

# Explaining “E”

written by JARGAL OYUNBILEG

Find out what the city’s ongoing conversion to a gross receipts tax means for your business.

**O**n December 31, 2000, I arrived in San Francisco lugging two big suitcases smelling of mothballs to embark on my accounting education. The only plan I had was to study at City College of San Francisco. I did not know how privileged I was going to be: residing in this beautiful, eclectic city and working for a multilingual (English, Mongolian, Russian, German, Dutch, Chinese and Hebrew) public accounting firm.

A career in taxation may not sound enticing, but I can assure you that there are numerous gratifying aspects of working in this industry, especially in the Bay Area. We meet many young entrepreneurs with great hopes and dreams of succeeding quickly. Although fast and furious success can be uncertain, as the saying goes: “Nothing is certain except death and taxes.” So what does San Francisco tax on the privileges it provides?

The City of San Francisco requires any person engaging in business within the city to register and obtain a registration license upon the payment of registration fees. Proposition E, approved by San Francisco voters in November 2012, amended the city privilege tax and the business registration fee to be based on gross receipts rather than payroll expenses. Although the base of the tax determination was amended to take

effect beginning this year, the transition is set to occur gradually over a five-year period to allow taxpayers and the city time to adjust to the change. The payroll expense tax method will phase out and the gross receipts tax method will phase in completely by the end of 2017. Until then, any person engaging in business in San Francisco must register, pay registration fees and determine if their business is subject to the phasing-in gross receipts tax and/or the phasing-out payroll expense tax.

There is also an important change in the reporting of these taxes, especially for businesses that file a combined return for state income tax filing purposes. The following article describes the basics on Prop. E in its simplest form for general information purposes; as such, it is not an authority to exclusively rely on. As with all taxpayers—with their unique fact situations and tax planning considerations, benefits or concerns—consulting with your tax advisors and/or state and local administration for the specific tax attributes is highly recommended.

## Registration Fees

If a taxpayer meets the definition of engaging in business in San Francisco under Article 6.2-12 of the San Francisco Business and Tax Regulations, that taxpayer, regardless of where its business is located, is required to register with the city to operate within the city and obtain

a valid Business Registration Certificate. Currently, the registration fee is based on the payroll expense for the services rendered in San Francisco. This determination will begin changing because of Proposition E; the registration fee will be based on gross receipts beginning July 1, 2015. The minimum fee will increase for many businesses.

## Payroll Expense Tax

In accordance with Code Section 950, San Francisco is the only major city in California to base the privilege tax on payroll expense. Payroll expense is determined broadly in the code and includes not only the compensation paid to employees but also shareholders and partners of passthrough entities for their services rendered in the city. For the payroll expense tax determination, a real estate sales person or mortgage processor is regarded as an employee of the real estate agency or brokerage firm.

Prior to 2014, a 1.5% flat rate was applied to determine payroll expense tax; however, this rate is set to gradually phase out as the gross receipts tax phases in by the end of 2017. For most, the phase-out rates are 1.35% in 2014, 1.125% in 2015, 0.75% in 2016 and 0.375% in 2017.

Not all entities are subject to the payroll expense tax. Small, for-profit businesses in good standing and with less than \$250,000 in payroll expenses are exempt from the payroll expense tax. They will still have a tax filing requirement unless the city payroll expenses are less than \$150,000 and the city gross receipts are less than \$500,000. Please note that taxpayers exempt from the payroll tax are not automatically exempt from the gross receipts tax.



# THE SOLUTION TO YOUR PROBLEM TENANTS

[www.epsteingroup.com](http://www.epsteingroup.com)

## THE EPSTEIN GROUP REAL ESTATE ATTORNEYS

EXPERIENCED AGGRESSIVE REPRESENTATION  
REASONABLE RATES ♦ FREE CONSULTATION



THE EPSTEIN GROUP  
ATTORNEYS & COUNSELLORS AT LAW

Central Location ♦ Upper Market ♦ Castro  
2358 Market Street ♦ San Francisco, CA 94114  
Mark Epstein ♦ 415.863.5718

### Gross Receipts Tax

This tax is intended to better distribute taxes based on the business's ability to pay and to encourage job creation. According to San Francisco Business and Tax Regulations Code Section 952.3, "gross receipts" means the total amounts received or accrued by a person from whatever source derived including, but not limited to, amounts derived from sales, services, dealings in property, interest, rent, royalties, dividends, licensing fees, other fees, commissions and distributed amounts from other business entities. In general, if the receipts derived from the city are reportable in state income tax filings, they are also reportable in local tax filing.

Unlike the payroll expense tax, the gross receipts tax is not determined at a flat rate; tax rates vary by industry and by the size of the taxpayer. For example, rates on the real estate, rental and leasing services industry will range between 0.285% and 0.3%. On the other hand, the financial services industry will have rates ranging from 0.4% to 0.56%. During the five-year transition period, the city's controller will adjust the tax rates each year based on the actual collection of taxes and will publish the rates of both the gross receipts tax and payroll expense tax.

Some general exemptions and exceptions apply to certain taxpayers. Most nonprofit organizations and small businesses with less than \$1 million in gross receipts are exempt from the gross receipts tax but will have tax filing requirements and will need to evaluate the phasing-out payroll expense as stated above. Businesses with less than \$500,000 in San Francisco gross receipts and less than \$150,000 in San Francisco payroll expense will not have to file the returns.

### Related Entities and Multiple Locations

The definition of a "related entity" can be found in Code Section 952.5. In general, if a taxpayer files a single combined return for its commonly owned related entities for California state income tax filing, the taxpayer is also required to file a single



EPSTEIN GROUP  
REAL ESTATE INC.  
2358 Market Street  
San Francisco, CA 94114  
(415) 863.5718

[www.epsteingroup-re.com](http://www.epsteingroup-re.com)  
DRE Lic. 01523671



EPSTEIN GROUP  
REAL ESTATE  
INCORPORATED

## POWERFUL PROPERTY MANAGEMENT

GET THE STRENGTH OF  
AN ATTORNEY BEHIND YOU

combined return for the gross receipts tax and the business registration fee.

Taxpayers with multiple business locations within the city are required to file one return for all locations. Taxpayers with locations within and outside of San Francisco will have to apportion taxable receipts using one of the three ascribed factors: sales factor, payroll factor, or combined sales and payroll factor.

The above information is intended for basic information only to explain the major changes in the local business tax regulations affected by Proposition E. As such, taxpayers are urged to seek professional advice as fit for their own business.

The change in the privilege tax adds complexity, especially during the transition period and may increase taxes for some businesses. Hopefully, it will spur job growth and attract more small businesses and start-ups with exciting new ideas and innovations. After all, who would not want to enjoy temperate weather, exciting hills and diverse culture, all in one great city? But with great privilege comes great tax responsibility.

*Jargal Oyunbileg is a CPA at Shwiff, Levy & Polo, LLP. She enjoys going on short hikes, eating dim sum, and picking pine nuts in Mongolia. She can be contacted at [jargal@yoursrvc.com](mailto:jargal@yoursrvc.com).*

Be the  
Teacher's  
pet

Sign up for **SFAA** classes at [www.sfaa.org](http://www.sfaa.org) or by calling 415-255-2288

The nation's #1 multifamily lender is lending in your backyard.



## Bringing you low fees, great rates and local market expertise.

How did Chase become the nation's leader in multifamily lending? With great rates, low fees and a deep understanding of the local market—in communities just like the Bay Area. If you have an apartment building to purchase or refinance, call us today to learn how we can put our resources to work for you.

LOW FEES | GREAT RATES | STREAMLINED PROCESS

Call **Ingrid Marlow, Client Manager**  
(650) 737-6212 or [ingrid.marlow@chase.com](mailto:ingrid.marlow@chase.com)



**CHASE**



Credit is subject to approval. Rates and programs are subject to change; certain restrictions apply. Products and services provided by JPMorgan Chase Bank, N.A. #1 claim based on 2011 HMDA data. ©2013 JPMorgan Chase & Co. Member FDIC. All rights reserved.