

## Lingering Questions About the San Francisco Gross Receipts Tax

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*The first installment payment for the new San Francisco Gross Receipts Tax is due April 30, 2014. Many questions about the new tax remain as this deadline approaches. While the City has provided some relief from installment underpayment penalties, taxpayers need answers to these questions to accurately determine their tax liability.*

On November 26, 2013, the San Francisco Board of Supervisors approved amendments to the San Francisco Business and Tax Regulations Code ("Code"), providing for penalty relief for delinquent Gross Receipts Tax ("GRT") installment payments<sup>1</sup>, mandatory combined reporting for Payroll Expense Tax purposes, and the imposition of a new penalty for failure to file returns on a combined basis or failure to provide worldwide payroll or gross receipts information.

### Installment Payment Relief

One of the amendments to the Code provides welcome relief to taxpayers for delinquent GRT installment payments, the first of which is due April 30, 2014. GRT installment payments are due every April 30th, July 31st, and October 31st of the current tax year, and the last day of February of the immediately following tax year.<sup>2</sup> A delinquency penalty of 5 percent per month (not to exceed 20 percent in the aggregate) is imposed on any installment underpayment, and interest on such underpayments is imposed on any unpaid or under-paid balance at 1 percent per month.<sup>3</sup>

As a result of the above amendments to the Code, if a taxpayer makes an installment payment of at least 26 percent of its aggregate GRT and Payroll Expense Tax due in the preceding tax year, the delinquency penalty and interest charges will not apply.<sup>4</sup> Since the GRT is effective beginning in 2014, no penalty or interest will be imposed for any delinquent 2014 GRT installment payments so long as at least 26 percent



<sup>1</sup> San Francisco Ordinance No. 271-13.

<sup>2</sup> Section 6.9-3(a)(2). All citations are to the San Francisco Business and Tax Regulations Code, unless otherwise stated.

<sup>3</sup> Section 6.9-3(b).

<sup>4</sup> Section 6.9-3(b).

of the Payroll Expense Tax liability from the preceding year is timely paid with each installment.<sup>5</sup> Given the numerous uncertainties regarding the new GRT and a lack of comprehensive guidance from the San Francisco Office of the Treasurer and Tax Collector (“Treasurer”), this installment payment relief is a critical and welcome change to the law.

### Payroll Expense Tax Combined Reporting

The amendments to the Code also added new provisions requiring combined groups<sup>6</sup> to file a single Payroll Expense Tax return and assign a single person to file the return on its behalf. Each person within the combined group that is engaged in business in San Francisco (“the City”) must provide a power of attorney to the person filing the returns on behalf of the combined group authorizing that person to act on their behalf. The Payroll Expense Tax liability must be computed for each person within the combined group as if that person were filing its own separate return.<sup>7</sup>

### Penalty for Non-Compliance with Combined Reporting

The amendments to the Code also provide that a return will be considered an “incomplete return” and subject to a \$500 penalty for each occurrence where: (1) a taxpayer is required to file a return on a combined basis and fails to do so; or (2) a taxpayer is required to report worldwide gross receipts or worldwide payroll and fails to do so.<sup>8</sup>

Below is a summary of the key provisions of the GRT, and some existing open questions.

### Introduction to the GRT

Beginning in 2014, every person engaging in business within the City shall pay an annual GRT measured by the person’s gross receipts from all taxable business activities attributable to the City.<sup>9</sup> The GRT will be phased-in and the existing Payroll Expense Tax phased-out over a 5-year period.<sup>10</sup> GRT rates and rules for attributing taxable gross receipts to the City vary by industry.

### Persons Subject to the GRT

Persons that may be subject to the GRT are defined broadly to include:<sup>11</sup>



<sup>5</sup> Those required to pay the Administrative Office Tax (see below for a discussion thereof) are also provided with this penalty relief. Section 6.9-3(b).

<sup>6</sup> See below for a discussion of combined groups.

<sup>7</sup> Section 907(b).

<sup>8</sup> Section 6.17-3(b).

<sup>9</sup> Section 953(a). Any person or combined group whose gross receipts for the preceding tax year did not exceed \$1,000,000 is exempt from the GRT. Section 954.1. Organizations exempt from federal or California income tax are also exempt from the GRT, except for gross receipts from unrelated trade or business activities that are attributable to the City. Section 954(a) and (b).

<sup>10</sup> Section 959. In 2014, only 10 percent of the maximum rates authorized by the GRT will apply, and the Payroll Expense Tax rate from the preceding year will be reduced by 10 percent. For 2015 - 2017, it is estimated that 25 percent, 50 percent, and 75 percent of the maximum GRT rates will apply, respectively, with corresponding reductions to the Payroll Expense Tax rates. By 2018, it is estimated that the GRT will completely replace the Payroll Expense Tax. The above phase-in percentages are targets subject to adjustment by the Controller of the City, depending on the amount of tax revenue generated by the GRT. During the phase-in period, both the GRT and the Payroll Expense Tax apply.

<sup>11</sup> Section 6.2-15.

any individual, firm, company, partnership, limited liability partnership, joint venture, association, proprietorship, social club, fraternal organization, joint stock company, domestic or foreign corporation, limited liability company, estate, trust, business trust, receiver, trustee, trustee in bankruptcy, administrator, executor, assignee, syndicate, or any other group or combination acting as a unit, whether mutual, cooperative, fraternal, nonprofit or otherwise.

## Nexus

A person is “engaging in business within the City” for purposes of the GRT if the person does any of the following, or a representative or agent does any of the following for the benefit of that person:<sup>12</sup>

- maintains a fixed place of business within the City,
- owns, rents, leases, or hires real or personal property within the City for business purposes,
- regularly maintain a stock of tangible personal property within the City, for sale in the ordinary course of the person's business,
- employs or loans capital on property within the City,
- solicits business within the City for all or part of any seven days during a tax year; or
- performs work or renders services within the City for all or part of any seven days during a tax year,
- utilizes the streets within the City in connection with the operation of motor vehicles for business purposes for all or part of any seven days during a tax year,
- exercises corporate or franchise powers within the City, or
- liquidates a business when the liquidators thereof hold themselves out to the public as conducting such business.

Notwithstanding the above, no person shall be deemed to be engaging in business within the City for purposes of the GRT and the business registration if its activities in the City consist solely of one or more of the following:<sup>13</sup>

- using the services of an unrelated investment advisor,
- maintaining documents of formation, incorporation, or registration within the City,
- being an owner, member, or other participant in an entity engaging in business within the City which is a pass-through entity for federal income tax purposes, or
- having trustees or directors who meet or reside within the City.



<sup>12</sup> Section 6.2-12. This section also applies for purposes of determining whether a person is subject to the Payroll Expense Tax or business registration requirements.

<sup>13</sup> Section 952.3(g).

Furthermore, no person shall be deemed to be “engaging in business within the City” for purposes of the GRT if that person is an individual whose only gross receipts within the City are derived from investments of that individual’s own funds in financial instruments.<sup>14</sup> Gross receipts of an individual shall not include interest, dividends, capital gains and similar items or investment income earned from the investment of that individual’s own capital.<sup>15</sup>

### Combined Reporting

A person engaging in business within the City must file a single GRT return on a combined basis with all of that person’s related entities.<sup>16</sup> That person, and all of its related entities constitute a combined group. A person is a “related entity” to the taxpayer if that person and the taxpayer are permitted or required by the California Franchise Tax Board (“FTB”) under Cal. Rev. & Tax Code (“CRTC”) section 25102 et seq., to have their income reflected on the same combined report.<sup>17</sup>


CRTC section 25102 provides that the FTB may permit or require two or more “persons” as defined in CRTC section 19, that are owned or controlled directly or indirectly by the same interests to file a combined report, and that FTB is authorized to impose the corporation tax as though the combined entire net income was that of one person in order to properly reflect the proper income of any such person.

CRTC section 19 defines a “person” that FTB may permit or require to file a combined report under CRTC 25102 to include “any person, firm, partnership, general partner of a partnership, limited liability company, registered limited liability partnership, foreign limited liability partnership, association, corporation, company, syndicate, estate, trust, business trust, or organization of any kind . . . [including a] trustee, trustee in bankruptcy, receiver, executor, administrator, or assignee.”

Every combined group must choose a single person to file the GRT return on its behalf.<sup>18</sup> Each person within the combined group engaging in business within the City must provide a power of attorney to the person filing the return, authorizing the person to act on its behalf with respect to payments, refunds, audits, resolutions, and any other items related to the tax liability reflected in the return.<sup>19</sup> The person filing the combined return shall pay the tax liability reflected on the return and any liability determined on audit.<sup>20</sup>

The Treasurer’s instructions to its general Power of Attorney, Form POA-1 state that:

Form POA-1 executed by the “key filer” of a combined group with respect to the business registration certificate application and/or renewal, the Gross Receipts Tax, and the Payroll Expense Tax will automatically apply to all members of the combined group during the periods covered by the Form POA-1. Members of a combined group may also execute their own Form POA-1 (separate from the key filer) to authorize an individual to represent the member’s interests only.

 <sup>14</sup> Section 952.3(f).

<sup>15</sup> Section 952.3(f).

<sup>16</sup> Section 956.3.

<sup>17</sup> Section 956.3.

<sup>17</sup> Section 952.5. If two or more persons derive gross receipts solely from sources within California, and their business activities are such that, if conducted both within and outside California, a combined report would be required under CRTC section 25102, then those persons are related entities and must file a combined report for GRT purposes.

<sup>18</sup> Combined groups must also file single Payroll Expense Tax returns and business registration applications, as well as pay the business registration fee on a combined basis. Sections 907(b), 855(d) and 856(a).

<sup>19</sup> Section 956.3.

<sup>20</sup> Section 956.3.

The Treasurer has also created Form POA-2 – Authorization To Be Included In Combined Filings. The Form POA-2 instructs each member of a combined group to file a POA-2 authorizing the key filer of the combined group to file GRT and Payroll Expense Tax returns and apply for business registration certificates on behalf of the member. The POA-2 instructions state that a statute of limitations waiver by the key filer will waive the statute of limitations for all members of the combined group, but combined group members may be independently assessed or billed for their own liability if the key filer fails to act on their behalf.

The POA-2 instructions state that the key filer should be the parent entity if the parent entity is a San Francisco taxpayer.<sup>21</sup> If not, the key filer may be any other member of the combined group that is a San Francisco taxpayer. Once executed, the POA-2 is effective for the current year, and all future years until it is either revoked, the member is no longer part of the combined group, or until the key filer can no longer operate as the key filer for the combined group. The instructions state who should execute the POA-2 on behalf of corporations, partnerships, limited liability companies, and other business entities to be included in the combined filings.

#### **Open Questions:**

- Must non-unitary but “related entities” be included together in a combined GRT return?
- Is there a quantitative measure for determining sufficient ownership or control over an entity to require combined GRT reporting?
- Are unitary foreign affiliates whose income and apportionment factors are partially included in a California water’s-edge return (e.g., Controlled Foreign Corporations (“CFCs”)) required to be included in a combined GRT return? If so, to what extent?
- Once the GRT is computed on a combined basis, how is the GRT liability apportioned to each person within the combined return?

#### **Taxable Gross Receipts**

The term “gross receipts” is broadly defined as the total amounts received or accrued by a person from whatever source derived, and includes amounts derived from sales, services, dealings in property, interest, rent, royalties, dividends, licensing fees, other fees, commissions, and distributed amounts from other business entities, and encompasses all amounts that constitute gross income for federal income tax purposes.<sup>22</sup>

The following items are not gross receipts for purposes of the GRT:<sup>23</sup>

- federal, state, and local taxes imposed with respect to retail sales, third-party taxes collected and remitted to a governmental entity on behalf of customers, and tax refunds received from a governmental entity,
- amounts received from or charged to any person that is a related entity to the taxpayer,



<sup>21</sup> The term “taxpayer” means a person required under the Code to file a return or pay or remit a tax. Section 6.2-20.5.

<sup>22</sup> Section 952.3(a).

<sup>23</sup> Section 952.3(c)-(e).

- grants received from governmental entities,
- gifts,
- interest, dividends, capital gains, other amounts received on account of financial instruments,<sup>24</sup> and distributions from business entities provided such items are directly derived exclusively from the investment of capital and not from the sale of property other than financial instruments, or from the provision of services, to any person,<sup>25</sup>
- allocations of income or gain, or distributions (such as dividends, interest and other returns on capital) from an entity treated as a pass-through entity for federal income tax purposes, provided such allocations or distributions are derived exclusively from an investment in such entity, and not from any other property sold to, or services provided to, such entity,
- gross receipts of a pass-through entity which is subject to the GRT shall not also constitute gross receipts for any owner of that entity,
- certain receipts from rent controlled buildings,<sup>26</sup>
- receipts from sales of real property in which the Real Property Transfer Tax has been paid to the City,<sup>27</sup>
- the cost to acquire financial instruments,<sup>28</sup>
- the cost basis of real property sold,<sup>29</sup> and
- amounts received by the original issuer of a financial instrument.<sup>30</sup>

Gross receipts shall not include receipts from business activities if, and only so long as and to the extent that, the City is prohibited from taxing such receipts under the Constitution or laws of the United States or of the State of California.<sup>31</sup>

**Open Question:**

- Are the gross receipts of non-taxpayer members that are sourced to the City included in the calculation of the combined group's GRT (i.e., a *Finnigan* approach)? If so, how are such gross receipts allocated amongst the taxpayer members of the combined group?

<sup>24</sup> "Financial instruments" include stocks or other similar written instruments evidencing a right to participate in the assets of any business, bonds or other evidence of indebtedness, or any other marketable security. Section 952.3(e).

<sup>25</sup> Referred to collectively as "investment receipts." Section 952.3(d).

<sup>26</sup> Section 954(d).

<sup>27</sup> Section 954(e).

<sup>28</sup> Section 952.3(e). To the extent that any loss on the sale or exchange of financial instruments reduces the gross income of a person for federal income tax purposes in the year the loss is incurred, that loss shall reduce gross receipts from the sale or exchange of financial instruments, but not below zero. Such losses may not be carried back or carried forward to reduce gross receipts in a tax year other than that in which the loss was incurred.

<sup>29</sup> Section 952.3(e). As noted, if the real property sold was subject to the City's Real Property Transfer Tax, the gain and the gross proceeds from such sale are not taxable gross receipts. Section 954(e).

<sup>30</sup> Section 952.3(e).

<sup>31</sup> Section 954(c).

## Credits

The Enterprise Zone Tax Credit, the Biotechnology Exclusion, and the Clean Technology Business Exclusion, each available under the Payroll Expense Tax (together, the “Payroll Expense Tax Exclusion Credit”) will be allowed to offset combined business tax liability so long as they are in effect,<sup>32</sup> even after the Payroll Expense Tax is entirely phased-out.<sup>33</sup> The Payroll Expense Tax Exclusion Credit may be claimed against the tax liability only of the person who qualified for the credit and not against any liability of related entities or other members of that person’s combined group.<sup>34</sup>

If a person would be eligible for the Central Market Street Limit<sup>35</sup> under the Payroll Expense Tax (whether or not the Payroll Expense Tax has been fully phased-out, but so long as that exclusion is in effect), that person shall owe the lesser of the combined business tax liability or the amount of its Central Market Street liability.<sup>36</sup> Combined business tax liability for these purposes means the sum of the GRT and the Payroll Expense Tax a person owes that is attributable to locations in the Central Market Street and Tenderloin Area under the rates established for the tax year.<sup>37</sup>

Taxpayers will receive a credit to the extent that they have paid a tax substantially similar to the GRT to any other taxing jurisdiction on gross receipts attributed to the City and taxed under the GRT.<sup>38</sup>

### **Open Question:**

- May taxpayers claim a credit against the GRT for gross receipts taxes imposed by foreign countries and states, as well as local governments?

## Industry Categories

The GRT identifies seven industries, each of which has specific tax rate schedules and gross receipts apportionment and allocation methodologies. The industries are (1) retail trade, wholesale trade, and certain services, (2) manufacturing, transportation and warehousing, information, biotechnology, clean technology, and food services, (3) accommodations, utilities, and arts, entertainment and recreation, (4) private education and health services, administrative and support services, and miscellaneous business activities, (5) construction, (6) financial services, insurance, and professional, scientific, and technical services, and (7) real estate and rental and leasing services.

These industries are further defined by references to numerical codes of the North American Industrial Classification System (“NAICS”). For purposes of the GRT, references to particular NAICS codes are intended to apply the definitions and descriptions adopted in that system.<sup>39</sup>

<sup>32</sup> Combined business tax liability is the sum of the GRT and the Payroll Expense Tax. Section 960.

<sup>33</sup> Section 960(c). The Enterprise Zone Tax Credit, Biotechnology Exclusion, and Clean Technology Business Exclusion are authorized under Sections 906A, 906.1, and 906.2, respectively.

<sup>34</sup> Section 960(c).

<sup>35</sup> The Central Market Street Limit is the person’s Payroll Expense Tax liability under Section 906.3 calculated at a 1.5 percent tax rate. Under Section 906.3, eligible businesses with fixed locations in the Central Market Street and Tenderloin Area may generally exclude payroll attributable to those locations, so long as the total Payroll Expense Tax is no less than the amount paid for the 2010 tax year.

<sup>36</sup> Section 961(c).

<sup>37</sup> Section 961(b).

<sup>38</sup> Section 954(g).

<sup>39</sup> Section 952.4.

### **Retail Trade, Wholesale Trade, and Certain Services**

The base tax rate applicable to the business activities of retail trade, wholesale trade, and certain services starts at 0.075 percent, and gradually increases to 0.160 percent for gross receipts over \$25,000,000.<sup>40</sup>

“Retail trade” includes the activity of retailing any type of personal property, generally without significantly transforming its characteristics, rendering services incidental to the retail sale of property, and includes business activity described in NAICS codes 44 and 45.<sup>41</sup>

“Wholesale trade” includes the activity of wholesaling property, generally without transformation, and rendering services incidental to the sale of property on a wholesale basis, and includes business activity described in NAICS code 42.<sup>42</sup>

“Certain services” includes repair and maintenance services, personal and laundry services, and religious, grant making, civic, professional and similar organizations that are not otherwise exempt, and includes business activity described in NAICS codes 811, 812, and 813.<sup>43</sup>

### **Manufacturing, Transportation and Warehousing, Information, Biotechnology, Clean Technology, and Food Services**

The base tax rate applicable to the business activities of manufacturing, transportation and warehousing, information, biotechnology, clean technology, and food services starts at 0.125% and gradually increases to 0.475% for gross receipts over \$25,000,000.<sup>44</sup>

“Manufacturing” includes the activity of transforming materials, substances or components into new products by mechanical, physical or chemical means, includes the activity of assembling component parts of manufactured products, and includes business activity described in NAICS codes 31, 32, and 33.<sup>45</sup>

“Transportation and warehousing” includes the activities of providing transportation of passengers and/or goods, warehousing and storage for goods, scenic and sightseeing transportation, support activities related to modes of transportation, and includes business activity described in NAICS codes 48 and 49.<sup>46</sup>

“Information” includes producing and distributing information or cultural products, providing the means to transmit or distribute those products, processing data, and includes business activity described in NAICS code 51.<sup>47</sup>

“Biotechnology” includes conducting biotechnology research and experimental development, and operating laboratories for biotechnology research and experimental development, using DNA, cells, and/or bioprocessing techniques, as well as the application thereof to the development of therapeutics, diagnostic products and/or devices to improve human health, animal health, and agriculture.<sup>48</sup>



<sup>40</sup> Section 953.1(a).

<sup>41</sup> Section 953.1(b).

<sup>42</sup> Section 953.1(c).

<sup>43</sup> Section 953.1(d).

<sup>44</sup> Section 953.2(a).

<sup>45</sup> Section 953.2(b).

<sup>46</sup> Section 953.2(c).

<sup>47</sup> Section 953.2(d).

<sup>48</sup> Sections 953.2(e) and 906.1.



“Clean Technology” means a business in which at least seventy-five percent of all business activities carried on during the tax year are directly related to one or more of the following activities:<sup>49</sup>

- Research and development and/or associated manufacturing applying scientific advances to the production, distribution or storage of clean energy,
- Research and development and/or associated manufacturing applying scientific advances to prototype or commercially viable materials and products powered by clean energy, including but not limited to single passenger vehicles and fueling infrastructure,
- Research and development and/or associated manufacturing applying scientific advances to prototype or commercially viable techniques, materials and products that materially improve energy efficiency, water conservation or air quality, or
- Research and development, manufacture and/or installation of solar panels.

“Food services” includes the activity of preparing meals, snacks and/or beverages to customer order for immediate on-premises or off-premises consumption, includes drinking places and business activity described in NAICS code 722.<sup>50</sup>


#### **Accommodations, Utilities, and Arts, Entertainment and Recreation**

The base tax rate applicable to the business activities of accommodations, utilities, and arts, entertainment and recreation starts at 0.300% and gradually increases to 0.400% for gross receipts greater than \$25,000,000.<sup>51</sup>

“Accommodations” includes the activity of providing lodging or short-term accommodations for travelers, vacationers, or others, and includes business activity described in NAICS code 721.<sup>52</sup>

“Utilities” includes the activities of the generation, transmission and distribution of electric power, the distribution of natural gas, the provision and distribution of steam supply, the treatment and distribution of water supply, the removal of sewage, and includes business activity described in NAICS code 22, but excludes establishments primarily engaged in waste management services.<sup>53</sup>

“Arts, entertainment and recreation” includes the activity of operating facilities or providing services to meet cultural, entertainment or recreational interests of customers or patrons, and includes business activity described in NAICS code 71.<sup>54</sup>

 <sup>49</sup> Sections 953.2(e) and 906.2.

<sup>50</sup> Section 953.2(f).

<sup>51</sup> Section 953.3(a).

<sup>52</sup> Section 953.3(b).

<sup>53</sup> Section 953.3(c).

<sup>54</sup> Section 953.3(d).

**Private Education and Health Services, Administrative and Support Services, and Miscellaneous Business Activities.**

The base tax rate applicable to the business activities of private education and health services, administrative and support services, and miscellaneous business activities starts at 0.525% and gradually increases to 0.650% for gross receipts over \$25,000,000.<sup>55</sup>

“Private education and health services” includes the activity by persons other than governmental agencies of providing instruction and training in any subject, or of providing health care or social assistance for individuals and includes business activity described in NAICS codes 61 and 62.<sup>56</sup>

“Administrative and support services” includes the activity of performing routine support activities for the day-to-day business activities of others, and includes business activity described in NAICS code 56.<sup>57</sup>

“Miscellaneous business activities” includes all business activities not otherwise exempt and not elsewhere subjected to a gross receipts or administrative office tax.<sup>58</sup>

**Construction**

The base tax rate applicable to the business activities of construction starts at 0.300% and gradually increases to 0.450% for gross receipts over \$25,000,000.<sup>59</sup>

“Construction” includes the activity of preparing sites for, subdividing land for, or working on, buildings or engineering projects, including highways and utility systems, and includes business activity described in NAICS code 23.<sup>60</sup>

**Financial Services, Insurance, and Professional, Scientific and Technical Services**

The base tax rate applicable to the business activities of financial services, insurance, and professional, scientific and technical services starts at 0.400% and gradually increases to 0.560% for gross receipts over \$25,000,000.<sup>61</sup>

“Financial services” includes the activities of engaging in or facilitating financial transactions, and includes business activity described in NAICS codes 521, 522, and 523.<sup>62</sup>

“Insurance” includes the activities of facilitating or supporting the pooling of risk by underwriting insurance and annuities and, includes business activity described in NAICS code 524.<sup>63</sup>

“Professional, scientific and technical services” includes the activity of providing for others, specialized professional, scientific, or technical services that require a high degree of expertise and training, and includes business activity described in NAICS code 54.<sup>64</sup>



<sup>55</sup> Section 953.4(a).

<sup>56</sup> Section 953.4(b).

<sup>57</sup> Section 953.4(c).

<sup>58</sup> Section 953.4(a).

<sup>59</sup> Section 953.5(a).

<sup>60</sup> Section 953.5(b).

<sup>61</sup> Section 953.6(a).

<sup>62</sup> Section 953.6(b).

<sup>63</sup> Section 953.6(c).

## Real Estate and Rental and Leasing Services

The base tax rate applicable to the business activities of real estate and rental and leasing services starts at 0.285% and gradually increases to 0.300% for gross receipts over \$25,000,000.<sup>65</sup>

“Real estate and rental and leasing services” includes the activities of renting, leasing, or otherwise allowing the use of tangible or intangible assets, the activity of providing related services, and includes business activity described in NAICS code 53.<sup>66</sup>

## Allocation and Apportionment Provisions

All persons deriving gross receipts from business activities both within and outside the City use one of the following three methods to determine the amount of gross receipts derived from business activity within the City, depending on the industry of that person: (1) allocation of gross receipts (“Allocation Method”), (2) payroll factor, or (3) an evenly weighted combination of (1) and (2) (“Combination Method”).<sup>67</sup>

The **APPENDIX** at the end of this Alert is a chart of the gross receipts allocation and apportionment methodologies for each industry identified by the GRT.

### Allocation Method

For all persons required to use the Allocation Method to determine gross receipts derived from business activities within the City, gross receipts are allocated as follows:<sup>68</sup>

- Gross receipts from the sale, lease, rental or licensing of real property are in the City if the real property is located in the City.
- Gross receipts from sales of tangible personal property are in the City if the property is delivered or shipped to a purchaser within the City, regardless of the f.o.b. point or other conditions of the sale.
- Gross receipts from the rental, lease or licensing of tangible personal property are in the City if the property is located in the city.
- Gross receipts from services are in the City to the extent the purchaser of the services received the benefit of the services in the City.
- Gross receipts from intangible personal property are in the City to the extent the property is used in the City.
- Gross receipts from sales related to financial instruments are in the City if the customer is located in the City.

<sup>64</sup> Section 953.6(d).

<sup>65</sup> Section 953.7(a).

<sup>66</sup> Section 953.7(b).

<sup>67</sup> Sections 956, 956.1, and 956.2.

<sup>68</sup> Section 956.1(b)-(f).

## Payroll Factor

For all persons required to use the payroll factor to determine gross receipts derived from business activities within the City, all combined gross receipts of the person are multiplied by a fraction, the numerator of which is payroll in the City, and the denominator combined payroll.<sup>69</sup>

“Combined gross receipts” are the total worldwide gross receipts of a person and all related entities to that person.<sup>70</sup> “Combined payroll” is the total worldwide compensation paid by a person and all related entities to that person.<sup>71</sup> “Payroll in the City” is the total amount paid for compensation in the City by the person and by all related entities to the person.<sup>72</sup> “Compensation” means wages, salaries, commissions and any other form of remuneration paid to employees for services.<sup>73</sup> Section 902.1 of the Payroll Expense Tax generally includes as “compensation” any amounts paid to the owners of pass through entities for the performance of services to the pass through entity. That section was not incorporated into the GRT payroll factor provisions.<sup>74</sup> However, if a person has no employees, compensation for GRT payroll factor purposes includes all taxable income for federal income tax purposes of the owners or proprietors of such person.<sup>75</sup> Compensation is sourced to the City based on the total number of working hours employed within the City divided by the total number of working hours within and outside the City.<sup>76</sup>


## Combination Method

The combination method is computed by adding one-half of the gross receipts derived from within the City determined under the Allocation Method and one-half of the gross receipts derived from within the City using the payroll factor.<sup>77</sup>

## Special Industry Rules

For the Accommodations industry, the amount of gross receipts subject to the GRT is the total amount of gross receipts derived or related to properties located or used within the City.<sup>78</sup>

The Construction industry must first use the Combination Method, and then reduce that amount by any amounts which were included in the person’s gross receipts within the City pursuant to the Allocation Method, and which that person paid to a subcontractor possessing a valid business registration certificate with the City during the tax year. In order to claim this reduction, a person must maintain an itemized schedule of payments to subcontractors and sufficient information to verify the subcontractor possessed a valid business registration certificate with the City. Reductions for any other costs, including without limitation, costs for materials, fees, equipment, or other services are not permitted.<sup>79</sup>

<sup>69</sup> Section 956.2(a).

<sup>70</sup> Section 956.2(b). If a water’s edge election under CRTS section 25110 is in effect, combined gross receipts shall be computed consistently therewith.

<sup>71</sup> Section 956.2(c). If a water’s edge election under CRTS section 25110 is in effect, combined payroll shall be computed consistently therewith. Note that the relevance of the payroll factor for California Corporation Tax purposes has diminished since the state now requires use of a single sales factor method of apportionment for most taxpayers.

<sup>72</sup> Section 956.2(d).

<sup>73</sup> Section 956.2(f).

<sup>74</sup> Section 956.2(d).

<sup>75</sup> Section 956.2(d).

<sup>76</sup> Sections 956.2(e) and 904.

<sup>77</sup> Sections 956, 956.1, and 956.2.

<sup>78</sup> Section 953.3(e).

<sup>79</sup> Section 953.5(c).

For person's engaged in Real Estate and Rental and Leasing Services, the amount of gross receipts subject to the GRT is the total amount of gross receipts derived from or related to properties located or used within the City. Gross receipts shall not include amounts derived from or related to properties located or used outside the City.<sup>80</sup>

### Multiple Business Activities

If a person or combined group engages in business activities in multiple industries, the tax rates and allocation and apportionment methodologies to be applied to that person or group are determined as follows:<sup>81</sup>

- If more than 80 percent of its gross receipts<sup>82</sup> are derived from a single industry, then the tax rates and allocation and apportionment provisions of that industry apply to all of its gross receipts derived from all business activities (the "80-Percent Rule").<sup>83</sup>
- If the 80-Percent Rule does not apply, but its business activities in the City are described in more than one industry, then such person or combined group shall separately compute the GRT for each industry.<sup>84</sup> However, if any one industry generates less than 20 percent of the total gross receipts of the person or group (the "Less Than 20-Percent Rule"), then the receipts and payroll from that industry activity may be combined for all purposes related to computing the GRT with whichever activity of the person or group that has the highest applicable tax rate.<sup>85</sup>

#### Open Questions:

- Does one look to the "person" or "combined group" to figure out whether the "80-Percent Rule" or "Less Than 20-Percent Rule" applies?
- Is the Less Than 20-Percent Rule optional?
- What if a business is engaged in multiple industries, none of which generate 20 percent or more of its total gross receipts?

### Other Key Provisions of the San Francisco Business and Tax Regulation Code

#### Business Registration Fees

The annual fee for obtaining a business registration certificate for tax years beginning on or after June 30, 2004, but ending on or before June 30, 2014 is based on the taxpayer's Payroll Expense Tax for the immediately preceding tax year, and ranges from a minimum of \$25 to a maximum of \$500.<sup>86</sup>



<sup>80</sup> Section 953.7(c).

<sup>81</sup> Section 953.9.

<sup>82</sup> The NAICS uses a different criteria for classifying multi-industry businesses. See NAICS "FAQs" at the following link: <https://www.census.gov/eos/www/naics/faqs/faqs.html>.

<sup>83</sup> Section 953.9(a).

<sup>84</sup> Section 953.9(b).

<sup>85</sup> Section 953.9(b)(1).

<sup>86</sup> Section 855(a). Unlike the GRT or Payroll Expense Tax, business registration fees are based on a fiscal year ending June 30<sup>th</sup>.

For the registration year ending June 30, 2015, the annual registration fee is based on payroll expense (not Payroll Expense Tax, as in prior years) for the immediately preceding tax year, and the fee ranges from a minimum of \$75 to a maximum of \$35,000 for those with payroll expense over \$40 million.<sup>87</sup> Beginning with the registration year ending June 30, 2015, the annual registration fee for administrative offices (discussed below) will be based on payroll expense from the immediately preceding tax year, and ranges from a minimum of \$15,000 to a maximum of \$35,000 for those with payroll expense over \$25 million. For registration years after June 30, 2015, annual registration fees are based on a taxpayer's gross receipts for the immediately preceding tax year, and range from a minimum of \$90 to a maximum of \$35,000 for those with gross receipts over \$200 million.<sup>88</sup> There are no provisions to apportion payroll expense or gross receipts within and without the City for purposes of determining the registration fees. Beginning with the registration year ending June 30, 2015, combined groups must apply for a business registration certificate and calculate their business registration fees on a combined basis.<sup>89</sup>

**Open Question:**

- Is the use of non-apportioned payroll expense or gross receipts to determine the annual registration fee consistent with the Commerce Clause of the United States Constitution?

**Administrative Office Tax**

Beginning in 2014, an "administrative office" is exempt from the GRT and the Payroll Expense Tax.<sup>90</sup> In lieu thereof, every person engaging in business within the City as an administrative office is subject to an annual administrative office tax equal to 1.4 percent of its total payroll expense attributable to the City.<sup>91</sup> If such person is a member of a combined group, then its tax shall be measured by the total payroll expense of the combined group attributable to the City. Such combined group shall pay the administrative office tax in lieu of the GRT and Payroll Expense Tax.<sup>92</sup>

Engaging in business within the City as an administrative office means:<sup>93</sup>

- A person is engaged in business within the City during the tax year and over 50 percent of the total combined payroll expense within the City of that person and its related entities for the preceding tax year was associated with providing administrative or management services exclusively to that person or related entities,
- the total combined number of employees of that person and its related entities within the United States as of the last day of the preceding year exceeded 1,000, and
- the total combined gross receipts of that person and its related entities reported on its federal income tax return(s) for the preceding tax year exceeded \$1,000,000,000.

 <sup>87</sup> Section 855(c).

<sup>88</sup> Section 855(e). Slightly lower registration fees apply businesses classified as to Retail Trade, Wholesale Trade and Certain Services. Section 855(e)(2).

<sup>89</sup> Section 855(d); 856(a).

<sup>90</sup> Section 953.8(a).

<sup>91</sup> The portion of the payroll expense of a person or combined group that is attributable to the City is determined under Section 904, which generally requires payroll expense be apportioned by the ratio of total number of working hours within the City to total number of working hours everywhere. Section 953.8(f).

<sup>92</sup> Section 953.8(a).

<sup>93</sup> Section 953.8(b).

"Administrative or management services" includes internal support services provided on an enterprise-wide basis. Examples include executive office oversight, company business strategy, recordkeeping, risk management, personnel administration, legal, accounting, market research and analysis, and training services. Administrative or management services does not include sales personnel or personnel actively engaged in marketing, research and development, direct customer service, and product support services.<sup>94</sup>

For purposes of the administrative office tax only, a related entity shall include any person who could be included in the same combined report under CRTC section 25102, but for the existence of a water's edge election under CRTC section 25110.<sup>95</sup>

### General Administrative Provisions

GRT returns are due on or before the last day of February of each year.<sup>96</sup> Thus, the first return to report the 2014 GRT is due February 28, 2015. There are no automatic extensions of time to file GRT returns. An extension is only permitted if good cause is shown, and even then, is limited to 60 days.<sup>97</sup>

Any return required to be filed on a combined basis, or to report worldwide gross receipts and payroll, and fails to do so is an incomplete return subject to a penalty of up to \$500 for each such failure.<sup>98</sup> In addition to all other penalties, a 50-percent penalty is imposed on the balance due if the tax finally determined by the Tax Collector exceeds the amount reported by the taxpayer by 25 percent or more.<sup>99</sup> The penalty will be waived if the underreporting of tax occurred notwithstanding the exercise of ordinary care by the taxpayer and the absence of wilful neglect.<sup>100</sup>

Every notice of a deficiency determination shall be served on the taxpayer within three years after the date that a return was due, or three years after it was filed, whichever is later.<sup>101</sup> Refunds must be claimed within one year of the alleged overpayment.<sup>102</sup> There are no explicit provisions allowing for the extension of time within which a taxpayer may file a claim for refund, or that otherwise references the administrative provisions of the CRTC.

In contrast, for purposes of the California income and franchise tax, the FTB must generally issue a notice of proposed assessment ("NPA") within four years after the return was filed.<sup>103</sup> Refund claims must generally be made within the later of four years of the return filing due date or one year of the date of the alleged overpayment.<sup>104</sup> The statute of limitations ("SOL") for such assessments and refund claims may be extended if the taxpayer files a waiver of the SOL for federal income tax purposes with the Internal Revenue Service ("IRS"),<sup>105</sup> the IRS makes a change or correction to the taxpayer's federal income tax return, or the taxpayer files an amended federal income tax return.<sup>106</sup>

<sup>94</sup> Section 953.8(d).

<sup>95</sup> Section 953.8(c).

<sup>96</sup> Section 6.9-1(b); 6.9-2(a).

<sup>97</sup> Section 6.9-4(a).

<sup>98</sup> Section 6.17-3(b).

<sup>99</sup> Section 6.17-2(c).

<sup>100</sup> Section 6.17-4.

<sup>101</sup> Section 6.11-2(a).

<sup>102</sup> Section 6.15-1(a).

<sup>103</sup> CRTC section 19057(a).

<sup>104</sup> CRTC section 19306(a).

<sup>105</sup> CRTC section 19065 and 19308.

<sup>106</sup> CRTC section 19059 and 19311.

**Open Questions:**

- Given the one year SOL on GRT refund claims, should taxpayers that anticipate annual federal and California adjustments consider filing protective GRT refund claims on an annual basis?
- GRT returns must be filed months before California returns. Will a water's edge election be effective for GRT purposes if made after the GRT return is filed?
- Fiscal year filers may have different group compositions during the calendar year. What will the composition of a combined GRT return look like in this context? How will the composition of the combined GRT return look where short-period California returns are filed?

**Conclusion**

The City afforded taxpayers and itself additional time to address some of the perplexing issues surrounding the GRT by eliminating penalties for delinquent GRT installment payments. However, the first GRT returns are due at the end of February 2015, and taxpayers still need answers to the questions posed above and others in order to comply with the GRT.

The Treasurer has indicated that it will not promulgate GRT regulations prior to the February 2015 filing deadline, and will not publish GRT tax return forms or instructions until sometime in 2015 (at best, only months before the first GRT returns are due). Although the Treasurer has released information that generally summarizes the GRT,<sup>107</sup> the information it has provided to date has not clarified ambiguities in the GRT, some of which are noted above. The Treasurer has announced on a public webcast<sup>108</sup> that it intends to release information later in 2014 for businesses to declare they are a combined group. Stay tuned.

<sup>107</sup> The information can be accessed at <http://sfgov.org/sf/sfbiztax>.

<sup>108</sup> The webcast can be accessed at [http://sanfrancisco.granicus.com/MediaPlayer.php?view\\_id=74&clip\\_id=19728](http://sanfrancisco.granicus.com/MediaPlayer.php?view_id=74&clip_id=19728).



**APPENDIX**  
GROSS RECEIPTS ALLOCATION AND APPORTIONMENT METHODOLOGIES

<b>Industry Classification</b>	<b>Sourcing Method</b>	<b>Authority</b>
Retail Trade	Combination	Section 953.1(e)
Wholesale Trade	Combination	Section 953.1(e)
Certain Services	Payroll	Section 953.1(f)
Manufacturing	Combination	Section 953.2(g)
Transportation and Warehousing	Combination	Section 953.2(g)
Information	Combination	Section 953.2(g)
Biotechnology	Combination	Section 953.2(g)
Clean Technology	Combination	Section 953.2(g)
Food Services	Combination	Section 953.2(g)
Accommodations	Gross receipts derived from or related to properties located or used within the City.	Section 953.3(e)
Utilities	Combination	Section 953.3(f)
Arts, Entertainment, and Recreation	Payroll	Section 953.3(g)
Private Education and Health Services	Payroll	Section 953.4(d)
Administrative and Support Services	Payroll	Section 953.4(d)
Miscellaneous Business Activities	Payroll	Section 953.4(d)
Construction	Combination, less certain receipts from subcontractors with valid City business registration certificates.	Section 953.5(c)
Financial Services	Payroll	Section 953.6(e)
Insurance	Payroll	Section 953.6(e)
Professional, Scientific, and Technical Services	Payroll	Section 953.6(e)
Real Estate and Rental and Leasing Services	Gross receipts derived from or related to properties located or used within the City.	Section 953.7(c)

*This material is not intended to constitute a complete analysis of all tax considerations Internal Revenue Service regulations generally provide that, for the purpose of avoiding United States federal tax penalties, a taxpayer may rely only on formal written opinions meeting specific regulatory requirements. This material does not meet those requirements. Accordingly, this material was not intended or written to be used, and a taxpayer cannot use it, for the purpose of avoiding United States federal or other tax penalties or of promoting, marketing or recommending to another party any tax-related matters.*

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