

MUNICIPAL BUSINESS TAXES Chapter 35.102 RCW

Tax Base Traditionally, there have been four different types of tax bases that have been used by cities for their taxes upon businesses:

- gross receipts or gross income;
- fees based on a particular type of activity;
- fees based on the number of employees; and
- fees based on floor space (square footage of buildings).

Until 2003 there were few statutory guidelines relating to the tax bases of municipal business taxes. In that year the Legislature enacted a more uniform system for such taxes, based upon a model ordinance which is to be formulated by cities working through the Association of Washington Cities (AWC). Codified as Chapter 35.102 RCW, the new municipal B&O tax ties many of the definitions to the state B&O tax in Chapter 82.04 RCW and state excise tax administrative procedures in Chapter 82.32 RCW. The model ordinance is intended to preserve some degree of flexibility for cities, but it does contain some mandatory provisions such as a \$20,000 minimum tax threshold for small businesses. RCW 35.102.130 requires that starting on January 1, 2008, municipal business taxes must provide for allocation and apportionment of gross income. Income for most business activities is to be allocated to the place where the activity occurs, whereas service income is to be apportioned based on payroll and the service-related income of the taxpayer. A new provision added in 2006 stipulates that income from printing or publishing of newspapers or magazines be allocated to the location where the printing activity is managed (as opposed to where the presses are located).

Tax Rate

GENERAL BUSINESS ACTIVITIES: RCW 35.21.710 sets a maximum rate of 0.2 percent for city taxes on business activities that are measured by gross receipts or gross income. However, if a city levied a higher rate on January 1, 1982, the rate need not be reduced, but future increases were limited to a maximum of 10 percent (i.e., 0.22 percent) and the amount that the rate could be increased annually was 2 percent (i.e., 0.004 percent per year). The city may increase the tax rate above these maximums if approved by the voters of the jurisdiction (RCW 35.21.711).

UTILITIES: RCW 35.21.870 sets a maximum rate of 6 percent on electrical, natural gas, steam energy, and telephone businesses, unless a higher rate is approved by the voters. Cities that levied a higher rate on April 20, 1982, were required to reduce the rate to 6 percent over a ten-year period, unless the higher rate was approved by the voters. There is no limit on the rate for other utilities, e.g., garbage, water, and sewer services.

OTHER REQUIREMENTS AND RATE LIMITS:

- Any license fee or tax on gross receipts/income that is imposed on retailing businesses must be levied at a single and uniform rate (RCWs 35.21.710 and 35A.82.050).
- Competitive telephone service must be taxed as a retailing activity which is limited to a rate of 0.2 percent (RCW 35.21.710 and 35A.82.050).
- Other telephone businesses operating within the city, if measured by gross receipts/income, must be taxed at a uniform rate which can be as high as 6 percent. The tax may apply to 100 percent of intrastate toll service. If the tax is levied on charges to other telecommunications companies for connection fees, switching charges, access charges, interstate service, or network telephone service purchased for resale, such tax must be at the same rate which applies to competitive telephone service, i.e., a maximum of 0.2 percent. (RCWs 35.21.712, .714 and .715 and 35A.82.055, .060 and .065)
- Any license fee or tax on financial institutions is limited to the rate which applies to other service activities and the definitions, deductions, and exemptions which pertain to the state B&O tax on financial institutions must also apply for the municipal tax (RCW 82.14A.010). The Department of Revenue is required to promulgate a rule defining the uniform apportionment of income of financial institutions for purposes of the local business taxes (RCW 82.14A.020); there are four rules which address this subject: WAC 458.28.010 – 458.28.040.
- Income of trucking firms is subject to allocation for purposes of determining the appropriate measure of local business taxes (RCWs 35.21.840-.850).
- Cities may not impose a gross receipts tax on intellectual property creating activities. A city may tax income received from royalties, but only if the taxpayer is domiciled within the same city (RCW 35.21.855).

VOTER APPROVAL: Any new or increased municipal business and occupation tax is subject to a referendum procedure (RCW 35.21.706). This allows the filing of a referendum petition to challenge a new or increased tax within seven days of the imposing ordinance. After the ballot title is prepared, the petitioner has 30 days to collect signatures. If at least 15 percent of the population of the jurisdiction sign the petition, then the ordinance imposing or increasing the business tax will appear upon the next ballot for approval by the voters.

Recent Collections

According to data reported by local governments to the State Auditor via the Local Government Financial Reporting System, municipal business taxes collected during calendar year 2005 amounted to \$788 million. Further breakdown of the city collections by specific type of B&O or utility tax is as follows:

	<u>Calendar 2005</u>	<u># Cities Reporting</u>
General business and occupation tax	\$241,770,315	37
Utility taxes on city's own utility	183,335,356	73
Utility taxes on private utilities	301,863,208	215
Utility taxes on government utilities	39,647,246	86
Utility consumer taxes	21,337,776	89
TOTAL CITY BUSINESS TAXES	\$787,973,901	

Levied by

Cities and towns only, except for financing a transit system per RCW 35.95.040 (see below). Counties are not authorized to levy general purpose B&O or utility taxes (although several counties levy a franchise fee on cable TV firms). The authority to levy municipal business taxes and license fees appears in several statutes in Title 35 RCW:

- RCW 35.21.710: General requirements for taxes measured by gross receipts and the 0.2 percent rate limit for all cities. (NOTE: This statute does not specifically state that cities may levy a business tax; rather it merely requires uniformity of rates on retailing and establishes the overall rate limit.)
- RCW 35.22.280: first class cities. The law lists many specific powers for first class cities. None of the various subsections specifically state that such cities may levy municipal business taxes. Subsection 2 allows cities to provide for the payment of the debts and expenses of the (municipal) corporation. Subsection 32 allows cities to "grant licenses for any lawful purpose, and to fix by ordinance the amount to be paid therefor." RCW 35.22.570 grants first class cities all powers that are given to other cities by Title 35 RCW, including specific authority for municipal business taxes.
- RCW 35.23.440(8): second class cities. This statute lists the powers of cities with populations ranging from 10,000 to 20,000 at the time of incorporation. This subsection permits a municipal license tax for purposes of revenue and regulation upon occupations, trades, and all businesses.
- RCW 35.27.370(9): towns. This statute provides authority for municipal corporations with populations from 300 to 1,500 at the time of incorporation

to license all businesses and fix the rates of such license taxes for purposes of regulation and revenue. RCW 35.27.500 authorizes towns to impose a "street poll tax" of up to \$2.00 annually upon each adult resident.

- RCW 35A.82.020 and .050: cities chartered under the optional municipal code. Authority is provided to such cities, regardless of size, to license businesses or impose excise taxes for purposes of regulation or revenue.
- RCW 35.95.040. Authority is provided to a city, county, county transportation authority, or public transportation benefit area to levy a gross receipts tax to finance a municipal transportation system.

GENERAL BUSINESS TAXES

According to a survey of all municipalities by the Association of Washington Cities,¹ 40 cities currently levy a B&O tax on businesses which is measured by a percentage of the firm's gross receipts. The reporting cities, all located in Western Washington, were:

Aberdeen	Everett	Pacific
Algona	Everson	Port Townsend
Bainbridge Island	Granite Falls	Rainier
Bellevue	Hoquiam	Raymond
Bellingham	Issaquah	Roy
Black Diamond	Kelso	Ruston
Bremerton	Lacey	Seattle
Buckley	Lake Forest Park	Shelton
Burien	Long Beach	Snoqualmie
Cosmopolis	Longview	Tacoma
Darrington	Mercer Island	Tumwater
Des Moines	North Bend	Westport
Dupont	Ocean Shores	Yelm
	Olympia	

The number of cities levying a gross receipts tax and the average rates for the four major business categories were as follows:

Retail businesses	-	37 cities; 0.164 percent
Wholesale businesses	-	38 cities; 0.158 percent
Manufacturing firms	-	39 cities; 0.156 percent
Service firms	-	37 cities; 0.204 percent

¹Municipal Tax Rates and Fees, 2006 Survey, Association of Washington Cities.

In addition to the reported 40 cities using gross receipts, there were many municipalities that reported using another type of tax base for their annual municipal business tax or license fee. Some cities that levy a local B&O tax on gross receipts also impose additional annual license fees. And many have a variety of additional fees on specific activities, such as home occupation licenses or fees for cabarets.

Approximately 185 cities levy business license fees. Most of these are comprised of a fixed dollar amount of license fee that is paid annually, although a few are limited to an initial one-time license fee for registration. Many of these are fixed fees, often in the \$25 - \$75 range, while some vary the fee according to the type of business activity. Fifty-six cities reported measuring the annual business tax by the number of employees. Typically, they levy a fixed dollar amount, plus a graduated fee depending upon the firm's employment. Finally, two cities -- Anacortes and Bothell -- reported using square footage of the business as a measure of the annual license fee.

UTILITY TAXES

The 2006 AWC survey identified cities that indicated they levied a municipal tax on one or more types of utility services. Many cities levy their utility taxes at the statutory maximum of 6 percent, although some have higher voter-approved rates. The major types of utilities, the average tax rate, and the number of cities reporting a utility tax in 2006 were:

<u>Type of Utility</u>	<u>Average Tax Rate</u>	<u># Reporting</u>
Natural gas	5.72%	147
Electric	5.68	205
Telephone	5.77	205
Cellular telephone	5.91	173
Pagers	5.70	87
Garbage	7.62	152
Water	8.29	159
Sewer	8.19	148
Storm drainage	7.10	55
Cable television	5.40	131

In general, a municipal utility tax levied on a utility activity operated by the same city applies to all customers of that utility, even if they live outside the boundaries of the city. But a municipal utility tax levied upon privately-owned utility companies only applies to customers who reside within the city.

Administration City Clerk, Treasurer, or other financial officer (e.g., Department of Revenue and Consumer Affairs in the City of Seattle).

Distribution of Receipts

Not specified in statute; presumed to be used for general purposes of the municipality, except for the local tax pursuant to RCW 35.95.040 which must be used to finance a municipal transportation system.

Exemptions

- Minimum tax threshold of \$20,000 in annual gross receipts, RCW 35.102.040(2,b).
- Credits to avoid multiple taxation or taxes on interstate commerce, RCW 35.102.060.
- Deduction for professional employer organizations for actual costs paid to employees, RCW 35.102.160 and 82.04.540(2).

History

It is not known when cities first began taxing business activities within their jurisdiction. Presumably, they first imposed license fees of a specified dollar amount. The use of gross receipts as a measure of the municipal business taxes probably began sometime after the initial state gross receipts tax, the Business Activities Tax of 1933 (succeeded by the B&O tax in 1935). Limitation of rates to 0.2 percent for general business activities and 6 percent for utilities was enacted in 1982. Legislation requiring uniformity in local B&O taxes was adopted in 2003; see discussion of Chapter 35.102 RCW above.

Discussion/Major Issues

Municipal business taxes are locally levied and collected. Unlike the property tax and the local sales tax, the state has had little involvement in the administration of these taxes. There has traditionally been little uniformity in tax rates and tax bases, which may be confusing for firms that do business in more than one city which levies a tax on general business activities. It is believed that the new requirements of Chapter 35.102 RCW will significantly improve the uniformity of local B&O taxes and reduce the potential for double taxation of the same income for inter-jurisdictional transactions.

The only statewide source of collection data for local business taxes is the annual reports made to the State Auditor as required by RCW 35.21.710, but this statute requires only reporting of taxes levied on retailers. There has been concern that not all cities have reported municipal business tax revenues and that the data may be incomplete, since it is not audited by the state.

The tax on general business activities, particularly as measured by gross receipts, has only been levied in a relatively small number of cities. Some cities, particularly those in Eastern Washington, have tried unsuccessfully to convince their voters to authorize the tax. In at least one instance, a local B&O tax was adopted by municipal ordinance but public sentiment forced its subsequent repeal.