Deloitte.

Deloitte Tax LLP | November 13, 2024

MULTISTATE INDIRECT TAX

San Francisco voters approve changes to city's business taxes

Tax Alert

Overview

On November 5, 2024, the City of San Francisco voters approved Proposition M, the "Local Small Business Tax Cut Ordinance." Effective January 1, 2025, Proposition M makes several changes to San Francisco's business tax regime, including: (1) increasing the Gross Receipts Tax rate and altering the apportionment method and weighting for many taxpayers; (2) lowering the threshold to be subject to Homelessness Gross Receipts Tax from $50 million to $25 million for most taxpayers; (3) lowering the Overpaid Executive Gross Receipts Tax rates; (4) modifying the rules applicable to taxpayers engaged in multiple business activities; (5) increasing the small business exemption to $5 million; and (6) various administrative changes, such as a nine month filing extension if tax on 110% of prior year receipts is paid by the original due date—the last day of February of the succeeding year. Other than administrative changes, the substantive aspects of the Commercial Rent Tax and Administrative Office Tax remain unchanged.

Further, the San Francisco Tax Collector has announced that it is drafting new regulations to provide clarity around three topics: (1) market sourcing; (2) taxpayer requests for binding Advanced Determinations; and (3) a new Voluntary Disclosure program.

This Tax Alert provides a brief overview of the ballot measure and provides some taxpayer considerations.

Changing business taxes

Since 2014, San Francisco has imposed a Gross Receipts Tax ("GRT") on persons "engaging in business" within the city. For years prior to 2025, San Francisco receipts were determined by three methods: payroll apportionment, market allocation, and an equal combination of the two (50% payroll apportionment and 50% market or "benefit received" within the city). Depending on the industry, Proposition M alters how a taxpayers' receipts are to be allocated or apportioned to San Francisco as well as the applicable tax rate. For example, professional and financial service businesses currently determine their receipts attributable to San Francisco based solely on a payroll factor that is the ratio of their San Francisco payroll to total payroll. Effective January 1, 2025, the payroll factor for such businesses will be de-weighted by 75%, and a new triple-weighted (75%) market factor will be added.

The same weighting methodology will also apply to retail, manufacturing, information services, and other businesses that currently apportion their receipts to San Francisco based on equally weighed payroll and market factors (i.e., 50% payroll and 50% market). As a result, most businesses operating in San Francisco will be required to use a 2-factor apportionment method: 25% based on their San Francisco payroll plus 75% of the receipts where the benefit was received by, or product delivered, to a customer in San Francisco.

Proposition M streamlines how an industry is categorized for purposes of assigning the tax rate and apportionment methodology. The current number of industry classifications is reduced from fourteen to seven categories. For businesses that fall into more than one category, Proposition M requires a separate computation of the gross receipts tax for each Business Activity Category. Further, most businesses with San Francisco taxable gross receipts up to $5 million are exempt from all of the gross receipts taxes.

Currently, the Homelessness Gross Receipts Tax ("HGRT") is an additional tax imposed on businesses with taxable San Francisco gross receipts exceeding $50 million. Proposition M lowers the threshold to taxable gross receipts exceeding $25 million for most categories, except Category 3 (Real Estate), while raising the tax rates for Categories 4 through 7. The HGRT is also included in the regular GRT rate tiers.

Proposition M makes various changes to the Overpaid Executive Gross Receipts Tax ("OEGRT"), including clarifying that highest paid managerial employee is not annualized or included in the median. The OEGRT must still be calculated and reported, albeit at 10% of the previous rates. The remaining 90% of the OEGRT is now incorporated into the regular Gross Receipts tax rate tiers.

Proposition M introduces various procedural changes, including a new 110% safe harbor rule, allowing a nine-month extension for filing the annual business tax return. For the extension to apply, a required payment consisting of 110% of the preceding tax year's liability and registration fee must be made by the original due date of the return, the last day of February. For an extension of a GRT return, a required payment includes 110% of such person's gross receipts tax liability and such person's business registration fee. Payment extends the filing deadline until November 30th. The 110% safe harbor rules apply to the registration fees and the following taxes: Gross Receipts Tax, Early Care and Education Commercial Rents Tax, Homelessness Gross Receipts Tax, Cannabis Business Tax, and Overpaid Executive Gross Receipts Tax.

In lieu of the receipts taxes above, some businesses with more than 1,000 U.S. employees and $1 billion in U.S. federal income may be subject to a payroll tax known as the Administrative Office Tax ("AOT"). The AOT includes GRT and HGRT components. Proposition M does not change the test whether a business is subject to AOT. However, the rates are modified.

Considerations

Persons currently operating in San Francisco should consider the impact of these measures on their operations. While the city has said that Proposition M was designed to be revenue neutral overall, the impact on specific taxpayers may vary considerably. Taxpayers should consider modeling out their potential tax impact under the new rules for their business.

Get in touch

Hal Kessler
Lindsay Crews

Deloitte.com | Unsubscribe | Manage email preferences | Legal | Privacy

30 Rockefeller Plaza
New York, NY 10112-0015
United States