



## INFORMATIONAL MEMORANDUM

TO: Finance Committee  
FROM: Peggy McCarthy, Finance Director  
CC: Mayor Ekberg  
DATE: July 11, 2018  
SUBJECT: Business & Occupation (B&O) Tax Next Steps

### ISSUE

During its review of the Public Safety Plan financing, the Committee requested additional information on B&O taxes, ultimately deciding to re-evaluate with regard to the General Fund. This is a follow up to the April 17, 2018 briefing where the Committee requested additional information about scaling the tax to be higher for larger commercial businesses and the personnel cost for various thresholds.

### BACKGROUND

Sales tax revenue has not grown in the past two years at the rate anticipated or budgeted. Additionally, the State's sales tax mitigation payments of approximately \$1.1 million annually will cease in 2019 based on a decision by the state legislature. These two revenue shortfalls have the potential to create a more than \$2 million annual budget gap. This budget gap was discussed with the Finance Committee in February through May in connection with the Public Safety Plan financing. Funding options comprise new and increased revenues in addition to expenditure reductions, including:

- Establish a B&O tax, \$700K - \$3 million
- Increase the gambling tax rate by 1% - 5%, potential revenue: \$380K - \$1.9 million
- Transportation Benefit District car tabs, \$200K to \$500K
- Increase other tax rates to the extent allowed without voter approval
- Reduce General Fund operational expenditures across-the-board
- Reduce General Fund operational expenditures based on Priority Based Budgeting
- Reduce the General Fund contribution to the CIP by \$500,000 annually

The B&O tax provides the greatest potential additional revenue. B&O Tax rates are calculated on gross receipts multiplied by the tax rate set by government. The rate can be set at 0.2% or lower. An exemption threshold exempts businesses with gross receipts below the threshold from B&O tax. The lower the exemption threshold, the higher the number of returns to process since a greater number of businesses are subject to the tax. The four major business sectors subject to the tax are:

1. retailing,
2. wholesaling,
3. manufacturing
4. service and other activities.

Taxation rates can vary across sectors, but not within them. Out of the 43 cities in the State with a B&O tax, 16 have varying rates from sector to sector; with the remainder having one rate for all sectors. Some cities have structured their rates to encourage growth in a specific sector. **Table 1** shows the rates and thresholds for some Puget Sound cities and for the State.

**Table 1. B&O Tax Rates, Puget Sound Cities and Washington State**

| Location   | Year Implemented | Manufacturing Rate | Retail Rate | Services Rate | Wholesale Rate | Exemption Threshold (Annual) |
|------------|------------------|--------------------|-------------|---------------|----------------|------------------------------|
| Burien     | 2007             | 0.001              | 0.001       | 0.001         | 0.001          | \$ 200,000                   |
| Des Moines | 2004             | 0.002              | 0.002       | 0.002         | 0.002          | \$ 75,000                    |
| Kent       | 2013             | 0.00046            | 0.00046     | 0.00152       | 0.00152        | \$ 250,000                   |
| Renton     | 2016             | 0.00085            | 0.00050     | 0.00085       | 0.00085        | \$ 500,000                   |
| Shoreline  | 2019             | 0.001              | 0.001       | 0.002         | 0.001          | \$ 500,000                   |
| WA State   |                  | 0.00484            | 0.00471     | 0.015         | 0.00484        | \$20,000                     |

Administering a B&O tax can be complex. Some businesses may engage in multiple activities, requiring them to report in more than one classification. Depending on whether a business is required to file quarterly or annually, a business may be subject to taxation in one quarter, but not in others.

Cities surveyed by staff – Kent, Renton and Shoreline - established a revenue target and set taxation rates and threshold based on their projections. Both Kent and Renton collected more tax than projected; Shoreline's tax goes into effect in 2019. Once the cities had been through a budget cycle, projections became more accurate. One city's initial target revenue was \$5 million, and their actual collected was over \$9 million. Another city's target revenue of \$3 million resulted in over \$4 million collected.

All cities queried hired additional staff for implementation and ongoing administration. The City of Kent has the highest number of returns and employs four full time B&O tax staff: two field auditors, one customer service specialist, and another in-house auditor. **Table 2** shows number of staff, program costs, and number of filings for three cities.

**Table 2: Staffing, Costs, and # of Filings by City**

| City      | FTE | Program Cost           | # of Filings |        |
|-----------|-----|------------------------|--------------|--------|
|           |     |                        | Quarterly    | Annual |
| Kent      | 4   | \$780,000              | 4,000        | N/A    |
| Renton    | 1   | \$250,000              | N/A          | 1,200  |
| Shoreline | 1   | \$245,000 <sup>1</sup> | N/A          | N/A    |

<sup>1</sup> Estimated. Source: 12/4/2017 City of Shoreline Staff Report.

**DISCUSSION**

Adoption of a B&O tax could close the budget gap created by the sales tax and sales tax mitigation revenue shortfall and continue to diversify and stabilize revenues. Additional revenue could reach \$3 million or more. See **Table 3** provides a range of revenue estimates.

**Table 3. Annual Projections for Tukwila based on 2017 Sales Tax Receipts\***

| Rate                     | \$200,000 Threshold | \$500,000 Threshold |
|--------------------------|---------------------|---------------------|
| 0.00050                  | \$807,398           | \$760,720           |
| 0.00085                  | \$1,372,577         | \$1,293,224         |
| 0.001                    | \$1,614,796         | \$1,521,440         |
| 0.002                    | \$3,229,593         | \$3,042,881         |
| Estimated # of Taxpayers | 941                 | 575                 |

\*Tukwila 2017 sales tax data set. Assumes 80% of total subject to the tax.

Based on initial analysis and research, staff recommends the following should Council decide to pursue a B&O tax:

1. apply the same rate among all sectors for simplicity in filing,
2. establish a \$500,000 threshold to exempt smaller businesses and reduce the number of returns to be processed,
3. adopt a rate of .15% to .2% to ensure budgetary goals are met and,
4. collect the tax on a quarterly basis to enhance the City's cash flow.

A potential timeline and action plan follows should work on implementing a B&O tax in the City of Tukwila continue:

| Timeframe                                 | Action Item  | By Whom                   |
|---|--|---------------------------|
| July and August, 2018                     | Outreach to businesses   | Staff                     |
| August 21, 2018 Finance Committee Meeting | Ordinance review, policy decisions on: <ul style="list-style-type: none"> <li>• Tax rates,</li> <li>• Exemption threshold,</li> <li>• Reporting frequency</li> </ul> | Council Finance Committee |
| September 4, Council Regular Meeting      | Ordinance approval   | Full City Council         |
| September through December 2018           | FileLocal Agreement – taxpayer portal  | Staff                     |
|   | Acquire software for interface between FileLocal and EDEN accounting system  | Staff                     |
|   | Recruit for B&O tax analyst  | Staff                     |
|   | Continue outreach and communication with business community  | Staff and City Council    |
| January 1, 2019                           | Legislation becomes effective.   | n/a                       |

**RECOMMENDATION**

The Committee is being asked to provide direction on the next steps that should be undertaken, if any, to establish and institute a Business & Occupation tax for the City.

