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San Francisco Payroll Expense Tax Lives on: Lower Rates in 2018

SUMMARY

San Francisco imposes a Payroll Expense Tax on the compensation earned for work and services performed within the city. The Payroll Expense Tax will not be phased out in 2018 as originally planned, due to less-than-expected revenue from the Gross Receipts Tax. The 2018 Payroll Expense Tax rate is 0.380 percent.

DETAILS

Background

Before 2014, San Francisco imposed a 1.5 percent payroll tax on businesses operating in the city. Starting in 2014, the Payroll Expense Tax was to be phased out over a five-year period and replaced with the Gross Receipts Tax, which has been gradually phased in from 2014 to 2018. For the 2018 tax year, the Payroll Expense Tax was to be completely phased out, with only the Gross Receipts Tax remaining.

The tax change was designed to be revenue neutral, and the Payroll Expense Tax phaseout was contingent on whether revenue requirements were met. San Francisco recently announced that those revenue requirements were not met because the Gross Receipts Tax revenue has been less than expected. As a result, the Payroll Expense Tax will remain in effect for 2018 going forward.

Payroll Expense Tax and Gross Receipts Tax

Under Article 12-A of its ordinances, San Francisco imposes the Payroll Expense Tax. The tax is calculated on the total compensation paid to individuals for services attributable to work performed within the city of San Francisco. Payroll expenses include salaries, wages, bonuses, commissions, property issued or transferred in exchange for the performance of services, including stock options, compensation paid to pass-through entity owners, and any other form of compensation for services.

San Francisco's Gross Receipts Tax ordinances are contained within Article 12-A-1. The Gross Receipts Tax applies to businesses engaged in business within the city, and it is required to be filed on a combined basis. The tax is calculated on the businesses' gross receipts attributable to San Francisco, with the term "gross receipts" being broadly defined by ordinance.

2018 Compliance Issues

The Controller's Office annually calculates a Small Business Exemption limit for both the Payroll Expense Tax and the Gross Receipts Tax. In 2018, the Controller's Office announced that the Small Business Exemption limits are $300,000 for the Payroll Expense Tax and $1,120,000 for the Gross Receipts

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Tax. A business exempt from both taxes does not need to file a return. A business exempt from only one tax, however, must file a return and enter $0 for the tax for which it is exempt.

The Controller's Officer also certified that the 2018 Payroll Expense Tax rate is 0.380 percent, which is reduced from 0.711 percent in 2017.

Ordinance 26-17 requires businesses to make quarterly estimated payments for both the Payroll Expense Tax and the Gross Receipts Tax, starting in 2017. Quarterly estimates must equal 25 percent of prior year or current year tax liabilities, whichever is less. If the business meets the Small Business Exemption limits, then quarterly estimates are not required.

INSIGHTS

- For the 2018 tax year, a business may still be subject to both the San Francisco Payroll Expense Tax and the Gross Receipts Tax.

- Given the breadth of San Francisco's definition of "payroll expense," management fees and carried interest could also constitute taxable payroll expenses.

- Complications can arise due to the combined reporting requirements of the Gross Receipts Tax, especially if flow-through entities exist within the unitary business group.

- Determining how to correctly calculate the amount of compensation earned within San Francisco or how gross receipts should be apportioned to San Francisco can also be challenging.