HOUSE BILL REPORT
ESSB 6050

As Reported by House Committee On:
Capital Budget
Finance

Title: An act relating to providing financial assistance to cities, towns, and counties.

Brief Description: Providing financial assistance to cities, towns, and counties.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Parlette, Doumit, Morton and Mulliken).

Brief History:
Committee Activity:
Capital Budget: 3/28/05, 4/1/05 [DPA];
Finance: 4/8/05, 4/15/05 [DPA(FIN w/o CB)s].

Brief Summary of Engrossed Substitute Bill
(As Amended by House Committee)

- Creates the City-County Assistance Account in the state treasury. Funds deposited in the account will be distributed equally to cities and counties.
- Specifies a separate distribution formula for cities and counties.
- Directs the Joint Legislative Audit and Review Committee (JLARC) to review the distribution of funds to cities and counties to determine the extent to which the distributions target needs of cities and counties for which the repeal of the Motor Vehicle Excise Tax had the greatest fiscal impact.

HOUSE COMMITTEE ON CAPITAL BUDGET

Majority Report: Do pass as amended. Signed by 21 members: Representatives Dunshee, Chair; Ormsby, Vice Chair; Jarrett, Ranking Minority Member; Hankins, Assistant Ranking Minority Member; Blake, Chase, Cox, Eickmeyer, Ericks, Flannigan, Green, Hasegawa, Kretz, Lantz, Moeller, Morrell, Newhouse, O'Brien, Schual-Berke, Springer and Upthegrove.

Minority Report: Do not pass. Signed by 6 members: Representatives DeBolt, Holmquist, McCune, Roach, Serben and Strow.

Staff: Susan Howson (786-7142).

Background:

The passage of Initiative 695 in November 1999 repealed the Motor Vehicle Excise Tax (MVET), which had been forecasted to generate approximately $1.6 billion in revenues during the fiscal 1999-01 biennium. The MVET statute apportioned 23.6 percent of collections to counties, cities, and public health districts for the purposes of criminal justice assistance, fire and police protection, sales tax equalization, and public health. For some jurisdictions, the MVET assistance represented a relatively significant part of the operating budget, in some cases providing over 50 percent of operating expenditures.

The MVET collections were distributed on a quarterly basis to city and county jurisdictions and on a monthly basis to public health districts and county public health departments. The final distributions to jurisdictions occurred in January, 2001, based on collections in October through December, 1999.

For the past three biennia, state appropriations have provided financial assistance to counties and cities to mitigate the loss of local revenue following the passage of Initiative 695. For the 2003-05 biennium, the operating budget provides $14 million to specified cities and counties for this purpose.

Summary of Amended Bill:

The City-County Assistance Account is created in the state treasury. Funds deposited in the account must be distributed equally to cities and counties. Expenditures from the account are subject to legislative appropriation.

A separate distribution formula for cities and counties is specified.

<u>County Distribution Formula</u>

Funds deposited into the account will increase local sales and use tax revenue by each county to the greater of $250,000 or:

- for a county with 100,000 population or less, 70 percent of the statewide per capita level of sales and use tax revenue for unincorporated areas of all counties imposing the sales and use tax; and

- for a county with more than 100,000 population, 65 percent of the statewide per capita level of sales and use tax revenue for unincorporated areas of all counties imposing the sales and use tax.

For each county with 15,000 population or less, the county shall receive the greater of the amount identified above or the amount received in local government assistance provided by the Department of Community, Trade and Economic Development (DCTED) as established in the 2004 omnibus operating budget.

For a county with 15,000 to 22,000 population, the county will receive in calendar years 2006 and 2007, the greater of the amount above or the amount in local government assistance provided by the DCTED in the 2004 omnibus operating budget.

Distributions will be ratably reduced should revenues be insufficient to fund distributions as provided in the bill. Should revenues exceed the amounts needed for the distributions, excess funds will be divided ratably, based on unincorporated population, among recipient counties that impose sales and use tax at the maximum rate.

City Distribution Formula

For a city with 5,000 population or less with a per capita assessed property value less than twice the statewide average for all cities, the city will receive the greater of:

- an amount necessary to increase revenues to 55 percent of the statewide per capita level of sales and use tax revenues for all cities imposing the tax in the previous calendar year;
- the amount received in local government assistance provided for Fiscal Year 2005 in the 2003-05 omnibus operating budget; and
- for a city with a per capita assessed property value less than 55 percent of the statewide average per capita assessed property value for all cities, an amount determined by subtracting the city's per capita assessed property value from 55 percent of the statewide average per capita assessed property value, divided by 1,000, and multiplied by the city's population.

For each city with more than 5,000 population with a per capita assessed property value less than the statewide average for all cities, the city will receive the greater of:

- an amount necessary to increase revenues to 50 percent of the statewide per capita level of sales and use tax revenues for all cities imposing the tax in the previous calendar year;
- for calendar years 2006 and 2007, the amount received in local government assistance provided for Fiscal Year 2005 in the 2003-05 omnibus operating budget; and
- for a city with a per capita assessed property value less than 55 percent of the statewide average per capita assessed property value for all cities, an amount determined by subtracting the city's per capita assessed property value from 55 percent of the statewide average per capita assessed property value, divided by 1,000, and multiplied by the city's population.

No city may receive more than $100,000 a year.

Distributions shall be ratably reduced should revenues be insufficient to fund distributions as provided in the bill. Should revenues exceed the amounts needed to make distributions as provided, excess funds shall be divided ratably, based on population, among recipient cities that impose sales and use tax at the maximum rate.

Other Provisions
The bill authorizes annual increases based on inflation for the $250,000 county distribution and the $100,000 city limit.

The JLARC is directed to review the distributions to cities and counties to determine the extent to which the distributions target needs of cities and counties for which the repeal of the Motor Vehicle Excise Tax had the greatest fiscal impact. The JLARC will report its findings, including any recommendations for changes to the distribution formulas, to the Legislature by December 31, 2008.

Amended Bill Compared to Engrossed Substitute Bill:

The Engrossed Substitute bill diverted a portion of the state Real Estate Excise Tax (REET) that is deposited into the Public Works Assistance Account (PWAA) to the City-County Assistance Account. The bill as amended removes this fund source from the bill.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Amended Bill: The bill takes effect on August 1, 2005.

Testimony For: (In support) Since the passage of Initiative 695, cities and counties have been struggling to balance their budgets. Local law enforcement needs make up the greatest percentage of county budgets and services have been cut as a result of budget reductions, leaving many services unmet, especially in counties with a low tax base. This proposal would take 1.6 percent of the 7.7 percent of REET going to the PWAA, approximately $20 million next biennium, and dedicate it to local governments on a formula basis with no restrictions as to how the local governments could use the funds.

(With concerns) REET is not an extremely reliable funding source. Local governments could be better served by another funding option. This solution does not befit the problem.

Testimony Against: The PTWF funds important local projects that protect health and safety infrastructure. Although the needs of local governments are important, diverting revenue from the PWTF, a program with it's own great needs, will not solve the problem. Setting a precedent of diverting revenue from the PWTF could jeopardize the future of funding for public safety and health projects.

Persons Testifying: (In support) Senator Parlette, prime sponsor; Bill Vogler, Washington State Association of Counties; Dean Burton, Garfield County; Steve Jenkins, City of Bridgeport; Jim Justin, Association of Washington Cities; Mike Whelan, Grays Harbor Sheriff; and Steve Whybark, Mason County Sheriff.

(With concerns) Bryan Wahl, Washington Association of Realtors.

(Opposed) Rick Slunaker, Associated General Contractors; David Ducharme, Utility Contractors Association of Washington; and Paul Locke.

Persons Signed In To Testify But Not Testifying: None.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass as amended by Committee on Finance and without amendment by Committee on Capital Budget. Signed by 5 members: Representatives McIntire, Chair; Hunter, Vice Chair; Conway, Hasegawa and Santos.

Minority Report: Do not pass. Signed by 4 members: Representatives Orcutt, Ranking Minority Member; Roach, Assistant Ranking Minority Member; Ahern and Ericksen.

Staff: Mark Matteson (786-7145).

Additional Background:

State business and occupation tax and public utility tax. Washington's major business tax is the business and occupation (B&O) tax. The B&O tax is imposed on the gross receipts of business activities conducted within the state, without any deduction for the costs of doing business. The tax is imposed on the gross receipts from all business activities conducted within the state. Revenues are deposited in the State General Fund. A business may have more than one B&O tax rate, depending on the types of activities conducted. The tax rate for most types of businesses that provide services, including subscription television services such as cable satellite, is 1.5 percent.

Public and privately-owned utilities are subject to the state public utility tax (PUT). The PUT is applied to the gross receipts received from the utility operations of certain types of business. Businesses subject to the PUT include those engaging in the generation or distribution of electricity, the distribution of gas; the distribution of water; the collection of sewerage; urban or motor transportation; railroads; and other public service businesses. Different rates apply, depending upon the specific utility activity, and most revenues are deposited to the State General Fund. Business activities subject to the PUT are exempt from the B&O tax.

Neither the B&O tax nor the PUT permits deductions for the costs of doing business, such as payments for raw materials and wages of employees. Nonetheless, several deductions and credits for specific types of business activities are allowed under the B&O tax and PUT. For example, a credit is allowed under the PUT to electric and natural gas utilities that provide billing discounts to low-income customers.

Local utility taxes and franchise fees. Under state law, cities may impose taxes on businesses for the purposes of regulation and raising revenue, but counties do not have any such general authority. Utility taxation is an aspect of this authority for cities. Cities' taxes upon utilities are based on gross receipts. State law limits the rate at which cities may tax electric, gas, steam and telephone utilities to 6 percent without voter approval. Other utilities may be taxed at higher rates.

Franchise fees are charges imposed by local governments on utilities to recoup the costs of administering the franchise and for the right to use local rights-of-way and other public properties. State law limits franchise fees only with respect to electric, natural gas, and telephone business franchises granted by cities, in which the fee charged must relate directly to certain administrative expenses incurred by the city.

Subscription television business - Excise taxation, franchise fees. Under state law, businesses that provide subscription television services, including cable television services, direct broadcast satellite services, and others, are subject to the state B&O tax under the general service classification at a rate of 1.5 percent on the television services provided. If the same business also sells or repairs tangible personal property, such sales or repair services are considered taxable retail sales. The business must collect sales tax from the customer on such sales and report gross income for B&O tax purposes under the retailing classification at a rate of 0.471 percent.

The rate at which cities and counties may tax or impose franchise fees on subscription television service activity is limited by federal law. With respect to cable television services, local tax rates are governed by the federal Cable Communications Policy Act of 1984, which requires that rates be comparable to other utility rates imposed by the city. The 1984 Act also allows cities and counties to impose franchise fees on cable television at a rate of up to 5 percent of gross receipts. With respect to direct satellite television services, the federal Telecommunications Act of 1996 prohibits local governments from imposing taxes or franchise fees on companies that provide such services.

Summary of Recommendation of Committee On Finance Compared to Recommendation of Committee On Capital Budget:

Imposes public utility tax at a rate of 8.5 percent on cable and satellite television business services, thereby removing state B&O taxes on such services. Allows a credit against the new tax for any local taxes and franchise fees imposed on such services, up to the rate of the new tax. Deposits the effective net revenue in the new account. Clarifies mitigation criteria for cities relating to assessed valuations, such that the criteria pertains to assessed valuations of taxable property, instead of all property. Modifies the mitigation option for cities with below-average property tax bases so that the mitigation amounts are compared to a standard equal to 50 percent of the statewide average per capita assessed property value, instead of 55 percent. Delays the first distributions from the account to January 1, 2006. Makes technical modifications to improve administrative clarity.

Appropriation: None.

Fiscal Note: Requested on April 15, 2005 for amended bill..

Effective Date of Amended Bill: The bill takes effect August 1, 2005, except section 7, relating to continuing the authority to allocate a proportionate share of interest earnings to the City-County Assistance Account, which takes effect July 1, 2006.

Testimony For: The financial situation is really serious for the smaller jurisdictions, which are eliminating public services in some instances. Many very small cities cannot keep city hall open for more than a few hours each day. Cowlitz County has eliminated 50 positions.

Other counties have made similar reductions. Columbia has zero reserves. Ferry County will not be able to make their payroll by the end of the year.

Counties have been requesting I-695 backfill for years. This is a difficult situation for small counties, where the backfill can be the majority of the general expense budget.

The distribution formula has been worked out with the cities and counties. The distribution funding is targeted to those jurisdiction that really need it. City assistance will go to 164 cities with no city receiving more than $100,000, and many receiving much less than that.

If a permanent funding source is found, then there will not longer be a need to ask for an appropriation for this purpose. The bill started with funding from a small part of the real estate excise tax that goes into the public works trust fund. The initial amount raised $20 million to fund the formula. The proposed amendment will have no impact on the general fund. This would be a permanent fix. The proposed amendment is not a general tax increase but a targeted utility tax. The funding source is equitable, fair and appropriate.

Revenue should not be diverted from the public works trust fund which provides money for infrastructure. Money should come from another funding source. The proposed amendment moves in the direction of providing tax parity between cable television and satellite television. Cable television pays local franchise and utility taxes which satellite television does not. Satellite television is no longer just in rural areas but in the urban areas as well. Currently cable television is at a competitive disadvantage to satellite television. Tax parity is a necessity.

Testimony Against: None.

Persons Testifying: Representative Takko; Bill Vogler, Washington State Association of Counties; Jim Justin, Association of Washington Cities; Ron Main, Broadband Communications Association of Washington; and Rick Slunaker, Associated General Contractors.

Persons Signed In To Testify But Not Testifying: None.