Mitigation Advisory Committee Meeting Minutes
November 28, 2007

Attendees:
Kevin Fuhrer, City of Tukwila
Sheila Gall, Association of Washington Cities
Jim Justin, Association of Washington Cities
Danielle Larson, City of Tacoma
Glen Lee, City of Seattle
Doug Levy, Cities of Everett, Kent, Federal Way, Renton, and Puyallup
Lucy Liu, City of Bellevue
Julie Murray, Washington State Association of Counties
Bob Nachlinger, City of Kent
Gary Prince, King County Department of Transportation
Jim Schmidt, Office of Financial Management
Jim Turpie, Community Transit
Iwen Wang, City of Federal Way

Department of Revenue Staff: Lorrie Brown, Matthew Bryan, Kim Davis, Miki Gearhart, Don Gutmann, Tim Jennrich, Tiffany Johnson, Rebecca Johnston, Diane Mielke, James Petit, Greg Potegal

How distribution works

Kim Davis - Issues 08-01 through 08-14 are informational documents explaining how local taxes are distributed to the counties and cities.

New PFDs in Yakima and Cowlitz counties are excluded from the legislation on mitigation.

If a city imposes a new local tax that is effective after July 1, 2008, will the city be mitigated for this tax?

Julie Murray – No. If you don't have the tax in place on July 1, 2008, you don't have a gain or loss so it is not mitigated.

Miki Gearhart – LIFTs can't impose their tax until July 1, 2009. Do we mitigate them?

Julie Murray – No. The statute drives mitigation.

Greg Potegal – Does this apply to rate changes too?

Julie Murray – Look at the statute. Mitigation was intended to deal with the unintended consequences of decisions you already made. It's a different issue if you changed your rate within the base year. There is a loss impact. But after we set the amount and say it is the final amount, it is final.

Bob Nachlinger – I am concerned about my PFD which initiated the sales tax credit as of January 1 so it will be imposing the credit during the base year of mitigation. Will that be prorated for the half a year that the tax is in place?

Julie Murray – We would try to fully mitigate those that made a rate change during the year.

Lorrie Brown – Fiscal Year 2009 is like the snapshot in time that you get mitigated for. Whatever happens in FY 2009 we fix to make it whole. If a jurisdiction imposes a new tax in January 2008 which is half of the first year, we will expand that to represent a whole year. What happens if it gets imposed in the middle of FY 2009? You get mitigated for that increased tax rate for half the year.

Julie Murray – I would disagree because you mitigate the tax base, not the dollar amount. Whatever the tax rate is on June 30, 2009, the end of the base year.

Lorrie Brown – FY 2009 is the year that you are supposed to be made whole for. That is what you are getting mitigated for. There are two base years. FY 2008 is what we are using as a comparison because that is the first year in the pre-sourcing year.

The first issue is what is the base year – FY 2008 or FY 2009? The second issue is what is the rate that we use?

Julie Murray – We are not mitigated for FY 2010 and beyond. We are mitigating the state of the world in FY 2008. I was proposing that we do look at FY2009 and then on June 30, 2009, we look at the state of the world and then that is it. Whatever rate they imposed up to that time is the one we use.

Jim Turpie – I propose that anything that is imposed after FY 2008 is not mitigated. We are trying to make them whole for FY 2008. I agree we should try to make it an annualized number and mitigate for that. I don't understand why you would mitigate if you impose a new tax in the middle of FY 2009.

Lorrie Brown – When we are mitigating we are looking at FY 2008 and comparing it to FY 2009. We mitigate for the growth that happens in FY 2009. It is consistent that if you change your rate in FY 2009, we need to mitigate for that. What isn't clear is if you mitigate for the whole year or the portion of the year that you changed the rate.

Doug Levy – How do you handle an annexation where the actual program starts before July 1, 2008, which is when the annexation is effective?

Don Gutmann – If the tax rate changes, we could be using a new tax rate for the second quarter. Do we go back and recalculate the first quarter?

Julie Murray – No. The base year in other discussions has been FY 2008. Mitigation is intended to compensate for the tax base change post-sourcing. The reality of what happened to you happens in FY 2009. The actions that local governments take in FY 2009 should be accounted for fully. The change in the base stays the same, and that is what we are mitigating.

Miki Gearhart – I look at FY 2008 as the base year and FY 2008 and FY 2009 is the basis for deciding mitigation.

Bob Nachlinger – If I have the authority to raise my sales tax rate and I did that in FY 2009, that change in the rate would reduce my mitigation because it would be imposed during FY 2009.

Lorrie Brown – The change is based on taxable retail sales, so it wouldn't be reduced.

Julie Murray – What happens in FY 2009 should count.

Don Gutmann – What rates do you use – those at the end of FY 2008 or at the end of FY 2009?

Glen Lee – I would agree with what Julie is saying. You are bringing things on board in FY 2009 because of business decisions and not because of mitigation.

Jim Justin – We need to get a sense of where everybody is on this issue.

Jim Turpie – You're trying to figure out what you would have gotten. There is no loss. In FY 2008 you're 100 percent. On July 1, 2008, you impose destination sourcing and then in FY 2009 you're trying to figure out what you actually lost in FY 2008. I don't see that that is what is intended.

Miki Gearhart – The loss is the loss in the tax base. If you look at the base, the rate doesn't matter.

Jim Turpie – If you get into the issue of rates, if you're imposing a new tax and you're saying you want to adjust the base, there is no way you have had any loss because you didn't have the tax in the first place.

Greg Potegal – If there is no loss in FY 2009 compared to FY 2008, you can't mitigate.

Lorrie Brown – We will look at the statute and interpret it and bring it back to the next meeting.

Should changes in tax rates or new taxes be reflected in mitigation if they happened in FY 2009?

Jim Turpie – If somebody imposed a large tax in FY 2009 and it is mitigated, that takes money from other jurisdictions.

Julie Murray – The discussion about being prorated is beyond this committee.

Miki Gearhart – Does it make sense to mitigate for someone who is at a lower tax rate than the maximum? Yes.

Lorrie Brown – The first issue is if an annexation happens in FY 2008.

Jim Turpie – Does it assume that the tax rate in the annexed area will likely be a change or stay the same?

Lorrie Brown – We will assume the rate is the same.

Issue 06-01 a – If an annexation happens during the middle of FY 2008, it will muddy the data. Because FY 2008 is the year that we compare against. When we do our comparison, we won't have a full year of activity.

Jim Turpie – The firm itself – does it start reporting differently?

Lorrie Brown – Yes – that is the problem. We would see a change in their reporting. They will report the same but to a different location code. We can use GIS to figure out what firms will fall within the boundaries of the annexation. We can do that in FY 2008. We can change their location code to the new location code that they are annexed to for the prior quarters before they were annexed so it looks like a full year of data for that firm which is what we want for the comparison.

Glen Lee – If you create a data base to correct for this, how accurate is the estimate?

Iwen Wang – If a company has ten stores in 1700 and one goes into location code 1701, will you pick up that company?

Don Gutmann – No – we will not be able to track that.

Glen Lee – That's why I am asking how difficult this is. It seems to me that most of the money would be from multi-store firms.

Lorrie Brown – We would have to use the Employment Security data, but the Employment Security data is old.

We might want to set a threshold by the size of the business and/or by the size of the annexation.

Jim Justin – Will there be a threshold on the size of the annexation – below the threshold, you do everything?

Don Gutmann – It is based more on the composition of the businesses. If a business has a single store, that is no problem. We will try to have it account for businesses with multiple stores, and that will be a problem.

Bob Nachlinger – How would you identify if a new store opens and there are already two in the jurisdiction?

Don Gutmann – We would have to look at Employment Security data. They have the number of employees for each store.

Miki Gearhart – There are two very large annexations this year – Auburn and Renton.

Don Gutmann – We can report back on the size of the problem and then we can decide on thresholds.

Lorrie Brown – Is everybody okay with setting some thresholds?

Iwen Wang – For multi-store locations.

Lorrie Brown – Before FY 2009, we can look at the data and then decide on thresholds.

Issue 06-01 b – this is an issue whether it happens in the beginning or the middle of FY 2009 – the data gets muddied for the 2008/2009 comparison. If an annexation happens in the second quarter of FY 2009, it looks like an increase in destination sourcing but in reality it is because of the annexation. The problem is how do we separate those two out? If we don't adjust, we will be overmitigating the net loss and the net gain.

Glen Lee – I think the real issue is the strip malls that have multi-site businesses. The destination issue is tiny. The real issue is by bringing that firm into your city, you don't know how much revenue that firm will bring in.

Lorrie Brown – If we don't adjust for them, it will make the net loss and gain numbers too big.

Julie Murray – We are back to the question of what are we trying to mitigate. If annexation happens in FY 2009, we are trying to compare FY 2008 to the annexation in FY 2009.

Lorrie Brown – You're right that part of the issue is who should get the mitigation that goes with the firm that is annexed. There is a data issue, too, that would muddy our estimates.

Julie Murray – If we don't care about the other things that are happening, why would we care about any annexations that happen?

Lorrie Brown – It will change things in the data that are due to destination sourcing.

We will find out who the firms are and then we will adjust the FY 2008 data. We will change the FY 2008 data to the annexing jurisdiction's location code. We would have to do it quarter by quarter. We propose to go back to quarter two of FY 2008 and change a portion of the 1700 revenue from Firm A to 1701 to reflect the change because of annexation. Each quarter we would do the changes and at the end of the year, we would sum up the quarters because we have the one quarter where there isn't the change. There are some difficulties in getting the data.

If we adjust the data in that way, that does imply that what happens with the annexation goes to the annexing jurisdiction. The annexing jurisdiction will get the mitigation for the annexed firms. We can not think of any other way to fix the data. If we don't fix it, we will be overestimating the net losses and gains.

Jim Justin – You are shifting mitigation that may have otherwise gone to the county to the city. If there are only four counties, I don't think there would be significant annexations and not a significant impact.

Kim Davis – Jim, do you think nothing should be done?

Jim Justin – No.

Lorrie Brown – It is more of a problem during FY 2009. There is a two-week window to determine the mitigation amounts, so we don't have time to get the data into GIS and identify the firms. At the end of the year we will have more time to identify the firms. To get the data we will have the annexing jurisdictions give us the names of the big firms that they are annexing.

Bob Nachlinger – When you finally set the mitigation for the 2009 year, it will go to the jurisdictions on September 30, 2009?

Lorrie Brown – Another issue is how long do we want to wait to fix the mitigation. Right now, that is in flux.

Bob Nachlinger – If you made the final payment for the fiscal year, there could be a plus or minus adjustment.

Lorrie Brown – We need to discuss whether we would go back after the final and true everything up.

Julie Murray – I think we should look at the final amount prospectively.

Glen Lee – If we show up with a list of firms and they're all multi-site firms in the unincorporated county, I can't figure out how they will be resolved.

Iwen Wang – It takes 60 to 90 days to get the revenue from a new annexation, so there is time to identify the firms.

Lorrie Brown – We are reflecting the annexation that happened in FY 2009 in the data. There will be thresholds and we will look at that later. We will do the estimates quarter by quarter the best we can, but everyone knows that they won't be perfect. We will do that prospectively but will not go back and adjust if we are wrong.

In issue 06-01 c, if an annexation takes place after the data is fixed, does the net loss or gain that is associated with the annexed area go with the annexing jurisdiction or stay with the original jurisdiction?

Julie Murray – We covered this – after the year we don't account for those. It is a set amount. We recognize that some areas will gain from that, but it is a compromise that we agreed on.

Jim Turpie – If a city is a net loser and you don't account for the annexation, do you account for the fact that their revenue is reduced and won't it be due to the voluntary sellers instead of the annexation?

Lorrie Brown – I think it is okay. I need to think about this a bit more.

Issue 06-02 is that we will not have any post-mitigation data when we need to calculate the appropriation for the next biennium. We will have to start with our best estimate based on the sourcing study and we would put that in as a place holder. Does everybody understand that the number will change pretty late in the process? It will change in February. We would then have enough data to give them the actual number.

Julie Murray – Will you have at least one quarter of data by that point?

Lorrie Brown – We will have two quarters of data.

Julie Murray – If we are way off of the number for the first year, we will want to adjust that. It is a combination of looking at the sourcing study and looking at the quarterly data. The following year it would be a supplemental request for the remainder.

Lorrie Brown – The other issue that I would like to talk about is how long should we wait until we finalize those numbers? At the end of FY 2009 when we have a full year of data, it has been implied that we would do the final numbers. But because of some earlier issues, we had talked about waiting a while until we have more data and do the final numbers a quarter or two later. Several issues are the late filers and the annual reporters and the annexation data. The proposal is to wait for two more quarters until we finalize the mitigation amount. Then we get to be on a calendar year and we would divide the amount into four equal quarters.

Gary Prince – If it is in December it will go into the next budget, so that is okay.

Julie Murray – Will you create a calendar when the payments will happen, when we think we will make the adjustments, etc.

Lorrie Brown – Good idea. We can put that together.

Gary Prince – When is the first time you get a check for the fixed amount?

Lorrie Brown – Two quarters after December 30, 2009, so that would be June. Mitigation starts July 1, 2008, the first payment goes out December 1, 2008, for Quarter 3 activity – July, August, and September. In December 2009 we will have a full year of data and the payment will be for July, August, and September 2009. We propose to wait two more quarters until June 30, 2010.

Iwen Wang – December 2009 is already two months beyond the fiscal year.

Lorrie Brown – We have to wait for two more quarters so we have more time to clean up the data, more taxpayers reporting correctly, data on annexations, etc.

Kim Davis – In order to include the annuals we need to wait for the annual data. We can only make adjustments every December thereafter, so we talked about having more time to discuss the other adjustments.

Jim Turpie – I don't understand why, if we are going to fix our data as of the end of 2009, the first quarterly check wouldn't come out in March.

Lorrie Brown – We would use the whole year of data and come up with the best estimate of what mitigation would be. The payment would be a quarter of that. We would do that in December. In March we will re-estimate this because there will be more late filers, we can have better data on annexations, etc. The amount in March might be different than in December because the data is cleaner. At that point, we would stop improving the estimate.

Kim Davis – This would be fixing the estimate on a fiscal year instead of a calendar year – that might not be a positive thing.

Jim Turpie – I thought two quarters beyond the end of the year. On March 30, 2010, you're on an annual year basis and you would be paid for a calendar year. If you're using the data from two quarters, March 30 is where the first fixed payment should be.

Bob Nachlinger – I disagree – it won't pick up the annual tax filers. I have one city where annual filers represent 21 percent of its sales tax.

Julie Murray – I want it to be fixed only prospectively. The number will never grow. It will only change for voluntary sales.

Jim Justin – I would rather wait for 18 months and get better data – fix on June 30.

Iwen Wang – By March you should have 18 months of data.

Kim Davis – The December data isn't due to the state until January.

Lorrie Brown – We are cleaning up and refining the same data, we are not adding data because we would be reflecting growth after FY 2009.

Jim Turpie – When you are analyzing the data, are you starting in July 1, 2008?

Lorrie Brown – We don't get any data until September 15.

Kim Davis – If the group wants to close in March we will do the best we can with the data we have.

Jim Turpie – When are you going to stop looking at new data? At the end of March? When are you going to fix the data that you are analyzing and set the payment?

Lorrie Brown – On the quarter by quarter data, we will be looking at the data until two weeks before the payment information needs to go to the State Treasurer. We want to get as many adjustments in as possible. It is our call or your call as to when we stop. I am hearing that most people want the June 30 check to be the first check.

Jim Turpie – How are you going to determine the tax base?

Lorrie Brown – We will look at the statute and confer with agency lawyers.

<u>Master List of Issues</u>

Issue 01-02 – Negatives in data – will have at December meeting
02 Issues – Errors made by taxpayers – late to change – Done
03 Issues – Other errors made by taxpayers – 03-01, 03-02, and 03-04 will be discussed at the next meeting. 03-03 and 03-05 are done.
04 Issues – Tracking changes in business reporting – 04-01 and 04-02 will be discussed at the next meeting. 04-03, 04-04, and 04-05 are done.
05 Issues – Modeling process – Discuss 05-01 maybe after the legislative session. 05-02 is done.
06 Issues – Mitigation fund/allocations/what is mitigation? We will finish these issues after the base year is determined at the next meeting.
07 Issues – What is mitigated? Next meeting
08 Issues – Done
09 Issues – Done

Lorrie Brown – After we make all the recommendations, DOR will lay them out and look at them research-wise. The committee will prioritize them.

Miki Gearhart – There is a lot of clean-up work on the documents. Let us know if there are parts that are unclear.

Lorrie Brown – We will start taking about communication issues after the legislative session.

Julie Murray – Timeline – how and when are we going to know when the Department decides to do something different? Keep all decisions open until we do the communication effort. We might want to rethink some things. Determine the final process before the session starts. There are also legal issues.

Iwen Wang – Will you e-mail the cleaned-up versions the first week of January so we can communicate them to the cities for their review?

Miki Gearhart – Probably not by the first week of January.

Lorrie Brown – After the legislative session starts we are going to start modeling, so we do need to firm up these decisions. The programming will be a tremendous amount of work and the testing needs to be done before we get the data.