

April 2, 2018

## MEMORANDUM

**To:** Finance and Neighborhoods Committee  
**From:** Dan Eder, Central Staff Deputy Director  
Erik Sund, Budget & Finance Coordinator  
**Subject:** Tax Structure Issue Identification

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In [Resolution 31782](#), the Council stated its intent to consider a new tax on businesses that would generate between \$25 million and \$75 million and be in effect on January 1, 2019. This memo highlights policy choices for imposing such a tax. We invite Councilmembers to provide Central Staff with your feedback and policy preferences to inform the bill that will be drafted in the next few weeks for the Council's consideration. The current schedule anticipates that the Council's April 23, 2018 Introduction & Referral Calendar will include a bill addressing a new business tax.

### 1. Revenue Amount

The Progressive Revenue Task Force (PRTF) recommends imposing a \$75 million target, “[g]iven the scale of the need for deeply affordable housing, shelter, and services.” This amount can be scaled either within the range identified in Resolution 31782 or to a different target.

*Options:*

- A) \$25 million.
- B) \$50 million.
- C) \$75 million.
- D) Some other amount.

### 2. Type of Tax

Resolution 31792 explicitly identified an Employee Hours Tax (a new business tax measured by the number of full-time equivalent (FTE) employees) as well as other unspecified progressive taxes. The PRTF proposed another type of new business tax for the Council's consideration: a Payroll Tax that would be measured by payroll compensation paid to employees.

The City's Finance and Administrative Services Department (FAS) indicates that the process steps and timelines for each option would be quite different. The Employee Hours Tax can be collected beginning January 1, 2019; however, a Payroll Tax cannot be collected until later than January 1, 2019.

*Options:*

- A) Employee Hours Tax only
- B) Payroll Tax only
- C) Employee Hours Tax plus a Payroll Tax
- D) Employee Hours Tax or a Payroll Tax (allow each business to choose)

### **3. Employee Hours Tax: Per FTE Tax Rate**

If the Council decides to impose an Employee Hours Tax, then there are several policy options.

#### *Options:*

- A) Single Rate. The per FTE tax rate is determined by the Council's revenue target, the estimated number of employers that are expected to pay the tax after any exemptions, and the estimated number of FTE employees working for those employers.
- B) Stepped Rates. The per FTE tax rate varies depending on the number of FTEs working for each employer. As provided in Appendix B1 of the PRTF's recommendations, the per FTE rate could be lower for firms with a smaller number of FTEs and then rise for firms with higher FTE counts. The City does not currently have data needed to identify the stepped rates that would be needed to achieve a particular revenue target with much precision.

### **4. Payroll Tax: Tax Rate**

If the Council decides to impose a Payroll Tax, then there are several policy options. No matter which option is selected, FAS indicates that the Payroll Tax cannot be in effect January 1, 2019. Furthermore, the City does not currently have data needed to set rates to achieve a particular revenue target with much precision.

#### *Options:*

- A) Single Rate. The tax rate is determined by the Council's revenue target and the estimated amount of payroll for those employers that are expected to pay the tax after any exemptions.
- B) Stepped Rates. The tax rate varies depending on either the overall payroll or on the number of FTEs working for employers who are not exempted. As provided in Appendix B1 of the Progressive Revenue Task Force's recommendations, the payroll tax rate could be lower for firms with a smaller number of FTEs and then rise for firms with higher FTE counts.

### **5. Exemption for Smaller Businesses**

Some existing City laws treat smaller businesses differently than larger businesses. For instance, the [Business License Tax](#) (often referred to as the "Business and Occupation" or "B&O" tax) exempts all businesses with less than \$100,000 in taxable gross receipts. Similarly, Seattle's [Minimum Wage and Minimum Compensation](#) applies differently to employers with 500 or fewer employees than to those with over 500 employees.

The Council may consider whether to have the new business tax apply only to large employers. If so, the Council could consider exempting smaller employers. There are multiple ways of measuring what a “smaller business” is, as described in Attachment A.

*Options:*

- A) No exemptions – tax would be paid by all businesses regardless of size.
- B) Exempt all smaller businesses and determine a definition (using taxable gross receipts or some other metric).

**6. Exemptions by Type of Business**

The Council may want to consider exempting some businesses for reasons other than taxable gross receipts. For instance, the Council may want to exempt all businesses in certain industries or non-profits (regardless of size). The Progressive Revenue Task Force recommended exempting marijuana-related businesses

*Options:*

- A) No exemptions – tax would be paid by all businesses regardless of industry.
- B) Exempt (or partially exempt) all businesses in one or more industries.
- C) Exempt (or partially exempt) all non-profits.

**7. Alternative Flat Tax for Exempted Businesses**

The Progressive Revenue Task Force recommended that smaller businesses be exempted from the new business tax. The task force recommended that there be a form of alternative minimum tax should be applied to exempted businesses between. In the event that some businesses are exempted based on taxable gross receipts, non-profit status, or industry, then the task force’s further recommendation is that a flat \$395 tax be imposed on any such exempted businesses with taxable gross receipts between (for instance) \$500,000 and an exemption threshold.

*Options:*

- A) No flat tax for exempted businesses.
- B) Include a flat tax for all exempted businesses.
- C) Include a flat tax for some exempted businesses, such as ones with taxable gross receipts above a certain minimum.

**Attachments:**

- A. Selected Definitions for “Small Business”

cc: Kirstan Arestad, Central Staff Director

## **Attachment A: Selected Definitions for “Small Business”**

**Federal:** The federal Small Business Administration (SBA) provides [hundreds of definitions](#) based on North American Industry Classification System (NAICS) codes describing different types of businesses. For instance, the SBA classifies a supermarket as a small business if it has less than \$32.5 million in gross receipts. In contrast, both a full-service restaurant and a real estate appraiser would qualify as a small business with gross receipts under \$7.5 million. Most manufacturing firms are evaluated based on the number of employees rather than gross receipts; the threshold differs depending on what type of manufacturing (e.g., cheese manufacturers have a 1,250 employee threshold, but the threshold for hardware manufacturers is 500 employees).

**State:** Washington State’s Office of Minority & Women’s Business Enterprises program eligibility is a [standard](#) of up to \$23.98 million across all categories of minority- and women-owned businesses that want to contract with state agencies.

**County:** King County’s Small Contractor and Supplier program [standard](#) is that qualifying businesses cannot exceed 50% of SBA’s current size standards. Moreover, the personal net worth of each owner(s) must not exceed \$1.32 million.

**City:** The City’s Office of Economic Development asks for minority- and women-owned businesses to identify as a small business if they meet the criteria for the small business definition used by any one of the following: the Small Business Administration, the State of Washington, or King County.