

# HOUSE BILL REPORT

## ESHB 1153

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### As Passed House:

March 11, 2005

**Title:** An act relating to equalizing the costs of providing municipal services to newly annexed areas.

**Brief Description:** Equalizing the costs of providing municipal services to newly annexed areas.

**Sponsors:** By House Committee on Local Government (originally sponsored by Representatives Springer, Nixon, Clibborn, Jarrett, Simpson, P. Sullivan, Shabro and B. Sullivan).

### Brief History:

#### Committee Activity:

Local Government: 1/26/05, 2/10/05 [DPS].

#### Floor Activity:

Passed House: 3/11/05, 58-35.

### Brief Summary of Engrossed Substitute Bill

- Authorizes qualifying cities to impose and collect a voter-approved, utility-based annexation surtax to customers within an annexation area.
- Limits the amount of time that revenue may be collected under the surtax to a maximum of ten years.
- Specifies that revenue collected from surtax must be collected as a utility tax and must be used solely to provide, maintain, and operate municipal services for the annexation area.
- Requires the Department of Revenue to develop and provide technology pertaining to the collection of the surtax.

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## HOUSE COMMITTEE ON LOCAL GOVERNMENT

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 4 members: Representatives Simpson, Chair; Clibborn, Vice Chair; B. Sullivan and Takko.

**Minority Report:** Do not pass. Signed by 3 members: Representatives Schindler, Ranking Minority Member; Ahern, Assistant Ranking Minority Member; and Woods.

**Staff:** Ethan Moreno (786-7386).

**Background:**

Current law authorizes multiple methods for municipal annexations. While cities and towns have separate statutory provisions for classifications, governance, and operation, the annexation methods they may employ are largely similar. With some exceptions, annexation methods generally require voter and/or property owner approval.

Cities and towns may impose a tax on utility businesses for the privilege of conducting business. Taxes imposed under this authority are traditionally based upon gross receipts or gross income. City and town utility taxes on electrical energy, natural gas, steam energy or telephone businesses may not exceed 6 percent unless a higher rate was approved by the jurisdiction's voters. There is no statutory limit on the rate for other traditionally taxed utilities, such as solid waste services, water and sewer services, and cable television services.

Every city and town first imposing a business and occupation tax or increasing the rate of tax after April 22, 1983, must provide for a referendum procedure that is applicable to the ordinance imposing the tax or rate increase. In accordance with specified provisions, if a sufficient number of valid signatures are obtained by the referendum petitioner, the referendum measure must be voted upon at a special or general election.

The Department of Revenue (DOR) was established by the Legislature in 1967. The DOR has numerous duties and responsibilities specified in statute pertaining to the assessment, collection, and administration of taxes in Washington.

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**Summary of Engrossed Substitute Bill:**

Authorization Provisions

Any city with a population greater than 30,000 that imposes a utility tax and that is located in a county with a population greater than 700,000 may also impose and collect a temporary annexation surtax of up to 10 percent on the business activity of providing a utility service to customers within an annexation area if:

- the city legislative authority has adopted a resolution initiating annexation according to specified provisions or has annexed an area within the preceding 12 months;
- the city legislative authority has adopted a resolution or ordinance determining that the projected cost of providing municipal services to the annexation area exceeds the projected general revenue the city would otherwise receive from the area on an annual basis; and
- a ballot proposition authorizing the surtax is submitted to the voters in the annexation area and is approved by a majority of those voting on the proposition.

Collection and Use Provisions

Revenue from the surtax must be collected in the same manner as the utility tax on that utility service. "Utility tax" is defined to mean any tax on the privilege of conducting a utility business, including business activities traditionally taxed as utilities. A utility business, however, does not include a qualifying telephone business. The surtax is separate from and in addition to other utility taxes and is not subject to the 6 percent tax rate limit that applies to certain utility businesses.

The surtax must be measured by the gross receipts or income received from the business of providing utility services to the annexation area. "Annexation area" is defined to mean, in part, an area that was annexed to a city during the preceding 12 months, or that is the subject of a resolution pertaining to specific annexation methods requiring voter approval. The surtax may not be imposed before the date the area is annexed to the city and may not be imposed for more than 10 years from its date of first collection.

Revenue from the surtax must be used solely to provide, maintain, and operate municipal services for the annexation area. "Municipal services" is defined to mean those services customarily provided to the public by a city government.

The council of a city authorized to collect the surtax must hold an annual public hearing and must adopt an ordinance setting the surtax rate. The adopted rate must not exceed that which the city deems necessary to generate revenue equal to the difference between the city's cost to provide, maintain, and operate municipal services for the annexation area, and the general revenues the city would otherwise expect to receive from the annexation area during that year. The rate may not exceed 10 percent and may not exceed the voter-approved rate.

#### Ballot Provisions

Ballot propositions pertaining to the surtax must be prepared by the city attorney for the annexing city and must conform with requirements for local ballot measures. The ballot proposition must state:

- the commencement date for collection of the surtax;
- the maximum rate of the surtax;
- the utility services to which the surtax may be applied; and
- the final year in which a surtax may be imposed.

A ballot proposition proposing the surtax may be submitted simultaneously with any ballot proposition or propositions regarding annexation under specified provisions. The election costs associated with the surtax proposition must be paid by the city.

Notwithstanding other provisions of law, the surtax must not be the subject of a local initiative or be subject to local referendum.

#### Department of Revenue

A city that imposes the surtax must notify the Department of Revenue (DOR) of the boundaries of the annexation area, the rate of the surtax, the effective date of the surtax, and related changes. The surtax and any subsequent change in the rate may take effect no earlier

than 75 days after the DOR receives notice of the surtax or change, and only on the first day of specified months.

The DOR must develop and provide technology by which a utility can determine customers subject to the surtax and the applicable rate. A person who collects and remits a surtax to the imposing city and who calculates the tax using technology developed and provided by the DOR must be held harmless and is not liable for the difference in amount due nor subject to penalties or interest resulting from the proper use of the technology.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect 90 days after adjournment of session in which bill is passed.

**Testimony For:** (Original bill) The genesis of this bill resides in cities' commitment to realizing provisions of the Growth Management Act (GMA) for urban areas. Unincorporated urbanized areas exist within urban growth areas. These unincorporated areas generally receive lower levels of service, are extraordinarily expensive to serve, and are areas that counties would like to have annexed or incorporated. This bill addresses unincorporated islands of territory that, because of insufficient tax bases, do not have a possibility of being annexed or incorporated. Much of what remains to be incorporated are residential areas and the costs of providing services to these areas exceeds the revenue generated from them. This bill is an effort to find a financing system to help cities like Kirkland provide services to newly annexed areas. This bill will provide a new annexation tool that cities may use.

Under the GMA, unincorporated areas within the urban growth boundary are expected to be annexed to cities. Residents within a potential annexation area established by Kirkland are supportive of annexation for service-related reasons. Absent annexation, these unincorporated areas face declining service levels from counties. The surtax that may be imposed under this bill is not envisioned as continuing beyond a transitional period. The surtax that may be imposed under this bill may last for 10 years, may not exceed certain limits, may be phased out, and requires voter approval.

Resolving annexation challenges will require a number of tools. A recent study by the Department of Community, Trade, and Economic Development indicated that cities could benefit from additional tools to finance annexation costs.

The proponents of this bill have attempted to address constitutional concerns about uniform taxation. This bill is an effort to reconcile annexation expectations with reality. Cities do not want to ask current citizens to subsidize the expenses associated with newly annexed areas. The provisions of the bill should be expanded to allow additional cities to impose the surtax. Proponents of this bill are willing to work on amendments to the legislation. The Kirkland

business community is supportive of the legislation and additional services that would result from annexation.

**Testimony Against:** Washington levies the third highest taxes in the nation against wireless providers. The current tax rate for wireless providers exceeds 21 percent. Under the provisions of this bill, the tax rate for wireless services could be 32 percent. Additionally, the wire line marketplace is competitive and, under this bill, other competing entities would not have to collect the surtax. The provisions of this bill would be administratively problematic, difficult and costly to implement, and may conflict with uniformity requirements for taxes. This bill will place an additional tax burden upon customers and better alternatives exist.

Under current law, cable television customers pay a franchise fee of up to 5 percent: this is effectively a tax. For certain utilities, the maximum tax that a city can impose is 6 percent. Cable television providers are not subject to this limit and have higher tax rates. This bill could exacerbate competitive disadvantages for cable providers and would result in industry opposition to annexations. A local improvement district would be a better alternative for raising revenue.

This bill unfairly focuses on the business community, especially one sector of that community. Businesses will not have a voice in the surtax approval process.

(With Concerns) This bill should be amended. The bill does not make it clear how a utility would identify where an annexation area is and who could be subject to the charges. The DOR uses geographic information systems (GIS). The DOR should develop GIS tools to identify people that are subject to the surtax. The tax rate provisions of the bill should be clarified. The bill may raise constitutional questions and it should sunset on a specified date.

Cities do not impose utility taxes on water-sewer districts. If a city assumes a water-sewer district, a utility tax can be imposed without voter approval.

If the bill is amended to include provisions allowing other cities to impose the surtax, counties would like to have additional time to consider other options for possibly affected areas.

**Persons Testifying:** (In support of original bill) Representative Springer, prime sponsor; Mary Alice Burleigh, Tracy Burrows and Mike Ryherd, City of Kirkland; Mike Doubleday, City of Burien; Doug Levy, Cities of Kent, Renton and Puyallup; Chuck Williams, King County; and Dave Williams, Association of Washington Cities.

(With concerns) Mike Tracy, Puget Sound Energy; Joe Daniels, Washington Association of Water & Sewer Districts; Paul Parker, Washington State Association of Counties; and George Hadley, Private Citizen.

(Opposed) Steve Gano, Cingular Wireless; Tom McBride, Association of Washington Business; Barb Young, Sprint; and Ron Main, Cable Association.

**Persons Signed In To Testify But Not Testifying:** None.