



RINA Alert!

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SAN FRANCISCO PROPOSITION Q (City Payroll Tax)

By John McGovern

San Francisco Proposition Q, passed on November 4, 2008 and effective January 1, 2009, clarifies the existing San Francisco 1.5% payroll tax law (Business and Tax Regulations Code 902.1), primarily in regards to ordinary income from pass-through entities.

The primary provisions of Section 902.1, which was in existence prior to January 1, 2009, remain intact. These include the following:

1. All compensation paid to, or on behalf of, the benefit of an individual, including salaries, wages, bonuses, commissions, property received in exchange for services (including but not limited to stock options), and any other type of compensation for service, if this service was performed, in whole or in part, in the City of San Francisco, is subject to the tax.
2. There is no exclusionary language regarding the type of entity. All entities are subject to the tax as long as they engage in the "performance of services."
3. In general, every person or entity doing business in the City and County of San Francisco must register to do business in San Francisco, pay an annual registration fee, file an annual Payroll Tax Expense Tax Statement, and pay the payroll tax expense tax based on a 1.5% tax rate (unless eligible for the exemption provision described in Item 4 of the following section).
4. Return of capital and other income of a capital gain nature is not subject to the tax.
5. Investment income and other passive income is not subject to the payroll tax. The compensation must be "in exchange for the performance of services." (see complete wording in Item 2 below).
6. Right to acquire an ownership interest in exchange for services is subject to the tax.
7. Real estate professionals (real estate salespersons or mortgage brokers) must include all compensation paid to other salespersons or mortgage processors, regardless of whether these salespersons or mortgage brokers maintain independent licenses, and regardless of whether these compensated individuals are employees or independent contractors. The language used in the code is "...to perform... services in the business in which such broker conducts under the authority of his or her license..." The tax, therefore, follows the license used in the sales agreement.

Proposition Q amends wording in Section 902.1 and adds Section 902.2 to clarify that all income (except capital gain/loss income) from pass-through entities is subject to the payroll tax. The changes to the code can be summarized as follows:

1. The definition of "compensation" was amended to specifically include compensation paid to shareholders of pass-through entities. This includes net income earned during the year whether it is distributed or not.
2. Paragraph (a) of Code Section 902.1 was amended (amendments in italics and underlined) to state: "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 "PC" 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..."
3. Pass-through entities are defined as: Trusts, Partnerships, S-Corps, LLCs, LLPs, and any other person or entity not subject to federal tax.
4. Professional Corporations entitled to a deduction for distributions to owners and beneficiaries are also included under the definition of pass-through entities. Such distributions, if received in exchange for the performance of services, are subject to the payroll tax.
5. There is a safe-harbor provision that allows the owner to calculate total compensation as the amount reported on the owner's W-2 plus the amount equal to 200% of compensation for its most highly paid quartile (25%) of employees, provided the entity has at least 4 employees.
6. The exemption provision was raised from \$166,667 (total compensation for the entity) to \$250,000 and indexed to increase by \$10,000 annually beginning in 2011.
7. New penalties for failure to file a return will be imposed based on the taxpayer's tax liability. The penalties are \$100 plus 10% of the tax liability, if the payroll tax liability is less than \$1,000, and \$250 plus 10% of the tax liability, if the payroll tax liability is more than \$1,000.

If you have any questions regarding this new tax payment requirement, please call your RINA representative.

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