[Payroll Expense Tax]

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

Note: Additions are single-underline italics Times New Roman; deletions are strikethrough 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. ORDAINED that Pursuant to Article XIIIC of the Constitution of the State of California, the Board of Supervisors hereby submits this ordinance shall be submitted to the qualified electors of the City and County of San Francisco, at the November 4, 2008 general municipal election and that this ordinance shall become operative only if approved by the qualified electors at such election.

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

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

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

(c) Any individual compensated in his or her capacity as a real estate salesperson or mortgage processor shall be deemed an employee of the real estate broker or mortgage broker for or under whom such individual performs services, and any compensation received by such individual, including compensation by way of commissions, shall be included in the payroll expense of such broker. For purposes of this Section, "real estate broker" and "mortgage broker" refer to any individual licensed as such under the laws of the State of
California who engages the services of salespersons or a salesperson, or of mortgage processors or a mortgage processor, to perform services in the business which such broker conducts under the authority of his or her license; a "salesperson" is an individual who is engaged by a real estate broker to perform services, which may be continuous in nature, as a real estate salesperson under an agreement with a real estate broker, regardless of whether the individual is licensed as a real estate broker under the laws of the State of California; a "mortgage processor" is an individual who is engaged by a real estate broker or mortgage broker to perform services, which may be continuous in nature, as a mortgage processor under an agreement with such real estate broker or mortgage broker, regardless of whether the mortgage processor is also licensed as a mortgage broker under the laws of the State of California.

(d) All compensation, including all pass-through compensation for services paid to, on behalf of, or for the benefit of owners of a pass-through entity, shall be included in the calculation of such entity's payroll expense tax base for purposes of determining such entity's tax liability under this Article. For purposes of this section, the "pass-through compensation for services" of a pass-through entity shall be the aggregate compensation paid by such entity for personal services rendered by all such owners, and shall not include any return on capital investment. The taxpayer may calculate the amount of compensation to owners of the entity subject to the Payroll Expense Tax, or the taxpayer may presume that, in addition to amounts reported on a W-2 form, the amount subject to the payroll expense tax is 90% of the amount of net earnings from self-employment derived from the entity for federal income tax purposes for each owner, an amount that is two hundred percent (200%) of the average annual compensation paid to, on behalf of, or for the benefit of the employees of the pass-through entity whose compensation is in the top quartile (i.e., 25%) of the entity's employees who are
based in the City; provided, the total number of employees of the entity based in the City is not less than twenty-four.

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

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

SEC. 905-A. SMALL BUSINESS TAX EXEMPTION.
(a) Notwithstanding any other provisions of this Article, "small business enterprises," as hereinafter defined, shall be exempt from payment of the Payroll Expense Tax; provided, however, that small business enterprises shall pay the annual registration fee pursuant to Section 855 of Article 12.
(b) The term "small business enterprise" shall mean and include any taxpayer:
(1) Whose tax liability under this Article, but for this exemption provision, would not exceed $2,500 and, effective January 1, 2009, whose taxable payroll expense does not exceed $250,000 and;
(2) Who has filed a tax return by the last date of February for the preceding tax year. If the taxpayer fails to file a return by that date, the taxpayer shall be subject to a penalty as specified in subsection (d).
(c) **For the 2011 tax year, and each second succeeding tax year, the Tax Collector shall**

increase the ceiling for the Small Business Tax Exemption (rounded to the nearest $10,000 increment)

to reflect increases in the United States Department of Labor's Bureau of Labor Statistics consumer
price index for all urban customers for the San Francisco-Oakland-San Jose area for each of the
preceeding two tax years.

(d) **In lieu of the penalty specified in Section 6.17-3 of this Article for failing to file a**

return, any person who otherwise qualifies for the small business exemption set forth in this
Section who fails to file a return by the last date of February shall pay a penalty as follows:

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

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

(e) The Tax Collector may, in his or her discretion, reduce the penalty set forth in
subsection (c) to not less than $100 upon a showing that the late filing of the return was due
to reasonable cause and not due to willful neglect.
Section 3. This ordinance does not change any of the Payroll Expense Tax rates in Section 903.1 and reaffirms the current rates.

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

By: ______________
Michael Slattery
Deputy City Attorney
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July 22, 2008 Board of Supervisors — AMENDED, AN AMENDMENT OF THE WHOLE BEARING NEW TITLE
Ayes: 10 - Ammiano, Chu, Daly, Dufty, Elsbernd, Maxwell, McGoldrick, Mirkarimi, Peskin, Sandoval
Excused: 1 - Alioto-Pier

July 22, 2008 Board of Supervisors — PASSED ON FIRST READING AS AMENDED
Ayes: 10 - Ammiano, Chu, Daly, Dufty, Elsbernd, Maxwell, McGoldrick, Mirkarimi, Peskin, Sandoval
Excused: 1 - Alioto-Pier

July 29, 2008 Board of Supervisors — FINALLY PASSED
Ayes: 10 - Ammiano, Chu, Daly, Dufty, Elsbernd, Maxwell, McGoldrick, Mirkarimi, Peskin, Sandoval
Excused: 1 - Alioto-Pier
I hereby certify that the foregoing Ordinance was FINALLY PASSED on July 29, 2008 by the Board of Supervisors of the City and County of San Francisco.

Angela Calvillo
Clerk of the Board

Date Approved

Mayor Gavin Newsom