

CITY COUNCIL AGENDA ITEM
CITY OF SHORELINE, WASHINGTON

AGENDA TITLE:	Adoption of Ordinance No. 870 – Amending Chapter 3.22, Business & Occupation Tax, and Chapter 3.23, Tax Administrative Code, to Conform with Association of Washington Cities’ Model Ordinance for Business & Occupation Tax
DEPARTMENT:	Administrative Services
PRESENTED BY:	Rick Kirkwood, Budget & Tax Manager Alice Kim, Business & Occupation Tax Analyst
ACTION:	<input checked="" type="checkbox"/> Ordinance <input type="checkbox"/> Resolution <input type="checkbox"/> Motion <input type="checkbox"/> Discussion <input type="checkbox"/> Public Hearing

PROBLEM/ISSUE STATEMENT:

Ordinance No. 808, which reflected updates to the Washington State Business and Occupation (B&O) Tax Model Ordinance from 2013, was adopted by the City Council on December 4, 2017. Ordinance No. 808 created two new Chapters in the Shoreline Municipal Code (SMC) - Chapter 3.22, Business & Occupation Tax and Chapter 3.23, Tax Administrative Code – which established and provides for a B&O Tax in the City of Shoreline.

To incorporate changes required by two bills passed in the 2019 Legislative session, a work group of cities met over the past several months to update the B&O Tax Model Ordinance. Given these changes, SMC Chapter 3.22 and 3.23 must be amended. Proposed Ordinance No. 870, which Council discussed on November 4, 2019, would amend these Chapters of the SMC. Tonight, Council is scheduled to adopt proposed Ordinance No. 870.

RESOURCE/FINANCIAL IMPACT:

B&O Taxes are major revenue sources for a number of cities, including Shoreline, and comprise one of the four main revenue sources provided to cities by the state legislature (the other three being property taxes, sales taxes, and utility taxes). There is no financial impact associated with tonight’s action; however, implementation of the change to the apportionment formula for service income may impact the level of gross receipts a business may allocate to Shoreline.

RECOMMENDATION

Staff recommends that Council adopt Ordinance No. 870 amending SMC Chapters 3.22 and 3.23 to conform with the Association of Washington Cities’ Model Ordinance for Business & Occupation Tax.

Approved By: City Manager **DT** City Attorney **MK**

BACKGROUND

In 2003, the legislature passed a bill that required the Association of Washington Cities (AWC) to convene a committee to develop a model ordinance for all cities imposing a Business and Occupation (B&O) Tax. The legislature was concerned about the lack of uniformity of city B&O Tax ordinances and about the possibility that some business income was subject to multiple taxation. Since 2004, all cities imposing a B&O Tax have been required to follow the Washington State B&O Tax Model Ordinance procedures, which includes certain mandatory definitions, penalty and interest provisions, and payment periods. The B&O Model Ordinance cannot be updated more often than every four years. The last updates to the B&O Model Ordinance in 2012 were adopted by cities in 2013.

On December 4, 2017, the City Council adopted Ordinance No. 808, which created two new Chapters in the Shoreline Municipal Code - Chapter 3.22, Business & Occupation Tax and Chapter 3.23, Tax Administrative Code – which established a B&O Tax in the City of Shoreline. These code chapters reflect the updates to the model ordinance from 2013.

2019 Model Ordinance Update

Two bills were passed in the 2019 Legislative session regarding B&O Taxes: House Bill (HB) 1403 regarding service apportionment rules and HB 1059 regarding annual tax filers. A work group of cities, including Bellevue, Burien, Kent, Seattle, Shoreline, Snoqualmie, and Tacoma, met over the past several months to update the B&O Model Ordinance to incorporate changes required by HB 1403 and the Administrative Provisions to incorporate changes required by HB 1059. In addition, as part of the implementation of the change, a workgroup of city tax managers has drafted a proposed city Apportionment of Service Receipts Model Rule to assist in uniformity of implementation. The workgroup also solicited comments from the business community during two stakeholder meetings conducted in September and October 2019.

Given the apportionment changes to the 2019 B&O Model Ordinance, Shoreline Municipal Code (SMC) Chapter 3.22, Business & Occupation Tax (Attachment A – Exhibit A), must be amended to conform with the changes, as follows:

- *Service Apportionment Definition of Customer Location Hierarchy:* SMC Section 3.22.077, Allocation and apportionment of income when activities take place in more than one jurisdiction, adopts changes to service apportionment tests, definition of business activity tax, customer, and customer location, and alternative apportionment process effective January 1, 2020, as provided in HB 1403. The previous version defined “customer location” as where the majority of the “contacts” occurred between the business and the customer. The new definition establishes a hierarchy of factors, depending on whether the customer is residential or business.
- *Technical Changes:*
 - SMC 3.22.030: Makes technical corrections to titles and individual words.
 - SMC 3.22.090(H): Makes technical changes to update the RCW reference to the tax exemption for motor vehicle fuel.

In addition to the proposed changes to SMC Chapter 3.22, SMC Chapter 3.23, Tax Administrative Code (Attachment A – Exhibit B), must also be amended to conform with the 2019 Administrative Provision changes as follows:

- *Annual Tax Filing Deadline:* SMC 3.23.040, When due and payable – Reporting periods – Monthly, quarterly, and annual returns – Threshold provisions or relief from filing requirements – Computing time periods – Failure to file returns, includes language linking the change to April 15 for annual tax return filing by referencing RCW 82.32.045 effective January 1, 2021, as provided in HB 1059. Per Section 6 of Ordinance No. 870, this amendatory language is effective on January 1, 2021.
- *Definition of Engaging in Business:* The definition of “engaging in business” in SMC 3.23.030, Definitions, removes the section for contracting with the city to align with the model business license definition adopted by cities last year.

Any updates to mandatory provisions, other than those required by statute or otherwise noted, must be adopted with an effective date of January 1, 2020.

DISCUSSION

Proposed Ordinance No. 870 (Attachment A), which was discussed by Council on November 4, 2019, provides for these amendments to the State Model B&O Ordinance. The staff report for the November 4th Council discussion can be found at the following link:

<http://cosweb.ci.shoreline.wa.us/uploads/attachments/cck/council/staffreports/2019/staffreport110419-9a.pdf>.

During the November 4th Council discussion, Council did not have any specific questions or concerns with the proposed ordinance and directed staff to bring back proposed Ordinance No. 870 for adoption on a future consent calendar. Tonight, Council is scheduled to adopt proposed Ordinance No. 870.

RESOURCE/FINANCIAL IMPACT

B&O Taxes are major revenue sources for a number of cities, including Shoreline, and comprise one of the four main revenue sources provided to cities by the state legislature (the other three being property taxes, sales taxes, and utility taxes). There is no financial impact associated with tonight’s action; however, implementation of the change to the apportionment formula for service income may impact the level of gross receipts a business may allocate to Shoreline.

RECOMMENDATION

Staff recommends that Council adopt Ordinance No. 870 amending SMC Chapters 3.22 and 3.23 to conform with the Association of Washington Cities’ Model Ordinance for Business & Occupation Tax.

ATTACHMENTS

Attachment A: Proposed Ordinance No. 870

Attachment A, Exhibit A: SMC Chapter 3.22 – Business and Occupation Tax

Attachment A, Exhibit B: SMC Chapter 3.23 – Tax Administrative Code

ORDINANCE NO. 870

**AN ORDINANCE OF THE CITY OF SHORELINE, WASHINGTON
AMENDING SHORELINE MUNICIPAL CODE CHAPTER 3.22,
BUSINESS AND OCCUPATION TAX, AND CHAPTER 3.23, TAX
ADMINISTRATIVE CODE.**

WHEREAS, the City of Shoreline is a non-charter optional municipal code city as provided in Title 35A RCW, incorporated under the laws of the state of Washington; and

WHEREAS, on December 4, 2017, the City Council adopted Ordinance 808, establishing a Business and Occupation Tax applicable within the City; and

WHEREAS, pursuant to RCW 35.102.040, the City established SMC Chapters 3.22 and 3.23 consistent with the mandatory provisions of the model ordinances developed by Washington cities, through a work group established by the Association of Washington Cities (Model Ordinance Work Group), related to imposition and collection of such a tax; and

WHEREAS, during the 2019 Regular Session the Washington State Legislature adopted Substitute House Bill 1403, chapter 101, Laws of 2019, an act related to simplifying the administration of municipal business and occupation tax apportionment; and

WHEREAS, SHB 1403 seeks to simplify the administration by adopting a new sourcing hierarchy for the income factor, excluding services receipts from the income factor denominator attributable to jurisdictions where the taxpayer would not be subject to tax, and establishing guidelines for the application of an alternative apportionment method; and

WHEREAS, during the 2019 Regular Session the Washington State Legislature adopted Substitute House Bill 1059, chapter 63, Laws of 2019, an act extending the B&O tax return filing due date for annual filers; and

WHEREAS, SHB 1059 sets parameters for when the payment of B&O taxes, along with reports and returns, from annual filers is due; and

WHEREAS, the effective date of the amendatory language arising from SHB 1059 is January 1, 2021 and the effective date of the amendatory language arising from SHB 1403 is January 1, 2020; and

WHEREAS, the Model Ordinance Work Group has developed amendatory language for the model ordinances based on SHB 1403 and SHB 1059 and the City needs to amend SMC Chapters 3.22 and 3.23 to reflect this language;

**NOW THEREFORE, THE CITY COUNCIL OF THE CITY OF SHORELINE,
WASHINGTON DO ORDAIN AS FOLLOWS:**

Section 1. Amendment to Chapter 3.22 Business and Occupation Tax. SMC Chapter 3.22 Business and Occupation Tax is amended as set forth in Exhibit A to this Ordinance.

Section 2. Amendment to Chapter 3.23 Tax Administration. SMC Chapter 3.23 Tax Administrative Code is amended as set forth in Exhibit B to this Ordinance.

Section 3. Severability. Should any section, subsection, paragraph, sentence, clause, or phrase of this ordinance or its application to any person or situation be declared unconstitutional or invalid for any reason, such decision shall not affect the validity of the remaining portions of this Ordinance or its application to any person or situation.

Section 4. Corrections by City Clerk or Code Reviser. Upon approval of the City Attorney, the City Clerk and/or the Code Reviser are authorized to make necessary corrections to this Ordinance, including the corrections of scrivener or clerical errors; references to other local, state, or federal laws, codes, rules, or regulations; or ordinance numbering and section/subsection numbering and references.

Section 5. Publication and Effective Date. A summary of this Ordinance consisting of the title shall be published in the official newspaper.

- A. Section 1 of this Ordinance, amending SMC Chapter 3.22, shall take effect at 12:01 am January 1, 2020.
- B. Section 2 of this Ordinance, amending SMC Chapter 3.23, shall take effect at 12:01 am January 1, 2021.

PASSED BY THE CITY COUNCIL ON NOVEMBER 18, 2019

Mayor Will Hall

ATTEST:

APPROVED AS TO FORM:

Jessica Simulcik Smith
City Clerk

Margaret King
City Attorney

Date of Publication: , 2019
Effective Date: , 2019

ORDINANCE No. 870

Exhibit A

Amendments to SMC Chapter 3.22

SMC 3.22.030(E)(2) “E” Definitions is amended as follows:

2. “Engaging in business” means commencing, conducting, or continuing in business, and also the exercise of corporate or franchise powers, as well as liquidating a business when the liquidators thereof hold themselves out to the public as conducting such business.

a. The city expressly intends that “engaging in business” include any activity sufficient to establish nexus for purposes of applying the tax under the law and the constitutions of the United States and the state of Washington. Nexus is presumed to continue as long as the taxpayer benefits from the activity that constituted the original nexus-generating contact or subsequent contacts.

b. This subsection sets forth examples of activities that constitute engaging in business in the city, and establishes safe harbors for certain of those activities so that a person who meets the criteria may engage in de minimis business activities in the city without having to register and obtain a business license pursuant to SMC Title 5 or pay city business and occupation taxes. The activities listed in this subsection are illustrative only and are not intended to narrow the definition of “engaging in business” in this subsection. If an activity is not listed, whether it constitutes “engaging in business” in the city shall be determined by considering all the facts and circumstances and applicable law.

c. Without being all-inclusive, any one of the following activities conducted within the city by a person, or its employee, agent, representative, independent contractor, broker or another acting on its behalf, constitutes “engaging in business” and requires a person to register and obtain a business license pursuant to SMC Title 5:

i. Owning, renting, leasing, maintaining, or having the right to use, or using, tangible personal property, intangible personal property, or real property permanently or temporarily located in the city;

ii. Owning, renting, leasing, using, or maintaining an office, place of business, or other establishment in the city;

iii. Soliciting sales;

iv. Making repairs or providing maintenance or service to real or tangible personal property, including warranty work and property maintenance;

v. Providing technical assistance or service, including quality control, product inspections, warranty work, or similar services on or in connection with tangible personal property sold by the person or on its behalf;

vi. Installing, constructing, or supervising installation or construction of real or tangible personal property;

vii. Soliciting, negotiating, or approving franchise, license, or other similar agreements;

viii. Collecting current or delinquent accounts;

ix. Picking up and transporting tangible personal property, solid waste, construction debris, or excavated materials;

x. Providing disinfecting and pest control services, employment and labor pool services, home nursing care, janitorial services, appraising, landscape architectural services, security system services, surveying, and real estate services, including the listing of homes and managing real property;

xi. Rendering professional services such as those provided by accountants, architects, attorneys, auctioneers, consultants, engineers, professional athletes, barbers, baseball clubs and other sports organizations, chemists, psychologists, court reporters, dentists, doctors, detectives, laboratory operators, teachers, and veterinarians;

xii. Meeting with customers or potential customers, even when no sales or orders are solicited at the meetings;

xiii. Training or recruiting agents, representatives, independent contractors, brokers or others, domiciled or operating on a job in the city, acting on its behalf, or for customers or potential customers;

xiv. Investigating, resolving, or otherwise assisting in resolving customer complaints;

xv. In-store stocking or manipulating products or goods, sold to and owned by a customer, regardless of where sale and delivery of the goods took place;

xvi. Delivering goods in vehicles owned, rented, leased, used, or maintained by the person or another acting on its behalf; or

~~xvii. Accepting or executing a contract with the city, irrespective of whether goods or services are delivered within or without the city, or whether the person's office or place of business is within or without the city.~~

SMC 3.22.077 Allocation and apportionment of income when activities take place in more than one jurisdiction.

Gross income, other than persons subject to the provisions of Chapter 82.14A RCW, shall be allocated and apportioned as follows:

A. Gross income derived from all activities other than those taxed as service or royalties under SMC 3.22.050(A)(7) shall be allocated to the location where the activity takes place.

B. In the case of sales of tangible personal property, the activity takes place where delivery to the buyer occurs.

C. In the case of sales of digital products, the activity takes place where delivery to the buyer occurs. The delivery of digital products will be deemed to occur at:

1. The seller's place of business if the purchaser receives the digital product at the seller's place of business;

2. If not received at the seller's place of business, the location where the purchaser or the purchaser's donee, designated as such by the purchaser, receives the digital product, including the location indicated by instructions for delivery to the purchaser or donee, known to the seller;

3. If the location where the purchaser or the purchaser's donee receives the digital product is not known, the purchaser's address maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith;

4. If no address for the purchaser is maintained in the ordinary course of the seller's business, the purchaser's address obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith; and

5. If no address for the purchaser is obtained during the consummation of the sale, the address where the digital good or digital code is first made available for transmission by the seller or the address from which the digital automated service or service described in RCW 82.04.050(2)(g) or (6)(b) was provided, disregarding for these purposes any location that merely provided the digital transfer of the product sold.

D. If none of the methods in subsection C of this section for determining where the delivery of digital products occurs are available after a good faith effort by the taxpayer to apply the methods provided in subsections (C)(1) through (C)(5) of this section, then the city and the taxpayer may mutually agree to employ any other method to effectuate an equitable allocation of income from the sale of digital products. The taxpayer will be responsible for petitioning the city to use an alternative method under this subsection. The city may employ an alternative method for allocating the income from the sale of digital products if the methods provided in subsections (C)(1) through (C)(5) of this section are not available and the taxpayer and the city are unable to mutually agree on an alternative method to effectuate an equitable allocation of income from the sale of digital products.

E. For purposes of subsections (C)(1) through (C)(5) of this section, the following definitions apply:

1. “Digital automated services,” “digital codes,” and “digital goods” have the same meaning as in RCW 82.04.192;
2. “Digital products” means digital goods, digital codes, digital automated services, and the services described in RCW 82.04.050(2)(g) and (6)(c); and
3. “Receive” has the same meaning as in RCW 82.32.730.

F. Gross income derived from activities taxed as services and other activities taxed under SMC 3.22.050(A)(7) shall be apportioned to the city by multiplying apportionable income by a fraction, the numerator of which is the payroll factor plus the service-income factor and the denominator of which is two.

1. The payroll factor is a fraction, the numerator of which is the total amount paid in the city during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period. Compensation is paid in the city if:

a. The individual is primarily assigned within the city;

b. The individual is not primarily assigned to any place of business for the tax period and the employee performs 50 percent or more of his or her service for the tax period in the city; or

c. The individual is not primarily assigned to any place of business for the tax period, the individual does not perform 50 percent or more of his or her service in any city and the employee resides in the city.

2. The service-income factor is a fraction, the numerator of which is the total service income of the taxpayer in the city during the tax period, and the denominator of which is the total service income of the taxpayer everywhere during the tax period. Service income is in the city if the customer location is in the city.:

~~a. The customer location is in the city; or~~

~~b. The income-producing activity is performed in more than one location and a greater proportion of the service-income-producing activity is performed in the city than in any other location, based on costs of performance, and the taxpayer is not taxable at the customer location; or~~

~~c. The service-income-producing activity is performed within the city, and the taxpayer is not taxable in the customer location.~~

3. Gross income of the business from engaging in an apportionable activity must be excluded from the denominator of the service income factor if, in respect to such

activity, at least some of the activity is performed in the city, and the gross income is attributable under (2) of this subsection to a city or unincorporated area of a county within the United States or to a foreign country in which the taxpayer is not taxable. For purposes of this subsection (F)(3), “not taxable” means that the taxpayer is not subject to a business activities tax by that city or county within the United States or by that foreign country, except that a taxpayer is taxable in a city or county within the United States or in a foreign country in which it would be deemed to have a substantial nexus with the city or county within the United States or with the foreign country under the standards in RCW 35.102.050 regardless of whether that city or county within the United States or that foreign country imposes such a tax.

34. If the allocation and apportionment provisions of this subsection (F) do not fairly represent the extent of the taxpayer’s business activity in the city ~~or cities in which the taxpayer does business~~, the taxpayer may petition for or the tax administrators may jointly require, in respect to all or any part of the taxpayer’s business activity, ~~that one of the following methods be used jointly by the cities to allocate or apportion gross income~~, if reasonable:

- a. Separate accounting;
- b. ~~The use of a single factor~~ The exclusion of any one or more factors;
- c. The inclusion of one or more additional factors that will fairly represent the taxpayer’s business activity in the city; or
- d. The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer’s income.

5. The party petitioning for, or the tax administrator requiring, the use of any method to effectuate an equitable allocation and apportionment of the taxpayer’s income pursuant to subsection (4) of this subsection (F) must prove by a preponderance of the evidence:

- a. That the allocation and apportionment provisions of this subsection (F) do not fairly represent the extent of the taxpayer’s business activity in the city; and
- b. That the alternative to such provisions is reasonable.

The same burden of proof shall apply whether the taxpayer is petitioning for, or the tax administrator is requiring, the use of an alternative, reasonable method to effectuate an equitable allocation and apportionment of the taxpayer’s income.

6. If the tax administrator requires any method to effectuate an equitable allocation and apportionment of the taxpayer’s income, the tax administrator cannot impose any civil or criminal penalty with reference to the tax due that is attributable to

the taxpayer's reasonable reliance solely on the allocation and apportionment provisions of this subsection (F).

7. A taxpayer that has received written permission from the tax administrator to use a reasonable method to effectuate an equitable allocation and apportionment of the taxpayer's income shall not have that permission revoked with respect to transactions and activities that have already occurred unless there has been a material change in, or a material misrepresentation of, the facts provided by the taxpayer upon which the tax administrator reasonably relied in approving a reasonable alternative method.

G. The definitions in this subsection apply throughout this section:

1. "Apportionable income" means the gross income of the business taxable under the service classifications of a city's gross receipts tax, including income received from activities outside the city if the income would be taxable under the service classification if received from activities within the city, less any exemptions or deductions available.

2. "Business activities tax" means a tax measured by the amount of, or economic results of, business activity conducted in a city or county within the United States or within a foreign country. The term includes taxes measured in whole or in part on net income or gross income or receipts. "Business activities tax" does not include a sales tax, use tax, or a similar transaction tax, imposed on the sale or acquisition of goods or services, whether or not denominated a gross receipts tax or a tax imposed on the privilege of doing business.

23. "Compensation" means wages, salaries, commissions, and any other form of remuneration paid to individuals for personal services that are or would be included in the individual's gross income under the Federal Internal Revenue Code.

4. "Customer" means a person or entity to whom the taxpayer makes a sale or renders services or from whom the taxpayer otherwise receives gross income of the business.

35. "Customer location" means ~~the city or unincorporated area of a county where the majority of the contacts between the taxpayer and the customer take place.~~ the following:

a. For a customer not engaged in business, if the service requires the customer to be physically present, where the service is performed.

b. For a customer not engaged in business, if the service does not require the customer to be physically present:

(i) The customer's residence; or

(ii) If the customer's residence is not known, the customer's billing/mailling address.

c. For a customer engaged in business:

- (i) Where the services are ordered from;
- (ii) At the customer's billing/ mailing address if the location from which the services are ordered is not known; or
- (ii) At the customer's commercial domicile if none of the above are known.

4-6. "Individual" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee of that taxpayer.

5-7. "Primarily assigned" means the business location of the taxpayer where the individual performs his or her duties.

6-8. "Service-taxable income" or "service income" means gross income of the business subject to tax under either the service or royalty classification.

7-8. "Tax period" means the calendar year during which tax liability is accrued. If taxes are reported by a taxpayer on a basis more frequent than once per year, taxpayers shall calculate the factors for the previous calendar year for reporting in the current calendar year and correct the reporting for the previous year when the factors are calculated for that year, but not later than the end of the first quarter of the following year.

~~8. "Taxable in the customer location" means either that a taxpayer is subject to a gross receipts tax in the customer location for the privilege of doing business, or that the government where the customer is located has the authority to subject the taxpayer to gross receipts tax regardless of whether, in fact, the government does so.~~

H. Assignment or apportionment of revenue under this section shall be made in accordance with and in full compliance with the provisions of the Interstate Commerce Clause of the United States Constitution where applicable.

SMC 3.22.090 Exemptions.

Subsection 3.22.090(H) is amended as follows:

H. Amounts Derived from Manufacturing, Selling or Distributing Motor Vehicle Fuel. This chapter shall not apply to the manufacturing, selling, or distributing of motor vehicle fuel, as the term "motor vehicle fuel" is defined in RCW ~~82.36.010~~ 82.38.020 and exempt under RCW ~~82.36.440~~ 82.38.280; provided, that any fuel not subjected to the state fuel excise tax, or any other applicable deduction or exemption, will be taxable under this chapter.

ORDINANCE No. 870

Exhibit B

Amendments to SMC Chapter 3.23

SMC 3.23.040 When due and payable – Reporting periods – Monthly, quarterly, and annual returns – Threshold provisions or relief from filing requirements – Computing time periods – Failure to file returns.

Subsection SMC 3.23.040(A) is amended as follows:

A. Other than any annual license fee pursuant to SMC Title 5, the tax imposed by Chapters 3.22, 3.30, and 3.32 SMC, and any other applicable chapters or sections, shall be due and payable in quarterly installments. At the director's discretion, businesses may be assigned to a monthly, annual, or active nonreporter reporting period depending on the tax amount owing or type of tax. Tax payments are due on or before ~~the last day of the next month following the end of the assigned reporting period covered by the return~~ the time as provided in RCW 82.32.045(1), (2), and (3).

*****Note to Code Revisor: Per Section 6 of Ordinance 870, this amendatory language is effective at 12:01 am on January 1, 2021.**