

City of Seattle Proposed 2008 Approach to B&O Tax Changes September 17, 2007

In 2003, the State Legislature passed a bill (now codified as RCW 35.102.130) that changes how cities can impose their Business and Occupation (B&O) taxes on certain types of business activities. These changes were sought by various organizations representing businesses and were not sought nor supported by Seattle or other cities. The new law goes into effect on January 1, 2008. The most notable changes are:

- Income earned from providing services will now be apportioned between the city where the employee providing the service is based (the “payroll factor”) and the place where the majority of contacts with the customer occurs (the “service income factor”).
- Income earned from the sale of tangible personal property will be allocated to the place of delivery to the buyer.

These changes affect only a subset of businesses. The first change affects businesses providing services to clients in many cities, such as legal and accounting firms. The second change affects businesses shipping products from warehouses or similar facilities. Most businesses, including most retailers and personal service providers, will not be affected. These changes will require substantial additional recordkeeping by affected businesses.

In 2005, the State Department of Revenue estimated these changes would reduce B&O revenue for cities by about \$23.3 million, with Seattle losing about \$15.6 million. Projecting these results to 2008 means Seattle will lose about \$21.9 million in B&O revenue.

While Seattle has experienced significant revenue growth in recent years, the City has not fully restored services cut during the 2001-2003 recession and has since committed to major new investments in public safety (including 105 new police officers), transportation, and ending homelessness. Multi-year forecasts show that the City cannot meet these commitments if the B&O revenue is lost.

In response, Mayor Greg Nickels has proposed a square footage business tax similar to what Bellevue has used for many years. Under this proposal, the only businesses that would pay any square footage business tax would be those affected by the two changes imposed by the new State law described above. Further, under the Mayor’s proposal, no business would pay more tax on its activities than would have been the case under existing (2007) tax law. Thus, some businesses will pay the same total tax as under existing law, some will pay less, but none will pay more. The new square footage business tax is expected to raise approximately \$18.6 million in 2008, resulting in a net revenue loss of about \$3.3 million.

The square footage business tax will be imposed at two different rates to reflect how businesses use space to generate revenue. Businesses with office or production space in Seattle will be taxed at 39 cents per square foot per quarter. Businesses with other space in Seattle (such as storage or warehousing space) will be taxed at 13 cents per square foot per quarter. Square footage taxes will be collected at the same time as the current gross receipts B&O tax using a supplemental tax form.

NOTE: This is a simple explanation of the proposal; details are included in the proposed ordinance and rules.