



**Municipal Business and Occupation Tax  
Study of Potential Net Fiscal Impacts  
(Allocation and Apportionment Study)**

Prepared Pursuant to  
Chapter 79, Laws of 2003 (EHB 2030)

Washington State Department of Revenue  
Cindi L.H. Yates, Director

November 2005



STATE OF WASHINGTON  
DEPARTMENT OF REVENUE  
OFFICE OF THE DIRECTOR

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November 30, 2005

The Honorable Christine O. Gregoire  
Office of the Governor  
P.O. Box 40002  
Olympia, Washington 98504-0002

**Re: Municipal Business and Occupation Tax Report of Potential Net Fiscal Impacts**

Dear Governor Gregoire:

Enclosed is the final report for the Study of Potential Net Fiscal Impacts (Allocation and Apportionment Study), which is legislatively mandated in Section 15 of Engrossed House Bill 2030 (EHB 2030). The Study of Potential Net Fiscal Impacts examines the allocation provisions and apportionment method contained in Section 13 of EHB 2030. The study also estimates the positive and negative fiscal impacts of the allocation provisions and apportionment method on local jurisdictions. In addition to examining the fiscal impacts, the report includes proposals for addressing any adverse revenue impacts to the local jurisdictions.

The Department of Revenue's Legislation and Policy and Research Divisions prepared this report. If you have any questions, please contact Russ Brubaker, the Assistant Director of the Legislation and Policy Division, at (306) 570-6131. Copies of this report are also being distributed to Representative Jim McIntire, Chair of the House Finance Committee; Senator Margarita Prentice, Chair of the Senate Ways and Means Committee; the members of their committees, and committee staff.

Sincerely,

A handwritten signature in cursive script that reads "Cindi L.H. Yates".

Cindi L.H. Yates  
Director

Enclosure

cc: Senate Ways and Means Committee Members and Staff  
House Finance Committee Members and Staff  
Marty Brown, Director of Legislative Affairs, Office of the Governor  
Victor Moore, Director, Office of Financial Management  
Patsy Ellis, Office Manager, Governor's Executive Policy Office  
Irv Lefberg, Chief of Forecasting, Office of Financial Management  
Scott Merriman, Legislative Director, Office of Financial Management  
Jim Schmidt, Executive Policy Analyst, Office of Financial Management





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November 30, 2005

The Honorable Jim McIntire, Chair  
House Finance Committee  
P.O. Box 40600  
Olympia, Washington 98504-0600

The Honorable Margarita Prentice, Chair  
Senate Ways and Means Committee  
P.O. Box 40411  
Olympia, Washington 98504-0411

**Re: Municipal Business and Occupation Tax Study of Potential Net Fiscal Impacts**

Dear Chairs McIntire and Prentice:

I am pleased to present to you the Department of Revenue's study of the potential net fiscal impacts of Chapter 79, Laws of 2003 (EHB 2030) on local jurisdictions. This report is submitted pursuant to Section 15 of EHB 2030, which directs the Department to conduct a study and report the results to the Governor and the fiscal committees of the Legislature by November 30, 2005. We will be distributing a copy of the report to each member of your committee, as well as staff.

The report begins with a summary of the potential net fiscal impacts to local jurisdictions from the allocation and apportionment methods provided in Section 13 of EHB 2030 which takes effect January 1, 2008. The study also provides eight proposals for mitigating such impacts. The mitigation proposals were prepared with the assistance of Municipal B&O Advisory Committee composed of representatives from the business community and cities that impose a municipal business and occupation tax.

City and business representatives are continuing their discussions on possible mitigation options. Should they reach a consensus on a joint proposal, it will be submitted as an addendum to this report.

We believe the information contained in this report will be useful to you in your deliberations.

Sincerely,

A handwritten signature in cursive script that reads "Cindi L.H. Yates".

Cindi L.H. Yates  
Director

Enclosure



## Municipal Business and Occupation Tax Study of Potential Net Fiscal Impacts

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cc: The Honorable Christine O. Gregoire, Governor  
Senate Ways and Means Committee Members and Staff  
House Finance Committee Members and Staff  
Marty Brown, Director of Legislative Affairs, Office of the Governor  
Victor Moore, Director, Office of Financial Management  
Patsy Ellis, Office Manager, Governor's Executive Policy Office  
Irv Lefberg, Chief of Forecasting, Office of Financial Management  
Scott Merriman, Legislative Director, Office of Financial Management  
Jim Schmidt, Executive Policy Analyst, Office of Financial Management

## **ACKNOWLEDGEMENTS**

The Department of Revenue appreciates the contributions of the following members of the Municipal Business and Occupation Tax Advisory Committee, members of the Allocation and Apportionment Technical Advisory Group, the Association of Washington Cities and their members, and the Department staff who contributed to this report.

### **Municipal B&O Tax Advisory Committee Members**

#### **Business Representatives**

Amber Carter	Association of WA Business (AWB)
Carolyn Fletcher	Starbucks Coffee Company
Carolyn Logue	National Federation of Independent Business (NFIB)
Tom McBride	Association of WA Business (AWB)
Lew McMurrin	Washington Software Alliance (WSA)
Al Ralston	The Boeing Company
Mike Roben	KOM Consulting LLC
Gary Smith	Independent Business Association (IBA)
Wes Uhlman	Wes Uhlman and Associates Inc.

#### **City Representatives and Alternates**

Dwight Dively	City of Seattle
Stan Finkelstein	Association of WA Cities (AWC)
Sheila Gall (Alternate)	Association of WA Cities (AWC)
Gayla Gjertsen	City of Tumwater
Therese Holm	City of Bellingham
Elmer (Ned) Johnston, Jr.	City of Everett
Jim Justin (Alternate)	Association of WA Cities (AWC)
Randy Lewis	City of Tacoma
Randy Lewis	City of Westport
Lucy Liu	City of Bellevue

### **Allocation and Apportionment Technical Advisory Group Members**

Mike Bernard	Madison Cooke
Ron Bueing	Deloitte & Touche
Gayla Gjertsen	City of Tumwater
Lucy Liu	City of Bellevue
Mel McDonald	City of Seattle
Chuck Pietka	Moss Adams LLP
Mike Roben	KOM Consulting LLC
Jodie Trueblood	City of Tacoma
Dan Wright	Grant Thornton, LLP

# Municipal Business and Occupation Tax Study of Potential Net Fiscal Impacts

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## EXECUTIVE SUMMARY

In 2003, the Legislature enacted Engrossed House Bill 2030 (EHB 2030) which provided for a more uniform system of municipal business and occupation (B&O) taxes. It required the cities, working through the Association of Washington Cities (AWC), to form a committee to adopt a model ordinance for municipal B&O taxes.

EHB 2030 also directed the Department of Revenue to perform two studies, a baseline study and a study of potential net fiscal impacts. The Baseline Study was completed in December 2004 and included a comparison of definitions in the municipal B&O tax model ordinance with definitions in the state B&O tax chapter 82.04 RCW, a discussion of definition deviations, and estimates of the fiscal impacts of the deviations on taxpayers.

The Municipal Business and Occupation Tax Study of Potential Net Fiscal Impacts examines the allocation provisions and apportionment method contained in section 13 of EHB 2030. The study also estimates the positive and negative fiscal impacts of the allocation provisions and apportionment method on local jurisdictions. In addition to examining the fiscal impacts, the report includes proposals for addressing any adverse revenue impacts to the local jurisdictions. The Department consulted regularly with the advisory and technical committees. We relied heavily upon input from those business and city representatives. The report of the study is due to the Governor and the fiscal committees of the Legislature by November 30, 2005.

After examining potential net fiscal impacts and proposals for mitigating adversely affected local jurisdictions, the Department finds:

- That the allocation and apportionment provisions contained in EHB 2030 will result in an estimated revenue loss of \$23.3 million in the first year for 39 cities that impose a municipal B&O tax.
- Several options exist for mitigating the potential losses. Eight proposals are presented in this report. They range from repealing section 13 of EHB 2030 (apportionment) to providing full and permanent state-funded compensation using state resources. Proposals for local funding sources for mitigation and centralized administration are also presented.

After listening to each others' proposals, interests, and concerns, representatives of the cities and the business community saw the potential for developing a joint mitigation proposal. In the final few advisory committee meetings and on their own initiative between meetings, discussions were held and drafts exchanged with considerable progress made toward that end. While they did not reach a conclusion by the deadline for this report, they plan to continue their discussions over the next few weeks, and should they reach a consensus, submit an additional agreed to mitigation proposal as an addendum to this report.

## INTRODUCTION

In 2003, the Legislature enacted Engrossed House Bill 2030 (EHB 2030), which provided for a more uniform system of municipal business and occupation (B&O) taxes. It directed the Association of Washington Cities (AWC), with input from the business community, to adopt a model ordinance to serve as a foundation for municipal ordinances that impose a B&O tax on gross receipts. According to the AWC, all cities that impose a B&O tax have adopted the model ordinance. A baseline study, which compared the definitions in the model ordinance with the state definitions, reasons for the deviations, and estimated impacts, was conducted by the Department of Revenue (Department). A report of the study can be found on the Department's Internet site at [www.dor.wa.gov](http://www.dor.wa.gov).

In addition to the model ordinance provisions, EHB 2030 required a new system for the allocation and apportionment of gross income subject to a municipal B&O tax. Apportionment refers to a method of dividing the tax base among the various jurisdictions in which the taxpayer engages in business. Most apportionment laws involve the use of a formula in which the division of a business' income between jurisdictions is based on one or more factors relating to sales income, property value, and payroll amounts. The effect is that a jurisdiction may impose a tax only on a portion of the total income earned by a business that is attributed to the jurisdiction. Allocation refers to the assignment of income to a single jurisdiction. For example, EHB 2030 provides that all income derived from royalties for the granting of intangible rights is allocated to the commercial domicile of the taxpayer.

The new system takes effect on January 1, 2008. In the case of sales of tangible personal property, the taxable activity is taxed in the location where the delivery to the buyer occurs. Gross income from taxable service activities is apportioned to a location on the basis of a two-factor formula consisting of a payroll and service income factor. The new system of allocation and apportionment is a change from the current methods and could result in a loss of revenue for some cities.

EHB 2030 directed the Department to conduct a study of the potential net fiscal impacts of the legislation with particular emphasis on the apportionment and allocation methods contained in Section 13. Additionally, the Department was to examine and recommend options to address any adverse revenue impacts to the local jurisdictions.

The Department met on several occasions with the Municipal B&O Tax Advisory Committee and the Allocation and Apportionment Technical Advisory Group to discuss the study design, methodology, and results.

The findings of the municipal B&O tax study of potential net fiscal impacts, also known as the allocation and apportionment study, are presented in this report. This study was completed using information from 39 of the 40 cities that currently impose a local B&O tax. The city of Des Moines adopted a local B&O tax at the end of 2004, therefore data from that city was not available for this study. The report is due to the Governor and fiscal committees of the Legislature by November 30, 2005.

**ESTIMATED POTENTIAL NET FISCAL IMPACTS**

**Findings**

The Department finds that the allocation and apportionment provisions contained in EHB 2030 will result in an estimated revenue loss of \$23.3 million in the first year for the 39 cities included in this study. This loss results from the elimination of "throwback." Throwback refers to the ability of a city to impose its B&O tax on all of the income generated from activities that occur, at least in part, in a jurisdiction that does not impose a B&O tax if some portion of the activity occurs within the taxing city. Under EHB 2030, throwback is largely eliminated. Throwback is, however, maintained under the apportionment provisions of EHB 2030 for service activities if all or a majority of the service activities are performed within the taxing city, and the customer is located in an unincorporated area of a county.

**Table 1  
Revenue Impacts of Allocation and Apportionment Provisions  
Calendar Year 2004**

<b>City</b>	<b>Loss</b>	<b>Percent</b>
Bellevue	(\$2,023,000)	8.7%
Bellingham	(\$632,000)	2.7%
Everett	(\$773,000)	3.3%
Seattle	(\$15,565,000)	66.8%
Tacoma	(\$1,505,000)	6.5%
All other cities	(\$2,802,000)	12.0%
<b>Total</b>	<b>(\$23,300,000)</b>	<b>100.0%</b>

Table 1 shows the potential revenue impact for one year for the five largest cities with a business and occupation tax. The potential impacts are based on calendar year 2004 tax data.

The city of Seattle accounted for \$15.6 million or 67 percent of the total loss of \$23.3 million. The largest five cities represented \$20.5 million or 88 percent of the total. The net impact to the remaining 34 cities totaled \$2.8 million or 12 percent. Appendix A shows the net impact of the new allocation and apportionment provisions for each of the 39 cities included in this study.

**Apportionment of Service Income**

A Technical Advisory Group was formed from the full Municipal B&O Tax Advisory Committee. This smaller group consisted of both city and business representatives. The Department met with the Technical Advisory Group a number of times to discuss the methodology and the results.

The group agreed that the best way to collect data on the new apportionment formula was to send an informational tax return to each city's B&O tax taxpayers. The cities mailed this return along with each city's quarterly tax return in March 2005. A copy of the return can be found in

Appendix H. Questions on the return focused on service income earned in the state of Washington and at the local level. Each taxpayer was asked to estimate the payroll and service factors that made up the new apportionment formula. The Department received over 12,000 informational returns with service income. The overall response rate for the informational tax return was estimated at 47 percent. This response rate gave us a very representative sample from which to derive our estimates. A more detailed explanation of the methodology behind each estimate can be found in Appendix F.

**Table 2**  
**Revenue Impacts of Apportionment for Service Income**  
**Calendar Year 2004**

<b>City</b>	<b>Loss</b>	<b>Percent</b>
Bellevue	(\$236,000)	4.6%
Bellingham	(\$45,000)	0.9%
Everett	(\$62,000)	1.2%
Seattle	(\$4,040,000)	78.9%
Tacoma	(\$483,000)	9.4%
All other cities	(\$256,000)	5.0%
<b>Total</b>	<b>(\$5,122,000)</b>	<b>100.0%</b>

Table 2 shows the revenue impact of the new provisions for the apportionment of service income. The estimated loss in B&O tax revenues is given for the five largest cities with a municipal B&O tax. The potential loss to the cities for one year based on 2004 city service income data totaled \$5.1 million.

The city of Seattle accounted for \$4.0 million or 79 percent of the total potential loss of \$5.1 million. The largest five cities represented \$4.9 million or 95 percent of the total. The net impact to the remaining 34 cities totaled \$256,000 or 5 percent. Appendix B shows the net impact of the new apportionment provisions for one year for each of the 39 cities included in this study.

**Allocation Provisions for Construction, Wholesale, and Retail Activities**

EHB 2030 provides that the sale of tangible personal property is allocated to where delivery to the buyer occurs. In consultation with the Technical Advisory Committee, the Department determined that the construction, wholesale, and retail industries would be most affected by the new allocation method. Employment Security data, the Department's excise tax data, and Washington's state Input/Output model were used to arrive at the potential impact of the new allocation provisions. A more detailed explanation of the methodology can be found in Appendix F.

**Table 3**  
**Revenue Impacts of Allocation Provisions for Construction, Wholesale, and Retail**  
**Calendar Year 2004**

<b>City</b>	<b>Construction</b>	<b>Wholesale</b>	<b>Retail</b>
Bellevue	(\$184,000)	(\$1,382,000)	(\$221,000)
Bellingham	(\$301,000)	(\$322,000)	\$36,000
Everett	(\$174,000)	(\$463,000)	(\$74,000)
Seattle	(\$3,424,000)	(\$8,100,000)	(\$1,000)
Tacoma	(\$281,000)	(\$774,000)	\$33,000
All other cities	(\$880,000)	(\$1,702,000)	\$36,000
<b>Total</b>	<b>(\$5,244,000)</b>	<b>(\$12,743,000)</b>	<b>(\$191,000)</b>

Table 3 shows the potential revenue impact of the new allocation provisions for construction activity and sales of tangible personal property. The loss in B&O tax revenues by industry is given for the five largest cities with a municipal B&O tax. The loss to the cities totaled \$5.2 million for sales occurring in the construction industry. Seattle accounted for \$3.4 million or 65 percent of the total for construction industry. The five largest cities accounted for \$4.4 million or 83 percent of the total. The losses estimated for one year using 2004 data totaled \$12.7 million for the wholesale industry while the potential losses for the retail industry are \$191,000. The revenue impacts for all 39 cities can be found in Appendices C, D, and E.

The key data source for these loss estimates is the Department's state excise tax data. Using these data for estimating the revenue impact of the allocation provisions assumes that the cities would experience the same level of compliance as the state for their B&O tax. The Department employs an audit staff that maintains this level of compliance while only three cities imposing a B&O tax employ an audit staff. These cities are Bellevue, Seattle, and Tacoma. The actual losses that could be experienced by the other 36 cities could be smaller than these estimates if there is no audit enforcement.

## MITIGATION

In September 2005 the full advisory committee reviewed the potential impacts developed by the Department and the technical advisory group and began discussion of various mitigation proposals. The committee agreed that any and all proposals should be open for discussion. It was also decided that two written statements about mitigation principles by the city and business representatives would be included in this report. While there was no initial proposal that garnered full support, the committee did not want to rule out the possibility that a committee consensus could be obtained on a preferred mitigation proposal.

Eight mitigation proposals are presented in detail for consideration in the body of the report. Proposals cover:

- 1) repealing section 13 of EHB 2030 (apportionment);
- 2) providing full and permanent state-funded compensation through existing state resources;
- 3) increasing the state B&O tax rates to fund full and permanent compensation;
- 4) delaying apportionment until a full non-appropriated, permanent funding source for compensation is available;
- 5) delaying the implementation date of EHB 2030 for two additional years;
- 6) creating a system whereby apportionment implementation can be delayed based on real impacts of the new law on actual revenues and expenses for an individual city;
- 7) DOR administration of local B&O taxes; and
- 8) providing mitigation to impacted cities through additional taxing authority by increasing the local B&O tax rate capacity where needed or providing a local-option sales and use tax designed as a credit against the state sales and use tax.

After listening to each others' proposals, interests, and concerns, representatives of the cities and the business community saw the potential for developing a joint mitigation proposal. In the last few advisory committee meetings and on their own initiative between meetings, they held several discussions and exchanged drafts that have made considerable progress toward that end. While they did not reach a conclusion by the deadline for this report, they plan to continue their discussions over the next few weeks, and should they reach a consensus, submit an additional agreed to mitigation proposal as an addendum to this report.

### **City Principles for B&O Tax Apportionment and Allocation Study** *(Presented by the AWC)*

Forty Washington cities currently impose a gross receipts business and occupation (B&O) tax. EHB 2030, approved by the Legislature in 2003, made a number of changes regarding the implementation of this tax. Section 13 of EHB 2030 will significantly reduce local B&O tax revenues beginning in 2008. We believe it is appropriate for the state to fully compensate cities for this revenue loss.

EHB 2030 also required cities that levy a B&O tax to adopt a model ordinance. The development of the ordinance came out of an effort by cities to address allegations regarding multiple taxation, while also making the tax easier to administer, fair and equitable, and more

consistent but preserving local flexibility, revenue neutrality, and control over this important revenue source for cities.

Cities voluntarily began the B&O Tax Model Ordinance project in the spring of 2000, when neither a 1999 Task Force involving legislators, businesses, and cities, nor a legislative process in 2000, resulted in a solution. The AWC and six cities (Seattle, Tacoma, Everett, Bellevue, Bellingham, and North Bend) participated in technical drafting and policy groups, supported a comprehensive outside legal review, and made presentations to every B&O taxing jurisdiction. Every B&O tax city reviewed the model ordinance and was provided a chance for input and revisions. During subsequent state sponsored task forces and opportunities for business input, cities incorporated provisions and compromised to concerns by including a minimum taxability threshold requirement, standardized definitions, and the multiple activities tax credit provision. All of these have negatively impacted the revenues of B&O tax cities, in addition to the administrative burdens of revising and adopting the model ordinance.

By early 2003, the B&O tax cities representing the majority of B&O tax revenues had already adopted the model ordinance, which provides uniform tax definitions and consistent multiple activities tax credits and allocation rules that eliminated even the potential for multiple taxation. Adoption of the ordinance also required many cities to raise their thresholds to meet the mandate of \$20,000 per year minimum, resulting in revenue losses. Regardless, in 2003 ESHB 2030 was introduced and passed requiring cities to develop and adopt a model ordinance and implement allocation and apportionment provisions in 2008.

Cities never supported the concept of apportionment and opposed the legislation. At the time, cities predicted that the allocation and apportionment provisions would negatively impact local budgets, and that loss was recently documented by this study at \$23.3 million, based on 2004 revenue data. The Legislature and the state have a responsibility to address these documented losses.

Cities voluntarily developed and implemented a model ordinance that creates consistency among cities in definitions and administrative procedures. We also voluntarily developed and implemented provisions to reassure that there would never be multiple taxation of the same revenue. Implementation of these procedures have already placed substantial administrative burdens on cities and caused some revenue losses. Cities should be fully compensated for the implementation of allocation and apportionment provisions that go into effect January 1, 2008.

### **Basic Principles of the Business Community Pertaining to Municipal B&O Taxation** *(Presented by the AWB, the NFIB, and the IBA)*

#### **Overview**

Local taxation in Washington is very complex. This is particularly a problem for businesses doing business in multiple locations because many of the state's cities impose B&O taxes and/or a public utility tax while others do not. To compound the problem, a business located in a B&O tax city that also has sales in other locations outside the city may well face double taxation on the sale as each city claims B&O taxes on the same sale. Also, some cities impose "throwback"

requirements requiring businesses to pay city B&O taxes on sales made in non-B&O tax jurisdictions outside the taxing city.

Businesses doing business in multiple B&O tax cities receive a quarterly tax report for each city they do business in and may result in the business having to complete 15 or more city B&O tax reports each quarter which results in substantial administrative cost to the taxpayers as well as the cities. The high level of complexity and high administrative costs make compliance extremely challenging and overly costly.

Forty cities impose B&O taxes on the gross receipts of activities conducted by businesses without any deduction for the costs of doing business. A city with a B&O tax imposes the tax on a business if the city determines that there is nexus.

Over the years, each city enacted its own definitions and tax classifications through various ordinances. This led to a complicated and confusing situation in which taxpayers are confronted with differing interpretations of the tax laws from the state to the local level and among the cities. As a result, the Legislature in 2003 required adoption of a model B&O ordinance by the state's cities that impose a B&O tax (EHB 2030).

The business community supported EHB 2030 as a means to bring fairness, uniformity and consistency to municipal B&O taxation while eliminating multiple taxation of the same business activity. The intent of the bill was to require the cities to adopt a model ordinance with uniform definitions for all cities. Small businesses were protected from taxation when they only did minimal business in a city through the establishment of a uniform minimum threshold of \$20,000. Situations where two cities each attempted to collect 100 percent of tax owed on the activity were eliminated. To further ensure that cities only collect tax on activities performed within their jurisdiction, an apportionment provision was put into the law but implementation was delayed to give cities time to adjust.

### **Municipal B&O Tax Principles**

- The business community supports the imposition of mandatory municipal B&O tax apportionment (without “throwback”) as defined in EHB 2030 along with a single, combined city B&O tax report where a single taxpayer’s municipal B&O tax liability is reported for all B&O tax cities in Washington State on the one form.
- The business community supports taxation of gross receipts only in the city where the transaction or business activity occurs.
- Under the adopted model ordinance, taxpayers may be treated as having nexus even where the taxpayers’ only activity is delivering into a city using its own trucks or acting on its behalf. The business community supports a requirement of a significant physical presence in the jurisdiction as a prerequisite to taxation by that city.
- The cities’ adoption of a model code as required by EHB 2030 allows for unacceptable deviations that eliminate B&O tax consistency among the cities. Short of a true model code, the requirement that taxes be apportioned among jurisdictions and collected by the Department of Revenue (Department) is the best way to eliminate multiple taxation, reduce



tax administration costs for both taxpayer and municipalities, facilitate greater voluntary taxpayer compliance, and ensure consistent B&O tax administration.

## **Mitigation Proposals**

The following proposals were presented by the Municipal B&O Tax Advisory Committee members and the Department of Revenue. Where appropriate, city representatives, business representatives, and the Department have made comments about each proposal.

## Proposal #1

### **Sponsor**

Association of Washington Cities

### **Description**

Repeal apportionment

### **Mechanism for Mitigation**

Eliminate losses to cities due to apportionment by repealing Section 13 of EHB 2030 providing for apportionment.

### **Duration of Mitigation**

Permanent

### **Amount of Mitigation**

Full mitigation of losses by eliminating mechanism that creates them.

### **Source of Funds**

N/A

## **Sponsor's Statements of Advantages and Disadvantages**

### **Advantages**

Achieves the policy objectives of the original municipal B&O tax task force, equity and fairness in local B&O tax administration, while eliminating the tax loss to cities caused by apportionment.

Eases the administrative burden. The apportionment formula provided in EHB 2030 will be administratively burdensome for both cities and businesses to administer. Many believe it is unworkable in its current form.

Eliminates burden on small business to upgrade accounting systems to comply with apportionment.

Eliminates the need for special legislation by industries seeking exemption from apportionment, e.g. SHB 2033 (Modifying the Allocation of Printing and Publishing Income) from the 2005 legislative session.

### **Disadvantages**

None listed.

## **Comments from City Representatives on Advisory Committee**

This is a city sponsored proposal.

## Comments from Business Representatives on Advisory Committee

### **NFIB Comments:**

Oppose – Apportionment is a necessary part of streamlining within our Municipal B&O system to bring fairness back to the system and ensure that taxes are imposed only based on business done within the city.

### **IBA Comments:**

Strongly Oppose – Apportionment is fundamental to a fair, reasonable and just tax system. Taxes imposed should be based on business done in a taxing jurisdiction. For taxes imposed by states, across state lines, it would violate the Constitution’s commerce clause not to have apportionment (See PUBLIC UTILITY DISTRICT No. 2 OF GRANT COUNTY et al., Respondents, v. THE STATE OF WASHINGTON, Appellant (Wn.2d 232, 510 P.2d 206). Cities cannot impose their B&O taxes across state lines without full apportionment. The same approach must apply to municipal B&O taxes within the state for the municipal B&O taxes to be considered fair, reasonable and just within Washington State.

The “throwback” provisions now being applied by B&O tax cities in Washington State are likewise in violation of a fair, reasonable and just tax system and must be ended as soon as possible to protect the future economic well-being of Washington State. “Throwback” has been found to be a violation of the commerce clause of the U.S. Constitution (see *Home Interiors & Gifts, Inc. v. Strayhorn*, (July 28, 2005), and *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274) and cannot be applied across state lines. In good conscience and for the economic well being of the state, they can no longer be applied within Washington State either.

### **AWB Comments:**

Forty cities impose B&O taxes on the gross receipts of activities conducted by businesses without any deduction for the costs of doing business. A city with a B&O tax imposes the tax on a business if the city determines that there is nexus. Currently, if nexus is established, some cities assert a B&O tax on the entire value of the transaction or particular activity involved without regard to the place where the transaction or business activity occurs. AWB supports taxation of gross receipts only in the city where the transaction or business activity occurs. Under the adopted model ordinance, taxpayers may be treated as having nexus even where the taxpayers’ only activity is delivering into a city using its own trucks or acting on its behalf. AWB supports a requirement of a significant physical presence in the jurisdiction as a prerequisite to taxation by that city.

The cities' adoption of a model code as required by EHB 2030 allows for unacceptable deviations that eliminate B&O tax consistency among the cities. AWB believes that the revenue system should be simple, straightforward, and easily understandable in order to foster voluntary compliance and to minimize administrative costs of compliance. Moreover, the revenue system should make every effort to mitigate or reduce any involuntary compliance-related cost burdens on business. Short of a true model code, the requirement that taxes be apportioned among jurisdictions and collected by the Department of Revenue (Department) is the best way to eliminate multiple taxation, ensure consistent B&O tax administration, and encourage voluntary

compliance. Therefore, AWB supports the immediate imposition of mandatory municipal B&O tax apportionment and collection to be administered by the Department. While apportionment should begin as scheduled, AWB recognizes that the formula scheduled to take effect in 2008 has problems and can be improved in order to make it better for both cities and businesses.

In short, AWB opposes the proposal and supports the following three positions:

1. Ensure that, where a business performs activities in multiple jurisdictions, municipal B&O taxes are apportioned so a business is taxed only on the transaction or business activities performed within the taxing jurisdiction and collectively at no more than 100 percent of its gross receipts taxable in Washington.
2. Support the transfer of the duty to collect and administer municipal B&O and public utility taxes to the state Department of Revenue. This would lessen the taxpayers' reporting burden, ensure consistent application of B&O taxation, and increase tax compliance for local jurisdictions.
3. Support a model municipal B&O code that is consistent with the state B&O code and that is applied consistently among jurisdictions.

### **DOR Comments**

The apportionment formula in section 13 of EHB 2030 contains ambiguities that make the formula challenging for taxpayers and the cities to apply. These include issues with the terms "everywhere" and "costs of performance" and the definitions of "service income," "customer location," and "tax period." Consideration should be given to adopting a revised apportionment formula that addresses ambiguities and is easier for taxpayers and the cities to apply before the formula becomes effective on January 1, 2008.

## **Proposal #2**

### **Sponsor**

Association of Washington Cities

### **Description**

Full and permanent state-funded compensation to 40 B&O tax cities for growing losses each year associated with the implementation of apportionment. Fund from state revenue source, i.e. share of state B&O taxes.

### **Mechanism for Mitigation**

Determine actual losses for each city. Provide for supplemental reporting by businesses similar to survey data compiled for study. Supplemental reports would document actual losses due to apportionment.

Allocate a percentage share of a state revenue source in an account for B&O tax cities compensation. Index the allocation to grow at a rate similar to revenue losses. Allocate distributions based on a formula and provide for periodic revisions according to updated information.

### **Duration of Mitigation**

Permanent

### **Amount of Mitigation**

Full mitigation of growing actual losses to 40 B&O cities.

### **Source of Funds**

Share of existing or new state revenue source, i.e. formula percentage of share of state B&O taxes.

### **Sponsor's Statements of Advantages and Disadvantages**

#### **Advantages**

Would fully compensate all B&O tax cities for significant negative consequences of ESHB 2030. The Department of Revenue has documented a \$23.3 million loss in local B&O tax revenues to cities based on 2004 revenues.

Available funds for compensation could grow with state revenues and could be indexed to grow at a similar rate to losses.

#### **Disadvantages**

Impacts state revenues.

Would require some supplemental reporting by businesses.

## **Comments from City Representatives on Advisory Committee**

This is a city sponsored proposal.

## **Comments from Business Representatives on Advisory Committee**

### **NFIB Comments:**

Oppose – The changes made in HB 2030 were intended to change the way in which municipal B&O taxes are collected and therefore meant to change the amount of taxes collected by the jurisdiction. Any losses should only be associated with a one-time change in the way in which a city can tax; therefore full and permanent mitigation would only give B&O cities money they would not otherwise be receiving under the law.

### **IBA Comments:**

Oppose – Proposal #7 provides permanent mitigation opportunities through tax administration efficiency and improved voluntary compliance. Requiring state taxpayers to subsidize cities to continue tax revenues based on excessive taxes the cities have collected over the years is simply bad tax policy. When federal courts find that state taxes are illegal and unjustified, the state is no longer allowed to collect those taxes and federal taxpayers are not required to make the state “whole.” Also, please see our comments under Proposal #1.

### **AWB Comments:**

Please see comments to Proposal #1.

In addition, AWB opposes a mitigation plan- temporary or permanent. It is AWB’s position that the apportionment formula simply ensures that, where a business performs activities in multiple jurisdictions, municipal B&O taxes are apportioned so that a business is taxed only on the transaction or business activities performed within the taxing jurisdiction and that should in no event be more than 100 percent of a company’s gross receipts taxable in Washington. The apportionment formula clarifies proper apportionment and should not be considered the cause of any losses that may accrue to local jurisdictions. The fact that some jurisdictions will lose revenue is a result of excessive revenues collected in the past which are now prohibited under the law. In the event a mitigation plan is contemplated by the legislature, under no circumstance should it be funded with general fund state dollars. The revenue system should avoid the generation of any revenue that is dedicated/earmarked to fund a purpose unrelated to the activity taxed.

### **DOR Comments**

Obtaining information for calculating cities' revenue losses would require continual additional reporting by businesses. To eliminate the need for continual additional reporting by businesses, this proposal could be modified to base mitigation on this study.

This proposal provides for permanent mitigation and requires a prediction of how losses due to apportionment would grow. Actual revenue losses would be difficult, if not impossible, to determine. At best, these figures would only be estimates.

This proposal could be modified to provide for less than full mitigation. A variation would be to fund mitigation at 50 percent (or some other percentage) and to phase it out over five, ten, or some other number of years.



## **Proposal #3**

### **Sponsor**

Association of Washington Cities

### **Description**

Raise state B&O tax rates in an amount sufficient to equal city losses and provide full, permanent state-funded compensation to 40 B&O tax cities for growing losses each year.

### **Mechanism for Mitigation**

Determine actual losses for each city. Provide for supplemental reporting by businesses to gather data to outline exact impacts by city.

Raise state B&O tax rates in an amount sufficient to equal city losses and provide full, permanent state-funded compensation to 40 B&O tax cities for growing losses each year.

### **Duration of Mitigation**

Permanent

### **Amount of Mitigation**

Full mitigation of growing actual losses to 40 B&O cities.

### **Source of Funds**

New state revenue from increase in state B&O tax rates.

## **Sponsor's Statements of Advantages and Disadvantages**

### **Advantages**

Would fully compensate all B&O tax cities for fiscally negative consequence of ESHB 2030. The Department of Revenue has documented a \$23.3 million loss in local B&O tax revenues to cities based on 2004 revenues.

Available funds for compensation would grow with state B&O tax revenues and at the same rate as losses.

Would not impact existing state revenues.

### **Disadvantages**

Would require supplemental reporting by businesses.

Would raise rates on all B&O taxpayers, not just those recipients of the \$23.3 million tax break.

## **Comments from City Representatives on Advisory Committee**

This is a city sponsored proposal.

## **Comments from Business Representatives on Advisory Committee**

### **NFIB Comments:**

Oppose – Small businesses in Washington State should not have to see their state B&O taxes increase to pay for a change in what taxes cities can collect – particularly when those tax collections have been in excess of business actually done in their taxing jurisdiction. Also, see comments under Proposal #2.

### **IBA Comments:**

Oppose – Proposal #7 provides permanent mitigation opportunities through tax administration efficiency and improved voluntary compliance. Requiring state taxpayers to subsidize cities to continue tax revenues based on excessive taxes the cities have collected over the years is simply bad tax policy. When federal courts find that state taxes are illegal and unjustified, the state is no longer allowed to collect those taxes and federal taxpayers are not required to make the state “whole.” Also, please see our comments under Proposal #1.

### **AWB Comments:**

Please see comments to Proposals #1 and #2.

In addition, AWB opposes any increase in the state B&O tax rates. The revenue system should be broadly based with the lowest possible rates that are consistent with the encouragement of economic expansion and private sector job creation. The revenue system should provide for distribution of liabilities between individuals and enterprises to ensure that the responsibility to fund societal needs does not fall disproportionately upon one group over another. The revenue system should not place businesses – whether wholly within Washington or in interstate commerce – at a competitive disadvantage.

The state’s tax system already places an inordinate amount of the revenue burden on business. According to a 2004 Milken Institute report, Washington ranks 14<sup>th</sup> highest of all the states in the cost of doing business, Oregon ranks 28<sup>th</sup> and Idaho ranks 46<sup>th</sup>. In Washington, business pays approximately 46 percent of the total state and local tax burden (Washington State Tax Structure Study Committee, November 2002)—54 percent if you add workers’ compensation and unemployment insurance costs. Among the seven western states, the average share of taxes paid by business is 29 percent, according to the Utah State Tax Commission.

The causes of this burden are many, including Washington’s tax structure. Washington has a punitive gross receipts tax (business and occupation tax), a modest property tax and a very high sales tax. Neighboring and competing states typically offer a lower or no sales tax, a property tax and an income tax. The significant and consistent difference is that Washington substitutes the gross receipts tax for the more common income tax. However, Washington’s gross receipts tax is typically higher than neighboring states’ income taxes because it is calculated on gross rather than net income. As a result, Washington’s business taxes are higher than most other states.

## **DOR Comments**

Obtaining information for calculating cities' revenue losses would require continual additional reporting by businesses. To eliminate the need for continual additional reporting by business, this proposal could be modified to base mitigation on this study.

This proposal provides for permanent mitigation and requires a prediction of how losses due to apportionment would grow. Actual revenue losses would be difficult, if not impossible, to determine. At best, these figures would only be estimates.

An increase of 1 percent in the B&O tax rates would be required for full mitigation based on the 2004 information. For example, the state B&O tax rate for manufacturing would increase from the current rate of 0.00484 to a rate of 0.004898. Such a small increase in the state B&O tax rate would result in tax rates carried out past the fifth decimal place in some cases, which could potentially increase errors in reporting. In turn, these errors create administrative burdens for taxpayers and DOR.

A variation of this proposal would be to fund mitigation at 50 percent (or some other percentage) and to phase it out over five, ten, or some other number of years.

## **Proposal #4**

### **Sponsor**

Association of Washington Cities

### **Description**

Delay apportionment until full non-appropriated, permanent funding source for compensation is available. Provide state funding source to provide full, permanent state-funded compensation to 40 B&O tax cities for growing losses each year when revenues are identified.

### **Mechanism for Mitigation**

Delay effective date of apportionment until state funding source becomes available to fully compensate losses to cities. When revenue source becomes available, allocate it to new fund to provide full, permanent state-funded compensation to 40 B&O tax cities for growing losses each year based on actual losses.

### **Duration of Mitigation**

Permanent

### **Amount of Mitigation**

Full mitigation of growing actual losses to 40 B&O cities.

### **Source of Funds**

New state funding source.

### **Sponsor's Statements of Advantages and Disadvantages**

#### **Advantages**

After delayed implementation, would fully compensate all B&O tax cities for fiscally negative consequence of EHB 2030. The Department of Revenue has documented a \$23.3 million loss in local B&O tax revenues to cities based on 2004 revenues.

Eases administrative burden. The apportionment formula provided in EHB 2030 will be administratively burdensome for both cities and business to administer. Many believe it is simply unworkable in its current form.

Gives state and cities more time to interpret and potentially amend problematic definitions within allocation and apportionment formulas. This effort could also benefit from the state's adoption of its service apportionment formula (currently a draft rule) and allow businesses to implement potentially conflicting definitions and formulas at different times.

Would not impact current state revenues.

## **Disadvantages**

### **Comments from City Representatives on Advisory Committee**

This is a city sponsored proposal.

### **Comments from Business Representatives on Advisory Committee**

#### **NFIB Comments:**

Oppose – This option would most likely result in a permanent delay because of the controversy over the provision of a permanent funding source. The idea of a city receiving permanent funding from the state simply because it cannot collect taxes after a law change is opposed by NFIB members. Cities, like state government, must adjust to create budgets based on the revenues they are allowed to collect. Limiting cities to only collecting taxes on activities within their jurisdictions is only fair to all taxpayers.

#### **IBA Comments:**

Oppose – The current municipal B&O tax system is unfair and illegal. A solution must be found sooner than later. See Proposal #7 as a more responsible option. Also, please see our comments under Proposal #1.

#### **AWB Comments:**

Please see comments to Proposals #1, #2, and #3.

#### **DOR Comments**

Obtaining information for calculating cities' revenue losses would require continual additional reporting by businesses. To eliminate the need for continual additional reporting by businesses, this proposal could be modified to base mitigation on this study.

This proposal provides for permanent mitigation and requires a prediction of how losses due to apportionment would grow. Actual revenue losses would be difficult, if not impossible, to determine. At best, these figures would only be estimates.

A variation would be to fund mitigation at 50 percent (or some other percentage) and to phase it out over five, ten, or some other number of years.

## Proposal #5

### **Sponsor**

Mike Roben

### **Description**

Defer implementation date

### **Mechanism for Mitigation**

Defer implementation date for two additional years

### **Duration of Mitigation**

Two-year deferral

### **Amount of Mitigation**

Defer the effective date of the implementation

### **Source of Funds**

None

## **Sponsor's Statements of Advantages and Disadvantages**

### **Advantages**

1. Easier “sell” to Legislature than a request for financial resources since no funds required from state.
2. Equivalent to 100 percent funding for two years.
3. Provides cities additional time to budget for the impact.

### **Disadvantages**

1. Delays effective date of legislation.

## **Comments from City Representatives on the Advisory Committee**

Cities appreciate the concept behind this proposal, particularly the recognition that apportionment will be difficult to implement and will cause severe budget losses to local jurisdictions.

However, this option does not address mitigation once apportionment is implemented after the deferral expires. Therefore, cities would prefer to continue discussions under Proposal #7 that would tie delayed implementation to a system of mitigation.

As a note, a preferred length of time for deferral would be three years so that implementation would coincide with the beginning of a biennial budget to accommodate those cities that budget every two years, which are statutorily required to begin in odd-numbered years.

## **Comments from Business Representatives on Advisory Committee**

### **NFIB Comments**

Oppose – Simply deferring the implementation date for no specific reason only pushes the problem to a later date rather than forcing the cities to change their practices (and revenue streams) to adapt to the law change.

### **AWB Comments:**

Please see comments to Proposal #1.

### **DOR Comments**

None

## **Proposal #6**

### **Sponsor**

NFIB, based on discussions during negotiations on HB 2030

### **Description**

To set up a system whereby apportionment implementation can be delayed based on the real impacts of the new law on actual revenues and expenses for an individual city.

### **Mechanism for Mitigation**

Using 2006 actual revenues vs. expenses, each city would determine the impact of apportionment on their city budget. The impact would be indicated by showing an actual reduction in total revenues in terms of a percentage.

Mitigation would only occur if the actual reduction in total revenues results in negative revenue over expense number. If revenues in 2006, less apportionment impact, still exceed projected expenses, then the city would not be eligible for apportionment mitigation and would be expected to fully implement apportionment on schedule in 2008.

If a city has a revenue reduction of 20 percent to 29 percent that brings its revenues below expenses, the city can delay implementation of apportionment until 2010 in order to go to voters with ideas for changing the tax base.

If a city has a revenue reduction of 30 percent or more bringing into a negative balance, the city can delay implementation of apportionment until 2013 in order to go to voters with ideas for changing the tax base.

### **Duration of Mitigation**

One-time mitigation based on delay mechanism outlined above

### **Amount of Mitigation**

Amount of mitigation beyond the delay only would be up to local officials and local voters based on their individual needs.

### **Source of Funds**

No funds needed unless approved by local officials and voters

### **Sponsor's Statements of Advantages and Disadvantages**

#### **Advantages**

- Implements full apportionment but allows negatively impacted cities time to go to local officials and voters to examine city revenues and make necessary changes.



- Mitigation would be locally controlled, not state controlled, and therefore based on the needs of the individual city.

### **Disadvantages**

- Local voters and officials may be unwilling to change tax base to accommodate new revenue sources or may be unwilling to reduce expenditures to help mitigate impact.
- Mitigation would be short term and would result in cities adjusting revenues and expenditures to meet the letter of the new law rather than receiving ongoing money to replace loss.

### **Comments from City Representatives on Advisory Committee**

This option has several problems. First, it would be administratively difficult to determine actual losses without implementation of apportionment, and the requirement linking losses to total revenues and expenses ignores the reality of economic cycles within cities. It also implies that budgetary dislocations will be less of an issue for jurisdictions that may have increased revenues, regardless of whether those revenues (or expenses) are linked to annexations, one-time revenues, such as construction-related revenues, grants, etc., or an economic upturn.

Second, the threshold of a 20 percent revenue loss would effectively mean that no city would receive mitigation.

### **Comments from Business Representatives on Advisory Committee**

#### **NFIB Comments:**

Neutral – The only benefit to this proposal over other delay tactics is that it attempts to tie the delay to ACTUAL losses by the cities – not just reduced revenues. It also does not apply a permanent funding strategy under the assumption that the city will have to find its own way to adapt to the law at some point.

#### **IBA Comments:**

Oppose – A fundamental to a fair, reasonable and just taxing system is that all taxpayers are treated the same. Phasing in apportionment implementation will treat taxpayers differently depending on which jurisdiction they are doing business in which is not fair, reasonable or just. See Proposal #7 as a more responsible option.

#### **AWB Comments:**

Please see comments to Proposal #1.

#### **DOR Comments**

This proposal does not clearly explain how actual revenue losses would be calculated, or whether each city would calculate its losses, or if some agency or other third party would determine losses.

Obtaining information for calculating cities' revenue losses would require continual additional reporting by businesses. Actual revenue losses would be difficult, if not impossible, to determine. At best, these figures would only be estimates. To eliminate the need for continual additional reporting by businesses, this proposal could be modified to base mitigation on this study.

Under this proposal some cities would have to implement the allocation and apportionment provisions of EHB 2030 on schedule in 2008 while some cities would delay implementation until 2010 or 2013. Some cities would have apportionment while others would not.

## Proposal #7

### Sponsor

Mike Roben, Ron Bueing, Association of Washington Business\*, Independent Business Association\*, National Federation of Independent Business\*

*\* Time has not allowed a full review of this proposal by the organization's members but the organization anticipates that its members will support the concepts in this proposal. Whatever proposal is developed through the stakeholder process will be subject to approval by the organization's governing authority.*

### Description

Create a single municipal B&O tax reporting form for businesses located in cities imposing a B&O tax. The return would be sent from the Department of Revenue (DOR) to all business taxpayers in cities imposing a municipal B&O tax. The returns would be mailed back to the DOR for depositing of the funds, distributing funds to the cities, and preparing a report for each city based on the returns received. The DOR would perform functions associated with taxpayer information, tax collection, auditing, and other administration.

Improve current municipal B&O tax uniformity to the maximum extent possible by utilizing one of the following options:

1. Municipal B&O tax laws would be the same as the state's B&O tax laws.
2. The cities have a single municipal B&O tax law in state statute that applies to all cities with a B&O tax. This law would parallel state B&O tax laws but may deviate with respect to exemptions, deductions, and credits. This municipal B&O tax law is separate from the state's B&O tax law so the cities have "ownership." Interpretations under the municipal B&O tax laws – using the state's existing Board of Tax Appeals, etc. - apply uniformly to all B&O tax cities.
3. The cities have a single municipal B&O tax law adopted by rule through the DOR. This municipal B&O tax adopted by rule applies to all cities with a B&O tax. This law would parallel state B&O tax laws but may deviate with respect to exemptions, deductions and credits. This municipal B&O tax rule is separate from the state's B&O tax law and rule, and the cities have "control" and "ownership." Interpretations under the municipal B&O tax rules – using the state's existing Board of Tax Appeals, etc. - would apply uniformly to all B&O tax cities.

## **Mechanism for Mitigation**

Each B&O tax city would enjoy an increase in tax collections and a reduction in both direct and indirect costs as follows:

- Increase in tax revenues by increasing compliance simply through a single return for all cities. The sales could much more easily be reconciled among B&O tax cities. Reporting will be far easier for all sizes of business taxpayers, resulting in increased compliance and tax collections.
- Increased licensing fees would also be a result as a firm reporting in a B&O tax city that also has a license fee will be clearly identified for licensing purposes.
- Auditing efficiency will increase dramatically which will strongly encourage greater voluntary compliance and thus increase tax revenues to each B&O tax city.
- Reduction in direct costs by not having to prepare tax reports, mail tax reports, data enter tax reports, account for taxes paid, answer tax questions.
- Reduction in indirect costs such as not having to provide taxpayer information and advice if this activity were transferred to the DOR.

**An option for additional mitigation could include** adding a small surtax (i.e. 1 percent of total taxes due) to the bottom of the municipal B&O tax report to be used for direct mitigation allocation among the adversely affected B&O tax cities. All municipal B&O tax taxpayers would pay this surtax. It would be up to the cities to allocate the funds from this mitigation account.

## **Duration of Mitigation** (Dollar estimates provided by sponsors.)

- \$5 million to \$19 million per year in permanent mitigation will result from reduced costs to cities not having to collect the taxes individually.
- \$4 million to \$16 million per year in permanent mitigation will result from increased voluntary compliance.
- \$2 million per year in temporary mitigation – over a five-year period with a phase-out to allow for a phase-in of more voluntary compliance - will result from a 1 percent surtax on the municipal B&O taxes due.

## **Source of Funds**

- Permanent funds through improved voluntary compliance
- Permanent funds through improved reporting efficiencies
- Temporary funds through a new temporary surtax

## **Statements of Advantages and Disadvantages**

### **Advantages**

- Substantial savings for taxpayers by having only one form to complete
- Substantial savings for cities by not having to send forms to firms located outside their city
- Substantial savings to cities for not having to process returns from multiple jurisdictions
- Substantial permanent mitigation funding

- Substantial savings to cities if DOR provides both auditing and taxpayer assistance services to cities – results in effectively a one-stop shop for state and local business tax information.
- Improved voluntary compliance.
- Cities can still control their municipal B&O tax policies using one of the options above
- Much of the expected negative impact from apportionment is offset by permanent increases in tax revenues and permanently reduced costs.
- DOR is already collecting local sales taxes, and this concept would be similar in scope and thus relatively easy to do given the long-standing local sales tax collection experience of the DOR.
- Cities will be able to free up existing staff to attend to other city needs.
- Improved auditing and compliance tools for cities to collect the taxes owed them.

### **Disadvantages**

This proposal requires some cities to give up direct control of their individual city B&O tax and instead rely on city group-control through working with other B&O tax cities.

### **Comments from City Representatives on Advisory Committee**

Cities found this proposal to be a little unclear, since in some places it seemed to say that the Department of Revenue would control administration, but it also listed this provision as “optional.” The end of the proposal seemed to suggest that a city consortium would control definitions, administration, etc.

Cities would oppose the “optional” portions of the proposal related to state administration. The linkage of the city B&O tax to the state’s definitions and administration gives up too much local control, would result in DOR rulemaking and Board of Tax Appeals interpretations that could negatively impact cities, and, like the sales tax administration, would further subject cities to potential losses when the Legislature made changes in definitions that could disproportionately impact cities.

The alternative interpretation of this option offers cities some basis for continued study and discussions of mitigation and a centralized “city group-control” B&O administration process. Cities believe such a system would involve a tax form that includes all B&O tax cities and a central city consortium to collect, audit, and administer the taxes. However, any such discussions must adequately protect local control and revenues, provide adequate time and resources to develop the necessary administration processes and computer systems, and fully mitigate losses.

To make centralized administration by a city group-control process feasible, cities believe that at least an additional three-year delay would be needed in order to study the idea of a city-run consortium, develop an inter-local agreement, staff the administration, audit, and appeals functions, and develop a computer system that would be capable of administration and distribution. Cities would need to retain discovery audit authority for the other locally administered taxes and fees, such as utility and admissions taxes.

Cities also question the amount of administrative efficiencies and compliance increases assumed in the proposal, which seem to assume DOR administration in order to achieve the assumed reduction in expenses. In particular, the majority of the tax losses are in the few jurisdictions that have compliance and audit capabilities, and most cities do not have significant administrative costs associated with B&O tax administration. For the smaller cities, B&O tax administration is just a portion of a staff person's job, no staff reductions would occur, and very little actual "savings" would be realized by state administration.

Further, systems are already in place to potentially increase compliance. The state regularly shares sales and other tax data with cities which use this information to identify noncomplying taxpayers. Cities, like Bellevue and Tumwater, have the ability to license businesses through the state's master business license program, already resulting in any increased statewide registration compliance, but maintaining local control over local licensing and B&O tax administration.

In addition, this option does not account for an administrative burden on the Department of Revenue for potential tax administration. DOR charges an "administration fee" for the administration of other taxes, such as the sales tax, currently 1 percent of collections.

Finally, cities would like further discussions on the surtax proposal, as long as it was imposed statewide by the Legislature, did not have a limited duration, and was sufficient to fully compensate cities (it may need to be in excess of 1 percent of collections to fully compensate cities).

### **Comments from Business Representatives on the Advisory Committee**

#### **NFIB Comments:**

Support – The concept of centralization allows cities to reduce administrative costs thus mitigating any revenue loss that may occur as a result of the law change. However, the mitigation is one that is built into the structure of the system without impacting taxpayers. In addition, centralization of local B&O taxes could easily result in greater tax compliance by small business because of better communication, reduced administrative costs for business, and greater understanding of tax laws.

#### **IBA Comments:**

Support – This provides significant and permanent mitigation for B&O tax cities while ensuring a fair, reasonable and just tax system in Washington State for all B&O tax cities. It also provides additional temporary mitigation to assist the cities through the transition from the current unjust tax system to the fair, reasonable and just fully apportioned B&O tax system. The law of the land in the United States through the Constitution's commerce clause is a fully apportioned tax system without "throwback" provisions. Clearly, based on fair, reasonable and just tax policies, a fully apportioned tax system that does not include any throwback provisions is the law of the land in the United States and clearly must be in Washington State to enhance the state's ability to encourage businesses to locate and do business in Washington State.

The IBA estimates permanent mitigation of \$23 million annually (without any determination as to the degree of confidence) to cities in both administrative savings by not having to send out, receive, data entry, and account for multiple tax reports (estimated to be many times the number of taxpayers as each city sends an individual tax report to taxpayers both inside and outside their cities under the current system meaning taxpayers must complete city B&O tax reports for many different cities each quarter) and increased tax collections via improved compliance simply due to simplifying the administration. This compares very favorably with the estimated revenue loss of between \$19.4 million and \$23.3 million. These estimates have been shared with the cities and the Department as part of the meetings held during 2005.

### **AWB Comments:**

AWB is a sponsor of this proposal (with one consistent state and municipal B&O tax law) subject to final approval by AWB's governing authority.

### **DOR Comments**

There would be substantial costs for the state to administer this proposal as constructed. The more uniform the tax system, the lower the costs will be for state administration. From the Department's perspective the most efficient and cost effective system for state administration of local B&O taxes would have the following characteristics:

- Uniform tax base and definitions matching the state B&O tax base and definitions.
- Uniform tax rates.
- Few or no local tax credits or deductions.
- Uniform tax liability threshold matching the state liability threshold for reporting.
- Tax reporting frequencies same as state reporting frequencies.
- DOR conducts audits and assesses and collects unpaid tax in addition to the return processing function.
- DOR hears appeals of tax assessments and makes determinations.
- State penalties and interest provision apply.
- All administrative provisions of chapter 82.32 RCW apply.
- State administrative fee (a percentage of local B&O tax revenue received) is applied to recover costs of administration.
- All city B&O taxes administered by state, no opt-in or opt-out provisions.
- An accounting system for local B&O taxes separate from the state system of accounting for current state excise taxes. Local B&O tax revenues would be distributed separately from other state or local taxes. The state would not distribute local B&O taxes reported until paid.
- Electronic reporting required. (The more paper allowed, the higher the costs to administer. With paper come increased errors in reporting. Electronic filing of tax returns would also allow for more local variations, such as credits or deductions unique to an area, without substantially increasing costs.)

DOR assumes that Proposal #7 would not affect local administration of other local taxes and fees such as local public utility and admissions taxes, business improvement and LID assessments,

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licensing and registration fees, and assorted other local charges. It is assumed that businesses would file separate returns to the cities (not the state) for such taxes.

Regarding option #3 in this proposal (adopting municipal B&O tax law using DOR rule making) – municipal tax law should be imposed by statute instead of rule.



## Proposal #8

### Additional Option

Description by the Department of Revenue

### Description

Provide negatively impacted cities additional taxing authority.

#### **The following two options could be used to provide additional taxing authority:**

- **Option 1:** Allow jurisdictions to use their existing local B&O tax rate capacity to mitigate losses and provide additional capacity where needed.
- **Option 2:** Provide a local option sales and use tax for those negatively impacted cities identified in this study. The local-option sales and use tax could be designed as a credit against the state sales and use tax, resulting in no overall increase in state and local sales and use taxes within the jurisdiction.

### Duration of Mitigation

It could either be permanent or temporary.

### Amount of Mitigation

It could be full or partial mitigation based on the Department's study.

### Source of Funds

- New local revenues from increase in local B&O tax rates
- State general fund revenues from the local-option sales and use tax credited against the state sales and use tax

### Sponsor's Statements of Advantages and Disadvantages

#### **Advantages**

- Option #1 of this proposal would not impact state revenues.
- Would not require supplemental reporting by businesses.
- Would not require the Department of Revenue to perform any further studies on the fiscal impacts of the apportionment and allocation provisions of EHB 2030.
- Could be packaged with other mitigation proposals such as centralized administration of local B&O taxes or delaying the allocation and apportionment provisions of EHB 2030.
- Cities could make an individual choice to mitigate with this option.

#### **Disadvantages**

- Could be politically difficult to raise taxes.
- Depending on the amount of additional taxing authority provided, some jurisdictions may not be fully mitigated.

- The local sales and use tax as a credit against the state sales and use tax option negatively impacts state revenues.

### **Comments from City Representatives on Advisory Committee**

Cities appreciate the concept of providing full mitigation for the estimated \$23.3 million loss through local tax authority.

The ability to raise B&O tax rates to mitigate losses would be helpful to some but not all B&O tax cities. While many B&O tax cities are at the 0.002 maximum rate allowed by RCW 35.21.710, several more cities are actually above that rate due to grandfathered rates or voter approved higher rates for specific purposes. This also asks city councils to make local tax votes to compensate for an action imposed by the state Legislature. Cities would prefer the surtax option in Proposal #7 which would be enacted by the Legislature and would apply in all B&O tax cities to spread the mitigation burden.

The second proposal to provide a local option sales tax is preferable to local option B&O tax rate increases, especially if it were accompanied by a state sales tax offset. That way, the taxpayer would not see an overall tax rate increase. This factor is especially important for those cities nearer to the border, such as Longview, whose taxpayers are more sensitive to sales tax increases.

### **Comments from Business Representatives on Advisory Committee**

#### **NFIB Comments:**

Oppose – Additional taxing authority is not necessary when the cities need to adjust simply to a law change that forces them to only collect taxes within their jurisdiction. The “negatively impacted cities” in the Department’s studies only dealt with the revenue loss under EHB 2030. The numbers do not indicate which cities actually have revenues below budget projections and a city that has increasing overall revenues should not be given carte blanche additional taxing authority. The numbers in the study are not necessarily 100 percent accurate and therefore are not reliable for long term projections.

#### **IBA Comments:**

Oppose – Higher taxes should not be imposed until all other mitigation options have been implemented. Proposal #7 provides significant permanent mitigation for affected cities while also providing a significant administrative improvements and reduced burdens on taxpayers as compared to the current duplicative and overly complex municipal B&O tax system operating in Washington State. Higher taxes must be the last resort in any mitigation mechanism, and small businesses oppose tax increases.

#### **AWB Comments:**

Please see comments to Proposals #1, #2, and #3.

With respect to local option taxes, AWB asserts that the revenue system should function as an integrated and rational system at all governmental levels. For example, each aspect of the

revenue system must be comprehensively evaluated to ensure that incremental actions do not result in inconsistent or conflicting revenue system policies. The state should only authorize revenue policies at the local level that do not undermine the stability of the revenue system as a whole. In addition, the revenue system must be accountable to the persons or entities burdened by or benefiting from any revenue system modification. Alteration or modification of the revenue system should occur in a clear and overt manner. Persons or entities who will be burdened by or benefit from such actions must: (1) be provided understandable written statements explaining any proposed changes and their consequences; and (2) be given ample opportunity to express their opinions and, ideally, to vote on such proposals. Covert or automatic modifications must be avoided. Finally, the revenue system should avoid the generation of any revenue that is dedicated/earmarked to fund a purpose unrelated to the activity taxed.

### **DOR Comments**

The second option, providing a local-option sales and use tax that is credited against the state sales and use tax, would require a small initial expenditure impact by the Department of Revenue for implementation.

Municipal Business and Occupation Tax Study of Potential Net Fiscal Impacts

**Appendix A**  
**Combined Impact of Allocation and Apportionment**  
**Calendar Year 2004**

Location Code	City	Service Gain or Loss	Construction Loss	Wholesaling Loss	Retailing Gain or Loss	Net Gain or Loss
1401	Aberdeen	(34,000)	(96,000)	(282,000)	(45,000)	(457,000)
1701	Algona	0	0	(19,000)	2,000	(17,000)
1804	Bainbridge Island	(12,000)	(13,000)	(5,000)	24,000	(6,000)
1704	Bellevue	(236,000)	(184,000)	(1,382,000)	(221,000)	(2,023,000)
3701	Bellingham	(45,000)	(301,000)	(322,000)	36,000	(632,000)
1705	Black Diamond	(8,000)	(20,000)	(1,000)	5,000	(24,000)
1801	Bremerton	(43,000)	(80,000)	(216,000)	(7,000)	(346,000)
2702	Buckley	(4,000)	(38,000)	(8,000)	3,000	(47,000)
1734	Burien	(8,000)	(12,000)	(31,000)	10,000	(41,000)
1402	Cosmopolis	0	0	(5,000)	0	(5,000)
3103	Darrington	0	(1,000)	0	(1,000)	(2,000)
2704	Dupont	(2,000)	0	(10,000)	3,000	(9,000)
3105	Everett	(62,000)	(174,000)	(463,000)	(74,000)	(773,000)
3703	Everson	0	0	0	0	0
3107	Granite Falls	0	0	(1,000)	0	(1,000)
1404	Hoquiam	3,000	(9,000)	(74,000)	3,000	(77,000)
1714	Issaquah	(34,000)	(76,000)	(66,000)	(62,000)	(238,000)
0803	Kelso	6,000	(9,000)	(84,000)	11,000	(76,000)
3402	Lacey	63,000	(57,000)	0	2,000	8,000
1717	Lake Forest Park	16,000	(15,000)	(1,000)	74,000	74,000
2502	Long Beach	(2,000)	(6,000)	(2,000)	4,000	(6,000)
0804	Longview	(50,000)	(81,000)	(125,000)	11,000	(245,000)
1719	Mercer Island	(55,000)	(51,000)	(222,000)	65,000	(263,000)
1722	North Bend	(4,000)	(31,000)	(25,000)	(25,000)	(85,000)
1409	Ocean Shores	(1,000)	(2,000)	(2,000)	2,000	(3,000)
3403	Olympia	(60,000)	(70,000)	(171,000)	(64,000)	(365,000)
1723/2723	Pacific	(4,000)	(90,000)	(57,000)	6,000	(145,000)
1601	Port Townsend	(11,000)	(10,000)	(21,000)	12,000	(30,000)
3404	Rainier	0	(2,000)	0	0	(2,000)
2503	Raymond	6,000	(2,000)	(12,000)	4,000	(4,000)
2712	Roy	0	(6,000)	0	(1,000)	(7,000)
2713	Ruston	0	(1,000)	0	4,000	3,000
1726	Seattle	(4,040,000)	(3,424,000)	(8,100,000)	(1,000)	(15,565,000)
2301	Shelton	(5,000)	(18,000)	(6,000)	(5,000)	(34,000)
1728	Snoqualmie	(4,000)	(7,000)	(1,000)	0	(12,000)
2717	Tacoma	(483,000)	(281,000)	(774,000)	33,000	(1,505,000)
3406	Tumwater	(4,000)	(65,000)	(251,000)	15,000	(305,000)
1408	Westport	(1,000)	0	(2,000)	(4,000)	(7,000)
3407	Yelm	(4,000)	(12,000)	(2,000)	(10,000)	(28,000)
<b>Totals</b>		<b>(5,122,000)</b>	<b>(5,244,000)</b>	<b>(12,743,000)</b>	<b>(191,000)</b>	<b>(23,300,000)</b>

Municipal Business and Occupation Tax Study of Potential Net Fiscal Impacts

**Appendix B**  
**Revenue Impact of Apportionment of Service Income**  
**Calendar Year 2004**

Location Code	City	Current Service Income	Apportioned Service Income	Gain or Loss in Taxable Income	Tax Rate	Gain or Loss in Taxes
1401	Aberdeen	128,918,000	119,820,000	(9,098,000)	0.003750	(34,000)
1701	Algona	0	0	(913,000)	0.000300	0
1804	Bainbridge Island	0	0	(11,936,000)	0.001000	(12,000)
1704	Bellevue	5,396,122,000	5,238,204,000	(157,918,000)	0.001496	(236,000)
3701	Bellingham	849,017,000	838,849,000	(10,168,000)	0.004400	(45,000)
1705	Black Diamond	2,789,000	1,286,000	(1,503,000)	0.005000	(8,000)
1801	Bremerton	337,756,000	316,189,000	(21,567,000)	0.002000	(43,000)
2702	Buckley	0	0	(2,218,000)	0.002000	(4,000)
1734	Burien	349,361,000	333,661,000	(15,700,000)	0.000500	(8,000)
1402	Cosmopolis	0	0	(163,000)	0.000000	0
3103	Darrington	326,000	454,000	128,000	0.002000	0
2704	Dupont	10,291,000	8,262,000	(2,029,000)	0.001000	(2,000)
3105	Everett	2,036,205,000	1,974,563,000	(61,642,000)	0.001000	(62,000)
3703	Everson	0	0	(96,000)	0.000000	0
3107	Granite Falls	0	0	(585,000)	0.000000	0
1404	Hoquiam	64,260,000	65,711,000	1,451,000	0.002000	3,000
1714	Issaquah	577,096,000	542,970,000	(34,126,000)	0.001000	(34,000)
0803	Kelso	53,481,000	56,306,000	2,825,000	0.002000	6,000
3402	Lacey	237,753,000	269,143,000	31,390,000	0.002000	63,000
1717	Lake Forest Park	71,526,000	79,380,000	7,854,000	0.002000	16,000
2502	Long Beach	109,241,000	108,194,000	(1,047,000)	0.002000	(2,000)
0804	Longview	491,396,000	466,582,000	(24,814,000)	0.002000	(50,000)
1719	Mercer Island	268,467,000	213,140,000	(55,327,000)	0.001000	(55,000)
1722	North Bend	33,594,000	31,720,000	(1,874,000)	0.002000	(4,000)
1409	Ocean Shores	39,398,000	38,856,000	(542,000)	0.002000	(1,000)
3403	Olympia	856,369,000	826,213,000	(30,156,000)	0.002000	(60,000)
1723/2723	Pacific	0	0	(1,763,000)	0.002000	(4,000)
1601	Port Townsend	91,757,000	86,435,000	(5,322,000)	0.002000	(11,000)
3404	Rainier	0	0	(438,000)	0.001000	0
2503	Raymond	18,277,000	21,281,000	3,004,000	0.002000	6,000
2712	Roy	54,000	27,000	(27,000)	0.002000	0
2713	Ruston	0	0	77,000	0.002000	0
1726	Seattle	14,405,861,000	13,432,276,000	(973,585,000)	0.004150	(4,040,000)
2301	Shelton	193,406,000	188,749,000	(4,657,000)	0.001000	(5,000)
1728	Snoqualmie	20,290,000	17,694,000	(2,596,000)	0.001500	(4,000)
2717	Tacoma	2,966,842,000	2,846,157,000	(120,685,000)	0.004000	(483,000)
3406	Tumwater	137,626,000	135,642,000	(1,984,000)	0.002000	(4,000)
1408	Westport	0	0	(191,000)	0.005000	(1,000)
3407	Yelm	25,260,000	23,329,000	(1,931,000)	0.002000	(4,000)
<b>Totals</b>		<b>29,772,739,000</b>	<b>28,281,093,000</b>	<b>(1,509,872,000)</b>		<b>(5,122,000)</b>

**Appendix C**  
**Revenue Impact of Allocation Provisions for Construction**  
**Calendar Year 2004**

<b>Location Code</b>	<b>City</b>	<b>Loss in Taxable Income</b>	<b>Tax Rate</b>	<b>Loss in Taxes</b>
1401	Aberdeen	(32,154,000)	0.003000	(96,000)
1701	Algona	(1,644,000)	0.000300	0
1804	Bainbridge Island	(12,546,000)	0.001000	(13,000)
1704	Bellevue	(123,027,682)	0.001496	(184,000)
3701	Bellingham	(176,823,000)	0.001700	(301,000)
1705	Black Diamond	(3,953,000)	0.005000	(20,000)
1801	Bremerton	(64,165,000)	0.001250	(80,000)
2702	Buckley	(19,170,000)	0.002000	(38,000)
1734	Burien	(24,160,000)	0.000500	(12,000)
1402	Cosmopolis	(568,000)	0.000000	0
3103	Darrington	(737,000)	0.002000	(1,000)
2704	Dupont	(99,000)	0.001000	0
3105	Everett	(173,933,000)	0.001000	(174,000)
3703	Everson	(4,064,000)	0.000000	0
3107	Granite Falls	(2,680,000)	0.000000	0
1404	Hoquiam	(4,313,000)	0.002000	(9,000)
1714	Issaquah	(94,605,000)	0.000800	(76,000)
803	Kelso	(8,961,000)	0.001000	(9,000)
3402	Lacey	(57,064,000)	0.001000	(57,000)
1717	Lake Forest Park	(7,654,000)	0.002000	(15,000)
2502	Long Beach	(3,188,000)	0.002000	(6,000)
804	Longview	(81,334,000)	0.001000	(81,000)
1719	Mercer Island	(51,157,000)	0.001000	(51,000)
1722	North Bend	(15,291,000)	0.002000	(31,000)
1409	Ocean Shores	(1,212,000)	0.002000	(2,000)
3403	Olympia	(69,881,000)	0.001000	(70,000)
1723/2723	Pacific	(44,871,000)	0.002000	(90,000)
1601	Port Townsend	(7,135,000)	0.001400	(10,000)
3404	Rainier	(1,678,000)	0.001000	(2,000)
2503	Raymond	(911,000)	0.002000	(2,000)
2712	Roy	(2,913,000)	0.002000	(6,000)
2713	Ruston	(614,000)	0.001000	(1,000)
1726	Seattle	(1,592,406,000)	0.002150	(3,424,000)
2301	Shelton	(17,845,000)	0.001000	(18,000)
1728	Snoqualmie	(4,840,000)	0.001500	(7,000)
2717	Tacoma	(211,736,000)	0.001530	(281,000)
3406	Tumwater	(64,949,000)	0.001000	(65,000)
1408	Westport	(15,000)	0.005000	0
3407	Yelm	(6,225,000)	0.002000	(12,000)
<b>Totals</b>		<b>(2,990,521,682)</b>		<b>(5,244,000)</b>

**Appendix D**  
**Revenue Impacts of Allocation Provisions for Wholesale**  
**Calendar Year 2004**

Location Code	City	Loss in Taxable Income	Tax Rate	Loss in Taxes
1401	Aberdeen	(187,700,000)	0.001500	(282,000)
1701	Algona	(62,862,000)	0.000300	(19,000)
1804	Bainbridge Island	(4,736,000)	0.001000	(5,000)
1704	Bellevue	(924,120,000)	0.001496	(1,382,000)
3701	Bellingham	(189,326,000)	0.001700	(322,000)
1705	Black Diamond	(140,000)	0.005000	(1,000)
1801	Bremerton	(135,026,000)	0.001600	(216,000)
2702	Buckley	(3,839,000)	0.002000	(8,000)
1734	Burien	(62,327,000)	0.000500	(31,000)
1402	Cosmopolis	(2,508,000)	0.002000	(5,000)
3103	Darrington	(186,000)	0.000000	0
2704	Dupont	(10,006,000)	0.001000	(10,000)
3105	Everett	(462,927,000)	0.001000	(463,000)
3703	Everson	(194,000)	0.002000	0
3107	Granite Falls	(547,000)	0.002000	(1,000)
1404	Hoquiam	(36,817,000)	0.002000	(74,000)
1714	Issaquah	(82,076,000)	0.000800	(66,000)
0803	Kelso	(83,608,000)	0.001000	(84,000)
3402	Lacey	(52,594,000)	0.000000	0
1717	Lake Forest Park	(743,000)	0.002000	(1,000)
2502	Long Beach	(1,165,000)	0.002000	(2,000)
0804	Longview	(125,137,000)	0.001000	(125,000)
1719	Mercer Island	(222,279,000)	0.001000	(222,000)
1722	North Bend	(12,568,000)	0.002000	(25,000)
1409	Ocean Shores	(1,203,000)	0.002000	(2,000)
3403	Olympia	(170,513,000)	0.001000	(171,000)
1723/2723	Pacific	(28,635,000)	0.002000	(57,000)
1601	Port Townsend	(14,815,000)	0.001400	(21,000)
3404	Rainier	0	0.001000	0
2503	Raymond	(6,145,000)	0.002000	(12,000)
2712	Roy	0	0.001000	0
2713	Ruston	0	0.001000	0
1726	Seattle	(3,767,442,000)	0.002150	(8,100,000)
2301	Shelton	(6,362,000)	0.001000	(6,000)
1728	Snoqualmie	(703,000)	0.001500	(1,000)
2717	Tacoma	(759,291,000)	0.001020	(774,000)
3406	Tumwater	(251,040,000)	0.001000	(251,000)
1408	Westport	(506,000)	0.003500	(2,000)
3407	Yelm	(1,793,000)	0.001000	(2,000)
<b>Totals</b>		<b>(7,671,879,000)</b>		<b>(12,743,000)</b>

Municipal Business and Occupation Tax Study of Potential Net Fiscal Impacts

**Appendix E**  
**Revenue Impacts of Allocation Provisions for Retail**  
**Calendar Year 2004**

Location Code	City	Current Retailing Income	Allocated Retailing Income	Gain or Loss in Tax Base	Tax Rate	Gain or Loss in Tax
1401	Aberdeen	231,965,000	216,872,000	(15,093,000)	0.003000	(45,000)
1701	Algona	4,431,000	10,803,000	6,372,000	0.000300	2,000
1804	Bainbridge Island	78,569,000	103,064,000	24,495,000	0.001000	24,000
1704	Bellevue	2,233,547,000	2,086,146,000	(147,401,000)	0.001496	(221,000)
3701	Bellingham	965,594,000	986,511,000	20,917,000	0.001700	36,000
1705	Black Diamond	5,631,000	6,538,000	907,000	0.005000	5,000
1801	Bremerton	391,383,000	385,674,000	(5,709,000)	0.001250	(7,000)
2702	Buckley	14,483,000	16,094,000	1,611,000	0.002000	3,000
1734	Burien	281,885,000	301,272,000	19,387,000	0.000500	10,000
1402	Cosmopolis	3,763,000	4,070,000	307,000	0.000000	0
3103	Darrington	3,181,000	2,569,000	(612,000)	0.002000	(1,000)
2704	Dupont	3,212,000	6,322,000	3,110,000	0.001000	3,000
3105	Everett	1,034,248,000	959,839,000	(74,409,000)	0.001000	(74,000)
3703	Everson	5,192,000	5,292,000	100,000	0.000000	0
3107	Granite Falls	13,964,000	6,006,000	(7,958,000)	0.000000	0
1404	Hoquiam	23,813,000	25,189,000	1,376,000	0.002000	3,000
1714	Issaquah	550,957,000	474,072,000	(76,885,000)	0.000800	(62,000)
0803	Kelso	114,357,000	125,016,000	10,659,000	0.001000	11,000
3402	Lacey	323,831,000	326,129,000	2,298,000	0.001000	2,000
1717	Lake Forest Park	19,957,000	56,798,000	36,841,000	0.002000	74,000
2502	Long Beach	14,045,000	15,869,000	1,824,000	0.002000	4,000
0804	Longview	344,354,000	355,587,000	11,233,000	0.001000	11,000
1719	Mercer Island	43,013,000	107,907,000	64,894,000	0.001000	65,000
1722	North Bend	92,583,000	80,211,000	(12,372,000)	0.002000	(25,000)
1409	Ocean Shores	15,981,000	17,101,000	1,120,000	0.002000	2,000
3403	Olympia	913,217,000	848,737,000	(64,480,000)	0.001000	(64,000)
1723/2723	Pacific	20,500,000	23,287,000	2,787,000	0.002000	6,000
1601	Port Townsend	58,861,000	67,431,000	8,570,000	0.001400	12,000
3404	Rainier	2,088,000	2,103,000	15,000	0.001000	0
2503	Raymond	12,917,000	14,782,000	1,865,000	0.002000	4,000
2712	Roy	3,614,000	3,363,000	(251,000)	0.002000	(1,000)
2713	Ruston	1,286,000	4,878,000	3,592,000	0.001000	4,000
1726	Seattle	4,303,641,000	4,303,158,000	(483,000)	0.002150	(1,000)
2301	Shelton	101,159,000	95,970,000	(5,189,000)	0.001000	(5,000)
1728	Snoqualmie	9,090,000	9,349,000	259,000	0.001500	0
2717	Tacoma	1,844,673,000	1,866,078,000	21,405,000	0.001530	33,000
3406	Tumwater	189,241,000	204,446,000	15,205,000	0.001000	15,000
1408	Westport	6,583,000	5,763,000	(820,000)	0.005000	(4,000)
3407	Yelm	41,247,000	36,427,000	(4,820,000)	0.002000	(10,000)
<b>Totals</b>		<b>14,322,056,000</b>	<b>14,166,723,000</b>	<b>(155,333,000)</b>		<b>(191,000)</b>



## Appendix F

### Methodology

#### Apportionment of Service Income

The Department estimated the loss for the apportionment of service income based on the data received on the informational return. The cities mailed almost 77,000 returns to their quarterly taxpayers and received back almost 32,000 completed returns. To ensure that the returns were completed by firms subject to the cities' service classification, we confirmed that the firms were taxed under the service classification of the state B&O tax. As a double check, we provided a listing of the 100 largest taxpayers to each city imposing a B&O tax. This additional step eliminated a small number of returns for each city. The final sample consisted of 12,009 returns, representing an estimated 47 percent of the service activity income earned in cities imposing a B&O tax.

The survey responses are a sample by industry of the service activity in each city. We inflated the survey responses to represent the entire industry by stratifying the service firms in each city into ten industry classifications as follows:

- 1) Agriculture, Forestry and Mining
- 2) Construction
- 3) Manufacturing
- 4) Wholesale/Trade
- 5) Information, Finance, Insurance and Real Estate
- 6) Professional, Scientific and Technical Services
- 7) Administrative and Support Services
- 8) Health Services
- 9) Personal Services
- 10) Other Services

The inflation factor for each city and industry classification equaled the total number of employees in the city divided by the total number of employees represented by firms in the sample based on data from the Washington State Employment Security Department (ESD).

#### Allocation of Construction and Sales of Tangible Personal Property

The Department derived the revenue impact of the new allocation provisions required by EHB 2030 through the use of the Department's excise tax data, ESD data on employees and wages, and Washington's Input/Output model. An input/output model is constructed by surveying all of the industrial sectors in the state about their total sales and purchases. That information goes into a matrix, or table of numbers, that relates the outputs of all industrial sectors (sales to consumers, to industry, and exports) to the inputs to those industries (all the goods, services, labor, and so forth that the industries must purchase in order to generate the outputs). In a balanced system, the total value of outputs must equal the value of total inputs.

The estimates of the allocation provisions of EHB 2030 also take into account the loss of "throwback." Before the allocation and apportionment provisions of EHB 2030 become effective, a business located in a city with a B&O tax (the home city) can earn income from activity occurring outside that city in a jurisdiction not imposing a B&O tax and still be subject to the home-city's tax on that activity. This income is "thrown back" to the home city if the home city imposes its B&O tax on that activity, and some of the business activity being taxed occurs in the home city.

### **Construction**

The Department estimated the loss resulting from the allocation of construction income based on the elimination of throwback. The throwback loss was measured in two steps. We first measured the amount of statewide income that could be thrown back to cities imposing a B&O tax. Using the Department's excise tax data, a database was created containing the income earned by construction firms that had employees in one of the cities imposing a B&O tax. The income equaled the amount taxable under the wholesaling and retailing classifications of the state B&O tax. For each construction firm, the income was multiplied by a ratio equal to that firm's retail sales earned in a jurisdiction without a B&O tax compared to their total statewide retail sales. This final estimate represents the statewide throwback loss per taxpayer. The throwback was summed across taxpayers to represent total throwback loss for all cities that impose a B&O tax.

We then allocated the statewide throwback loss among the cities imposing a B&O tax by using each construction firm's number of employees in each of the B&O tax cities compared to the firm's total number of employees in all of the cities imposing a B&O tax. In other words, each firm's total throwback income was allocated to the cities imposing a B&O tax based on the fraction of the firm's employees that were located in each of the cities with a B&O tax.

### **Wholesale sales of tangible personal property**

The Department estimated the loss for the allocation of wholesaling income based on the elimination of throwback. The throwback loss was measured in two steps. We first measured the amount of statewide income that could be thrown back to cities imposing a B&O tax. After determining the jurisdictions into which wholesalers sold, the Department created a database containing the income earned by firms with employees in one of the cities imposing a B&O tax. The income equaled the taxable amount under the wholesaling classification of the state B&O tax. In order to estimate the throwback for this group of taxpayers, we estimated the amount sold in non-B&O tax jurisdictions. Based on the Washington Input/Output model we estimated that 53 percent of sales made by wholesalers are to retailers and 47 percent of sales are made to non-retailers. The statewide throwback loss for sales to retailers was calculated by multiplying wholesaler income from sales to retailers by a percentage equal to the amount of retail sales to cities with a B&O tax over statewide retail sales. The statewide throwback loss for sales to non-retailers was calculated by multiplying wholesaler income from sales to non-retailers by the ratio of employment in non-B&O tax cities over statewide wholesale employment.

We then allocated the statewide throwback loss among the cities imposing a B&O tax by using each taxpayer's number of employees in each of the B&O tax cities compared to the taxpayer's total number of employees in all of the cities imposing a B&O tax.

### **Retail sales of tangible personal property**

The Department estimated the loss for the allocation of retailing income based on local sales tax data. The allocation of retail sales of tangible personal property for local B&O tax purposes before the effective date of the allocation provisions of EHB 2030 parallels the current sourcing of local sales tax with one exception: sales of tangible personal property delivered from a warehouse. For sales that are delivered from a warehouse for local B&O tax purposes, income is taxed by the city in which the sale transaction occurs (i.e., the store or other facility where the seller makes contact with the buyer). For local sales tax purposes, however, sales are sourced to the location of the warehouse from which the property is delivered. Therefore, in order to use the Department's local sales tax data as a base for the current method of allocating retail sales of tangible personal property for local B&O tax purposes, warehouse deliveries were removed from the base and reallocated based on where the sales transactions took place instead of the location of the warehouse from which the goods were delivered.

The allocation of retail sales of tangible personal property for local B&O tax purposes after the effective date of the allocation provisions of EHB 2030 will parallel the destination-based sourcing for local sales tax under the Streamlined Sales and Use Tax Agreement (SSUTA)<sup>1</sup>. Therefore the impact of the change in the allocation of retail sales of tangible personal property for local B&O tax purposes will parallel the impact of the proposed change in local sales tax sourcing under the SSUTA. The Department prepared a study in 2004 ("the sourcing study") that estimated the net gain or loss to each jurisdiction as a result of the sourcing provisions of the SSUTA. The estimates of net loss or gain are used for the estimate of the loss resulting from the allocation of retail sales of tangible personal property under EHB 2030. However, these estimates in the sourcing study include a loss related to sales of goods delivered from warehouses. Because the allocation of income from retail sales of tangible personal property for local B&O tax purposes currently depends on where the sales transaction takes place and not on the location of the warehouse from where the goods are delivered, the net gain or loss estimates of the sales tax base in the sourcing study were adjusted by subtracting out the sales related to warehouse deliveries and reallocating those sales to where the sales transactions occurred.

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<sup>1</sup> The Streamlined Sales and Use Tax Agreement is a multi-state agreement designed to simplify state sales and use tax structures and to make them more uniform. Sourcing determines what jurisdiction is entitled to the tax generated from a particular transaction. Under current law, local sales tax on the sale of goods is sourced to the jurisdiction where the retail outlet is located at or from which delivery is made. Thus, if a sale transaction occurs in a store in Seattle but the goods are delivered to the buyer from a warehouse in Tukwila, the sale is sourced to Tukwila. Under the SSUTA sourcing rules, sales of goods are generally sourced to the place where the buyer receives the goods.

**Appendix G**

**Engrossed House Bill 2030**

Secretary of State  
State of Washington

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ENGROSSED HOUSE BILL 2030

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Passed Legislature - 2003 Regular Session

State of Washington                      58th Legislature                      2003 Regular Session

By Representatives Kessler, Cairnes, Talcott, McDonald, Schindler,  
Shabro, Pearson and Holmquist; by request of Governor Locke

Read first time 02/19/2003. Referred to Committee on Finance.

AN ACT Relating to changing requirements regarding state and local tax to provide for municipal business and occupation tax uniformity and fairness; adding new sections to chapter 35.21 RCW; creating new sections; prescribing penalties; and providing an effective date.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec. 1.** LEGISLATIVE FINDINGS AND INTENT. The legislature finds that businesses in Washington are concerned about the potential for multiple taxation that arises due to the various city business and occupation taxes and are concerned about the lack of uniformity among city jurisdictions. The current system has a negative impact on Washington's business climate. The legislature further finds that local business and occupation tax revenue provides a sizable portion of city revenue that is used for essential services. The legislature recognizes that local government services contribute to a healthy business climate.

The legislature intends to provide for a more uniform system of city business and occupation taxes that eliminates multiple taxation, while allowing for some continued local control and flexibility to cities.

NEW SECTION. **Sec. 2.** MUNICIPAL BUSINESS AND OCCUPATION TAX--LIMITED SCOPE. This act does not apply to taxes on any service that historically or traditionally has been taxed as a utility business for municipal tax purposes, such as:

- (1) A light and power business or a natural gas distribution business, as defined in RCW 82.16.010;
- (2) A telephone business, as defined in RCW 82.04.065;
- (3) Cable television services;
- (4) Sewer or water services;
- (5) Drainage services;
- (6) Solid waste services; or
- (7) Steam services.

## Municipal Business and Occupation Tax Study of Potential Net Fiscal Impacts

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### NEW SECTION. **Sec. 3.** MUNICIPAL GROSS RECEIPTS TAX--DEFINITIONS.

The definitions in this section apply throughout this act, unless the context clearly requires otherwise.

- (1) "Business" has the same meaning as given in chapter 82.04 RCW.
- (2) "City" means a city, town, or code city.
- (3) "Business and occupation tax" or "gross receipts tax" means a tax imposed on or measured by the value of products, the gross income of the business, or the gross proceeds of sales, as the case may be, and that is the legal liability of the business.
- (4) "Value of products" has the same meaning as given in chapter 82.04 RCW.
- (5) "Gross income of the business" has the same meaning as given in chapter 82.04 RCW.
- (6) "Gross proceeds of sales" has the same meaning as given in chapter 82.04 RCW.

NEW SECTION. **Sec. 4.** MUNICIPAL BUSINESS AND OCCUPATION TAX--MODEL ORDINANCE. (1)(a) The cities, working through the association of Washington cities, shall form a model ordinance development committee made up of a representative sampling of cities that as of the effective date of this section impose a business and occupation tax. This committee shall work through the association of Washington cities to adopt a model ordinance on municipal gross receipts business and occupation tax. The model ordinance and subsequent amendments shall be adopted using a process that includes opportunity for substantial input from business stakeholders and other members of the public. Input shall be solicited from statewide business associations and from local chambers of commerce and downtown business associations in cities that levy a business and occupation tax.

(b) The municipal research council shall contract to post the model ordinance on an internet web site and to make paper copies available for inspection upon request. The department of revenue and the department of licensing shall post copies of or links to the model ordinance on their internet web sites. Additionally, a city that imposes a business and occupation tax must make copies of its ordinance available for inspection and copying as provided in chapter 42.17 RCW.

(c) The definitions and tax classifications in the model ordinance may not be amended more frequently than once every four years, however the model ordinance may be amended at any time to comply with changes in state law. Any amendment to a mandatory provision of the model ordinance must be adopted with the same effective date by all cities.

(2) A city that imposes a business and occupation tax must adopt the mandatory provisions of the model ordinance. The following provisions are mandatory:

(a) A system of credits that meets the requirements of section 6 of this act and a form for such use;

(b) A uniform, minimum small business tax threshold of at least the equivalent of twenty thousand dollars in gross income annually. A city may elect to deviate from this requirement by creating a higher threshold or exemption but it shall not deviate lower than the level required in this subsection. If a city has a small business threshold or exemption in excess of that provided in this subsection as of January 1, 2003, and chooses to deviate below the threshold or exemption level that was in place as of January 1, 2003, the city must notify all businesses licensed to do business

## Municipal Business and Occupation Tax Study of Potential Net Fiscal Impacts

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within the city at least one hundred twenty days prior to the potential implementation of a lower threshold or exemption amount;

(c) Tax reporting frequencies that meet the requirements of section 7 of this act;

(d) Penalty and interest provisions that meet the requirements of sections 8 and 9 of this act;

(e) Claim periods that meet the requirements of section 10 of this act;

(f) Refund provisions that meet the requirements of section 11 of this act; and

(g) Definitions, which at a minimum, must include the definitions enumerated in sections 3 and 12 of this act. The definitions in chapter 82.04 RCW shall be used as the baseline for all definitions in the model ordinance, and any deviation in the model ordinance from these definitions must be described by a comment in the model ordinance.

(3) Except for the system of credits developed to address multiple taxation under subsection (2)(a) of this section, a city may adopt its own provisions for tax exemptions, tax credits, and tax deductions.

(4) Any city that adopts an ordinance that deviates from the nonmandatory provisions of the model ordinance shall make a description of such differences available to the public, in written and electronic form.

**NEW SECTION. Sec. 5. MUNICIPAL GROSS RECEIPTS TAX--NEXUS.** A city may not impose a business and occupation tax on a person unless that person has nexus with the city. For the purposes of this section, the term "nexus" means business activities conducted by a person sufficient to subject that person to the taxing jurisdiction of a city under the standards established for interstate commerce under the commerce clause of the United States Constitution.

**NEW SECTION. Sec. 6. MUNICIPAL BUSINESS AND OCCUPATION TAX--MULTIPLE TAXATION--CREDIT SYSTEM.** (1) A city that imposes a business and occupation tax shall provide for a system of credits to avoid multiple taxation as follows:

(a) Persons who engage in business activities that are within the purview of more than one classification of the tax shall be taxable under each applicable classification.

(b) Notwithstanding anything to the contrary in this section, if imposition of the tax would place an undue burden upon interstate commerce or violate constitutional requirements, a taxpayer shall be allowed a credit only to the extent necessary to preserve the validity of the tax.

(c) Persons taxable under the retailing or wholesaling classification with respect to selling products in a city shall be allowed a credit against those taxes for any eligible gross receipts taxes paid by the person (i) with respect to the manufacturing of the products sold in the city, and (ii) with respect to the extracting of the products, or the ingredients used in the products, sold in the city. The amount of the credit shall not exceed the tax liability arising with respect to the sale of those products.

(d) Persons taxable under the manufacturing classification with respect to manufacturing products in a city shall be allowed a credit against that tax for any eligible gross receipts tax paid by the person with respect to extracting the ingredients of the products manufactured in the city and with respect to manufacturing the products other than in the city. The amount of the credit shall not exceed the tax liability arising with respect to the manufacturing of those products.

## Municipal Business and Occupation Tax Study of Potential Net Fiscal Impacts

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(e) Persons taxable under the retailing or wholesaling classification with respect to selling products in a city shall be allowed a credit against those taxes for any eligible gross receipts taxes paid by the person with respect to the printing, or the printing and publishing, of the products sold within the city. The amount of the credit shall not exceed the tax liability arising with respect to the sale of those products.

(2) The model ordinance shall be drafted to address the issue of multiple taxation for those tax classifications that are in addition to those enumerated in subsection (1)(c) through (e) of this section. The objective of any such provisions shall be to eliminate multiple taxation of the same income by two or more cities.

NEW SECTION. **Sec. 7.** MUNICIPAL BUSINESS AND OCCUPATION TAX--REPORTING FREQUENCY. A city that imposes a business and occupation tax shall allow reporting and payment of tax on a monthly, quarterly, or annual basis. The frequency for any particular person may be assigned at the discretion of the city, except that monthly reporting may be assigned only if it can be demonstrated that the taxpayer is remitting excise tax to the state on a monthly basis. For persons assigned a monthly frequency, payment is due within the same time period provided for monthly taxpayers under RCW 82.32.045. For persons assigned a quarterly or annual frequency, payment is due within the same time period as provided for quarterly or annual frequency under RCW 82.32.045.

NEW SECTION. **Sec. 8.** MUNICIPAL BUSINESS AND OCCUPATION TAX--PENALTIES AND INTEREST. (1) A city that imposes a business and occupation tax shall compute interest charged a taxpayer on an underpaid tax or penalty in accordance with RCW 82.32.050.

(2) A city that imposes a business and occupation tax shall compute interest paid on refunds or credits of amounts paid or other recovery allowed a taxpayer in accordance with RCW 82.32.060.

NEW SECTION. **Sec. 9.** MUNICIPAL BUSINESS AND OCCUPATION TAX--PENALTIES. A city that imposes a business and occupation tax shall provide for the imposition of penalties in accordance with chapter 82.32 RCW.

NEW SECTION. **Sec. 10.** MUNICIPAL BUSINESS AND OCCUPATION TAX--CLAIM PERIOD. The provisions relating to the time period allowed for an assessment or correction of an assessment for additional taxes, penalties, or interest shall be in accordance with chapter 82.32 RCW.

NEW SECTION. **Sec. 11.** MUNICIPAL BUSINESS AND OCCUPATION TAX--REFUND PERIOD. The provisions relating to the time period allowed for a refund of taxes paid shall be in accordance with chapter 82.32 RCW.

NEW SECTION. **Sec. 12.** MUNICIPAL BUSINESS AND OCCUPATION TAX--DEFINITIONS--TAX CLASSIFICATIONS. (1) In addition to the definitions in section 3 of this act, the following terms and phrases must be defined in the model ordinance under section 4 of this act, and such definitions shall include any specific requirements as noted in this subsection:

- (a) Eligible gross receipts tax.
- (b) Extracting.
- (c) Manufacturing. Software development may not be defined as a manufacturing activity.
- (d) Retailing.

## Municipal Business and Occupation Tax Study of Potential Net Fiscal Impacts

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- (e) Retail sale.
- (f) Services. The term "services" excludes retail or wholesale services.
- (g) Wholesale sale.
- (h) Wholesaling.
- (i) To manufacture.
- (j) Commercial and industrial use.
- (k) Engaging in business.
- (1) Person.
- (2) Any tax classifications in addition to those enumerated in subsection (1) of this section that are included in the model ordinance must be uniform among all cities.

**NEW SECTION. Sec. 13. MUNICIPAL BUSINESS AND OCCUPATION TAX-- ALLOCATION AND APPORTIONMENT OF INCOME.** A city that imposes a business and occupation tax shall provide for the allocation and apportionment of a person's gross income, other than persons subject to the provisions of chapter 82.14A RCW, as follows:

(1) Gross income derived from all activities other than those taxed as service or royalties shall be allocated to the location where the activity takes place.

(a) In the case of sales of tangible personal property, the activity takes place where delivery to the buyer occurs.

(b) If a business activity allocated under this subsection (1) takes place in more than one city and all cities impose a gross receipts tax, a credit shall be allowed as provided in section 6 of this act; if not all of the cities impose a gross receipts tax, the affected cities shall allow another credit or allocation system as they and the taxpayer agree.

(2) Gross income derived as royalties from the granting of intangible rights shall be allocated to the commercial domicile of the taxpayer.

(3) Gross income derived from activities taxed as services shall be apportioned to a city by multiplying apportionable income by a fraction, the numerator of which is the payroll factor plus the service-income factor and the denominator of which is two.

(a) The payroll factor is a fraction, the numerator of which is the total amount paid in the city during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period. Compensation is paid in the city if:

- (i) The individual is primarily assigned within the city;
- (ii) The individual is not primarily assigned to any place of business for the tax period and the employee performs fifty percent or more of his or her service for the tax period in the city; or
- (iii) The individual is not primarily assigned to any place of business for the tax period, the individual does not perform fifty percent or more of his or her service in any city and the employee resides in the city.

(b) The service income factor is a fraction, the numerator of which is the total service income of the taxpayer in the city during the tax period, and the denominator of which is the total service income of the taxpayer everywhere during the tax period. Service income is in the city if:

- (i) The customer location is in the city; or
- (ii) The income-producing activity is performed in more than one location and a greater proportion of the service-income-producing activity is performed in the city than in any other location, based on costs of performance, and the taxpayer is not taxable at the customer location; or



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(iii) The service-income-producing activity is performed within the city, and the taxpayer is not taxable in the customer location.

(c) If the allocation and apportionment provisions of this subsection do not fairly represent the extent of the taxpayer's business activity in the city or cities in which the taxpayer does business, the taxpayer may petition for or the tax administrators may jointly require, in respect to all or any part of the taxpayer's business activity, that one of the following methods be used jointly by the cities to allocate or apportion gross income, if reasonable:

- (i) Separate accounting;
- (ii) The use of a single factor;
- (iii) The inclusion of one or more additional factors that will fairly represent the taxpayer's business activity in the city; or
- (iv) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

(4) The definitions in this subsection apply throughout this section.

(a) "Apportionable income" means the gross income of the business taxable under the service classifications of a city's gross receipts tax, including income received from activities outside the city if the income would be taxable under the service classification if received from activities within the city, less any exemptions or deductions available.

(b) "Compensation" means wages, salaries, commissions, and any other form of remuneration paid to individuals for personal services that are or would be included in the individual's gross income under the federal internal revenue code.

(c) "Individual" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee of that taxpayer.

(d) "Customer location" means the city or unincorporated area of a county where the majority of the contacts between the taxpayer and the customer take place.

(e) "Primarily assigned" means the business location of the taxpayer where the individual performs his or her duties.

(f) "Service-taxable income" or "service income" means gross income of the business subject to tax under either the service or royalty classification.

(g) "Tax period" means the calendar year during which tax liability is accrued. If taxes are reported by a taxpayer on a basis more frequent than once per year, taxpayers shall calculate the factors for the previous calendar year for reporting in the current calendar year and correct the reporting for the previous year when the factors are calculated for that year, but not later than the end of the first quarter of the following year.

(h) "Taxable in the customer location" means either that a taxpayer is subject to a gross receipts tax in the customer location for the privilege of doing business, or that the government where the customer is located has the authority to subject the taxpayer to gross receipts tax regardless of whether, in fact, the government does so.

**NEW SECTION. Sec. 14. MUNICIPAL BUSINESS AND OCCUPATION TAX--IMPLEMENTATION BY CITIES--CONTINGENT AUTHORITY.** Cities imposing business and occupation taxes must comply with all requirements of sections 2 through 13 of this act by December 31, 2004. A city that has not complied with the requirements of sections 2 through 13 of this act by December 31, 2004, may not impose a tax that is imposed by a city on the privilege of engaging in

## Municipal Business and Occupation Tax Study of Potential Net Fiscal Impacts

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business activities. Cities imposing business and occupation taxes after December 31, 2004, must comply with sections 2 through 13 of this act.

**NEW SECTION. Sec. 15. STUDY OF POTENTIAL NET FISCAL IMPACTS.**

(1) The department of revenue shall conduct a study of the net fiscal impacts of this act, with particular emphasis on the revenue impacts of the apportionment and allocation method contained in section 13 of this act and any revenue impact resulting from the increased uniformity and consistency provided through the model ordinance. In conducting the study, the department shall use, and regularly consult with, a committee composed of an equal representation from interested business representatives and from a representative sampling of cities imposing business and occupation taxes. The department shall report the final results of the study to the governor and the fiscal committees of the legislature by November 30, 2005. In addition, the department shall provide progress reports to the governor and the fiscal committees of the legislature on November 30, 2003, and November 30, 2004. As part of its report, the department shall examine and recommend options to address any adverse revenue impacts to local jurisdictions.

(2) For the purposes of this section, "net fiscal impacts" means accounting for the potential of both positive and negative fiscal impacts on local jurisdictions that may result from this act.

(3) It is the intent of the legislature through this study to provide accurate fiscal impact analysis and recommended options to alleviate revenue impacts from this act so as to allow local jurisdictions to anticipate and appropriately address any potential adverse revenue impacts from this act.

**NEW SECTION. Sec. 16. BASELINE STUDY.** The department of revenue shall report by December 31, 2004, to the governor and the fiscal committees of the legislature on the definitions used in the proposed model ordinance. The report shall detail the status of the definitions using the baseline standards under section 4(2)(g) of this act, noting any deviations from the definitions in chapter 82.04 RCW and the reason for such deviation. The report shall also estimate the fiscal impact on taxpayers of any deviations from the definitions under chapter 82.04 RCW.

**NEW SECTION. Sec. 17. CAPTIONS.** Captions used in this act are not any part of the law.

**NEW SECTION. Sec. 18.** Sections 2 through 14 of this act are each added to chapter 35.21 RCW.

**NEW SECTION. Sec. 19. EFFECTIVE DATE.** Section 13 of this act takes effect January 1, 2008.


Passed by the House March 19, 2003.

Passed by the Senate April 10, 2003.

Approved by the Governor April 21, 2003.

Filed in Office of Secretary of State April 21, 2003.

**Appendix H**

	<b>Washington State Department of Revenue Informational Return for the City of Seattle</b>
Name of Firm	Department of Revenue Registration Number _____ - _____ - _____
<b>Part 1 – 2004 Service Activity Income</b>	
<p>1a. Did your business provide service activity in the State of Washington in 2004?                  If yes, please answer the remaining questions.                  If no, check box. You do not need to answer any further questions. <input type="checkbox"/></p>	
<p><u>Service activity income</u> means: Taxable income (after deductions and exemptions) from Service activity.</p>	
1b. Please estimate your Total 2004 service activity income from services provided in the State of Washington.	\$ <input style="width: 150px;" type="text"/>
1c. Please estimate your 2004 service activity income as reported to the City of Seattle under the Business and Occupation Tax classification.	\$ <input style="width: 150px;" type="text"/>
<p>In 2008 <u>Service activity income in Seattle</u> will mean:</p> <ul style="list-style-type: none"> <li>• Income from a customer located in the City of Seattle; or</li> <li>• Income from a customer located in an unincorporated area for which all service activity or the majority of the service activity is performed in the City of Seattle instead of the location of the customer.</li> </ul>	
1d. Approximately what percentage of your Total 2004 Washington service activity income would have been earned in Seattle, given the definition above?	<input style="width: 100px;" type="text"/> %
<b>Part 2 – 2004 Service Activity Wages Paid</b>	
<p style="text-align: center;"><u>Payroll</u> means:                  Compensation paid such as: salaries; wages; commissions which are paid to: employees; owners; partners.</p>	
2a. Please estimate your total 2004 Washington payroll.	\$ <input style="width: 150px;" type="text"/>
<p><u>Payroll in Seattle</u> means: employees, owners, or partners meet any of the following location criteria:</p> <ul style="list-style-type: none"> <li>• The employees, owners, or partners assigned office or work station is located within the City of Seattle; or</li> <li>• The employees, owners, or partners are not primarily assigned to any place of business and they perform fifty percent or more of their service in the City of Seattle; or</li> <li>• The employees, owners, or partners are not primarily assigned to any place of business; they do not perform fifty percent or more of their service in any city, but reside in the City of Seattle.</li> </ul>	
2b. Approximately what percent of your Washington payroll was paid to employees, owners or partners in the City of Seattle?	<input style="width: 100px;" type="text"/> %
<p>REV 90 0021 (02/17/05)</p>	