
$100,001 - $250,000	$100
$250,001 - $500,000	$100
$500,001 - $750,000	$200
$750,001 - $1,000,000	$300
$1,000,000 - $2.5 million	$100
$2.5 million - $7.5 million	$250
$7.5 million - $15 million	$500
$15 million - $25 million	$500
$25 million - $50 million	$22,500
$50 million - $100 million	$45,500
$100 million and over	$100,000