

Payroll Expense Tax (SMC 5.38)

City of Seattle Tax Training



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- Payroll Expense and Compensation
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2022 CPI Adjustment

- On January 1, 2022, and on January 1 of every year thereafter, the payroll expense tax is adjusted for CPI linked inflation.

| | 2021 | 2022 |
|---|--------------|--------------|
| SMC 5.38.040.A.1: Prior year exemption | \$ 7,000,000 | \$ 7,386,494 |

| | 2021 | 2022 |
|---|------------------|------------------|
| SMC 5.38.030: Employer payroll expense | \$ 100,000,000 | \$ 105,521,339 |
| | \$ 1,000,000,000 | \$ 1,055,213,392 |

| | 2021 | 2022 |
|---|------------|------------|
| SMC 5.38.030: Employee annual compensation | \$ 150,000 | \$ 158,282 |
| | \$ 400,000 | \$ 422,085 |

Payroll Expense Tax

- Effective Jan. 1, 2021
- Imposed on persons engaging in business in Seattle
 - Must have \$7,386,494 of payroll expense in prior year
- Imposed on the business, NOT on the employee
- In addition to any license fee or tax imposed by the City, the State, or other governmental entity.



Payroll Expense and Compensation

- The payroll expense of employees with annual compensation of \$158,282 or more in the current calendar year is used to compute the tax.
- Payroll expense means compensation paid in Seattle to employees.
 - Compensation means “remuneration” as defined by the Washington State Family and Medical Leave program.
 - Compensation includes:
 - Employee contributions to deferred compensation plans
 - Net distributions, or incentive payments earned for services rendered or work performed.



Who is an Employee?

- Any person that performs work, labor, or personal services of any nature for compensation is an employee.
- Includes owners of passthrough entities if they perform work, labor, or services for the business:
 - members of LLCs,
 - partners in partnerships,
 - owners of other pass-through entities, and
 - sole proprietors
- Independent contractors unless exempt (see slide “Tax Exemptions”)
- Excludes compensation to owners of pass-through entities **not** earned for services rendered/work performed.



Compensation Paid in Seattle

- “Payroll expense” = compensation paid in Seattle to employees.
- To determine payroll expense, businesses may use either:
 - The “hours method”, or
 - The “primarily assigned method”
- Required to make the election on the 1st return filed for that year.
 - If no method selected, then the primarily assigned method is presumed to be used.
 - Same method applies to all employees for the entire tax year.



“Hours Method”

- The amount of compensation paid in Seattle is:
 - (1) 100% of the compensation paid to employees that work exclusively in Seattle; and
 - (2) For employees who work partly within and partly outside Seattle, employee’s annual compensation multiplied by the total number of the employee’s hours worked in Seattle over the total number of the employee’s hours worked everywhere.

$$\text{Compensation Paid in Seattle} = \text{Annual Compensation} \times \frac{\text{Hours Worked in Seattle}}{\text{Total Hours Worked Everywhere}}$$

- Assumes 1,920 for employee’s hours worked everywhere.
 - If actual hours worked are more, the employer must be able to document the number of actual hours.



Example 1

Beta Corp elects to use the Hours Method to determine compensation paid in Seattle. All of Beta Corp's employees work exclusively in Seattle for the tax period except for employee M. Employee M works partly in and partly outside Seattle. In 2022, employee M worked 770 hours in Seattle and the remaining hours were worked outside Seattle. Therefore, 40% of employee M's annual compensation is paid in Seattle.

$$\text{Compensation Paid in Seattle} = \text{Annual Compensation} \times \frac{770 \text{ Hours Worked in Seattle}}{1,920 \text{ Hours Worked Everywhere}}$$

Compensation paid to all other Beta Corp employees is paid in Seattle because they worked exclusively in Seattle.

“Primarily Assigned Method”

- If the Hours Method is not elected, then compensation is paid in Seattle is determined using the “Primarily Assigned Method.”
- Compensation paid in Seattle is determined by three cascading criteria:
 - (1) The employee is primarily assigned in Seattle;
 - (2) The employee is not primarily assigned in Seattle but performs 50% or more of their services in Seattle during the tax period; or
 - (3) The employee is not primarily assigned to any place of business and does not perform 50% or more of their services in any city, but the employee resides in Seattle.
- “Primarily assigned” means the business location of the taxpayer where the employee performs their duties for the tax period.
 - An employee that performs more than 50% of their duties at the business location of the taxpayer will be primarily assigned to that business location.



Example 2

Company A elects to use the Primarily Assigned Method for determining compensation paid in Seattle. Company A has three employees in Seattle in 2022, employee X, Y, and Z. All three employees perform their duties at Company A's headquarters in Seattle. Employees X, Y and Z are primarily assigned in Seattle because they perform their duties at Company A's business location in Seattle. Therefore, compensation paid to employees X, Y and Z is paid in Seattle and included in Company A's payroll expense.



Example 3

Company B elects to use the Primarily Assigned Method for determining compensation paid in Seattle. Company B has an office in Seattle and has three employees, employees K, L, and M. Employees K and L perform 100% of their duties at Company B's office in Seattle for the tax period. In 2022, employee M spends 60% of their time performing services at a client's worksite in Kent, Washington and 40% of their time performing duties at the Seattle office. Compensation paid to employees K and L is paid in Seattle because employees K and L are primarily assigned within Seattle. Employees K and L are primarily assigned within Seattle because they spend more than 50% of their time performing their duties at the business location of the taxpayer in Seattle. However, employee M's compensation is not paid in Seattle. Employee M is not primarily assigned within Seattle because employee M does not spend more than 50% of their time performing their duties at the business location of the taxpayer. Additionally, because employee M performs 50% or more of their time performing services for the tax period in Kent, Washington, their compensation is not paid in Seattle.



Example 4

Company D elects to use the Primarily Assigned Method for determining compensation paid in Seattle. Company D has its headquarters in Seattle. Employee P is an equipment technician and has an office at Company D's headquarters. Employee P travels to customer locations to service equipment and is rarely in the office. At the end of the year, Company D determines that employee P spends 15% of their time performing services in Seattle, 20% in Redmond, 25% in Bellevue, 30% in Renton, and 10% out-of-state. Employee P is not primarily assigned to any place of business for the tax period because they do not spend more than 50% of their time performing duties at the business location of Company D. Furthermore, employee P does not spend 50% or more of their time performing duties in any city. Therefore, compensation paid to employee P is considered paid in the city where the employee resides.



Tax Rates

- Tax is on payroll expense of employees with \$158,282 or more in annual compensation.
 - Rates are based on payroll expense in **Seattle** in **current** year.

| | Payroll Expense | | |
|---|---|--|---|
| | Less than \$105,521,339 | \$105,521,339 but less than \$1,055,213,392 | \$1,055,213,392 or greater |
| Annual compensation \$0 - \$158,281.99 | N/A | N/A | N/A |
| Annual compensation \$158,282 - \$422,084.99 | Rate = 0.7% (Seven-tenths percent) | Rate = 0.7% (Seven-tenths percent) | Rate = 1.4% (One and four- tenths percent) |
| Annual compensation \$422,085 and greater | Rate = 1.7% (One and seven- tenths percent) | Rate = 1.9% (One and nine- tenths percent) | Rate = 2.4% (Two and four- tenths percent) |

- Payroll Expense and Annual Comp updated for 2022 CPI Adjustment



Example 5

Company A has employees in Seattle. In 2021, Company A had \$9 million of Seattle payroll expense and \$10 million of Seattle payroll expense in 2022. Company A elected to use the Primarily Assigned Method for determining compensation paid in Seattle. In 2022, Company A has 55 employees that earn \$100,000 per year, 10 employees that earn \$200,000 per year, and 5 employees that earn \$500,000 per year.

Company A's 2022 Seattle Payroll Expense Tax would be:

| COMPANY A | | | | | |
|--|-----------|----------------------|---------------------|-------|-----------------|
| Payroll in Seattle (Prior Year) | | \$ 9 Million | | | |
| Payroll in Seattle (Current) | | \$ 10 Million | | | |
| Compensation | # of Emp. | Annual Salary | Payroll Exp | Rate | Tax |
| \$0 - \$158,281.99 | 55 | \$100,000 | \$5,500,000 | N/A | \$0 |
| \$158,282 - \$422,084.99 | 10 | 200,000 | 2,000,000 | 0.70% | 14,000 |
| \$422,085 and greater | 5 | 500,000 | 2,500,000 | 1.70% | 42,500 |
| TOTAL | 70 | | \$10,000,000 | | \$56,500 |

Example 6

Company C has 6,960 employees in Seattle. In 2021, Company C had \$1.1 billion of Seattle payroll expense and \$750 million of Seattle payroll expense in 2022. Company C Has elected to use the Primarily Assigned Method for determining compensation paid in Seattle. In 2022, Company C has 6,600 employees that earn \$100,000 per year, 300 employees that earn \$200,000 per year, and 60 employees that earn \$500,000 per year

Company C's 2022 Seattle Payroll Expense Tax would be:

| COMPANY C | | | | | |
|--|------------------|----------------------|----------------------|-------------|------------------|
| Payroll in Seattle (Prior Year) | | \$1.1 billion | | | |
| Payroll in Seattle (Current) | | \$750 million | | | |
| Compensation | # of Emp. | Annual Salary | Payroll Exp | Rate | Tax |
| \$0 - \$158,281.99 | 6,600 | \$100,000 | \$660,000,000 | N/A | \$0 |
| \$158,282 - \$422,084.99 | 300 | 200,000 | 60,000,000 | 0.70% | 420,000 |
| \$422,085 and greater | 60 | 500,000 | 30,000,000 | 1.90% | 570,000 |
| TOTAL | 6960 | | \$750,000,000 | | \$990,000 |

Example 7

Alpha Corp had \$9 million in total employee compensation in the prior year and has elected to use the Hours Method to determine compensation paid in Seattle in the current year. Alpha Corp had 30 employees with annual compensation of \$200,000 and each of these employees worked 960 hours or 50% of their hours in Seattle. Alpha Corp had 5 employees with annual compensation of \$500,000 and each of these employees worked 1,536 hours or 80% of their hours in Seattle. The remaining \$3,500,000 of Alpha Corp's total compensation paid was earned by employees making less than \$158,282 and they worked exclusively in Seattle during the tax period.

Employees who worked exclusively in Seattle: The amount of compensation paid in Seattle is 100% of the compensation paid to employees who worked exclusively in Seattle.

Compensation earned by employees making less than \$158,282 = \$3,500,000

Employees who worked partly in and partly outside in Seattle:

30 employees with annual compensation of \$200,000

Compensation Paid in Seattle = $\$200,000 \times 960/1,920$ (50%) = \$100,000 per employee

Total Comp Paid in Seattle = $\$100,000 \times 30$ employees = \$3,000,000



Example 7 (continued)

Employees who worked partly in and partly outside Seattle

5 employees with annual compensation of \$500,000

Compensation Paid in Seattle = $\$500,000 \times 1,536/1,920$ (80%) = \$400,000 per employee

Total Comp Paid in Seattle = $\$400,000 \times 5$ employees = \$2,000,000

| ALPHA CORP | | | | |
|---------------------------------|---------------------|--------------------|-------|-----------------|
| Payroll in Seattle (Prior Year) | | \$ 9 Million | | |
| Payroll in Seattle (Current) | | \$ 8.5 Million | | |
| Compensation | Annual Salary | Payroll Exp | Rate | Tax |
| \$0 - \$158,281.99 | \$3,500,000 | \$3,500,000 | N/A | \$0 |
| \$158,282 - \$422,084.99 | 6,000,000 | 3,000,000 | 0.70% | 21,000 |
| \$422,085 and greater | 2,500,000 | 2,000,000 | 1.70% | 34,000 |
| TOTAL | \$12,000,000 | \$8,500,000 | | \$55,000 |



Tax Exemptions

- Businesses exempt from the payroll expense tax:
 - Business with Seattle payroll expense less than \$7,386,494 **in the prior year**
 - Grocery businesses
 - Retail & Wholesalers businesses who have at least 70% of the gross income from the retail sales of food and food ingredients.
 - Entities for which the City does not have authority to tax:
 - Federal, state and local governments and subsidiaries
 - Insurance businesses and their appointed insurance producers
 - Businesses that only sell motor vehicle fuel
 - Businesses that only sell liquor
- Independent contractors whose compensation is included in the payroll expense of another business is also exempt
 - Prior slide “who is an employee”



Tax Exemptions

- Taxpayers with less than \$7,386,494 in payroll expense in Seattle in the prior year.
 - No returns due for the current year.
 - Even if employees with annual compensation of \$ 158,282 or more paid in Seattle in current year.
- Taxpayers with \$7,386,494 or more in payroll expense in Seattle in the prior year.
 - Files a return. Could be a zero return if no employees with annual compensation of \$158,282 or more.
- If utilizing the Hours Method may exclude payroll expense of employees who work within Seattle less than 40 hours during the tax year.



Non-Profit Healthcare Entities

- Jan. 1, 2021 through Dec. 31, 2023, payroll expense of employees with annual compensation of \$150,000 to \$399,999.99 at non-profit healthcare entities may be deducted from the Payroll Expense Tax.
- “Non-profit healthcare entity” means:
 - Non-profit entity that provide comprehensive healthcare services, including primary and specialty care, and other non-profit health care entities that provide at least 50 percent of their services to patients covered by Apple Health and TRICARE;
 - Non-profit entities that conduct life sciences R&D; or
 - A capitated provider group operated by a fully non-profit carrier licensed under chapter 48.44 or 48.46 RCW.



When is the Tax Due?

- Tax effective Jan. 1, 2021
 - The tax for 2021 is not due until **Jan. 31, 2022** – *the due date of the fourth quarter.*
- After 2021, the tax will be due and payable on a quarterly basis – same as the Business License tax.
 - If taxes are reported by a taxpayer more than once per year, taxpayers may use the prior calendar year payroll expense to estimate reporting for the first 3 quarters and “true-up” reporting on the fourth quarter return.



How is the Tax Reported and Paid?

- **Online:** <https://www.filelocal-wa.gov/>
 - Payment Options: MC, VS, and ACH debit.
 - Electronic filing requires electronic payment.

OR

- **Manual:** Downloadable form
 - <https://www.seattle.gov/license-and-tax-administration/business-license-tax#copy>
 - Manual filing requires manual payment. A paper check will need to be submitted.



FileLocal Registration—What is Needed?

- Seattle account number and/or State of Washington UBI number.
- Businesses can locate these identification numbers on our website:
<https://www.seattle.gov/license-and-tax-administration/find-a-licensed-business>

- **Example**
 - Legal Name: **2018 FILELOCAL TEST ACCOUNT**
 - Trade Name: **DBA FILELOCAL TEST ACCOUNT TEST**
 - Seattle Business License Tax Certificate Number: **826781**
 - UBI Number: **0008267810740905**
 - City Account Number: **0008267810740905**
 - Address: **700 5TH AVE SEATTLE, WA 98104-5058**
 - Phone: **(206) 684-8484**
 - NAICS: **541611, Administrative Management and General Management Consulting Services**
 - License types:**
 - BUSINESS LICENSE Renewal Date: **12/31/2017**
 - COMMERCIAL PARKING Renewal Date: **12/31/2018**

- Each business must file their own separate return. Bulk filings are not available.

Manual Filing: Paper Form Example

Illustrative Purposes Only

Category 1: Current Year Annual Seattle Payroll Expense Less Than \$105,521,339

| <u>Column A</u> Annual Employee Compensation | <u>Column B</u> Payroll Expense Total | <u>Column C</u> Deduction * | <u>Column D</u> Taxable Amount | <u>Column E</u> Tax Rate | <u>Column F</u> Tax Due |
|---|--|--------------------------------|-----------------------------------|-----------------------------|----------------------------|
| \$158,282 - Less than \$422,085 | | | | x 0.007 | |
| \$422,085 or more | | | | x 0.017 | |

Category 2: Current Year Annual Seattle Payroll Expense is \$105,521,339 Or More, But Less Than \$1,055,213,392

| <u>Column A</u> Annual Employee Compensation | <u>Column B</u> Payroll Expense Total | <u>Column C</u> Deduction * | <u>Column D</u> Taxable Amount | <u>Column E</u> Tax Rate | <u>Column F</u> Tax Due |
|---|--|--------------------------------|-----------------------------------|-----------------------------|----------------------------|
| \$158,282 - Less than \$422,085 | | | | x 0.007 | |
| \$422,085 or more | | | | x 0.019 | |

Category 3: Current Year Annual Seattle Payroll Expense \$1,055,213,392 Or More

| <u>Column A</u> Annual Employee Compensation | <u>Column B</u> Payroll Expense Total | <u>Column C</u> Deduction * | <u>Column D</u> Taxable Amount | <u>Column E</u> Tax Rate | <u>Column F</u> Tax Due |
|---|--|--------------------------------|-----------------------------------|-----------------------------|----------------------------|
| \$158,282 - Less than \$422,085 | | | | x 0.014 | |
| \$422,085 or more | | | | x 0.024 | |



**Questions:
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