

HOUSE BILL REPORT

HB 2681

As Reported by House Committee On: Local Government

Title: An act relating to including costs associated with preparing for new annexations within city sales and use tax authority.

Brief Description: Including costs associated with preparing for new annexations within city sales and use tax authority.

Sponsors: Representatives Fitzgibbon, Kochmar, Hargrove, Springer, Bergquist and Freeman.

Brief History:

Committee Activity:

Local Government: 2/3/14, 2/5/14 [DPS].

Brief Summary of Substitute Bill

- Extends the date by which an annexation must commence in order to impose an annexation sales and use tax by two years to January 1, 2017.
- Allows proceeds from an annexation sales and use tax to be used for a city's cost to prepare for annexation.
- Establishes requirements, which vary according to annexation method, that must be met by a city before it may impose the annexation sales and use tax for annexation preparation costs.

HOUSE COMMITTEE ON LOCAL GOVERNMENT

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 6 members: Representatives Takko, Chair; Gregerson, Vice Chair; Kochmar, Assistant Ranking Minority Member; Farrell, Fitzgibbon and Springer.

Minority Report: Do not pass. Signed by 3 members: Representatives Overstreet, Ranking Minority Member; Pike and Taylor.

Staff: Ethan Moreno (786-7386).

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Background:

Annexation Sales and Use Tax.

In 2004 the Legislature directed the Department of Community, Trade, and Economic Development (now known as the Department of Commerce) to study the progress of annexation and incorporation in six urban counties, and to identify barriers and incentives to fully achieving annexation or incorporation of urban growth areas in those counties. Lack of funding for municipal services during the transition period following annexation was one of the barriers identified by cities.

Legislation adopted in 2006 authorized qualifying cities to impose a sales and use tax to provide, maintain, and operate municipal services, a term defined to mean services customarily provided to the public by a city, in a newly annexed areas. Provisions governing the annexation sales and use tax (tax), which is a credit against the state sales tax and not an additional tax to a consumer, were amended in 2009 and in 2011.

There are numerous requirements that a city must meet before it may impose the tax. For example, the city must:

- be located in a county with more than 600,000 persons;
- annex an area that is consistent with the comprehensive plan adopted by the city in conformity with the Growth Management Act;
- commence annexation of a qualifying area using direct petition or election annexation methods prior to January 1, 2015; and
- adopt an ordinance or resolution stating that the projected cost to provide municipal services to the annexation area exceeds the projected general revenue that the city would otherwise receive from the area on an annual basis.

All revenue from the tax must be used to provide, maintain, and operate municipal services for the annexation area, an area for which an annexation has been completed. The revenues, which are collected by the Department of Revenue and remitted to the city, may 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 that the city would otherwise expect to receive from the annexation in a year. If the revenues from the tax and the revenues from the annexation area exceed the costs to the city to provide, maintain, and operate municipal services for the annexation area during a given year, the tax distributions must be suspended for the remainder of the year. Additionally, the tax may continue for no more than 10 years from the date that each increment of the tax is first imposed.

With limited exceptions, the rate of the tax is 0.1 percent for *each* annexed area with a population greater than 10,000, but less than 20,000, and 0.2 percent for an annexed area with more than 20,000 persons. Additionally, subject to specific requirements, the maximum rate of tax a city can impose under specific sales and use tax provisions for qualifying annexed areas with more than 16,000 residents is 0.85 percent.

Municipal Annexations.

Current law authorizes multiple methods for municipal annexations. While cities that operate under the Optional Municipal Code (code cities) have separate statutory requirements for

governance and operation than cities and towns that do not, the annexation methods that all cities and towns may employ are generally similar. A summary of the annexation methods is as follows:

- *Resolution-initiated election methods.* These methods require approval of city or town resolutions by voters residing in the proposed annexation area.
- *Petition-initiated election methods.* These methods include initiatives petitioned and approved by voters residing in the proposed annexation area.
- *Direct petition methods.* These methods require approval of direct petitions signed by property owners comprising a specific percentage of land value, without voter action. An alternative direct petition method based upon signatures from property owners and registered voters was enacted into law in 2003.
- *Resolutions only methods.* These methods include annexations for municipal purposes that are approved by a majority of the city or town legislative body, or other actions that do not require voter or property owner action.
- *Interlocal agreement methods.* These methods include annexations conducted by ordinance if specific requirements, including the negotiation of interlocal agreements between the participating jurisdictions, are satisfied.

Summary of Substitute Bill:

Numerous provisions governing the annexation sales and use tax (tax) are modified.

The date that an annexation must commence in order to impose the tax is extended by two years to January 1, 2017.

As a condition for imposing the tax, the city legislative authority must determine by resolution or ordinance that the projected cost to prepare for annexation and to provide municipal services to the annexation area (rather than only to provide municipal services to the area) exceeds the projected general revenue that the city would otherwise receive from the area on an annual basis.

Revenue collected from the tax may be used to prepare for annexation, in addition to being used to provide, maintain, and operate municipal services for the annexation area.

Consideration of costs for preparing for annexation in the annexation area are also to be used in determining the maximum revenue amount that may be generated by the tax, and for related administrative purposes, including required certifications with the Department of Revenue.

Provisions governing the initial imposition of the tax for assisting a city with annexation preparation costs are established. If the annexation is proceeding under an election method, the imposition may occur after the election approving the annexation, provided the annexing city has set an effective date of two or fewer years following the election. If the annexation is proceeding under a direct petition or interlocal agreement method, the imposition may occur after the city has set an effective date for the annexation of two or fewer years after the

date upon which the resolution or ordinance establishing the effective date for the annexation was adopted.

A definition related the imposition of the tax is modified. The definition of "annexation area" is amended to include areas that are being annexed, rather than only areas that have been annexed.

Substitute Bill Compared to Original Bill:

The amended bill: establishes requirements, which vary according to the employed annexation method, must be met by a city before it may initially impose the annexation sales and use tax to assist with annexation preparation costs; restores the definition of "commenced annexation," which was modified in the underlying bill, to current law; and makes technical changes.

Appropriation: None.

Fiscal Note: Preliminary fiscal note available.

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

Staff Summary of Public Testimony:

(In support) The annexation sales and use tax is a key tool for annexing areas in King, Pierce, and Snohomish counties. In these counties, there are urban areas that still need urban services, but without this bill, those areas will not be annexed, as doing so will be too expensive to cities. This bill will allow the annexation sales and use taxes to be collected earlier in the process to prepare for providing services to the annexed areas. Under this bill, cities will be better prepared for annexations and the tax rates will not increase. The tax is a great tool and deserves to be extended.

Working in partnership with cities, King County has completed six large, urban, unincorporated island annexations in the last seven years. The annexation tax is an incentive, has been a game changer, and has made large urban annexations (totaling over 100,000 persons) possible. These large annexations would not have taken place without the annexation sales and use tax. Annexations are complicated and time consuming. Cities need help to annex large urban areas and this bill will provide that much needed assistance. Services in unincorporated areas can improve when areas are annexed.

This tool does not represent a tax increase – it is a credit against the state sales tax. The bill simply extends the sunset date for a current authority and allows the credit to be received earlier in the annexation process. King County staff made a drafting error in the bill, and a friendly amendment will be offered to correct the error.

(Opposed) None.

Persons Testifying: Representative Fitzgibbon, prime sponsor; and Fred Jarrett, King County.

Persons Signed In To Testify But Not Testifying: None.