

San Francisco Gross Receipts Tax Update: New Regulations Impact Returns Due Today

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The San Francisco Office of the Treasurer and Tax Collector recently issued Gross Receipts Tax regulations, tax return filing instructions and other guidance addressing major changes to how owners of disregarded entities are taxed, combined reporting, and procedures for requesting a two-month extension of time to file returns that are otherwise due today.

Introduction

Beginning in 2014, every person engaging in business within San Francisco is subject to an annual Gross Receipts Tax (“GRT”) measured by the person’s gross receipts from all taxable business activities attributable to San Francisco.¹ The GRT will be phased in and the existing Payroll Expense Tax phased out over a 5-year period.² During this phase-out period, taxpayers must report their GRT and Payroll Expense Tax liabilities on a single tax return, the first of which is due March 2, 2015. A person engaging in business within San Francisco must file a single GRT and Payroll Expense Tax return on a combined basis with all of that person’s related entities.³

Extensions to May 1, 2015

The San Francisco Office of the Treasurer and Tax Collector (“Tax Collector”) has released a form for taxpayers to request a two-month extension of time to file their Gross Receipts Tax (“GRT”) and Payroll Expense Tax returns.⁴ While returns are due by March 2, 2015, they may be filed by May 1, 2015, without the

¹ San Francisco Business Tax Regulations Code (“Code”) section 953(a). Our Client Alert of April 29, 2014, provides a detailed discussion of the GRT and other related provisions of the Code, and may be accessed [at this link](#).

² Code section 959.

³ Code sections 956.3 and 907(b). 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 under Cal. Rev. & Tax Code section 25102 et seq., to have their income reflected on the same combined report. (Code section 952.5).

⁴ The form can be accessed [at this link](#). Taxpayers must report 2014 GRT and Payroll Expense Tax together electronically, or on Form BTAX-2014 if ineligible for electronic filing. The electronic filing system may be accessed [at this link](#). Electronic filing eligibility criteria are discussed, below.

imposition of additional interest, penalties, and fees if an extension request is postmarked or received by the Treasurer on or before March 2, 2015. To be eligible for the extension, taxpayers must have paid at least 90 percent of their estimated tax liability by March 2, 2015, and file the return on or before the extended due date of May 1, 2015. Instructions to the extension request form state that taxpayers will be notified in writing by the Tax Collector if an extension request is denied.

Penalty Waiver Requests

The Tax Collector has also released a form for taxpayers to request a waiver of penalties for delinquent tax return filing and tax payments.⁵ These penalties include a 5 percent per month delinquency penalty up to 20 percent in the aggregate for late payment of tax and a \$500 penalty for failure to timely file returns.⁶ According to the form, the tax must be paid in full before the Tax Collector will consider waiving any penalties.

GRT Tax Collector Regulations

Tax Collector Regulation 2014-1: Interpretations of the former San Francisco Gross Receipts Tax that was repealed in 2001 shall not apply to the current GRT.

Tax Collector Regulation 2014-2: Single-member entities (including single-member limited liability companies) that are disregarded for federal income tax purposes (“DRE”) will be disregarded for purposes of the GRT, the Payroll Expense Tax, and any business registration requirements.

The Tax Collector has released a form for sole owners to declare ownership of DREs. By submitting the form, the Treasurer will transfer all account information, including tax and fee payments and liabilities from the DRE to its sole owner, and will close the account of the DRE.⁷ The form states that the owner of the DRE will need to submit a business registration application if not already registered, and that such owner will need to update the new business registration number with any relevant San Francisco department to reflect the business account number of the owner.⁸ The Treasurer’s website states that any interest and penalties resulting from late registration by the DRE owner will be waived if the DRE itself was timely registered.⁹

Tax Collector Regulation 2014-3: Clarifies the definition of gross receipts subject to tax as applied to a person acting as an agent on behalf of a principal. Gross receipts are presumed to be received on a person’s own behalf, and not as an agent.¹⁰ However, gross receipts shall not include amounts received by a person acting as an agent or broker on behalf of a principal where the amounts received are (1) to be transferred to the principal, (2) to pay for the principal’s legal obligations to third parties, (3) to reimburse sums advanced by the agent for the principal’s legal obligations to third parties, or (4) to invest on behalf of the principal.¹¹

Regulation 2014-3 provides two examples. In *Example 1*, a client advances \$500 to his attorney to pay for court costs pursuant to a written agreement between the client and attorney requiring the client to advance

⁵ The form can be accessed [at this link](#).

⁶ Code sections 6.17-1(a) and 6.17-3(b).

⁷ This form can be accessed [at this link](#).

⁸ This includes any accounts for San Francisco’s transient occupancy tax, tourism improvement district fee, Moscone expansion district fee, parking tax, access line tax, utility users tax, stadium operator admission tax, and cigarette litter abatement fee.

⁹ See [this link](#). Page 7 of Online Filing Instructions released by the Tax Collector state that DRE owners will be the taxpayer for purposes of the GRT, Payroll Expense Tax, and business registration requirements.

¹⁰ Regulation 2014-3(e).

¹¹ Regulation 2014-3(d).

such amounts to the attorney separately from any attorney fees. *Example 1* concludes that because the attorney received the \$500 solely as an agent of the client to pay the client's legal obligation to the court, the \$500 is not a gross receipt of the attorney. In *Example 2*, Business A agrees to complete a project for Business B for a fee based on Business A's costs, plus 10 percent. Business A purchases all the goods and services necessary for it to complete the project in its own name. *Example 2* concludes that Business A is using the amounts received from Business B to pay for its own obligations, and therefore all amounts received by Business A from Business B are gross receipts upon which Business A is subject to tax.

GRT and Payroll Expense Tax Instructions¹²

Eligibility for Online Filing

The Tax Collector will generally require taxpayers to file GRT and Payroll Expense Tax returns electronically. However, certain taxpayers are not permitted to do so and must file paper returns.¹³ Such taxpayers include:¹⁴

- Those claiming the Biotechnology Exclusion, Clean Technology Business Exclusion, the Central Market Street and Tenderloin Area Payroll Expense Tax Exclusion, the Central Market Street Limit, and the Stock-Based Compensation Exclusion
- Combined groups claiming the Enterprise Zone Tax Credit or Payroll Expense Tax Exclusion resulting from qualification for the Enterprise Zone Tax Credit
- Those who were members of multiple combined groups during the tax year, or who were members of a combined group for only part of the year
- Combined groups with one or more part-year group members
- Combined groups that include only a portion of an entity. The instructions provide the following example:

Corporation A and Corporation B each own 30 percent of Partnership C. Under California franchise tax rules, Partnership C would be included in Corporation A and B's unitary group to the extent of their combined 60 percent ownership. In this scenario, the combined group with Corporation A, Corporation B, and 60 percent of Partnership C must file a paper return.¹⁵

¹² The GRT and Payroll Expense Tax Online Filing Instructions ("Instructions") are revised as of February 19, 2015, and may be accessed [at this link](#). As of the date of this publication, the Tax Collector has not released filing instructions for taxpayers required to file paper returns.

¹³ The Tax Collector has not posted paper copies of the GRT and Payroll Expense Tax returns online because "paper returns must be generated for each taxpayer." Taxpayers wishing to obtain paper tax returns are instructed to call (415) 701-2311 to request a paper copy. (Instructions, p. 4).

¹⁴ Instructions, p. 4.

¹⁵ Presumably, Corporations A and B in this example are members of the same combined reporting group for California income and franchise tax purposes.

Combined Reporting

Beginning with the 2014 tax year, all persons and their related entities must file GRT and Payroll Expense Tax returns on a combined basis, reflecting the gross receipts, payroll expense, and other tax attributes (e.g., credits and exclusions, payroll for apportionment of GRT, etc.) of all related entities.¹⁶

Part-Year Group Members

The Instructions note that if an entity was a member of a combined group for only a portion of the tax year, it must be included in the combined group return for only that portion of the year, and must file a separate return (or be included in a different combined return) for the portion of the tax year it was not a member.¹⁷


Combination with Exempt Entities

The Instructions list certain persons that are exempt from the GRT and Payroll Expense Tax, including bank and financial corporations that are exempt from local taxation under Article XIII, Section 27 of the California Constitution and Revenue & Taxation Code section 23182, and insurance companies exempt from local taxation under Article XIII, Section 28 of the California Constitution.

If a combined group for California franchise or income tax purposes includes an entity that is exempt from the Payroll Expense Tax and/or the GRT, the exempt entity may be treated as if it is not a related entity and not included in the combined return. In such a case, the gross receipts, payroll expense, and other tax attributes of these exempt entities would not be included in the combined GRT and Payroll Expense Tax return, but amounts received from or charged to any such exempt entities by other combined group members would not be excluded from the gross receipts of the combined group.¹⁸

Alternatively, such exempt entities may be treated as related entities, and their gross receipts and payroll expense may be included in the combined return for GRT apportionment purposes. However, because exempt entities are not taxable, the combined return would exclude their San Francisco gross receipts, and any payroll expense attributable to the exempt entities in calculating the Payroll Expense Tax. To include such exempt entities in a combined return, a combined group must include the exempt entities' total gross receipts, and the exempt entities' total and San Francisco payroll expense for GRT apportionment purposes.¹⁹

If a combined group elects to include an exempt entity in its combined return, the total gross receipts of the exempt entity would be included in the combined return, the San Francisco gross receipts of the exempt entity would be excluded from the combined return, and the San Francisco payroll of the exempt entity would be excluded for Payroll Expense Tax purposes, but the total payroll and San Francisco payroll expense would be included for purposes of combined group GRT apportionment.²⁰

 ¹⁶ The person filing a combined return on behalf of the combined group must obtain a Power of Attorney ("POA") from each person included in the combined return, but such POAs need not be filed with the Tax Collector. (Instructions, p. 6, 7).

¹⁷ Instructions, p. 6.

¹⁸ Instructions, p. 6.

¹⁹ Instructions, p. 6.

²⁰ Instructions, p. 6 and 7.

Combined Group Allocation and Apportionment

Combined groups must include payroll expenses for each entity in the combined group that is engaged in business in San Francisco for purposes of GRT apportionment.²¹ For purposes of the GRT, total gross receipts and total payroll is the total worldwide gross receipts and worldwide compensation, respectively of the combined group, unless a water's edge election for California income/franchise tax has been made, in which case such amounts are determined accordingly.²² San Francisco gross receipts include such gross receipts of all related entities, "regardless of the entities' individual connections to San Francisco."²³

Administrative Office Tax

Beginning in 2014, an "administrative office" is subject to an annual administrative office tax equal to 1.4 percent of total payroll attributable to San Francisco, and is exempt from the GRT and Payroll Expenses Tax.²⁴ To qualify as an administrative office, such person and its related entities must (1) have over 50 percent of total combined payroll attributable to San Francisco be associated with providing administrative or management services exclusively to itself or related entities (2) have more than 1,000 combined employees, and (3) have total combined gross receipts for federal income tax purposes of over \$1 billion.²⁵

The Instructions ask if total combined gross receipts reported for federal income tax purposes exceed \$1 billion to determine eligibility for the Administrative Office Tax. The Instructions state that if federal income tax returns for 2014 have yet to be filed, taxpayers should respond based on what will be reported to the federal government once the federal returns are filed.²⁶ The Instructions also note that to determine if 50 percent of total combined San Francisco payroll relates to intercompany administrative or management services (for purposes of eligibility for the Administrative Office Tax)²⁷ that payroll expense is determined in the same manner as it is for Payroll Expense Tax purposes, except stock options are excluded.²⁸

Lessors of Residential Real Estate

A lessor of residential real estate is treated as a separate person for each individual building for which it leases units, and must file a separate return for each building.²⁹ Businesses that are both lessors of residential real estate and also engaged in other business activities will be treated as at least two separate taxpayers. The instructions provide an example where Corporation A is a lessor of six residential real estate units in Building B, five residential units and a single commercial unit in Building C, and also sells widgets. The instructions state that Corporation A will be treated as three separate taxpayers (one for the six residential

 ²¹ Instructions, p. 15.

²² Instructions, p. 19, 20.

²³ Instructions, p. 20.

²⁴ Code section 953.8.

²⁵ Code section 953.8.

²⁶ Instruction, p. 10.

²⁷ "Administrative or management services" are noted in the instructions as including "internal support services provided on an enterprise-wide basis, such as executive office oversight, company business strategy, recordkeeping, risk management, personnel administration, legal, accounting, market research and analysis, and training services," but do not include "sales personnel or personnel actively engaging in marketing, research and development, direct customer service, and product support services." (Instructions, p. 10).

²⁸ Instructions, p. 10.

²⁹ See Instructions, p. 5.

units in Building B, one for the five residential units in Building C, and one for the single commercial unit in Building C and the widget business.³⁰

Conclusion

Taxpayers and the Tax Collector have serious issues to address before the inaugural GRT and Payroll Expense Tax returns are filed. For one, the GRT is based in substantial part on amounts to be reported on federal income tax returns. For calendar year taxpayers, these returns are generally not filed until mid-September of 2015 – over four months after the extended filing due date for GRT returns.

The problem is compounded for taxpayers that may be required to file their GRT and Payroll Expense Tax returns as a combined group, which is determined by reference to California franchise tax combined reporting groups. The extended due date for California franchise tax returns is one month later than the federal income tax return due date. The composition of the California franchise tax combined group will often not be known by the GRT extended due date. Once it is known, taxpayers will still have to grapple with adjusting the California combined reporting group to reflect constituency for GRT and Payroll Expense Tax purposes, which, unlike California, includes a broad array of non-corporate entities. The Tax Collector has yet to provide taxpayers with meaningful guidance on how this should be done.

While the two-month filing extension offered by the Tax Collector is a step in the right direction, it alone is insufficient for taxpayers and the Tax Collector to address some of these basic reporting and compliance issues.

The information presented is only of a general nature, intended simply as background material, is current only as of its indicated date, omits many details and special rules and accordingly cannot be regarded as legal or tax advice.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the author and contributors below.

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 ³⁰ Instructions, p. 16.

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