

HB 3134

Bill Analysis

February 22, 2000

Brief Description: Improving the administration of municipal taxes.

Bill Sponsors: Representatives Kessler, Mulliken, Cairnes and Grant.

Brief Summary of Bill

- City license fees cannot exceed \$100;
- City tax on public service businesses cannot exceed 6 percent of gross receipts;
- City tax on other businesses cannot exceed 0.2 percent of gross receipts, \$90 per employee, or \$0.1522 per square foot;
- City tax apportionment and other tax administration rules are created; and
- Department of Revenue must prepare a model city gross receipts tax ordinance and conduct a study of city gross receipts tax systems.

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Background:

License Fees

Cities may license businesses for the purposes of revenue and regulation. According to the Association of Washington Cities, 170 cities require a local business license to do business

within their jurisdictions. A business operating in more than one city may need multiple business licenses. Business license fees vary from flat fees to rates based on the type of business, number of persons employed, or square footage occupied by the business.

Taxes and Tax Rates

Thirty-seven cities impose business and occupation (B&O) taxes. City B&O taxes are imposed on the gross receipts of certain business activities conducted within cities without any deduction for the costs of doing business. Most cities classify business activities into four categories: manufacturing, retailing, wholesaling, and services. The Legislature has limited city B&O taxes to a maximum tax rate of 0.2 percent, but higher rates are possible if voter-approved or in effect prior to January 1, 1982.

The city B&O tax rate limit of 0.2 percent applies to all business activities except telephone and public service businesses. Public service businesses are sewage, water, electric, gas, and certain other utility businesses that are subject to state utility, rather than B&O, taxes. Cities are limited to a maximum tax rate of 6 percent on electric, gas, and telephone business activities. However, no rate limit applies to other types of public service activities, such as water or sewer services.

Business taxes that are imposed on telephone and public service businesses are often called city utility taxes. At least 217 cities impose utility taxes.

Tax Administration

The Department of Revenue administers and collects local sales and use taxes for cities. The department deducts 1 percent of the total city sales and use taxes collected for administration and collection expenses.

The department does not collect city B&O or public utility taxes. Each city is responsible for administering and collecting its own B&O or public utility taxes.

Tax Apportionment

Cities' taxation of business activities must meet due process and equal protection standards. As a matter of due process, a city must have nexus to tax a business. Nexus exists if a business conducts activities within the city that are sufficiently associated with the business's ability to establish or maintain a market for sales of its products in the city. Washington courts have upheld a city's ability to tax a business's total gross receipts when a business engages in activities both inside and outside of the city, as long as the business has nexus to

the city.

A business operating in more than one city may owe gross receipts taxes to multiple cities. Although cities are not required to coordinate their taxes, many cities have enacted provisions designed to prevent multiple taxation of the same activity. Most cities allow a deduction from taxable gross receipts for income derived from activities that are taxed by another city.

Tax Assessments and Refunds, Interest, & Penalties

If a business has underpaid its taxes, then the business may owe not only back taxes but also penalties and interest. Similarly, if a business has overpaid its taxes, a city may pay interest on the refunded amount. Each city determines its own interest rates and penalties. Per a sampling of nine cities' ordinances, interest rates vary from zero to 10 percent and penalty rates vary from 5 to 20 percent, with additional penalties up to 50 percent for fraud or evasion. Interest rates for assessing tax liabilities are not always the same as interest rates used for assessing tax refunds.

Each city also determines the time period over which tax liabilities or refunds may be assessed. Some cities have no limit. Other cities appear to have time limits ranging between two to five years. As an example, a city with a four year time limit would assess a business for taxes underpaid three years ago but not for taxes underpaid five years ago. A city's time limit may not apply, however, if a business failed to register with the city or engaged in fraud.

Summary of Bill:

License Fees

A city may charge businesses a general license fee for registration or certification purposes. The fee cannot exceed \$100 and must be the same amount for all businesses. A city may only require a business to obtain a license if the business has a direct physical presence in the city, generates taxable gross receipts within the city's boundaries, or engages in more than 40 hours of business activities within the city's geographical limits.

Taxes and Tax Rates

The term public service business activity– is defined as including telephone services and business activities that are subject to state public utility taxes. A city may impose a gross receipts tax on a public service business at a rate not to exceed 6 percent. A gross receipts tax is the only type of tax that a city may impose on a public service business activity.

Cities may tax businesses that are not public service businesses in one of three ways. A city

may impose a tax measured by the business's:

- gross receipts at a uniform rate not to exceed 0.2 percent;
- employees at a uniform rate not to exceed \$90 per full-time employee ; or
- size as measured by space occupied at a uniform rate not to exceed \$0.1522 per sq. ft.

A city is limited to one of these tax types unless the city had imposed more than one tax type prior to January 1, 2000. Although a city whose taxes predate January 1, 2000, may have more than one tax type, the city is limited to collecting only one type of tax from any given business.

Taxes enacted prior to January 1, 2000, may exceed rate limits. A city's voters may also approve tax rate increases, but no more than a 10 percent tax rate increase may appear on the ballot at any one time. A tax imposed for the first time must be voter-approved and cannot exceed 30 percent of general tax rate limits.

Tax Administration

Cities remain responsible for collecting and administering their B&O and public utility taxes. However, the Department of Revenue must prepare a model resolution and tax ordinance by July 1, 2001. By January 1, 2002, a city imposing a B&O tax or a public utility tax must either:

- adopt the model resolution and ordinance; or
- adopt and follow all statutory and regulatory provisions in existence for the state's B&O and utility taxes.

In preparing the model resolution and ordinance, the Department of Revenue must convene an advisory group with city and taxpayer interests equally represented.

The Department of Revenue is also required to conduct a study of city gross receipts tax systems. Among other things, the study is to examine the possibility of transferring responsibility for administration and collection of city gross receipts taxes to the department or to another entity. In conducting the study, the department is to form a study advisory committee with taxpayer and city interests equally represented. Report findings and recommendations are due by December 1, 2001.

Tax Apportionment

A city may only tax the gross receipts earned by a business from activities occurring within the city's geographical boundaries.

Generally, cities must allocate businesses' gross receipts from retail or wholesale sales in the

same manner that the Department of Revenue allocates local sales and use tax revenues with one exception. The exception involves deliveries. Cities must assign gross receipts from the sale of tangible personal property to the city or unincorporated area where the purchaser is located when delivery is made to the purchaser by private carrier, common carrier, or the seller. (In contrast, the Department of Revenue assigns sales tax revenues to the retail outlet at or from which delivery is made.)

Cities must assign gross receipts from manufacturing, extracting, or processing-for-hire activities to the city or unincorporated area where the activity actually occurs. If activities occur in more than one jurisdiction, gross receipts must be apportioned among the jurisdictions.

Cities must assign gross receipts from service activities to the city or unincorporated area where the services are primarily performed. When a person renders substantial services in more than one jurisdiction, cities must allow the person to apportion his or her gross receipts among the jurisdictions even though the person may not have an office or other permanent place of business in each jurisdiction.

A business's total gross receipts for city taxation purposes cannot exceed the business's total gross receipts for state taxation purposes. A city must allow a tax credit for any gross receipts earned by a business for activities previously taxed by another city.

Tax Assessments and Refunds, Interest, & Penalties

Cities must use the same interest rate to compute interest on city tax liabilities and refunds that the Department of Revenue uses to compute interest on state tax liabilities and refunds. This interest rate equals an annualized average of the federal short-term interest rate plus 2 percentage points.

Cities must assess the greater of a \$5 or 5 percent penalty on taxes that are paid late. Penalties increase depending on the lateness of a tax payment. The total penalty imposed cannot exceed the greater of \$20 or 35 percent of the tax due, except an additional 50 percent penalty is imposed when there is an intent to evade taxes. Also, a city must waive penalties if a late tax payment occurs due to circumstances beyond a taxpayer's control and under certain other circumstances.

Generally, the time period over which a city may assess tax liabilities or refunds is four years. However, the time period is seven years if a business has not registered with the city. There is no time limit if fraud or misrepresentation is shown.

Appropriation: None.

Fiscal Note: Requested.

Effective Date: Ninety days after adjournment of session in which the bill is passed.