SEATTLE CITY COUNCIL
CENTRAL STAFF

May 2, 2018

M E M O R A N D U M

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

Council Bill (C.B.) 119244 would establish new taxes on large businesses to increase funding for the City's investments in programs that address homelessness and build new affordable housing. The spending plan is found in Resolution 31810.

This memo identifies potential issues and options for amending the tax bill. Discussion of issues included in this memo is included as an item on the May 2, 2018 Finance & Neighborhoods Committee agenda.

I. Background

In Resolution 31782 (November 2017), 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. On March 9, the Progressive Revenue Task Force submitted its recommendations to the City Council. On April 2, 2018, Central Staff provided a memo highlighting several policy options for imposing such a tax and then a memo on April 25, 2018 summarizing the current tax bill.

II. Potential Issues for Consideration

A. Change the Revenue Target

The rates included in the current bill would raise approximately $75 million annually (plus inflation) to pay for affordable housing investments, services to address homelessness, and the administrative costs of standing up the new tax. Councilmembers may amend the current bill to set the tax rate higher or lower to achieve different outcomes. Any changes to the anticipated annual revenue should be reflected in changes to the Resolution 31810 spending plan.

Options:

1. Implement a rate that achieves a $150 million per year annual revenue target.
2. Implement a rate that achieves an annual revenue target that is lower $75 million.
3. No action.

B. Incentivize Charitable Contributions

To incentivize cash contributions to non-profit charitable organizations providing services to those experiencing homelessness, Councilmembers may wish to consider providing taxpayers an annual credit for cash contributions to such non-profit organizations. The credit could be a dollar for dollar offset up to the amount of tax otherwise owed or up to a specified amount per business per year.

The incentive would cause a decrease in the amount of the City's tax revenues. Council could reduce its anticipated amount of tax revenues accordingly or – at least in theory – maintain the same level of anticipated tax revenues by charging other taxpayers marginally more. However, Central Staff is not able to estimate with precision the amount of decreased revenues.

Options:

1. Include a credit for cash contributions.
2. No action.

C. Non-Profit Exemption

The current bill would exempt non-profit organizations from paying the new Employee Hours Tax (EHT) and the new Payroll Tax. However, provides that some non-profit organizations may not be exempted from the new business tax because a portion of the organization's income can be distributed to its members, directors, or officers.

The definition section of the tax bill provides that "non-profit" is "an organization in which no part of the income can be distributed to its members, directors, or officers and that holds a current tax exempt status as provided under Sec. 501(c)(3) of the Internal Revenue Code, as hereafter amended, or is specifically exempted from the requirement to apply for tax exempt status under Sec. 501(c)(3)" (emphasis added).

Under either of the "action" options outlined below, the exemptions would cause a decrease in the amount of City tax revenues. The Council could reduce its anticipated amount of tax revenues accordingly or – at least in theory – maintain the same level of anticipated tax revenues by charging other taxpayers marginally more. However, Central Staff is not able to estimate with precision the amount of decreased revenues.

Options:

1. Extend the exemption to all non-profits that hold a current tax exempt status as provided under Section 501(c)(3) of the federal Internal Revenue Service code.
2. Extend the exemption to all businesses organized under either (a) Section 501(c)(3) of the federal Internal Revenue Service Code or (b) the Revised Code of Washington (RCW) 24.06 (known as the Non-profit, Miscellaneous, and Mutual Corporations Act). This would exempt co-ops as well as any other businesses "organized under [RCW 24.06] for any lawful purpose including but not limited to mutual, social, cooperative, fraternal,

beneficial, service, labor organization, and other purposes; but excluding purposes which by law are restricted to corporations organized under other statutes" (RCW 24.06.015).

3. No action.

D. <u>Partial Credit for First Year Businesses</u>

The exemption threshold ($20 million in taxable gross receipts as measured by the Business & Occupation tax) is an "all or nothing proposition." In order to ease the transition to paying the tax, the Council could consider a one-time exemption from one or more of the quarterly tax payments owed by a business the first calendar year in which it owes the new business tax. Starting in 2020 (since all payers would be new in 2019), this would cover newly formed large businesses and large businesses that move to Seattle; and it would also cover existing businesses that grow to have taxable receipts in excess of the $20 million exemption threshold.

Implementation requires that the Department of Finance and Administrative Services (FAS) have the ability and resources to track businesses over time to determine whether and when a business first pierces the $20 million exemption threshold.

The credit would cause a decrease in the amount of tax revenues. The Council could reduce its anticipated amount of the City's tax revenues accordingly or – at least in theory – maintain the same level of anticipated tax revenues by charging other taxpayers marginally more. However, Central Staff is not able to estimate with precision the amount of decreased revenues.

<u>Options:</u>

1. Implement a credit of one or more quarterly payments for businesses in the first year they have taxable gross receipts in excess of $20 million.
2. No action.

E. <u>Eliminate Sunset Date</u>

Some Councilmembers have indicated a desire to make the Employee Hours Tax continue to be imposed if the Payroll Tax cannot be imposed consistent with the anticipated schedule.

The current bill provides that the Employee Hours Tax will end on December 31, 2020. The bill provides that a Payroll Tax will be imposed beginning on January 1, 2021 immediately after the Employee Hours Tax ends. However, the Department of Finance and Administrative Services may require a longer period of time to stand up the administrative process to implement the Payroll Tax (rulemaking, new tracking database, etc.). In that event, the Council would need to pass a future, separate ordinance to continue collecting the Employee Hours Tax. Without such a step, the City would need to make cuts to investments in affordable housing and homelessness services or identify other revenue sources to avoid the cuts.

If Councilmembers want to pursue this approach, then Central Staff will consult with the City Attorney's Office to explore options.

Options:

1. Extend the Employee Hours Tax in the event that implementation of the Payroll Tax is delayed.
2. No action.

F. Exempt Businesses Involved in Life Science, Medical Research, and Health Care Delivery

Some Councilmembers have expressed an interest in exempting life sciences businesses that develop medical devices and drugs, medical research institutions, and all hospitals (the current bill already exempts non-profits, including non-profit hospitals).

The credit would cause a decrease in the amount of the City's tax revenues. The Council could reduce its anticipated amount of tax revenues accordingly or – at least in theory – maintain the same level of anticipated tax revenues by charging other taxpayers marginally more. However, Central Staff is not able to estimate with precision the amount of decreased revenues.

Options:

1. Exempt all hospitals.
2. Exempt all life sciences businesses.
3. Exempt all medical research institutions.
4. Exempt all three entities or some other subset of more than one of these options.
5. No action.

cc: Kirstan Arestad, Central Staff Director