Council Subcommittee Meeting Date: February 10, 2014

CITY COUNCIL SUBCOMMITTEE MEETING #3
10-YEAR FINANCIAL SUSTAINABILITY PROJECT

CITY OF SHORELINE, WASHINGTON

AGENDA TITLE:	Continuing the Strategies Discussion
DEPARTMENT:	Administrative Services
PRESENTED BY:	Robert Hartwig, Administrative Services Director
ACTION:	__X__ Discussion

BACKGROUND:
At the first 10-Year Financial Sustainability Subcommittee meeting we reviewed the purpose, scope, and deliverables relating to this project. We also looked at challenges to sustainability. Finally, staff introduced the Base Scenario and discussed the assumptions used in the Base Scenario. The second Subcommittee meeting began the strategies discussion, where we covered various economic development and revenue strategies.

At tonight's meeting, we'll continue the strategies discussion regarding both economic development and revenue strategies and review the impact that some of these strategies have on the long-term projections. In addition, tonight's meeting will begin to cover the expenditure strategies available to close any structural budget gaps that might occur in the future. It is staff's hope that the Subcommittee will provide direction on strategies to include in the financial model.

The final alternatives selected will be modeled for presentation at the February 24th meeting. The updated model will be used to develop preferred alternatives at that meeting.

SUBCOMMITTEE QUESTIONS:
The Subcommittee had several questions during its last meeting. These are summarized in Attachment A at the end of this staff report.

STRATEGIES:

ECONOMIC DEVELOPMENT STRATEGIES
Economic development strategies were covered at the second Subcommittee meeting on January 28th. Alternatives included closing the gap with single family or multi-family residential development or with retail or non-retail commercial development. Based on the subcommittee discussion, the direction to staff was to include in the model an option for an additional 160 multi-family residential units annually (bringing the total to 320 units per year) and an additional 7,500 square feet per year of retail growth. As we look

at the model on Monday night, this assumption will be integrated so that the subcommittee can see the impact that this has on the long-term projections.

Questions for Council:

- *Does the Subcommittee wish to reopen this discussion?*
- *Any other questions?*

OTHER REVENUE STRATEGIES

Other revenue strategies besides economic development were also covered on January 28th. Options discussed included property tax, sales tax, gas tax, utility taxes and franchise fees (utility revenue), gambling tax, and cost recovery through new or increased fees. Other options explored new taxes and fees. These included a Business and Occupation (B&O) Tax, a revenue-generating Business License Fee, and an expansion of the $20 Transportation Benefit District (TBD) fee.

From this discussion, staff will keep open the options for a renewal of Proposition 1 (property tax levy lid lift), cost recovery options, and consideration of a Business and Occupation Tax in the future. The Subcommittee provided unanimous direction not to consider a strategy of increasing utility taxes for recommendation to the full Council. Staff will be adding the options related to these revenue strategies to the model for the subcommittee's review on Monday evening.

Questions for Council:

- *Does the Subcommittee wish to reopen this discussion?*
- *Any other questions?*

EXPENDITURE STRATEGIES

In addition to economic development and revenue options, there may be expenditure options available to the City to help with projected budget gaps in the future. This portion of the strategies discussion explores possible expenditure alternatives. It should be emphasized that the City Council has not taken any policy position on these alternatives as the Council would only do so after further review and exploration based on the recommendations coming from the Subcommittee. This discussion should be considered a review of options.

As noted in the Base Scenario, the first hypothetical gap that might surface is estimated in 2019. The alternatives outlined below should be seen as options to consider for future planning regarding the ten-year financial sustainability project.

The City's primary expenditure categories in the 2014 operating funds budget include:

Salaries & Benefits	$ 13.4 million	36.1%
Public Safety	13.2	35.6%
Services & Charges	5.4	14.6%
Transfers to Other Funds	2.0	5.4%
Intergovernmental Services	0.7	1.9%
Contingencies & Reserves	0.9	2.4%
All Other Expenditures	1.5	4.0%
Total	$ 37.1 million	100.0%

The basic assumptions for each expenditure area are included in Attachment B to this staff report. Each of these areas and potential options are considered below.

Salaries and Benefits
This category can be subdivided into two portions: salaries ($9.8 million) represent approximately 73% of this amount, while the remaining 27% ($3.6 million) relates to employee benefits such as medical insurance and pensions.

Since the model assumes a constant in City services, the model also assumes a constant in staffing levels over the next ten years. This is based on the 2014 staffing levels. It also uses 2014 budgeted salaries and benefits as the base and annual increases are applied to this base. Even though staff has used our best judgment in developing the forecast, there could be reasons why the assumptions used in Attachment B could be too high or too low. Some of these include:

- Natural turnover could produce more employees at lower steps in the pay scale therefore reducing the projected increase in salary costs and related benefits;
- Changes in the future Consumer Price Index (CPI) could be lower/higher than those used in the current assumptions;
- Service reductions/enhancements could be an option considered by the Council and therefore staffing levels would change correspondingly; or
- Projected employer contributions to the State Retirement System could be lower (or higher) than currently projected or the cost increases related to health benefits could change either as a result of lower premium cost increases or changes in policies as a result of the Affordable Care Act; or
- Changes are made to the City's compensation plan/policy, etc.

For purposes of this discussion, each 0.5% change in the annual salary costs would amount to a $49,000 per year difference. These changes if sustained, these changes would be cumulative and compounded over time.

Given that the City's compensation plan/policy was adopted by Council in 1997 and there has been consistent application of the adopted policy since that time any change to the plan should be considered carefully by the City Council. Staff would recommend that if the subcommittee anticipates that Council would want a review of the City's compensation plan/policy/strategy that this be something considered as part of the 2015 budget process as this review would require the support of a third-party consultant for this review as well as a communication and participation strategy for current employees. The scope and goal of the review would need to be clarified with Council as part of the budget process.

Achieving savings by reducing service levels is another option. Services provided by the operating funds were listed in Attachment C to the January 13th Subcommittee materials. The community has repeatedly expressed its interest in maintaining current levels of service, most notably with their support of Proposition 1 in 2010. Community reaction to reducing services would need to be considered as part of this strategy.

Assumptions relating to benefits also appear in Attachment B. In the area of employee benefits, pension benefits are controlled by contribution requirements set by the State.

Indirect pension savings would be achieved if salary increases were reduced (see above) or direct savings as a result of a reduced contribution rate being adopted by the State.

The other primary area of employee benefits comes from medical and related insurance payments. These expenditures amount to about $1.9 million per year in the operating funds. A 0.5% savings in this area would net about $9,500 per year in budget savings.

As with the salaries discussion there are various reasons why benefit projections may be high. It might also be possible to shift cost sharing so that a higher percentage of the costs are paid by employees. Again, the long-term effects of this change would need to be considered. Shoreline could become less competitive as a desirable employer; the change could have negative impacts on employee morale, etc. Again, staff would recommend that a broader review of compensation be considered if this is an area that the subcommittee would like to explore.

<u>Public Safety</u>

Public Safety is comprised of three main parts - law enforcement costs (Shoreline Police budget), jail costs, and court costs (municipal court, public defense and prosecution budgets). The Police Department ($10.7 million) is 82% of the total public safety budget, and of this total, about $7.3 million relates to salaries and benefits of the City's contracted police force. Supplies, uniforms, vehicles, and equipment are another $0.8 million. The remainder relates to County overhead, dispatch services, and special police units such as the SWAT team (the majority of these costs are also related to salaries and benefits of contracted staff). To give some idea of magnitude, the "fully loaded cost" (salaries, benefits, uniforms, equipment, etc) a King County contracted deputy (police officer) is currently $178,000 per year. Higher ranking officers have correspondingly higher costs. Achieving an overall annual 0.5% savings in this area would save the City about $53,500 per year.

Police costs are set by King County. In order to reduce these costs the City would ultimately have to reduce staffing levels or reorganize the department in a way that would replace staff at higher ranks with staff at lower ranks (for example, more patrol officers and fewer sergeants). Whether either of these possibilities is achievable given citizen demands for public safety is a topic that should be considered. Nonetheless, as one of the largest expenditure categories in the operating funds, law enforcement costs and services cannot be ignored as part of this analysis.

Additionally, a reduction in police service levels might have the result of lowering jail and court costs (see below). However, it is also possible that decreased police staffing could result in more criminal activity, thereby increasing jail and court costs.

Jail costs are budgeted at about $1.3 million per year. The City currently contracts with the King and Snohomish County jails for jail services. A 1% savings in this area would generate about $13,000 per year. Given the booking restrictions that were put in place at the Snohomish County Jail (SCJ) and recent termination of the City's SCJ contract, which will become effective May 5, 2014, it appears that, rather than savings, it is very likely that there will be additional jail costs in future years.

Currently, staff is looking at various options for how to provide jail services, both in the near and long term. It may be worth reopening negotiations with Yakima County to use its jail facility, as the City has done in the past. This may be an economically viable way to achieve savings, but it may also be inconvenient from a court transport perspective. Similarly, staff is looking at the SCORE misdemeanant jail in SeaTac as an option.

Shoreline incurs court costs of $1.2 million per year (municipal court services, prosecution, and public defense services). It should be noted that the majority of these costs are recovered through related court fines and fees. However, in 2014 the net of budgeted City expenditures offset by projected revenues is still roughly $561,000.   This is another area where recent changes (this time at the State level) have increased costs. It appears that more costs will be incurred for public defenders in the future, given a State Supreme Court order mandating case load limits. If a 1% savings could be achieved in this area, it would net $11,000 to the City.

Finally, all of these public safety areas are largely outside of the City's control. The City contracts with King County for police and court services, with King and Snohomish Counties for jail services and with two private contactors for prosecution and public defense services. Any attempt to control costs must either come from service reductions or as a collaborative cost saving effort between two or more entities.

Services and Charges

After the first two categories, the remainder of the expenditures budget is led by services and charges. These costs include:

Professional services contracts	$ 1.5 million
Grants to other agencies	0.7
Repairs & maintenance	0.6
Insurance premiums	0.4
All other (less than $0.25 million each)	2.2
Total	$ 5.4 million

A 1% savings in this area would generate about $54,000 per year.

Professional services include contracts with engineers, planners, software and hardware contracts, electricians, etc. Grants to other agencies include payments to Kruckeberg Garden, health and human services agencies, etc. Repair and maintenance costs are incurred to keep the City's facilities and equipment in good working order. Insurance payments relate to property, vehicle, and liability premiums. These payments protect the City from liability in the event of claims. In the cases of professional services and grants it is important to remember that in many cases these are services that the City would have to provide by increasing staff.

Transfers to Other Funds
The General and Streets Funds will transfer about $2.0 million to other funds in 2014. These transfers are as follows:

211	Debt Service	$ 612,451	For City Hall debt
301	General Capital	180,000	For capital projects & future soccer field replacements
312	Facil Major Maint	74,032	For capital projects
330	Roads Capital	1,089,045	$300,000 grant match, remainder is capital projects
505	Unemployment	17,500	For unemployment claims
	Total	$ 1,973,028	

In addition to these amounts, the General and Streets Funds are transferring a little over $1 million between each other. These transfers are excluded from the calculations because they have a zero effect when the two funds are combined as the City's operating funds. The possibility that the General Fund could reduce its transfer to the Streets Fund and other funds (freeing up more money for operations) was discussed at the second meeting as part of the revenue discussion.

Of the $1.97 million amount above, $800,000 relates to one time transfers to the Roads Capital Fund. This includes $300,000 for the grant matching program, and $500,000 for increased road maintenance projects. The ongoing transfer to Roads Capital is $289,000.

One-time transfers have not been included in the financial model for years beyond 2014. As a result, the net amount to work with is just under $1.2 million. As discussed at the last meeting, an additional $20 TBD (Transportation Benefit District) fee would generate about $800,000 per year for transportation related projects. The only effect this would have on the operating funds is the potential to reduce the annual transfer of $290,000 to the Roads Capital Fund for curb, gutter, and sidewalk maintenance, and transportation planning.

City Hall debt must be repaid according to the bond payment schedule. Transfers can be reduced for other projects, but the effect will be to defer maintenance on the City's existing infrastructure.

Intergovernmental Services, Contingencies, and Reserves
The intergovernmental services budget of $721,000 is made up of services that are provided to Shoreline by other units of government. King County provides about $300,000 in services for streets related activities (traffic signals, operations and maintenance of Aurora, bridge inspections, etc.). Another $260,000 relates to things like voter registration, elections, election pamphlets, ORCA passes, SWM charges, etc. The remainder is attributable to the annual audit, police overtime at the teen center, etc.

Savings in these areas would come with an associated reduction of services. In addition it would require cooperation from other governments. The fact that other governments provide these services also means that Shoreline does not have to hire additional staff to perform the work.

The City is required to maintain a $255,000 insurance reserve and a 2% contingency based on budgeted revenues. These items are part of a $926,000 budget for contingencies and reserves. It is difficult to reduce these amounts, as there have been times in which contingency funds have been used to pay for unexpected expenses. In addition, these amounts are part of the savings that result in expenditures coming in at 98% of budget each year (one of the assumptions of the Base Scenario).

<u>All Other Expenditures</u>
The remaining items in the operating funds budgets total $1.5 million. The largest expenditures making up this category include:

Office & program supplies	513,000
Small tools & equipment	209,000
Vehicles & large equipment	208,000
Equipment replacement charges	193,000
Equipment operations & maintenance	160,000
Software & licenses	132,000
Miscellaneous smaller items	85,000
Total	$ 1,500,000

A 1% savings in this area would generate about $15,000 annually. Counterbalancing this savings is the need to make these purchases. Failing to replace and maintain equipment results in deferred maintenance issues that become greater with each passing year.

Questions for Council:

- *Are there expenditure strategies that the Subcommittee would like to explore or remove from consideration?*
- *Are there other expenditure strategies that the Subcommittee would like to consider?*
- *Any other questions?*

ATTACHMENTS:

Attachment A - Responses to Subcommittee Questions
Attachment B - Expenditure Assumptions
Attachment C – DOR Self-Storage Tax Guide
Attachment D – General B & O Taxes & Business Licenses

10-Year Financial Sustainability Plan

Attachment A

Responses to Subcommittee Questions

February 10, 2014

Meeting date: January 28, 2014

ITEM	REPLY	STATUS
Add an agenda item to a future City Council meeting. Need to know how developers make development decisions. Can the City affect this decision making process?	Staff is planning to make this presentation at the March 17, 2014 Dinner Meeting.	Pending
Are self storage business operations taxable?	The rental of self storage units is considered rental of real estate when space is rented for 30 days or longer. The income is not taxable under the business and occupation tax (B&O). Retail sales by self storage businesses may include, but are not limited to sales of: moving boxes, rope, locks, or packing tape. These sales require the collection and remittance of retail sales tax, and B&O tax applies. Refer to the Self Storage Tax Guide from the Washington State Department of Revenue included as Attachment C.	Complete 2/10
Please clarify the voter approval requirement with regard to the implementation of a Business & Occupation Tax.	Refer to pp. 20-23 of MRSC's "A Revenue Guide for Washington Cities and Towns" included as Attachment D. The maximum tax rate for a General Business and Occupation Tax that can be imposed by a city's legislative body is 0.2 percent (0.002). All ordinances that impose a General Business and Occupation Tax for the first time must provide for a referendum procedure as delineated in RCW 35.21.706. Any city may levy a rate higher than 0.2 percent if it is approved by a majority of the voters.	Complete 2/10
The staff report stated that each 1% increase in the Gambling Tax rate would generate approximately $13,400 (a maximum of about $134,000 in new revenue).	A 1% increase in the Gambling Tax rate on card room gross receipts will actually generate $134,000 (a maximum of $1.34 million in new revenue if the rate is raised to 20%).	Complete 2/10

10-Year Financial Sustainability Plan
Assumptions Used in Forecast
February 10, 2014

Attachment B

EXPENDITURE ASSUMPTIONS

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Inflation	2.5%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.3%	2.4%
COLA (% of Inflation)	90.0%	90.0%	90.0%	90.0%	90.0%	90.0%	90.0%	90.0%	90.0%	90.0%
COLA (Projected)	2.3%	2.2%	2.2%	2.2%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%
Step Increases (% of Employees Receiving)	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	20.0%	20.0%	20.0%	20.0%
Step Increases (Average % Increase)	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Salaries & Wages AGR	2.4%	3.1%	3.1%	3.1%	3.1%	3.1%	2.9%	2.9%	2.9%	2.9%
Health Benefits AGR	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%
PERS Contribution Rate	10.4%	10.4%	10.4%	11.6%	11.6%	11.6%	11.6%	11.6%	11.6%	11.6%
PERS AGR	17.1%	3.2%	3.2%	14.9%	3.1%	3.1%	2.9%	2.9%	2.9%	2.9%
Utilities AGR	2.5%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.3%	2.4%
Police Contract AGR	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Jail Contracts AGR	-6.5%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	2.7%
District Court & Public Defense AGR	2.5%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.3%	2.4%
Services & Charges AGR	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.3%	2.4%
All Other Expenditures AGR	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

TRANSFERS TO OTHER FUNDS

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Debt Service	612,451	612,451	612,451	612,451	612,451	612,451	612,451	612,451	612,451	612,451
General Capital	130,000	130,000	130,000	130,000	130,000	130,000	130,000	130,000	130,000	130,000
Facilities Major Maint.	74,032	74,032	74,032	74,032	74,032	74,032	74,032	74,032	74,032	74,032
Roads Capital - Gambling Tax Equivalent	136,528	136,528	136,528	136,528	136,528	136,528	136,528	136,528	136,528	136,528
Roads Capital - Sidewalk & Street Overlay	152,517	152,517	152,517	152,517	152,517	152,517	152,517	152,517	152,517	152,517
Unemployment Fund	17,500	17,500	17,500	17,500	17,500	17,500	17,500	17,500	17,500	17,500
Total	1,123,028	1,123,028	1,123,028	1,123,028	1,123,028	1,123,028	1,123,028	1,123,028	1,123,028	1,123,028

Note: *AGR: Annual Growth Rate*

Attachment C

Self-Service Storage Businesses

October, 2011

Background

The rental of self-service storage units, where customers have direct access to individual storage units by separate access, is considered rental of real estate when space is rented for 30 days or longer. Income from this rental of real estate is not taxable under the business and occupation (B&O) tax. (See WAC 458-20-118)

Self-service storage businesses often make retail sales of tangible personal property (TPP) such as moving boxes. They may also make retail or wholesale sales when they auction off the contents of storage units where occupants have defaulted on their rental agreement.

Retail sales of TPP

Retail sales by self-service storage businesses may include, but are not limited to sales of:

- moving boxes;
- rope;
- locks; or
- packing tape.

These sales require the collection and remittance of retail sales tax, and retailing B&O tax applies.

Sales of storage unit contents

Chapter 19.150 RCW provides for the lien of and sale of storage unit contents by self-service storage businesses when the occupant defaults on terms of their rental agreement.

Retail Sales: When a self-service storage business sells the saleable contents to consumers, they must collect and remit retail sales tax.

Sales to Resellers: A self-service storage business is not required to collect sales tax when the buyer provides a copy of his, her, or its reseller permit (or other approved document) that documents the wholesale nature of the transaction.

No B&O Tax Due: However, because the self-service storage business is authorized to sell the occupant's contents only for the purpose of satisfying the lien against the occupant, the sales proceeds are not subject to the B&O tax.

Sales conducted by auctioneers

A self-service storage business may choose to hire a third-party auctioneer to conduct sales of storage unit contents on their behalf. The auctioneer will generally collect and remit sales tax on sales to consumers.

However, if the auctioneer does not both collect and remit the sales tax due to the Department of Revenue (Department) on these auction sales, the storage business is responsible for remitting the sales tax due.

Registration requirements

A business that is required to remit retail sales tax must register.

When a self-service storage business is responsible for remitting retail sales tax to the Department, it must register with the Department. This includes businesses that conduct their own auctions (as opposed to hiring a third party auctioneer).

To register with the Department of Revenue, please complete a Business License Application available online at http://bls.dor.wa.gov/

For more information

Please call our Telephone Information Center at 800-647-7706 or contact us.

General Business and Occupation Taxes and Business Licenses[80]

Business taxes and licenses come in three forms:

1. Excise (percentage) taxes levied on different classes of business to raise revenue. These are commonly called general business and occupation taxes.

2. Licenses for the purposes of regulation only.

3. Licenses to regulate and raise revenue.

◗ General Business and Occupation Taxes

These taxes are levied at a percentage rate on the gross receipts of the business, less some deductions. Businesses are put in different classes such as manufacturing, wholesaling, retailing, and services. Within each class, the rate must be the same, but it may differ among classes.

Effective April 20, 1982, the legislature set the maximum tax rate that can be imposed by a city's legislative body at 0.2 percent (0.002), but grandfathered in any higher rates that existed on January 1, 1982.[81] All ordinances that impose this tax for the first time or raise rates must provide

[80]RCW 35.22.280(32) authorizes any city of the first class: "To grant licenses for any lawful purpose, to fix by ordinance the amount to be paid therefor, and to provide for revoking the same . . . ." This language has been construed by the Washington Supreme Court as authorizing licenses for revenue purposes as well as regulation. The court has in at least three decisions upheld a business and occupation tax under the above language: *Fleetwood v. Read*, 21 Wash. 547, 552-553 (1899); *Seattle v. King*, 74 Wash. 277, 279 (1913); and *Pacific Telephone and Telegraph v. Seattle*, 172 Wash. 649, 653 (1933).

For second class cities, the authority is found in RCW 35.23.440(8): "License generally: To fix and collect a license tax for the purposes of revenue and regulation, upon all occupations and trades, and all and every kind of business authorized by law . . . ." RCW 35.27.370(9) provides the authority for towns: "To license, for the purposes of regulation and revenue, all and every kind of business, authorized by law and transacted and carried on in such town . . ." Under RCW 35A.82.020, a code city may "exercise the authority authorized by general law for any class of city to license and revoke the same for cause, to regulate, make inspections and to impose excises for regulation or revenue in regard to all places and kinds of business, production, commerce, entertainment, exhibition, and upon all occupations, trades and professions and any other lawful activity . . ."

[81]RCW 35.21.710. This statute also has a provision that allows cities that had rate higher than 0.2 percent on January 1, 1982 to increase the rate without a vote of the people. The increase is limited to a total of 10 percent of the January 1, 1982 rate, with the annual incremental increase limited to two percent of the current rate.

for a referendum procedure.[82] Any city may levy a rate higher than 0.2 percent, if it is approved by a majority of the voters.[83] Thirty-eight of Washington's 281 cities levy this tax.

Model Ordinance

In 2003, the legislature passed a bill that required the Association of Washington Cities (AWC) to convene a committee to develop a model ordinance that must be adopted by all cities imposing a B&O tax no later than December 31, 2004.[84] The legislature was concerned about the lack of uniformity of the cities' B&O tax ordinances and about allegations that some business income was subject to multiple taxation. As noted in the Final Bill Report, the legislation required that the model ordinance have certain mandatory provisions:

> a system of credits that prevent multiple taxation of the same income, a gross receipts threshold for small businesses;[85] tax reporting frequency requirements; provisions for penalties and interest, claim and refund provisions, and certain terms with definitions from the state B&O statutes or based on comparable definitions within the state B&O statutes.[86]

Beginning January 1, 2008, cities that levy the B&O tax must allow for allocation and apportionment,[87] as set out in RCW 35.102.130. A study done by the Department of Revenue estimated that this will reduce the taxable base and B&O taxes collected in all but four cities.[88] The total estimated losses for 2004 were $23.2 million, with Seattle being by far the biggest loser. AWC has posted on its web site a revised model ordinance that incorporates the allocation and apportionment provisions and the various legislative changes made since 2003.[89]

Business and occupation taxes are unpopular with business people and are termed inequitable by some tax experts because they tax gross receipts rather than profits. Other people argue that the entire state and local tax structure is inequitable because Washington has no income tax. The

[82] RCW 35.21.706. This referendum procedure must specify that a petition may be filed within seven days of the passage of the ordinance with the filing officer (e.g., city clerk). Within 10 days, the filing officer must confer with the petitioner as to form and style of the petition and write a ballot title. Then the petitioner has 30 days to gather the signatures of at least 15 percent of the registered voters. If sufficient valid signatures are submitted, the referendum is voted on at the next special election (see RCW 29A 04.330 for special election dates) as long as that election is at least 45 days after the certificate of sufficiency is received by the city. If a general election is to be held within 90 days, then the referendum must be voted on at the general election. However, the election statutes now require that a resolution calling for a special election must be given to the county auditor at least 52 days prior to the election, and a resolution calling a special election that would occur on the primary or general election date must be given to the auditor at least 84 days before the election. RCW 29A.04.330.

[83] RCW 35.21.711.

[84] Ch. 79, Laws of 2003 and ch. 35.102 RCW. RCW 35.102.020 states that the new chapter is of limited scope and does not apply to taxes on any service that traditionally or historically has been taxed as a utility business for municipal services, such as light and power, natural gas distribution, telephone, cable television, sewer, water, drainage, solid waste, and steam.

[85] Only gross receipts over $20,000 a year may be taxed.

[86] Washington State Legislature, *2003 Final Legislative Report* (Olympia, 2003), 156.

[87] Apportionment refers to an approach under tax law under which a multi-jurisdiction business is allowed to apportion, or divide, its taxable income among the jurisdictions in which it does business.

[88] Washington State Department of Revenue, *Municipal Business and Occupation Tax - Study of Potential Impacts (Allocation and Apportionment Study)* (Olympia, November 2005), 36.

[89] See also MRSC's web page on "Business and Occupation Taxes" at http://www.mrsc.org/Subjects/Finance/B-Otax.aspx

business and occupation tax is, along with the property tax, the sales tax, and utility taxes, one of the four major revenue options given to the cities by the legislature. The basic argument in favor of the tax is that businesses benefit from general government expenditures, especially police and fire services, that are supported by the tax.

Cities thinking of levying a gross receipts tax should consider whether they have the staff time and expertise necessary to administer this tax. In particular, the staff must routinely audit the tax accounts to ensure compliance. Any cities that have revenue-generating fees (described below) should also determine that firms are paying the correct amount, but this is probably easier to do for these fees.

◗ Regulatory License Fees[90]

Regulatory license fees fall into two categories. First, there are business license fees. One purpose of such fees is to register all businesses to provide the city with a record of the owners, in the event a citizen or a city department has a problem with a business. Another basic purpose would be to help ensure compliance with city ordinances (for example, zoning). Cities that levy a gross receipts business and occupation tax also need to register businesses to be able to check for their compliance in the payment of taxes. These fees are set at a flat rate per license in an amount designed to recover the administrative costs of registering the businesses and issuing the licenses, maintaining the files, etc. The fees charged should be fair and bear a reasonable relation to costs.[91] A reasonable charge might provide for recovery of the full costs of issuing the average license, including the direct salary and benefits of the staff, the indirect costs of management, and possibly even a share of computer acquisition costs.

Second, there are professional and occupational licenses. These are levied on such businesses as pawnbrokers, used goods stores, taxis and taxi drivers, and massage parlors. The license fee may include, in addition to the costs listed above, the costs of investigating the background of the person requesting the license. The license fees for professional and occupational licenses will vary by the kind of activity involved.

Many smaller cities levy the second kind of fee, but not the basic business license fee. Implementing a business license program is considered to be a sound management practice to protect the corporate city and its citizens.

◗ Revenue-Generating Regulatory Licenses

Rather than charge a single flat fee to license all businesses, cities that license to generate revenue use one or more criteria to set the fees. Criteria that we have seen used include: establishing ranges of employees or square footage of the business and then charging different fees depending upon the range in which the firm falls; charging different fees depending on the type of business; and using a flat rate per employee or square foot.

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[90]Many people refer to these fees as "taxes." Care needs to be taken to determine whether the person using the term "business tax" is referring to a gross receipts tax or a revenue-generating fee of the type discussed here.

[91]See McQuillin, *Municipal Corporations* §26.46 (December 2008); see, generally, *Patton v. Bellingham*, 179 Wash. 566 (1934), and *Homes Unlimited v. Seattle*, 90 Wn.2d 1544 (1978).

Twenty-seven of the 246 cities responding to this question in the 2008 Association of Washington Cities *Tax and User Fee Survey* have a range of fees, based on the number of people they employ. Eleven cities charge a fee per employee, per hour, or full-time equivalent employee. Three cities use the square footage of the establishment as the basis for their license fees. Some cities use a combination of two or three measures. Mountlake Terrace, for example, has a license that is based on number of employees and square footage. Bothell has a three-part fee that combines the number of employees, type of business, and square footage.[92] Kirkland has a base fee and a surcharge that uses ranges of number of employees and ranges of gross receipts.[93]

The law allows for a good deal of creativity in designing these license fees. However, classes of businesses must be clearly defined, with each business within each class being charged the same fee.[94]

[92]Bothell Resolution No. 1227 (2008).
[93]Kirkland Municipal Code §7.02.160(b).
[94]See McQuillin, *Municipal Corporations* §26.76 (December 2008).