



## INFORMATIONAL MEMORANDUM

TO: **Finance Committee**

FROM: **Vicky Carlsen, Finance Director**

BY: **Tony Cullerton Deputy Finance Director**

CC: **Mayor Ekberg**

DATE: **October 24, 2022**

SUBJECT: **Business & Occupation Tax Information**

### **ISSUE**

This memo provides information pertaining to the proposed Business and Occupation (B&O) tax in Tukwila to take effect January 1, 2024, including information on the tax rates, implementation, and potential revenue.

### **BACKGROUND**

Like many jurisdictions in Washington State, the City of Tukwila has experienced a structural deficit for multiple biennia. This is due to several factors, including the 1% limitation on regular property tax, the sunset of streamlined sales tax mitigation revenue, and ongoing expenses that are growing significantly faster than revenues.

On October 3<sup>rd</sup>, 2022, Mayor Ekberg presented his budget to the City Council. As part of the budget, the Mayor recommended the adoption of a modest B&O Tax as part of a “three-legged stool” approach to a balance budget, which also includes using one-time funds and keeping some open positions vacant over the coming biennium.

The State of Washington Revised Code of Washington (RCW) allows for local jurisdictions to levy a local B&O tax which is paid to the local government. While sales tax is collected by the State, local B&O taxes are administered by the taxing jurisdiction. This means the exemptions, collection, enforcement, and the administrative code are the responsibility of the taxing jurisdiction. Additionally, the implementation of a local B&O tax will require additional effort by both the taxing entity and the business. For example, the City will need to administer the tax, and businesses in Tukwila that are subject to it will need to file an additional tax return.

### **B&O Categories (NAICS Category Codes)**

The following categories are subject to B&O tax, per state law:

- Manufacturing
- Wholesaling
- Retail
- Service & Other Activities

These classifications are assigned a category rate that is assessed to all businesses within that category. Rates may differ among categories but all businesses within the same category must be assessed the same rate.

**DISCUSSION**

Businesses subjected to the local B&O tax are entities that meet all of the following criteria:

- The business falls into one (or more) of the NAICS category codes.
- The business maintains a physical address within the Tukwila city limit.
- Generate annual gross receipts equal to or more than \$20,000.
- Nonexempt businesses

**Exempt Businesses**

Per the State Model Ordinance for B&O taxes, the following eleven business and revenue types are exempt from being assessed a B&O tax.

- (1) Public utilities
- (2) Investments
- (3) Insurance business
- (4) Employees.
- (5) Amounts derived from sale of real estate.
- (6) Mortgage brokers' third-party provider services trust accounts.
- (7) Amounts derived from manufacturing, selling or distributing motor vehicle fuel
- (8) Amounts derived from liquor, and the sale or distribution of liquor
- (9) Casual and isolated sales
- (10) Accommodation sales
- (11) Taxes collected as trust funds

In addition to the State mandated exempt businesses, the City is proposing exemptions for nonprofit organizations exempt from federal income tax under section 501(c)(3) of the Internal Revenue code, businesses operating as a card room, and professional/amateur/semiprofessional sports teams. The City is proposing a threshold of \$750,000, meaning any business that earns \$750,000 or less is exempt from the tax.

**Surrounding Jurisdictions B&O Thresholds and Rates**

The State Model Ordinance for B&O tax requires cities to adopt an exemption threshold allowing businesses that gross revenues less than the adopted threshold to opt out of participation in the B&O tax program. The minimum allowable threshold as stipulated by RCW is \$20,000. The City of Tukwila is proposing a minimum threshold amount of \$750,000. Businesses generating gross revenues equal to or less than the \$750,000 threshold will be exempt from B&O taxes.

Category	Tukwila (Proposed)	Renton	Kent	Des Moines	Auburn	Burien
Manufacturing	0.00085	0.00085	0.00100	0.00200	0.00100	0.00100
Retail	0.00050	0.00050	0.00100	0.00200	0.00050	0.00100
Services & Other	0.00085	0.00085	0.00200	0.00200	0.00100	0.00100
Wholesale	0.00085	0.00085	0.00200	0.00200	0.00180	0.00100
<b>Threshold</b>	<b>\$750,000</b>	<b>\$500,000</b>	<b>\$250,000</b>	<b>\$50,000</b>	<b>\$500,000</b>	<b>\$200,000</b>

**Proposed Revenue**

Proposed B&O applies only to businesses with gross income over \$750,000 and includes higher exemptions than State law. Revenues are estimate until B&O implemented, forecast above assumes 100% collection and likely captures 501(c)3. Actual revenues expected to be \$3M.

Row Labels	Sum of Gross Income	Count	Rate	\$ Amount
Manufacturing	346,896,394	38	0.00085	294,862
Retail	1,689,165,125	208	0.00050	844,583
Service & Other Activities	2,155,345,125	355	0.00085	1,832,043
Wholesale	913,639,413	75	0.00085	776,594
<b>Grand Total</b>	<b>5,105,046,057</b>	<b>676</b>		<b>3,748,081</b>

**MODEST B&O TAX proposal**

- Highest gross revenue threshold of surrounding cities (\$750,000)
- Lowest rates of surrounding cities
- Proposed Exemptions:
  - 501(c)(3) organizations
  - Professional/Amateur/Semiprofessional sports teams
  - Cardrooms
- Effective January 1, 2024, giving businesses over a year to budget for the new tax.
- Forecasted revenues to be approximately \$3M per year.

**Benefits of a B&O Tax**

- Critical foundation of the “third legged stool” to balance this year’s bridge budget, which also includes holding vacancies open and using one-time funds.
- Without a B&O more cuts will be necessary throughout the organization.
- B&O tax revenues are unrestricted and may be used for any lawful governmental purpose.
- Reoccurring revenue that diversifies the City’s revenue sources.
- Only business with annual gross revenues above \$750k will be subject to B&O Tax. 501(c)3, cardrooms and amateur/semi-professional/professional sports teams exempt regardless of gross revenues.
- Several major surrounding cities have already implemented a B&O tax; other cities currently deliberating implementation as a part of the 2023/2024 budget process.
- The City establishes the Category Rates, exemptions and gross revenue threshold amount, thus maintaining significant influence over the impacts of the tax.
- A new revenue source diversifies our revenue sources and will assist with maintaining our current strong bond rating.

**Required next steps**

- Adoption of the State’s Model Administrative and B&O Tax Ordinance.
- Approve two new FTE positions in Finance (one in early 2023 to develop the program, one additional in late 2024 to help administer).
- Ongoing outreach with local businesses.

**Conclusion**

The implementation of a local B&O tax provides the City with an additional revenue source that will assist with current ongoing operations and programing, and provide a new continuous revenue stream for an additional, enhanced level of providing of services. The strategic identification of a \$750,000 gross revenue threshold will ensure that sole proprietors and small businesses are exempt. Without the addition of a new revenue source the City will have to reduce at least \$3M in services, resulting in reduction of staff, as well as programs and services important to the Tukwila community.

**RECOMMENDATION**

Discussion Only

**ATTACHMENTS**

- PowerPoint Presentation
- Deviations from Model Ordinance
- Local B&O Tax Rates 2022
- Exempt Business Exemption



# CITY OF TUKWILA

## Business & Occupation Tax Discussion

# WHAT IS A BUSINESS & OCCUPATION TAX

- A B&O tax is a gross receipts tax. It is measured on the gross income of the business.
- Washington, unlike many other states, does not have an income tax.
- Sales tax is collected by the State, local B&O taxes are administered and collected by the taxing jurisdiction.
- Exemptions, collection, enforcement, and the administrative code are the responsibility of the taxing jurisdiction.

# BUSINESSES SUBJECT TO B&O TAX PER STATE LAW

## Categories

- Manufacturing
- Wholesaling
- Retail
- Service & Other Activities

## Criteria

- Physical Tukwila address
- Annual gross receipts threshold greater than \$20k
- Nonexempt businesses

*While these are state requirements, jurisdictions can do more than what the State requires. We are proposing a higher threshold and additional exemptions.*

## BUSINESSES AND REVENUES EXEMPT FROM B&O TAX PER STATE LAW

- Public utilities
  - Amounts derived from manufacturing, selling or distributing motor vehicle fuel
- Insurance businesses
- Investments
  - Amounts derived from liquor, and the sale or distribution of liquor
- Employees
  - Casual and isolated sales
- Amounts derived from sale of real estate
  - Accommodation sales
- Mortgage brokers' third-party provider services trust accounts
  - Taxes collected as trust funds

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# SURROUNDING JURISDICTIONS B&O CATEGORY RATES & THRESHOLDS

Category	Tukwila (Proposed)	Renton	Kent	Des Moines	Auburn	Burien
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\* Renton Retail rate increase to 0.0007, effective 1/1/23

# MAYOR'S PROPOSED B&O: FORECASTED REVENUE

Proposed B&O applies only to businesses with gross income over \$750,000 and includes higher exemptions than State law.

Row Labels	Sum of Gross Income	Count	Rate	\$ Amount
Manufacturing	346,896,394	38	0.00085	294,862
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# MODEST B&O TAX PROPOSAL

- Highest gross revenue threshold of surrounding cities (\$750,000)
- Lowest rates of surrounding cities
- Proposed Exemptions:
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  - Professional/Amateur/Semiprofessional sports teams
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- Forecasted revenues to be approximately \$3M per year.

## BENEFITS OF A B&O TAX

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- Several major surrounding cities have already implemented a B&O tax; other cities currently deliberating implementation as a part of the 2023/2024 budget process.
- The City establishes the Category Rates, exemptions and gross revenue threshold amount, thus maintaining significant influence over the impacts of the tax.
- A new revenue source diversifies our revenue sources and will assist with maintaining our current strong bond rating.

## REQUIRED NEXT STEPS

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- Approve two new FTE positions in Finance (one in early 2023 to develop the program, one additional in late 2024 to help administer).
- Ongoing outreach with local businesses.

## Comparison of Deviations from Core Model Ordinance Provisions

### City of Tukwila

<b>B&amp;O TAX PROVISION:</b>	<b>Summary of Change from Model B&amp;O Tax Ordinance:</b>
.050 Imposition of the tax – tax or fee levied.	(2) The gross receipts tax imposed in this section shall not apply to any person whose gross proceeds of sales, gross income of the business, and value of products, including by-products, as the case may be, from all activities conducted within the City during any calendar year is equal to or less than \$750,000, or is equal to or less than \$187,500 during any quarter if on a quarterly reporting basis.
.090 Exemptions.	<ul style="list-style-type: none"> <li>• Nonprofit organizations exempt from federal income tax under Section 501(c)(3) of the Internal Revenue code (except retail sales)</li> <li>• Businesses operating as a casino</li> <li>• Amateur/Professional/Semi-Professional sports teams</li> </ul>





**Local business & occupation (B&O) tax rates^**  
**Effective January 1, 2022**

City	Phone #	Manufacturing rate	Retail rate	Services rate	Wholesale rate	Threshold	
						Quarterly	Annual
Aberdeen	(360) 533-4100	0.002	0.003 e	0.0037 e	0.003 e	\$5,000	\$20,000
Algona	(253) 833-2897	0.00045	0.00045	0.00045	0.00045	\$10,000	\$40,000
Auburn****	(253) 392-6496	0.001	0.0005	0.0010	0.0018		\$500,000
Bainbridge Island	(206) 780-8668	0.001	0.005	0.001	0.001		\$150,000
Bellevue	(425) 452-6851	0.001496	0.001496	0.001496	0.001496		\$170,000
Bellingham	(360) 778-8010	0.0017	0.0017	0.0044 e	0.0017	\$5,000	\$20,000
Blaine	(360) 332-8311	0.002			0.002		\$250,000
Bremerton	(360) 473-5311	0.0016	0.00125	0.002	0.0016		\$1,000,000
Burien	(206) 241-4647	0.001	0.001	0.001	0.001		\$200,000
Burlington	(360) 755-0531		0.001				\$1,000,000
Cosmopolis	(360) 532-9230	0.002	0.002	0.002	0.002	\$5,000	\$20,000
Darrington	(360) 436-1131	0.00075	0.00075	0.00075	0.00075		\$20,000
Des Moines	(206) 878-4595	0.002	0.002	0.002	0.002		\$50,000
DuPont	(253) 964-8121	0.001	0.001	0.001	0.001	\$5,000	\$20,000
Everett***	(425) 257-8610	0.001	0.001	0.001	0.001	\$5,000	\$20,000
Everson	(360) 966-3411	0.002			0.002		\$1,000,000
Granite Falls**	(360) 691-6441					\$5,000	\$20,000
Hoquiam	(360) 532-5700	0.002	0.002	0.002	0.002	\$5,000	\$20,000
Ilwaco	(360) 642-3145	0.002	0.002	0.002	0.002		\$20,000
Issaquah	(425) 837-3054	0.0012	0.0012	0.0015	0.0012	\$25,000	\$100,000
Kelso	(360) 423-0900	0.001	0.001	0.002	0.001		\$20,000
Kenmore	(425) 398-8900	0.002 *				\$5,000	
Kent	(253) 856-6266	0.001	0.001	0.002	0.002	\$62,500	\$250,000
Lacey	(360) 491-3214		0.001	0.002		\$5,000	\$20,000
Lake Forest Park	(206) 368-5440	0.002	0.002	0.002	0.002	\$5,000	
Long Beach	(360) 642-4421	0.002	0.002	0.002	0.002	\$5,000	
Longview	(360) 442-5040	0.001	0.001	0.002	0.001		\$20,000
Lyman	(360) 826-3033	0.002	0.002	0.002	0.002	\$5,000	\$20,000
Mercer Island	(206) 275-7783	0.001	0.001	0.001	0.001		\$150,000
North Bend	(425) 888-1211	0.002	0.002	0.002	0.002	\$5,000	
Ocean Shores	(360) 289-2488	0.002	0.002	0.002	0.002	\$5,000	\$20,000
Olympia	(360) 753-8327	0.001	0.001	0.002	0.001	\$5,000	\$20,000
Pacific	(253) 929-1100	0.002	0.002	0.002	0.002	\$5,000	\$20,000
Port Townsend	(360) 385-2700	0.002	0.002	0.002	0.002	\$0	\$100,000
Rainier	(360) 446-2265	0.002	0.002	0.002	0.002	\$5,000	
Raymond	(360) 942-3451	0.002	0.002	0.002	0.002	\$5,000	\$20,000
Renton	(425) 430-6400	0.00085	0.0005	0.00085	0.00085		\$500,000
Roy	(253) 843-1113	0.001	0.002	0.002	0.001	\$5,000	\$20,000
Ruston	(253) 759-3544	0.0011	0.00153	0.002	0.00102	\$5,000	\$20,000
Seattle	(206) 684-8484	0.00222 v	0.00222 v	0.00427 v	0.00222 v		\$100,000
Shelton	(360) 426-4491	0.001	0.001	0.001	0.001	\$5,000	\$20,000
Shoreline	(206) 801-2324	0.001	0.001	0.002	0.001	\$125,000	\$500,000
Snoqualmie	(425) 888-1555	0.0015	0.0015	0.0015	0.0015	\$5,000	
South Bend	(360) 875-5571	0.001	0.002	0.002	0.002	\$5,000	
Tacoma	(253) 591-5252	0.0011	0.00153	0.004 e	0.00102		\$250,000
Tenino	(360) 264-2368	0.002	0.002	0.002	0.002	\$5,000	\$20,000
Tumwater	(360) 754-5855	0.001	0.001	0.002	0.001	\$5,000	\$20,000
Westport	(360) 268-0131	0.0025 e	0.005 e	0.005 e	0.0025 e	\$5,000	
Yelm	(360) 458-3244	0.001	0.002	0.002	0.001	\$5,000	

(v) = voter approved increase above statutory limit

(e) = rate higher than statutory limit because rate was effective prior to January 1, 1982 (i.e., grandfathered).

\*Kenmore's B&O tax applies to heavy manufacturing only.

\*\*Granite Falls repealed its B&O tax for all businesses other than extracting.

\*\*\*For manufacturing gross receipts over \$8 billion, the B&O rate drops to 0.00025.

\*\*\*\*Auburn adopted a B&O tax effective January 1, 2022.

**NOTE:** Tax rates may apply to businesses categories other than those above. Thresholds are subject to change. Exemptions, deductions, or other exceptions may apply in certain circumstances. Contact the city finance department for more information.

^ Tax rates are provided for cities with general local B&O taxes as of the date listed. If a city is not listed, they have not reported to AWC that they have a local B&O tax. Contact the city directly for specific information or other business licenses or taxes that may apply.



### Exempt Businesses Per State

**(1) Public utilities.** This chapter shall not apply to any person in respect to a business activity with respect to which tax liability is specifically imposed under the provisions of [local utility tax cite].

**(2) Investments** - dividends from subsidiary corporations. This chapter shall not apply to amounts derived by persons, other than those engaging in banking, loan, security, or other financial businesses, from investments or the use of money as such, and also amounts derived as dividends by a parent from its subsidiary corporations.

**(3) Insurance business.** This chapter shall not apply to amounts received by any person who is an insurer or their appointed insurance producer upon which a tax based on gross premiums is paid to the state pursuant to RCW 48.14.020, and provided further, that the provisions of this subsection shall not exempt any bonding company from tax with respect to gross income derived from the completion of any contract as to which it is a surety, or as to any liability as successor to the liability of the defaulting contractor.

**(4) Employees.** (a) This chapter shall not apply to any person in respect to the person's employment in the capacity as an employee or servant as distinguished from that of an independent contractor. For the purposes of this subsection, the definition of employee shall include those persons that are defined in the Internal Revenue Code, as hereafter amended. (b) A booth renter is an independent contractor for purposes of this chapter.

**(5) Amounts derived from sale of real estate.** This chapter shall not apply to gross proceeds derived from the sale of real estate. This, however, shall not be construed to allow an exemption of amounts received as commissions from the sale of real estate, nor as fees, handling charges, discounts, interest or similar financial charges resulting from, or relating to, real estate transactions. This chapter shall also not apply to amounts received for the rental of real estate if the rental income is derived from a contract to rent for a continuous period of thirty (30) days or longer.

**(6) Mortgage brokers' third-party provider services trust accounts.** This chapter shall not apply to amounts received from trust accounts to mortgage brokers for the payment of third-party costs if the accounts are operated in a manner consistent with RCW 19.146.050 and any rules adopted by the director of financial institutions.

**(7) Amounts derived from manufacturing, selling or distributing motor vehicle fuel.** This chapter shall not apply to the manufacturing, selling, or distributing motor vehicle fuel, as the term "motor vehicle fuel" is defined in RCW 82.36.01082.38.020 and exempt under RCW 82.36.44082.38.280, provided that any fuel not subjected to the state fuel excise tax, or any other applicable deduction or exemption, will be taxable under this chapter. (Mandatory)

**(8) Amounts derived from liquor, and the sale or distribution of liquor.** This chapter shall not apply to liquor as defined in RCW 66.04.010 and exempt in RCW 66.08.120. (Mandatory)

**(9) Casual and isolated sales.** This chapter shall not apply to the gross proceeds derived from casual or isolated sales.

**(10) Accommodation sales.** This chapter shall not apply to sales for resale by persons regularly engaged in the business of making retail sales of the type of property so sold to other persons similarly engaged in the business of selling such property where (1) the amount paid by the buyer does not exceed the amount paid by the seller to the vendor in the acquisition of the article and (2) the sale is made as an accommodation to the buyer to enable the buyer to fill a bona fide existing order of a customer or is made within fourteen days to reimburse in kind a previous accommodation sale by the buyer to the seller.

**(11) Taxes collected as trust funds.** This chapter shall not apply to amounts collected by the taxpayer from third parties to satisfy third party obligations to pay taxes such as the retail sales tax, use tax, and admission tax.