

A Revenue Guide

for Washington Cities and Towns



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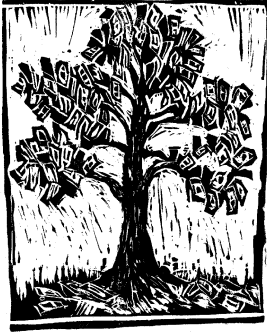
for Washington Cities and Towns

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Preface

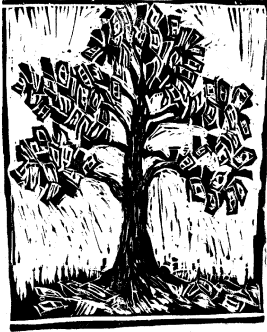
This new edition of *A Revenue Guide for Washington Cities and Towns*, first published in 1992, contains up-to-date information on the major revenue sources (and many of the minor ones) available to cities and towns for general government purposes, including the relevant statutory references and important court decisions. You will also find answers to frequently asked questions, such as:

- "What is the 106 percent lid and how was it affected by the passage of Referendum 47?"
- How can we spend real estate excise tax receipts?
- Can we give hotel-motel tax funds to a non-profit museum?
- How does sales tax equalization work?

What you will **not** find is information on Initiative 695. For a discussion of the effect of this initiative, if passed, on city revenues, please refer to *Budget Suggestions for 2000*, Municipal Research & Services Center: Seattle, August 1999, pp. 45-49.

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Contents

Taxes	1
Property Taxes	1
The Regular Property Tax Levy	1
Why Doesn't Everyone Levy the Maximum Amount?	
Referendum 47 and the 106 Percent Lid	2
You Don't Lose It If You Don't Use It – How This Works	
for Cities with a Population Under 10,000	4
You Don't Lose It If You Don't Use It – Referendum 47 and How This	
Works for Cities with a Population of 10,000 or More	4
What Happened to the Provision of Referendum 47 That Would Have	
Phased in Large Increases in Assessed Valuation?	5
Property Taxes and Budgets	5
Excess Levies for General Government Purposes – Levy Lid Lift	6
Excess Levies for General Government Purposes – One Year Levy	6
Receipt of Funds	7
Retail Sales and Use Tax	7
What's the City Rate?	7
In My City, I Pay 8.1 Percent. If Cities Get Only .85 Percent,	
Who Gets the Rest?	8
What Items Are Taxed?	9
Who Has to Pay a Use Tax?	9
Timing of Receipts	10
General Business and Occupation Taxes and Business Licenses	11
General Business and Occupation Taxes	11
Regulatory License Fees	12
Revenue-Generating Regulatory Licenses	13
Utility Business and Occupation Taxes	13
What Are the Limits on the Tax Rate?	13
What Do We Need to Do to Change a Rate?	14
Looking Ahead	15
Emergency Medical Services	15
Real Estate Excise Tax	16
How Can the First Quarter Percent – REET 1 – Be Spent?	16
Spending the Second Quarter Percent – REET 2	18

Contents continued

What's This Other One-Half Percent Real Estate Excise Tax?	18
Accounting for These Funds	18
Hotel-Motel Tax	18
What Are the Tax Rates?	19
City or County Tax?	20
How Can the Revenues Be Used?	20
Lodging Tax Advisory Committee	21
Gambling Tax	23
How Can We Spend the Proceeds?	23
Leasehold Excise Tax	23
Use Tax on Brokered Natural Gas	24
Ambulance Taxes	24
Admission Tax	24
State-Shared Revenues	27
Sales and Use Tax Equalization	27
Demystifying the Sales Tax Equalization Calculations	28
A Warning about Changes in Your Yearly Sales Tax Receipts and Their Effect on Equalization	29
Motor Vehicle and Camper Excise Taxes	30
Liquor Receipts – Profits and Taxes	30
Motor Vehicle Fuel Excise Tax – Gas Tax	31
Capron Refunds	31
Fire Insurance Premium Tax	32
Criminal Justice Revenues	33
Funds Distributed under RCW 82.14.320 – “High Crime”	33
Funds Distributed under RCW 82.14.330 – Population, High Violent Crime, and CTED Programs	34
Optional .1 Percent Sales Taxes	34
Spending Limitations on These Funds	35

Contents continued

Transportation Revenues	37
Local Option Motor Vehicle Fuel Excise Tax	37
Local Option Vehicle License Fee	38
Commercial Parking Tax	38
Where is the Discussion of the Street Utility?	38
How Can the Funds Be Used?	39
Other Revenue Sources	41
Franchise Fees	41
Transfer of Funds from Municipally Owned Utilities	41
Transfer of Funds from the LID Guaranty Fund	42
Interest on Investments	42
Traffic and Parking Fines	42
Parking Meters	43
Other Fees and Charges	43
Appendix	45

Taxes



"Everyone dislikes the property tax until the alternatives are considered."

Diane Paul

Property Taxes

One longtime legislative analyst from Olympia says that the Washington property tax is the most complicated in the nation. We plan to limit this discussion to what officials and staff in cities¹ really need to know. Even that is pretty complicated.

•The Regular Property Tax Levy

The maximum regular property tax levy for most cities is \$3.375 per thousand dollars assessed valuation (AV).² Some cities have a Firemen's Pension Fund. (If you do not know whether you have one, you probably do not.) Those cities can levy an additional \$0.225 per thousand dollars assessed valuation, resulting in a maximum levy of \$3.60 per thousand dollars AV.³ For cities that belong to a fire district and/or a library district, the rules are a little more complicated. Nominally they have a maximum rate of \$3.60 per thousand dollars AV. But, they can never collect that much because the levy of the special districts must be subtracted from that amount.⁴ The library district levy has a maximum rate of \$.50 per thousand dollars AV⁵ and the fire district levy can be as high as \$1.50.⁶ Therefore, if a city belongs to both a fire district and a library district, and if these districts are currently levying their maximum amount, then the local levy can be no higher than \$1.60 ($\$3.60 - .50 - 1.50 = \1.60).

If, for some reason, one (or both) of the special districts is not currently levying the maximum amount, the city's current levy could be higher. Assume that the fire district is only levying \$1.00 per thousand dollars AV. The maximum city levy would be $\$3.60 - 1.00 - .50 = \2.10 . But, if the fire district raises its levy in the future, then the city must reduce its levy by the same amount so that the total is never above \$3.60. Such a forced reduction can cause fiscal problems if it is not anticipated. If no one in your city hall knows what the special districts are currently levying, your county assessor can help you.

¹Throughout this publication, the words "city" or "cities" is used rather than the phrases "city and town" or "cities and towns." Unless otherwise noted, everything said about cities also applies to towns.

²RCW 84.52.043(1)(d).

³RCW 41.16.060.

⁴RCW 27.12.390 and RCW 52.04.081.

⁵RCW 27.12.050.

⁶RCW 52.16.130, RCW 52.16.140, and RCW 52.16.160 each provide for a levy of \$.50 per thousand dollars AV.

•Why Doesn't Everyone Levy the Maximum Amount? Referendum 47 and the 106 Percent Lid

If discussion of any tax law makes most people's eyes glaze over, discussion of the 106 percent lid puts people to sleep. In 1973, the legislature responded to people's concerns that property taxes were rising too fast by passing a law that established the 106 percent lid. What the 106 percent lid rule said was that your tax levy next year could be no more than 106 percent of your highest levy, beginning with the 1985 levy for 1986 taxes.⁷ An alternative way of stating it is to say that your levy could not increase by more than six percent.

In November 1997, the voters approved Referendum 47, which put some new constraints on the allowable levy increase for some cities.⁸ Cities with **a population of 10,000 or more** may only increase their levy by the rate of "inflation" or six percent, whichever is less.⁹ "Inflation" is defined as the increase in the implicit price deflator for personal consumption expenditures for the twelve-month period ending in July as published in the September issue of the *Survey of Current Business*, a publication of the Bureau of Economic Analysis of the federal Department of Commerce.¹⁰ An exception is made if the city legislative body makes a finding of "substantial need" in an ordinance or resolution that is passed by a majority plus one of the council or two out of three commissioners.¹¹

Cities with a population of less than 10,000 are not subject to this constraint. They may still increase their levy by six percent (assuming this does not put them above their maximum tax rate) with a simple majority vote.¹²

Taxes on new construction, changes in value of state-assessed utility property, and newly annexed property (hereafter referred to as "add-ons") are exempted from the lid/limit factor for cities of any size and may be added to the tax levy that is requested under the lid/limit factor.¹³

The easiest way to see what these lids mean in practice is to think of how a property tax levy is determined. The example below will use the 106 percent lid. If your city plans on limiting its levy increase to the growth in the implicit price deflator or some amount other than six percent, substitute that number for six percent in the example. Just remember that the sum of the percentage changes in assessed valuation and the tax rate must add up to the percentage change you have chosen for your levy increase on the right-hand side of the equation.

⁷WAC 458-19-020. RCW 84.55.010, which this WAC references, refers to "the three most recent years," rather than 1986. However, this WAC also references RCW 84.55.092, which includes the language "for taxes due in prior years, beginning with 1986." The Department of Revenue believes that the intent of the legislature was to have the dates in RCW 84.55.010 and RCW 84.55.092 be consistent, and they have written the rules on this basis. Practically, this is unlikely to become an issue since the highest levy for most taxing districts will be one of the last three years.

Note that although some people use the terms "tax **levy**" and "tax **revenue**" interchangeably, they are not quite the same. A levy is the amount you ask the assessor to collect. Revenue is the amount that is actually received. If any taxpayers are delinquent, the revenue received will be less than the levy.

⁸The legislature passed ch. 3, Laws of 1997, and sent Referendum 47 to the voters. Note that this referendum applies to all taxing jurisdictions, not only to cities.

⁹RCW 84.55.005(2)(c).

¹⁰RCW 84.55.005(1).

¹¹RCW 84.55.0101. Note that the term "substantial need" is not defined in the statutes.

¹²RCW 84.55.005(2)(a).

¹³RCW 84.55.010. Note that the statute does not mention the value of property that is annexed, but it too is exempt from this provision. WAC 458-19-035.

Your tax levy is a function of the following formula:

Assessed valuation/1,000 times tax rate equals tax levy

(We have to divide the assessed valuation by 1,000 before multiplying it by the tax rate because that rate is not applied to each dollar of assessed valuation, but to each one thousand dollars.)

To see how the 106 percent lid works, let's look at five cases. (In each case, we assume that your current year's levy is the highest since your city's 1986 levy.)

1. Assume that for next year your assessed valuation increases by exactly six percent. That means that at your current rate, your tax levy next year will be six percent higher. That is the maximum increase allowed and the county assessor will keep your rate constant.

$$\begin{array}{rcccl} & 6\% \uparrow & & 0\% & & 6\% \uparrow \\ & \text{AV}/1,000 & \times & \text{tax rate} & = & \text{tax levy} \end{array}$$

2. Assume that your assessed valuation does not increase at all. To get the allowable six percent increase in your levy, the county assessor will increase your tax rate by six percent if that does not put your rate over your statutory limit. If it does, the assessor will raise your rate to your statutory limit, but the increase will be less than six percent.

$$\begin{array}{rcccl} & 0\% & & 6\% \uparrow & & 6\% \uparrow \\ & \text{AV}/1,000 & \times & \text{tax rate} & = & \text{tax levy} \end{array}$$

3. Assume your assessed valuation goes up by four percent. Then the county assessor will increase your rate by two percent (again, as long as that does not put you over the maximum levy rate) and the combination of the four percent and two percent increases will give you a six percent increase in your levy.

$$\begin{array}{rcccl} & 4\% \uparrow & & 2\% \uparrow & & 6\% \uparrow \\ & \text{AV}/1,000 & \times & \text{tax rate} & = & \text{tax levy} \end{array}$$

4. Assume that your assessed valuation increases by more than six percent, say, eight percent. Then the county assessor will lower your rate by two percent so that the combination of the increase and decrease yield a six percent increase in your levy.

$$\begin{array}{rcccl} & 8\% \uparrow & & -2\% \downarrow & & 6\% \uparrow \\ & \text{AV}/1,000 & \times & \text{tax rate} & = & \text{tax levy} \end{array}$$

5. For the last case, assume that your AV has fallen, say by three percent. In this case the assessor will increase your rate by nine percent (assuming that does not put you over the statutory limit) to provide the six percent increase in your levy.

$$\begin{array}{rcccl} -3\% \downarrow & & 9\% \uparrow & & 6\% \uparrow \\ \text{AV}/1,000 & \times & \text{tax rate} & = & \text{tax levy} \end{array}$$

So how does this work with cities that are already at their statutory limit? Since the tax rate cannot be increased, their tax levies will increase only by the amount of the increase in their assessed valuation.

•You Don't Lose It If You Don't Use It – How This Works for Cities with a Population Under 10,000

Prior to 1986, cities had an incentive to raise their tax levies by the maximum amount allowed, even if they did not need the revenue that year. If they did not levy the maximum amount, they would suffer adverse consequences by not having that levy capacity in the future. Now cities can levy less than the maximum and then make it up in a future year.¹⁴ Here are two examples. Assume that for this year you had the assessor set a tax rate that resulted in the same levy as last year plus "add-ons." (You did not take your allowable six percent increase.) When you are doing your budget for next year, however, you realize that you need more revenue from the property tax because your sales tax receipts have fallen off. You can ask the assessor to set a tax rate for next year (assuming that it does not put you over your statutory limit) that raises your levy by six percent and then six percent again – $1.06 \times 1.06 = 1.1236$ – for a compounded increase of over 12 percent.

Now, a more complicated case where a city actually lowers its tax rate. Assume that during the current year (1999), your city has experienced a revenue windfall and has more money than it needs to fund the 2000 budget. (It could happen.) You could put the excess funds in a contingency fund or a "rainy day" fund, but the city council decides to give the taxpayers a break by lowering the property tax for 2000. During 2000 you receive no revenue windfall and you need more property tax revenue for the year 2001 budget. Before 1986, your maximum levy for 2001 would have been the amount you **actually** levied in 2000 plus an additional six percent under the 106 percent lid. (In this example, we are assuming that levy would have been the highest since 1986.) The 1986 act, however, allows you to levy the amount that you **could have** levied in 2000 plus an additional six percent unless that puts you over the maximum statutory rate. In 2000 you didn't use your maximum taxing capacity, but you didn't lose it. Note that cities under 10,000 need take no special action to "bank" this unused capacity.

•You Don't Lose It If You Don't Use It – Referendum 47 and How This Works for Cities with a Population of 10,000 or More

Although Referendum 47 did not amend RCW 84.55.092 (the "You Don't Lose It If You Don't Use It" statute), it did affect the way it is applied in cities with a population of 10,000 or more. The amount of levy capacity a city can protect is the difference between the maximum amount it could have levied under the law and the amount it actually levies. So, what is that maximum amount for

¹⁴RCW 84.55.092.

cities with a population of 10,000 or more? Is it the amount the city may levy with a simple majority vote of the council – an increase at the rate of growth of the implicit price deflator plus taxes from "add-ons?" Or, is it the amount the city could levy upon a finding of substantial need with a vote of a majority plus one – six percent plus "add-ons?"

The Department of Revenue made a ruling on this matter in October 1998,¹⁵ splitting the "baby down the middle," according to one commentator. If a city passes an ordinance or a resolution with a majority plus one¹⁶ finding "future substantial need," then the county assessor will protect the difference between what the city could have levied at six percent¹⁷ and the amount it actually levies. However, this affirmative act on the part of the city is required. For cities under 10,000, the assessor "banks" this capacity automatically. If a city with a population of 10,000 or more does not pass such an ordinance or resolution, then only the difference between what the levy could have been using the growth rate of the implicit price deflator plus "add-ons" and what was actually levied will automatically be protected.

•What Happened to the Provision of Referendum 47 That Would Have Phased in Large Increases in Assessed Valuation?

Property owners who had experienced large increases in assessed valuation in recent years found this feature of Referendum 47 very attractive.¹⁸ The actual mechanism proposed for this phasing in was rather complicated. But, it essentially would have meant that certain property owners would not have had to pay taxes on their full assessed valuations for a period of up to four years. The state supreme court found that this section of Referendum 47 violated article 7, section 1 of the state constitution.¹⁹ This section of the constitution requires that all taxes on the same class of property be uniform. This means there must be equality in valuing the property taxed as well as equal tax rates.

•Property Taxes and Budgets

A city must undertake a number of actions regarding property taxes at budget time. It must hold a public hearing on revenue sources for its general fund or current expense budget, discussing any possible property tax increases.²⁰ The statutes do not prescribe any specific notice requirements, so the city should follow its own procedures for giving notice of this hearing.

No property tax increase, other than that arising from new construction, any increase in the value of state-assessed utility property, or annexations, may be authorized without the passage of an ordinance or resolution that states the increase both in dollar and percentage terms.²¹ The City of Seattle and towns must pass a property tax levy ordinance and file it with the county by November 30.²² All other cities must certify their levies to the county by November 15.²³ Finally,

¹⁵Memorandum on "Levy Capacity of Taxing Districts" from Sandra G. Guilfoil, Assistant Director, Property Tax Division, Department of Revenue, to All Interested Parties, dated October 9, 1998.

¹⁶Or two out of three commissioners.

¹⁷Note that if an increase of six percent would put the city over its statutory limit, then it can only find a "future substantial need" for some lesser amount.

¹⁸Ch. 3, Laws of 1997, §105.

¹⁹*Belas v. Kiga*, 135 Wn.2d 913 (1998).

²⁰RCW 84.55.120.

²¹*Id.* and ch. 3, Laws of 1997, §209.

²²RCW 84.52.070.

²³RCW 84.52.020.

if a city with a population of 10,000 or more is going to make a finding of substantial need or future substantial need to preserve its levy capacity, it must pass an ordinance or resolution to that effect.²⁴

MRSC is often asked how many ordinances or resolutions a city really needs to carry out these actions. As before the passage of Referendum 47, a city must have an ordinance (not a resolution) that actually sets the property tax levy. Section 209²⁵ of Referendum 47, which requires that any tax increase be set out in dollars and percent, refers to a **separate** ordinance or resolution, and the Department of Revenue October 1998 memo repeats this language.²⁶ So, it appears that at least two ordinances, or an ordinance and a resolution, are necessary.

Although section 204²⁷ of Referendum 47 says that a finding of substantial need (or future substantial need per the Department of Revenue memo) must be done by ordinance or resolution, it does not use the word "separate." Presumably this means that this ordinance or resolution could be combined with one of the other two. Doing so would mean that a city council would have to pass the combination by a majority plus one. Any action needs the vote of two commissioners. Take any variation you can think of and we have seen some city using it. Presumably, the county assessors to whom these ordinances and resolutions were submitted found them acceptable. However, they may not be acceptable to other county assessors. Cities should check with their assessors if they have questions.

● **Excess Levies for General Government Purposes – Levy Lid Lift**

Cities that are levying property taxes at a rate lower than the statutory maximum can ask the voters to lift the levy lid by more than six percent. A simple majority vote is required.²⁸ For example, assume that your statutory maximum rate is \$3.375 per thousand dollars assessed valuation and that your rate next year under the 106 percent lid will be \$3.00. You can place a proposition before the voters to raise your levy by all or part of your remaining \$0.375 capacity. The proposition can limit the period for which the levy is made, but it need not do so.²⁹ And it can limit the purpose for which the funds will be spent, but this is not a requirement.³⁰ Of course, voters may be more likely to vote affirmatively if the period of time is limited and the purpose stated.

● **Excess Levies for General Government Purposes – One Year Levy**

Even cities that are currently levying their statutory maximum rate can ask the voters to raise their rate for one year.³¹ Many cities refer to this levy as an O and M (operations and maintenance) levy. There are two different scenarios for voter approval. If at least 60 percent of the voters vote "yes" with a voter turnout of more than 40 percent of the number of people voting in the last general election, the measure is passed. However, if the voter turnout is 40 percent or less of the number voting in the last general election, all is not lost. In that case, as long as the number of "yes" votes

²⁴RCW 84.55.0101 and ch. 3, Laws of 1997, §204. See also the Department of Revenue memo cited in footnote 15.

²⁵RCW 84.55.120.

²⁶See first line of first complete paragraph on page 3.

²⁷RCW 84.55.0101.

²⁸RCW 84.55.050(1).

²⁹RCW 84.55.050(3)(a). If the funds are going to be used to redeem debt, the maximum length of the levy is nine years. RCW 84.55.050(3)(b).

³⁰RCW 84.55.050(3)(b).

³¹RCW 84.52.052.

is equal to at least 60 percent times 40 percent of the number of people voting in the last general election, the measure will pass. If, for example, 1,000 people voted in the last general election, as long as at least 240 ($1,000 \times .4 = 400$; $400 \times .6 = 240$) people vote "yes" on the O and M levy, it will pass even if the number voting is less than 400 (40 percent of those voting in the last general election).³²

As with the levy lid lift, the purpose for which the money will be used does not need to be specified. However, it is not fiscally prudent to build an annual budget that assumes that the voters will renew the levy authority each year. A good use of these funds would be for a one-time expenditure.

•Receipt of Funds

Property taxes are due on April 30 and October 31.³³ This means that cities receive the bulk of their property tax revenue in May and June and in November and December. In some counties, the assessor transfers the city share of the revenue received on a daily basis. In other counties, the assessor makes the transfer on the 10th day of the month, paying interest on the balances it has held until that time.³⁴

Retail Sales and Use Tax³⁵

•What's the City Rate?

In 1970, the legislature granted cities and counties the right to tax retail sales at a rate of .5 percent.³⁶ The same legislation allocated 15 percent of the tax collected within cities to their respective counties.³⁷ In effect, this dropped the city rate to .425 percent. During the 1982 legislative session, another half penny of optional taxing authority was added making the potential local rate one percent.³⁸ As before, however, the legislature allocated 15 percent of this additional sales tax collected in each city to the county. For the county to fully share in a city's optional tax, however, it has to impose the optional tax in the unincorporated areas at a rate equal to that in the city.³⁹ If both a city and the county are levying the entire .5 percent optional tax, the effective city rate falls by 15 percent, leaving it with a net of .425 percent. This makes the maximum effective city rate equal to .425 percent plus .425 percent for a total of .850 percent, less a one percent administrative fee that the Department of Revenue charges.⁴⁰

³²RCW 84.52.052 and art. 7, §2(a) of the state constitution. Note that an easy way to express this alternative for voter approval is to say that when voter turnout is less than 40 percent of the voter turnout at the last general election, the "yes" votes must be at least 24 percent (240/1000) of the voter turnout at the last general election in order for the measure to pass.

³³RCW 84.56.020.

³⁴See RCW 84.56.230, RCW 36.29.110, and *Seattle v. King County*, 52 Wn. App. 628 (1988), *rev. denied*, 112 Wn.2d 1002 (1989) (Cities entitled to interest accumulated on tax collection prior to distribution).

³⁵In this section, "sales tax" refers to "sales and use tax" unless otherwise noted.

³⁶Ch. 94, Laws of 1970, 1st ex. sess., and RCW 82.14.030(1).

³⁷RCW 82.14.030(1).

³⁸RCW 82.14.030(2).

³⁹RCW 82.14.030(2).

⁴⁰RCW 82.14.050. Another example would be the case where the county is levying part of the optional tax, but at a lower rate than the city. For example, assume that the city is levying the entire optional tax and the county is levying .3 percent of the optional tax. The effective city rate on the optional tax would be .3 percent \times .85 = .255 percent (because the county gets 15 percent of this piece of the optional tax) plus .2 percent for a total optional tax of .455

At the time of this writing, 36 of 39 counties are levying the full penny, as are 267 of 278 cities.⁴¹ Two cities are levying a portion of the extra half cent. This optional tax may be imposed by a majority vote of the city's legislative body, but it is subject to a referendum.⁴² This referendum process applies to such an action even if the initiative and referendum procedures are not otherwise available to your city.

•In My City, I Pay 8.1 Percent. If Cities Get Only .85 Percent, Who Gets the Rest?

Up until the 1990 legislative session, the maximum possible total sales tax rate paid by purchasers in cities was 8.1 percent. This breaks down as follows: state, 6.5 cents on the dollar; counties, .15 cents; cities, .85 cents; and transit districts, a maximum of .6 cents. The Local Criminal Justice Fiscal Assistance Act added another one percent of taxing authority, providing a potential rate of 9.1 percent.⁴³ However, this additional taxing authority may be levied only for criminal justice purposes (at a maximum rate of .1 percent) or high capacity transit purposes.⁴⁴

In succeeding years, the legislature granted more optional sales tax authority to counties. If your county takes advantage of this additional authority, those making purchases in your city will pay a higher sales tax. For example, RCW 82.14.350 allows the legislative body in counties with populations of less than one million to send to the voters a proposal to increase the sales tax by .1 percent to construct, remodel, and operate jails and juvenile detention facilities. A simple majority vote is required.⁴⁵ A county may also ask the voters to approve a sales tax of .1 percent to provide funds for sports facilities, entertainment facilities, and convention facilities in a public facilities district.⁴⁶

percent. Adding this to the .425 percent that the city nets from the first half cent of the sales tax gives a total effective rate of .880 percent, less the state administrative fee.

⁴¹The City of Sammamish will levy the full cent when it incorporates in August 1999.

⁴²RCW 82.14.036. This referendum procedure must specify that a petition may be filed within seven days of the passage of the ordinance with the filing officer. 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 general election or at a special election. The election must take place no more than 120 days after the signed petition has been filed.

⁴³Ch.1, Laws of 1990, 2nd ex. sess., §901 and 902, as amended by ch. 21, Laws of 1993, 1st sp. sess., §6, and RCW 82.14.340 and RCW 81.104.170.

⁴⁴See page 34 for a discussion of the criminal justice sales tax and footnote 186. Currently, a .4 percent sales tax for high capacity transportation systems is levied by the Regional Transit Authority in portions of King, Pierce, and Snohomish counties. Adding in the .5 percent tax for the Mariners stadium, which is levied on food and beverages sold by restaurants, taverns, and bars in King County, means that consumers in those facilities are paying a sales tax of 9.1 percent. There is also a .017 tax on all taxable sales in King County for the baseball stadium and a .016 percent tax for the football stadium. These taxes are credited against the 6.5 percent state sales tax.

⁴⁵Ch. 10, Laws of 1995, 2nd sp. sess.

⁴⁶RCW 82.14.048. See ch. 36.100 RCW for information on county public facilities districts.

The 1999 legislature passed legislation that authorizes a county to ask the voters to raise the sales tax for the public facilities district to .2 percent beginning August 1, 2000. Ch. 165, Laws of 1999, §12. This same legislation allows a city or a group of contiguous cities to form a public facilities district to construct or remodel a convention, conference, or special events center. A .2 percent sales tax is authorized with voter approval beginning August 1, 2000. Ch. 165, Laws of 1999, §12.

•What Items Are Taxed?

The taxable base includes most retail sales of personal property to state residents. Of the various items that are exempted from the tax,⁴⁷ the most visible to consumers are food products consumed off the premises (most groceries are not taxed, but food and drink in a restaurant are)⁴⁸ and prescription drugs.⁴⁹ There have been two times when all food was taxed. Food was in the tax base from 1971, when the cities received their initial taxing authority, until July 1, 1978, when an initiative that had been approved by the voters to exempt food went into effect. Responding to the recession in the early 1980s, the legislature temporarily reimposed the tax on food from May 1982 through June 1983.

During the 1995, 1996, and 1997 legislative sessions, the legislature passed bills that created new sales tax exemptions. In 1995, machinery and equipment used by a manufacturer or a processor directly in a manufacturing operation were made exempt from the sales tax. The labor and services used to install the equipment was also made exempt.⁵⁰ The exemptions were extended in 1996 to charges for maintaining and repairing the machinery and equipment and replacing equipment.⁵¹ Equipment used in research and development, not just in manufacturing operations, was included.⁵² Legislation in 1997 provided a rebate of the state portion of the sales tax for large warehouses and grain elevators, but the cities' share of the tax was not affected.⁵³

Sales tax exemptions that may be of particular interest to cities are those for copying public records⁵⁴ (not a big ticket item, but a nuisance when cities had to collect and remit taxes on copies) and labor and services on street projects.⁵⁵

Note that services to persons and businesses – things like haircuts, doctors' bills, consultants' fees, etc. – are not "personal property," and most are not subject to the sales tax. However, during the 1993 legislative session, the sales tax was extended to some services. They include, after several amendments: hotel and motel coin-operated laundries; landscape services; health club services; tanning services; tattoo parlor services; massage, steam or Turkish bath services; dating and escort services; ticket broker services; and tour guide services.⁵⁶

•Who Has to Pay a Use Tax?

If purchases are made out-of-state by a Washington resident and the sales tax paid out-of-state is less than the rate being levied in the resident's city, state law requires that a use tax be calculated and paid to make up the difference.⁵⁷ For example, if you buy some clothes in Idaho, where the sales tax rate is five percent, and the tax rate in your city is 7.6 percent, you owe a use tax of 2.6 percent on the purchase price. In practice, most people do not pay a use tax on out-of-

⁴⁷The exemptions are listed in RCW 82.08.0251 through RCW 82.08.036.

⁴⁸RCW 82.08.0293.

⁴⁹RCW 82.08.0281.

⁵⁰Ch. 3, 1st sp. sess., Laws of 1995, and RCW 82.08.02565.

⁵¹Ch. 173, Laws of 1996, and RCW 82.08.02565.

⁵²Ch. 247, Laws of 1996, and RCW 82.08.02565.

⁵³Ch. 450, Laws of 1997, and RCW 82.08.820.

⁵⁴RCW 82.08.2525.

⁵⁵RCW 82.04.050(7). See also WAC 458-20-171.

⁵⁶Ch. 25, Laws of 1993, 1st sp. sess., amended by RCW 82.04.050 to define these services as a retail sale. See RCW 82.04.050(3)(e) through (h). RCW 82.04.050(2)(a) was amended to remove a tax exemption for coin-operated laundries.

⁵⁷See WAC 458-20-178(12).

state purchases except vehicles, where a use tax must be paid before they can be licensed. In 1992, the Supreme Court decided that Congress could pass legislation allowing states and local governments to tax mail order sales.⁵⁸ However, Congress has chosen not to do so. If a mail order firm has a retail outlet or other physical presence in a state, all mail order purchases made by customers in that state are taxed. Other purchases are not. For example, Washington residents pay sales tax on mail order purchases from Eddie Bauer, but not L.L. Bean. Potentially more damaging to cities' revenues are Internet sales. In passing the Internet Tax Freedom Act, Congress put a moratorium on new taxes on Internet purchases. This act did not affect existing sales taxes.

But, just as most citizens do not pay use taxes on mail order purchases, they also do not pay them on Internet purchases. Cities, however, must pay a use tax on any purchase on which they have not paid a sales tax, whether it was made by mail order or on the Internet,. The Department of Revenue does audits to ensure compliance. The use tax collected from residents in your jurisdiction is included in your monthly distribution.

•Timing of Receipts

Most retailers remit their sales taxes to the Department of Revenue by the 25th of each month for sales made during the prior month.⁵⁹ The department distributes that money to local governments on the last day of the following month after subtracting a small service charge.⁶⁰ This means that there is a minimum of a two- month lag between the time the taxes are collected by the retailer and they are received by the city. For example, tax on a purchase made on April 30 is sent to the Department of Revenue on or before May 25 and then is distributed to the city on June 30. The lag is more than two months for taxes collected earlier in April. Interest that is earned on these funds while they are in the hands of the state is paid to the local jurisdictions.⁶¹

⁵⁸*Quill Corporation v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992).

⁵⁹See RCW 82.08.060; WAC 458-20-228 and WAC 458-20-22801. The Department of Revenue can make administrative decisions to put smaller taxpayers on an annual or quarterly payment schedule.

⁶⁰RCW 82.14.050 - .060.

⁶¹RCW 82.14.050.

General Business and Occupation Taxes and Business Licenses⁶²

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. Commonly, cities follow state practice and put businesses in different classes such as manufacturing, wholesaling, retailing, and services. However, other classes may be chosen as long as they are "reasonable."⁶³ Within each class, the rate must be the same, but it may differ between classes. Note also, that all retail sales must be taxed at the same rate even if the city has established more than one class for retail sales.⁶⁴ According to a 1998 survey done by the Association of Washington Cities⁶⁵, 35 of Washington's 277 cities⁶⁶ reported that they levy such a tax.

Effective April 20, 1982, the legislature set the maximum tax rate that can be imposed by a city's legislative body at .2 percent (.002), but grandfathered in any higher rates that existed on January 1, 1982.⁶⁷ All ordinances that impose this tax for the first time or raise rates must provide for a

⁶²RCW 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 . . ."

⁶³See 9 McQuillin, *Municipal Corporations* §26.60 (3rd ed. rev. 1998).

⁶⁴RCW 35.21.710 which reads, in part:

Any city which imposes a license fee or tax upon business activities consisting of the making of retail sales of tangible personal property which are measured by gross receipts or gross income from such sales, shall impose such a tax at a single uniform rate upon all such business activities.

⁶⁵This survey is done annually and published in even-numbered years.

⁶⁶Kenmore, which incorporated on August 31, 1998, was not part of the survey. The City of Sammamish will incorporate on August 31, 1999, bringing the number of cities to 279.

⁶⁷RCW 35.21.710. This statute also has a provision that allows cities that had rate higher than .2 percent on January 1, 1982 to increase the rates 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.

referendum procedure.⁶⁸ Any city may levy a rate higher than .2 percent, if it is approved by a majority of the voters.⁶⁹

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 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. In 1989, the voters of Seattle supported a 12 percent⁷⁰ increase for law enforcement purposes.

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

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 costs of registering the firms and issuing the licenses, maintaining the files, and inspecting businesses to make certain that all have a license. The fees charged should be fair and bear a reasonable relation to costs.⁷¹ 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, if a computer is used to keep the records.

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.

⁶⁸RCW 35.21.706. The process is identical to that described for the optional sales tax in footnote 42, with the exception that the election does not have to take place within 120 days.

⁶⁹RCW 35.21.711.

⁷⁰That is 12 percent, **not** 12 percentage points. If the current rate is .001, a 12 percent increase would produce a new rate of .00112.

⁷¹See 9 McQuillin, *Municipal Corporations* §26.36 (3rd ed. rev. 1998); see, generally, *Patton v. Bellingham*, 179 Wash. 566 (1934), and *Homes Unlimited v. Seattle*, 90 Wn.2d 1544 (1978).

•Revenue-Generating Regulatory Licenses⁷²

Rather than charge a single flat fee to license all businesses, cities that license to generate revenue use a variety of criteria to separate businesses into different classes and then charge unique flat fees on each class.

For example, 30 of the 229 cities responding to this question in the 1998 Association of Washington Cities survey charge firms different fees, based on the number of people they employ. Seven cities charge different fees based solely on the type of business.⁷³ Three cities use the square footage of the establishment as the basis for their license fees.⁷⁴ Some cities combine two or three of the measures. Algona, for example, has a license that is based on number of employees and floor space over 3,000 square feet.⁷⁵ Bothell has a three part fee that combines the number of employees, type of business, and square footage.⁷⁶

The law allows for a good deal of creativity in designing these license fees. However, classes of businesses must be clearly defined, with each firm within each class being charged the same fee.⁷⁷

Utility Business and Occupation Taxes⁷⁸

Utility taxes may be levied on the gross operating revenues earned by private utilities from operations within the boundaries of a city and by a city's own municipal utilities.⁷⁹ Utilities on which taxes may be levied include electric, water, sewer, stormwater, gas, telephone, cable TV, and steam.

•What Are the Limits on the Tax Rate?

Legislation passed in 1982 limits the tax rate that a legislative body may impose on electric, gas, steam, and telephone utility services to six percent.⁸⁰ Cellular telephone and pager services may be taxed at the same rate as other telephone services.⁸¹ A city may ask the voters to approve a

⁷²Many 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.

⁷³They are Burlington, Ilwaco, Mabton, Mossyrock, Mount Vernon, Oak Harbor, and Pomeroy.

⁷⁴Kennewick, Pasco, and Sedro-Wooley.

⁷⁵City of Algona Municipal Code §2.50.080.

⁷⁶City of Bothell Resolution No. 1066.

⁷⁷See 9 McQuillin, *Municipal Corporations* §26.60 (3rd ed. rev.1998).

⁷⁸The statutory authority for utility taxes is found in the same places as that for business licenses and the general business and occupation taxes. See footnote 62.

⁷⁹Note that, at the present time, a city may levy taxes on any revenues earned from its operations outside the city limits. However, a city may **not** tax any income earned by another city's utility or a special district that operates within its boundaries. *King County v. Algona*, 101 Wn.2d 789 (1984). One exception is revenues from the sale of electricity in a city from a public utility district. RCW 54.28.070 allows such revenues to be taxed. No rate limit is given, but presumably the maximum limit for the tax (six percent) on other electricity providers applies.

⁸⁰RCW 35.21.870(1). Note that a utility tax may not be levied on interstate long distance service (RCW 35.21.714 and RCW 35A.82.060), but a service business and occupation tax may be levied (RCW 35.21.715 and RCW 35A.82.065).

⁸¹In *Western Telepage, Inc. v. City of Tacoma*, 95 Wn. App. 140 (1999), the Washington State Court of Appeals, Division II, found that one-way paging services fall within the statutory definition of "telephone business."

To tax cellular telephones and/or pager services, a city must take care with the definitions in its utility tax ordinance. The following definitions are currently recommended.

"Telephone business" means the business of providing access to a local telephone network,

rate of higher than six percent on these utilities. We know of at least four cities where such an increase has been approved for public safety purposes.⁸²

There are no restrictions on the tax rates for water, sewer, and stormwater utilities. The rate on cable TV is governed by the Cable Communications Policy Act of 1984.⁸³ It requires that the rate not be "unduly discriminatory against cable operators and subscribers." If a city has set all its tax rates at six percent, the rate on cable TV should probably be no higher than that. However, if rates on utilities other than electric, gas, or telephone are higher than six percent, an argument can be made that the tax on cable TV can be higher than six percent also without being "unduly discriminatory," because all the rates over which the jurisdiction's legislative body has control are higher than six percent.

•What Do We Need to Do to Change a Rate?

A city that imposes a tax for the first time or that increases a tax rate may be required to include a referendum clause in the ordinance. From its placement in the text, it is unclear whether RCW 35.21.706 (which very definitely requires a referendum clause for a gross receipts business and occupation tax) applies to utility taxes.⁸⁴ In response to inquiries, MRSC has suggested adoption of a cautious approach, recommending that referendum language be included in any increase to a utility tax. Nevertheless, we note that a number of cities have not included a referendum clause. A court decision or legislative amendment would clarify this matter.

local telephone network switching service, toll service, coin telephone services, telephonic, video, data, pagers, or similar communication, or transmission for hire, via a local telephone network, toll line or channel, cable, microwave, or similar communication or transmission system. The term includes cooperative or farmer line telephone companies or associations operating exchanges. "Telephone business" does not include the providing of competitive telephone service, or providing of cable television service, or other providing of broadcast services by radio or television stations.

"Competitive telephone service" means the providing by any person of telecommunications equipment or apparatus, directory advertising and lease of telephone street directories, or service related to that equipment or apparatus such as repair or maintenance service, if the equipment or apparatus is of a type which may be provided by persons not subject to regulation as telephone companies under Title 80 RCW, and for which a separate charge is made. Transmission of communication through cellular telephones is classified as "telephone business" rather than "competitive telephone service."

"Cellular telephone service" is a two-way voice and data telephone/telecommunications system based in whole or substantial part on wireless radio communications and which is not subject to regulation by the Washington Utilities and Transportation Commission (WUTC). This includes cellular mobile service. Cellular mobile service includes other wireless radio communications services such as specialized mobile radio (SMR), personal communications services (PCS), and any other evolving wireless radio communications technology which accomplishes the same purpose as cellular mobile service. Cellular telephone service is included within the definition of "telephone business" for the purposes of this chapter.

"Pager service" means service provided by means of an electronic device which has the ability to send or receive voice or digital messages transmitted through the local telephone network, via satellite or any other form of voice or data transmission.

⁸²RCW 35.21.870(1). In Pasco, voters approved higher rates for police purposes. The revenue from the voted tax increase in Richland is used for fire department operations. Kennewick has had a voted tax increase of 2.5 percent on electricity, natural gas, and telephone services since 1991. The revenue is used for police and fire department capital and operating needs. Toppenish increased rates by 2.5 percent for law enforcement purposes.

⁸³"Cable Communications Policy Act of 1984," §622(g)(2)(A) (47 U.S.C. §542(g)(2)(A)).

⁸⁴RCW 35.21.706, requiring the referendum procedure, immediately precedes RCW 35.21.710, providing for a limit on the general business and occupation gross receipts tax. The limitation placed on utility taxes in RCW 35.21.870 appears considerably later in the chapter.

Any tax changes for electric, telephone, and gas utilities cannot take effect until the end of sixty days.⁸⁵ If the utilities are private utilities, they need this time to apply to the Washington Utilities and Transportation Commission for a rate adjustment to reflect the tax change.

•Looking Ahead

During the next few years, city taxing authority for telecommunications and energy services will be changing and will undoubtedly look very different from what it is now. The tele-communications revolution means that new laws need to be developed to deal with all providers of these services, not just telephone companies. Telecommunications companies and cable television companies are beginning to offer similar services. Tax provisions that discriminate between them will need to be standardized. As electricity deregulation spreads, larger firms are purchasing power from outside the state and cities are losing utility tax on those revenues. A use tax, such as that levied on brokered natural gas, may be a solution.⁸⁶

Emergency Medical Services

All cities are allowed to ask the voters for authority to levy an additional property tax of up to 50 cents per thousand dollars of assessed valuation to support emergency medical services. The levy presented to the voters can be imposed for six years, ten years, or permanently.⁸⁷

There are two different scenarios for voter approval of this levy. If at least 60 percent of the voters vote "yes," with a voter turnout of more than 40 percent of the number of people voting in the last general election, the measure is passed. However, if the voter turnout is 40 percent or less of the number voting in the last general election, all is not lost. In that case, as long as the number of "yes" votes is equal to at least 60 percent times 40 percent of the number of people voting in the last general election, the measure will pass. If, for example, 1,000 people voted in the last general election, as long there is a majority "yes" vote of at least 240 ($1,000 \times .4 = 400$; $400 \times .6 = 240$), it will pass even if the number of people voting is less than 400 (40 percent of those voting in the last general election).⁸⁸

If a city imposes a permanent levy, it must account separately for the expenditure of the revenues.⁸⁹ In addition, a permanent levy is subject to a referendum **at any time**.⁹⁰ This provision means the "permanent" levy may not be permanent.

⁸⁵RCW 35.21.865.

⁸⁶See the discussion of brokered natural gas on page 24.

⁸⁷Ch. 224, Laws of 1999 and RCW 84.52.069(2). Note that under the prior legislation, the levy could be for a maximum of six years, but a city could choose to do it for less than six years. That is no longer an option.

⁸⁸*Id.* Note that an easy way to express this alternative for voter approval is to say that when voter turnout is less than 40 percent of the voter turnout at the last general election, the "yes" votes must be at least 24 percent ($240/1000$) of the voter turnout at the last general election in for the measure to pass.

⁸⁹Ch. 224, Laws of 1999, and RCW 84.52.069(3).

⁹⁰Ch. 224, Laws of 1999, and RCW 84.52.069(4). The standard referendum procedure (see footnote 42 for the sales tax) requires that a petition must be filed within **seven days** of the passage of the ordinance. Within ten days, the officer with whom the petition is filed must confer with the petitioner concerning the form and style of the petition and provide a ballot title. The petitioner has 30 days to gather valid signatures from at least 15 percent of the registered voters as of the last general election. If enough valid signatures are gathered, the referendum must be placed on the ballot at the next general election, if one is to be held within 180 days of the filing of the petition, or at a special election called for that purpose.

An EMS levy is a "regular property tax levy."⁹¹ As such, it is governed by RCW 84.55.010. After the initial levy is approved by the voters, cities with a population under 10,000 may increase the amount of the levy by a maximum of six percent a year plus an additional amount ("add-ons") from new construction, increases in state-assessed utility valuations, and annexations. Because of Referendum 47, cities with a population of 10,000 and over are limited each year to a levy increase that is no greater than the increase in the implicit price deflator for personal consumption expenditures, plus add-ons, unless the council makes a finding of "substantial need" with a majority plus one vote of the city council.⁹²

This levy is not subject to the limitation in RCW 84.52.043(2), which provides that the aggregate levies of special districts and the city and county shall not exceed \$5.90 per thousand dollars assessed valuation.⁹³ It is, however, subject to the constitutional provision that the aggregate of all regular property tax levies (except levies by ports) shall not exceed one percent of assessed value (\$10 per thousand dollars assessed valuation).⁹⁴

Real Estate Excise Tax

The real estate excise tax is levied on all sales of real estate, measured by the full selling price, including the amount of any liens, mortgages, and other debts given to secure the purchase.⁹⁵ The state levies this tax at the rate of 1.28 percent.⁹⁶ A locally-imposed tax is also authorized.⁹⁷ However, the rate at which it can be levied and the uses to which it may be put differs by city size and whether the city is planning under the Growth Management Act (GMA). All cities may levy a quarter percent tax (described as "the first quarter percent of the real estate excise tax" or "REET 1").⁹⁸ Cities that are planning under GMA have the authority to levy a second quarter percent tax (REET 2).⁹⁹ Note that this statute specifies that if the city is located in a county that is **required** to plan under GMA, the tax may be levied by a vote of the legislative body. If, however, the county **chooses** to plan under GMA, the tax must be approved by a majority of the voters.

•How Can the First Quarter Percent – REET 1 – Be Spent?

Cities That Are Not Planning Under GMA and Those That Are Planning But Have a Population Under 5,000. Both groups of entities have the same restrictions on their spending of REET 1 revenues. They must spend these funds for "for any capital purpose identified in a capital improvements plan and local capital improvements, including those listed in RCW 35.43.040."¹⁰⁰

⁹¹AGO 1993 No. 7.

⁹²Pages 2-5 contain an expanded discussion of levy limits under RCW 84.55.010 and Referendum 47. A vote of only two out of three commissioners is required.

⁹³RCW 84.52.069(5) and RCW 84.52.043(2)(d). RCW 84.52.010 sets out the order in which the special district levies get cut in the event that the aggregate rate exceeds \$5.90.

⁹⁴RCW 84.52.050 and art. 7, §2, of the Washington State Constitution. Note that excess levies for operations and maintenance (discussed on pages 6-7) are not subject to this one percent limit, nor are port district levies. RCW 84.52.052 and RCW 84.52.050.

⁹⁵RCW 82.46.010(5) and RCW 82.45.030. As with most taxes, there are some exemptions. Of interest to cities is the provision that sales **by** cities are exempt from the tax, but sales **to** cities are not. Ch. 25, Laws of 1993, 1st sp. sess. and RCW 82.45.010(m).

⁹⁶RCW 82.45.060.

⁹⁷See Chapter 82.46 RCW.

⁹⁸RCW 82.46.010(2).

⁹⁹RCW 82.46.035(2).

¹⁰⁰RCW 82.46.010(2).

RCW 35.43.040 lists local improvements that can be funded through a local improvement district (LID), including streets, parks, sewers, water mains, swimming pools, and gymnasiums.¹⁰¹

Capital projects not listed in the LID statute (for example, a fire station, city hall, or library) are also permitted uses **as long as** they are included in the city's capital improvement plan. Expenditures that are not allowed are such things as the purchase of police cars. Accountants may consider these to be "capital" for accounting purposes, but they are not "capital purposes" or "local capital improvements." A 1984 letter from the Attorney General to a county prosecutor defines "local capital improvements" as "various kinds of things which may be done to a tract or parcel of tangible real property as an improvement thereto."¹⁰² An Attorney General's Memorandum dated July 16, 1991 confirmed this definition.¹⁰³

Note that these funds may not be used for developing a capital facilities element or a capital improvement plan, but they can be used for design costs, engineering costs, surveys, etc. for specific projects in a capital facilities element or capital improvements plan. They also cannot be used for maintenance. If the project would be considered a "public work" for bidding purposes, then REET funds may be used as long as it is a permitted use as discussed above.

Cities With a Population of 5,000 or More That Are Planning Under GMA. These jurisdictions must spend the first quarter percent of their real estate excise tax receipts solely on capital projects that are listed in the capital facilities plan element of their comprehensive plan.

"Capital projects" are defined as:

those public works projects of a local government for planning, acquisition, construction, reconstruction, repair, replacement, rehabilitation, or improvement of streets; roads; highways; sidewalks; street and road lighting systems; traffic signals; bridges; domestic water systems; storm and sanitary sewer systems; parks; recreational facilities; law enforcement facilities; fire protection facilities; trails; libraries; administrative and judicial facilities...."

Because some legislators were concerned that jurisdictions might simply substitute REET 1 (and REET 2) revenues for other funds in financing these capital projects, the law was amended to require that the "legislative authority shall identify in the adopted budget the capital projects funded in whole or in part from the proceeds of the tax authorized in this section, and shall indicate that such tax is intended to be in addition to other funds that may be reasonably available for such capital projects."¹⁰⁴

¹⁰¹Note that in ch. 272, Laws of 1994, the legislature clarified its original intent that "local capital improvements" was intended to include the acquisition of real and personal property associated with such local capital improvements. This means that land acquisition for parks is a permitted expenditure.

¹⁰²Informal opinion dated March 6, 1984, from Phillip H. Austin, Senior Deputy Attorney General, to Alan A. Hancock, Deputy Prosecuting Attorney for Island County.

¹⁰³Memorandum opinion dated July 16, 1991, from Maureen Hart, Senior Assistant Attorney General, Legal/Fiscal Division, to Steven Marcotte, Assistant Chief Examiner, State Auditor's Office.

¹⁰⁴RCW 82.46.010(1) and RCW 82.46.035(1).

● Spending the Second Quarter Percent – REET 2

This part of the real estate excise tax may only be levied by cities that are required to or choose to plan under the Growth Management Act. All cities that levy this tax face the same provisions, whether their population is greater or less than 5,000.

For this quarter percent of the real estate excise tax, "capital project" means those:

public works projects of a local government for planning, acquisition, construction, reconstruction, repair, replacement, rehabilitation, or improvement of streets, roads, highways, sidewalks, street and road lighting systems, traffic signals, bridges, domestic water systems, storm and sanitary sewer systems, and planning, construction, reconstruction, repair, rehabilitation, or improvement of parks.¹⁰⁵

Note that acquisition of land for parks is not a permitted use of REET 2 receipts, although it is a permitted use for street, water, and sewer projects.

● What's This Other One-Half Percent Real Estate Excise Tax?

Cities that are not levying the optional half-cent sales tax under RCW 82.14.030(2) have the option of levying an additional one-half percent real estate excise tax.¹⁰⁶ These receipts are not designated for capital projects. They are a general fund revenue for city operating expenditures. Only one city, the City of Clarkston, has chosen to do this.¹⁰⁷ From a financial standpoint, the optional half-cent sales tax will probably always bring in more revenue than this additional one-half percent real estate excise tax. For border cities, however, who do not feel they are able to levy the optional sales tax, this tax is a revenue option.

● Accounting for These Funds

Because this revenue source has a dedicated purpose, it must be accounted for separately in a capital projects fund. Those cities that are planning under GMA and levying both REET 1 and REET 2 need to keep track of each of these revenues separately because the uses to which they may be put are different.¹⁰⁸

Hotel-Motel Tax

Most cities have had the authority to levy a "hotel-motel" or lodging tax of two percent since 1973.¹⁰⁹ Over the years, some cities got special interest legislation passed that increased the rate of their permitted levy and/or provided for certain uses of the tax revenue that were unique to them. In 1997, the legislature repealed much of chapter 67.28 RCW and gave most cities the same levy rate and permitted uses.

¹⁰⁵RCW 82.46.035(5).

¹⁰⁶RCW 82.46.010(3).

¹⁰⁷See Clarkston Municipal Code, §3.88.010.

¹⁰⁸RCW 82.46.035(4).

¹⁰⁹Ch. 34, Laws of 1973, 2nd ex. sess.

•What Are the Tax Rates?

Most cities may impose a "basic" two percent tax under RCW 67.28.180 on all charges for furnishing lodging at hotels, motels, and similar establishments (including bed and breakfasts and RV parks) for a continuous period of less than one month. This tax is taken as a credit against the 6.5 percent state sales tax, so that the total tax that a patron pays in retail sales tax and the hotel-motel tax combined is equal to the retail sales tax in the jurisdiction.¹¹⁰ In addition, most cities may levy an additional tax of up to two percent, for a total rate of four percent, under RCW 67.28.181(1). This "special" tax is **not** credited against the state sales tax. Therefore, if a city levies this additional tax, the total tax on the lodging bill will increase by two percent.

There are some exceptions:

- RCW 67.28.181(1) stipulates that this additional two percent tax may be levied as long as the total tax under chapter 36.100 RCW (the public facilities district tax), chapter 82.08 RCW (the state sales tax), chapter 82.14 RCW (the city, county, and transit district sales tax), chapter 67.28 RCW (the hotel-motel tax chapter), and chapter 67.40 RCW (the convention and trade center tax) does not exceed 12 percent. (Note that the sales tax for the Regional Transit Authority in portions of King, Pierce, and Snohomish counties is not included in making these calculations.) This means that most cities in King County may only levy a one percent tax.¹¹¹ Seattle cannot levy any tax. The total hotel-motel tax in Seattle is 15.2 percent, higher than in the rest of the county, because the convention center tax is higher.¹¹²
- Cities that had authority to levy a "special" tax before July 27, 1997 that allowed a rate higher than four percent, had that rate grandfathered in by the 1997 legislation.¹¹³ All the cities in Grays Harbor and Pierce counties are in this category plus Chelan, Leavenworth, Long Beach, Bellevue, Yakima, and Winthrop.
- Cities located in counties that had the authority to levy a four percent tax county-wide before January 1, 1997, are limited to the "basic" two percent rate.¹¹⁴ This affects cities in Snohomish and Cowlitz counties.
- Due to some unique circumstances,¹¹⁵ there was a period of time at the end of 1997 and beginning of 1998 when the outstanding taxing authority was six percent, rather than the four percent the legislature intended. During this time, Wenatchee and East Wenatchee raised their total tax to six percent. These rates were grandfathered in by the 1998 legislature.¹¹⁶

¹¹⁰RCW 67.28.180(1). Ch. 35, Laws of 1998, §2.

¹¹¹Cities in King County, other than Seattle, have an 8.2 percent sales tax, a two percent hotel-motel tax for the Kingdome/new football stadium, and a 2.8 percent hotel-motel tax for the convention center. These add up to 13 percent. Subtracting the two percent credit against the state sales tax brings the figure down to 11 percent, leaving room for a one percent tax.

¹¹²RCW 67.40.090(2)(d). The statutes provide that the maximum rate in Seattle is 15.2 percent. RCW 67.28.181(2)(c).

¹¹³RCW 67.28.181(2)(a).

¹¹⁴RCW 67.28.181(2)(b).

¹¹⁵See *Budget Suggestions for 1998*, Municipal Research and Services Center: Seattle, August 1997, pp. 26-32, for a discussion of the unintended consequences of the partial veto of ch. 452, Laws of 1997.

¹¹⁶RCW 67.28.181(2)(d).

•City or County Tax?

Counties also have the right to levy this tax but, in most cases, the county must allow a credit for any tax levied by a city.¹¹⁷ One exception is King County. The law provides that if any county pledged these tax revenues before June 26, 1975, to pay debt service on the construction of a "public stadium, convention center, performing arts center, or visual arts facilities," then it could collect the tax on a county-wide basis from all lodging facilities.¹¹⁸ In practical terms this means cities in King County are not able to levy the hotel-motel tax at rate higher than one percent, and Seattle can levy no tax at all, until the bonds issued for the new football stadium are retired in January 1, 2021.¹¹⁹

However, the law also has a provision for any cities that, before June 26, 1975, had pledged hotel-motel tax revenue to pay debt service for the construction of one of the facilities listed above. Those cities are able to continue to collect their hotel-motel tax until the debt is retired.¹²⁰ One such city is Bellevue, where the 6.5 percent state retail sales tax on the sale of lodging is reduced by both the two percent county hotel-motel tax and the two percent city tax. The city of Yakima and Yakima County also pledged hotel-motel tax revenues for a convention center before June 26, 1975, and the state sales tax there is subject to the same "double-dipping."

•How Can the Revenues Be Used?

These funds may be used solely for paying for tourism promotion and for the acquisition and/or operation of tourism-related facilities.¹²¹ "Tourism promotion" is defined as:

activities and expenditures designed to increase tourism, including **but not limited to** advertising, publicizing, or otherwise distributing information for the purpose of attracting and welcoming tourists; developing strategies to expand tourism; operating tourism promotion agencies; and funding marketing of special events and festivals designed to attract tourists. [Emphasis added].¹²²

Those who recall the previous language will note that this new language is broader. Cities may still advertise and publicize using written materials, advertisement on radio or television or in other media, banners, floats, etc. However, "activities and expenditures to increase tourism" could also include the salary and benefits of a city employee for the time spent promoting tourism, or the travel expenses of an employee who staffs a city booth at a convention. Note that hotel-motel tax funds may be spent only on **marketing** special events and festivals. These monies may **not** be spent on the costs of actually putting on the special events or festivals. There is nothing in the definition that limits the marketing to city events, as long as the events are designed to attract tourists.

¹¹⁷RCW 67.28.181(3). If a city is levying the entire four percent tax (or more, if a higher rate has been grandfathered in), the county may not levy its tax in that city.

¹¹⁸RCW 67.28.180(2)(b).

¹¹⁹RCW 67.28.180(2)(c)(ii).

¹²⁰RCW 67.28.180(2)(c)(iii).

¹²¹RCW 67.28.1815. "Tourism" is defined as "economic activity resulting from tourists, which may include sales of overnight lodging, meals, tours, gifts, or souvenirs." RCW 67.28.080(5). There is no stipulation that the tourism promotion be of a type that attracts overnight visitors. Of course, to the extent it does not, hotel-motel tax receipts will be lower.

¹²²RCW 67.28.080(6).

However, because of the state constitutional gift of public funds prohibition,¹²³ a city should enter into a contract with any private organization providing marketing services or any other tourist promotion activity. The contract should spell out the tourism-related services to be provided in exchange for city funding and what reports will be required. Also, any organization doing promotion on behalf of the city may only spend hotel-motel tax funds on items that the city itself could fund. This prohibits, for example, any expenditures on promotional hosting.

The limitation on using hotel-motel tax revenues for acquiring and/or operating tourism-related facilities is guided by the following definition:

"Tourism-related facility" means: real or tangible personal property with a usable life of three or more years, or constructed with volunteer labor, and used to support tourism, performing arts, or to accommodate tourist activities.¹²⁴

The prior legislation specifically mentioned certain facilities on which most cities could expend hotel-motel tax funds. These included stadiums, convention centers, performing and visual arts facilities, and public restrooms. Cities may still spend their hotel-motel funds on these facilities, but the new language allows a city to build and/or operate any facility that supports tourism or accommodates tourist activity. What kinds of facilities does this include? It depends. The guiding principle here is that the facilities should be used by tourists. So, for example, a municipal golf course, would likely be a permitted expenditure in Chelan, where it probably would not be if it were in a residential neighborhood in Spokane. Each situation is unique. We realize that is not as much guidance as many cities will want, but that is all we can give you in this publication. You are welcome, of course, to call our office or the state auditor's office to discuss a specific project.

One other guiding principle is that these tourism-related facilities must be owned and operated by the city, either individually or jointly with another municipality or private party.¹²⁵ A city cannot, for example, give money to a nonprofit museum, even though museums are a permitted use if owned by the city.¹²⁶

•Lodging Tax Advisory Committee¹²⁷

If a city with a population over 5,000 wishes to impose a new hotel-motel tax, raise the rate of an existing tax, repeal an exemption from the hotel-motel tax (we do not know if any cities are providing exemptions), or change the use of the tax proceeds, it must form a lodging tax advisory committee.

- This committee must have at least five members, appointed by the city council.
- The committee membership must include at least two representatives of businesses that are required to collect the hotel-motel tax, two people who are involved in activities that are

¹²³Art. 8, §2.

¹²⁴RCW 67.28.080(7).

¹²⁵RCW 67.28.120.

¹²⁶See letter dated October 28, 1987 from Leland T. Johnson, Assistant Attorney General, to Frederick C. Canavor, Jr., Prosecuting Attorney, San Juan County. This point is reiterated in a letter dated June 14, 1993, from Stacia Reynolds (now Hollar), General Counsel, Washington State Auditor's Office, to Paul Sullivan, Jr., City Attorney of Ellensburg.

¹²⁷RCW 67.28.1817.

authorized to be funded by this tax, and one elected city official who serves as chairperson of the committee.

- Organizations representing hotels and motels and organization involved in activities that can be funded by this tax may recommend people for membership.
- The number of committee members from organizations representing the hotels and motels and the number from organizations involved in activities that can be funded must be equal.
- A city's committee may include a non-voting county official.
- The council shall review the membership of the committee annually.

So, What Does the Committee Do? Any proposal to impose a new hotel-motel tax, raise the rate of an existing tax, repeal an exemption from the hotel-motel tax, or change the use of the tax proceeds, must be submitted to the lodging tax advisory committee for review and comment.

- This submission must occur at least 45 days before final action will be taken on the city's proposal. Even if the committee finishes its work before the 45 days are up, the city still must wait 45 days.
- The committee's comments shall include an analysis of the extent to which the proposal will accommodate activities for tourists or increase tourism, and of the extent to which it will affect the long-run stability of the fund to which the hotel-motel taxes are credited.
- If the advisory committee does not submit comments before the time that final action is to be taken on the proposal, the city may go ahead and take final action.

Each city that levies a hotel-motel tax must submit two reports to the Department of Community, Trade and Economic Development (CTED). The first report should have been submitted on October 1, 1998; the next is due on October 1, 2000. The report must contain the following information:

- The total hotel-motel tax rate in the city.
- The total hotel-motel tax revenue received in each of the preceding six years.
- A list of projects and activities funded by this tax.
- The amount of revenue expended for each project and activity.

This information will be used by CTED to make a report to the legislature.

Gambling Tax¹²⁸

Cities that choose to allow gambling activities within their borders may tax the gambling revenues. Currently, the maximum tax rate for bingo and raffles is 10 percent of the gross revenue less the amount paid for prizes. However this rate will fall to five percent effective January 1, 2000.¹²⁹ For amusement games, the tax can be two percent of gross revenues less the amount paid for prizes. The maximum rate for punch boards and pull-tabs and the base of the tax differ for nonprofit organizations and commercial stimulant operators. Cities may tax nonprofits at a rate of up to 10 percent on their net receipts (gross receipts less the amount awarded as prizes). They may tax commercial stimulant operators on their net receipts at a rate of up to 10 percent or on their gross receipts at a rate of up to five percent. Gross receipts from card games may be levied a 20 percent tax.

•How Can We Spend the Proceeds?

RCW 9.46.113 states that cities that levy gambling taxes "shall use the revenue from such tax **primarily** for the purpose of enforcement of the provisions of this chapter." [Emphasis added.] In 1991, the Washington State Supreme Court handed down a decision (*American Legion Post No. 32 v. City of Walla Walla*)¹³⁰ which clarified the definition of "primarily." In that decision, the court said that gambling tax revenues must "first be used" for gambling law enforcement purposes to the extent necessary for that city. The remaining funds may be used for any general government purpose.

The court also recognized that enforcement does not necessarily encompass only police activity directly related to gambling activities. A general police presence can help prevent illegal gambling activities. From a practical standpoint, and as an easy way to keep a trail for the auditor, funds should be spent first on direct gambling enforcement, then on other police functions and, if that does not exhaust the tax monies, then on non-police expenditures.

Leasehold Excise Tax

Most leases of publicly-owned real and personal property in the state are subject to a leasehold excise tax in lieu of a property tax.¹³¹ The 1976 legislature established a 12 percent tax¹³² to be levied either on the contract rent (when the lease is established by competitive bidding) or, in other instances, by the imputed economic rent as determined by the State Department of Revenue.¹³³ The 1982 legislature added a seven percent surcharge making the total rate 12.84 percent.¹³⁴

Cities and counties may collectively levy up to six percent of this 12.84 percent.¹³⁵ The maximum county rate is six percent and the maximum city rate is four percent. The county must give a credit for any city tax. Therefore, if a city is levying its maximum four percent, the county may collect only

¹²⁸RCW 9.46.110.

¹²⁹Ch. 221, Laws of 1999.

¹³⁰116 Wn.2d 1 (1991).

¹³¹See RCW 82.29A.130 for a list of leasehold interests exempt from the tax.

¹³²RCW 82.29A.030(1)

¹³³RCW 82.29A.020(2)(b).

¹³⁴RCW 82.29A.030(2).

¹³⁵See RCW 82.29A.040.

two percent in the city. These taxes are collected by the city and remitted to the Department of Revenue. After deducting an administrative fee,¹³⁶ the department distributes the taxes to local governments on a bimonthly basis.¹³⁷

Use Tax on Brokered Natural Gas¹³⁸

In 1986, the federal government deregulated the natural gas industry. Deregulation allowed large customers to bypass the gas utilities and bargain directly with independent marketers. These sales were, therefore, no longer a taxable event for utility business and occupation tax purposes. Some cities lost considerable revenue and, as a result, the legislature passed a law, effective July 1, 1990, allowing cities to levy a use tax on the purchases of brokered natural gas by consumers. The tax rate is equal to the city's utility tax on natural gas, which must be six percent or less. (There is a similar provision for the state which also lost utility tax revenues.)¹³⁹ Cities contract with the state to collect these taxes and they are distributed to local governments on a monthly basis.

Ambulance Taxes¹⁴⁰

If a city council determines that the city is inadequately served by the existing private ambulance service, it may establish a system for providing ambulance service as a public utility of the city or by contract with a private firm. To finance this service, the city is authorized to levy excise taxes. A business and occupation tax can be levied on the gross receipts of an ambulance company for the privilege of engaging in the ambulance business. The city can also levy a tax (sometimes called a "household tax") on all persons, businesses, and industries that are served by the ambulance service. Taxes collected must be used to finance the service and can be in addition to charges for the ambulance service itself.

Admission Tax

All cities may levy an admission tax in an amount no greater than five percent of the admission charge, as is authorized by RCW 35.21.280. This tax can be levied on admission charges (including season tickets) to places such as theaters, dance halls, circuses, clubs that have cover charges, observation towers, stadiums (except for high school sports), and any other activity where an admission charge is made to enter the facility.¹⁴¹

¹³⁶RCW 82.29A.080.

¹³⁷RCW 82.29A.090.

¹³⁸RCW 82.14.230.

¹³⁹RCW 82.12.022.

¹⁴⁰RCW 35.21.768.

¹⁴¹In *Ski Acres v. Kittitas County*, 118 Wn.2d 852 (1992), the Washington State Supreme Court ruled that the county could not levy its admission tax on ski lift tickets and/or rental equipment under RCW 36.38.010(2), which states, in part, that the term "admission charge" includes:

a charge made for rental or use of equipment or facilities for purpose of recreation or amusement, and where the rental of the equipment or facilities is necessary to the enjoyment of the privilege for which a general admission is charged, the combined charges shall be considered as the admission charge.

The admission tax must be collected, administered, and audited by the city. Some cities exempt certain events sponsored by non-profits from the tax. This is not a requirement, however.

The court agreed with the plaintiff that because one could enter the ski area without a charge, the county could not charge an admission tax on the ski lift price (or equipment rental). This same argument could apply to facilities such as bowling alleys and skating rinks.

Because the language in the city statute is **similar**, a court might find that cities also cannot levy an admission tax in cases where people can enter a place without paying even though they have to pay to participate in the activity in that place. The statute authorizing the admission tax for cities and towns, however, **is different** from the statute authorizing the county tax, and the area of difference is found in the language used by the Supreme Court to invalidate Kittitas County's application of the tax to ski lifts. Without additional guidance by the courts, it is difficult to conclude whether cities possess greater taxing authority. An argument to that effect certainly could be made.

State–Shared Revenues



"Don't tax me, and don't tax thee;
tax that man behind the tree."

Senator Russell Long

State-collected revenues that are shared with **all** cities are derived from three main sources: motor vehicle excise taxes including the travel trailer and camper excise tax, liquor receipts (profits and excise taxes), and gasoline taxes. Cities as a group receive a fixed percentage of each of these sources, and the funds are then allocated to individual jurisdictions on a per capita basis. In addition, many cities receive sales tax equalization payments. The fire insurance premium tax provides for a modest contribution to the firemen's pension fund in some cities, and three cities receive Capron refund payments.

Population figures, determined annually as of April 1 by the state demographer in the Office of Financial Management, are used as the basis for the per capita distribution of these funds. In newly incorporated areas, the population figure shown in the records of incorporation filed with the secretary of state is used until the next annual determination is made.¹⁴²

Sales and Use Tax Equalization¹⁴³

In 1982, the state legislature created a "municipal sales and use tax equalization account" in an effort to more equitably allocate revenues to cities in the state.¹⁴⁴ The account is funded by a 5.628 percent share of the state motor vehicle excise tax.¹⁴⁵

Payments are made to cities by the state treasurer on the last day of January, April, July, and October. Distributions are made first to those cities that have chosen not to impose the additional half-cent sales tax authorized in RCW 82.14.030(2). They receive an amount equal to forty-five fifty-fifths (45/55) of their motor vehicle excise tax distribution.¹⁴⁶ Next, payments are made to cities that received, on a per capita basis, an amount that was less than 70 percent of the state-wide city average per capita sales tax from the **first half cent** levied during the prior year.¹⁴⁷ All cities that qualify receive a per capita distribution that is equal to the difference between the "70 percent of the state-wide average" figure and their own per capita sales tax.

¹⁴²RCW 43.62.030.

¹⁴³In this section, "sales tax" refers to "sales and use tax."

¹⁴⁴See Chapter 49, Laws of 1982, 1st ex. sess. and RCW 82.14.210. There is a similar account for counties (RCW 82.14.200).

¹⁴⁵RCW 82.44.110(1)(e).

¹⁴⁶RCW 82.14.210(2).

¹⁴⁷RCW 82.14.210(3).

Cities that levy the second half cent of the sales tax, in addition to the first half cent, receive a second distribution.¹⁴⁸ In years in which the sales tax equalization account has sufficient funds, this second distribution will be equal in size to the first. If there are funds left in the account after making these distributions, they are distributed to **all** cities in October, based on their population.¹⁴⁹ In years in which there are **not** sufficient funds to give everyone a second distribution equal to the first, everyone's second distribution is cut back by an equal percentage amount so that the amount distributed just equals the funds available.¹⁵⁰

The original idea of sales tax equalization was to make certain that the combination of the sales tax that a jurisdiction earns from retail sales within its limits plus its equalization payments equaled, on a per capita basis, 70 percent of the state-wide average. This can no longer be achieved. Although, with the passage in November 1998 of Referendum 49,¹⁵¹ more money is being put into this account, our current forecast is that the incorporations of the City of Kenmore in August 1998 and the City of Sammamish in August 1999 will increase the total that is certified by an amount that is greater than the infusion of new money. Therefore, the payment on the second half cent of the sales tax will continue to be less than that on the first half cent.

•Demystifying the Sales Tax Equalization Calculations

Many city officials find sales tax equalization to be a very confusing revenue source. Perhaps the following example will help demystify it.

Assume that Twin Peaks has a population of 5,000, that it is levying the full one percent sales tax and that its sales tax receipts from the first half cent of the sales tax were \$175,000 last year. Assume also that sales tax receipts from the first half cent of the tax levied in all the incorporated areas during the prior year was \$280,000,000 and that the population in incorporated areas is 3,200,000. Here are the calculations that are done to determine the amount of equalization Twin Peaks will receive.

Step 1: Calculate the statewide per capita average sales tax and take 70 percent of it.

$$\begin{aligned} \$280,000,000/3,200,000 &= \$87.50 \\ \$87.50 \times .7 &= \$61.25 \end{aligned}$$

Each city will have its sales tax revenues from the first half cent equalized to \$61.25.

Step 2: Calculate Twin Peaks' sales tax receipts from the first half cent tax on a per capita basis.

$$\$175,000/5,000 = \$35.00$$

¹⁴⁸RCW 82.14.210(4).

¹⁴⁹RCW 82.14.210(7).

¹⁵⁰RCW 82.14.210(6).

¹⁵¹Ch. 321, Laws of 1998. The main thrust of this referendum was to move a portion of the motor vehicle excise tax receipts from the state General Fund to the Motor Vehicle Fund to pay debt service for a \$2.4 billion transportation package. However, as part of this bill, the legislature provided additional money for city sales tax equalization and city and county criminal justice accounts.

Step 3: Compare the figures from steps 1 and 2. Since the per capita sales tax that businesses in Twin Peaks generated is less than \$61.25 (70 percent of the statewide per capita average), it will receive equalization payments. The amount per capita will be the difference between \$61.25 and \$35.00.

$$\$61.25 - 35.00 = \$26.25$$

Step 4: Multiply the result in step 3 by Twin Peaks' population.

$$\$26.25 \times 5,000 = \$131,250$$

Step 5a: If there are enough funds available to fully fund cities, Twin Peaks will get \$131,250 for each half cent for a total of \$262,500, since it is levying both half cents of the sales tax.

$$\$131,250 \times 2 = \$262,500$$

Step 5b: If there are not enough funds, Twin Peaks will receive \$131,250 to equalize it on the first half cent, and a portion of \$131,250 for the second half cent. For example, assume that there is only enough money in the equalization account to give cities 80 percent of the amount they are certified for on the second half cent. Multiply:

$$\$131,250 \times .8 = \$105,000$$

The total distribution that Twin Peaks will receive is \$131,250 plus \$105,000, which equals \$236,250.

Since the money that is distributed by the state treasurer's office does not identify which funds are the equalization on the first half cent and which on the second half, it may be more intuitive to speak in terms of an average. If a city gets 100 percent on the first half cent and 80 percent on the second, that is 90 percent on the full penny ($100 + 80 = 180$; $180/2 = 90$) or a 10 percent cutback.

•A Warning about Changes in Your Yearly Sales Tax Receipts and Their Effect on Equalization

The sales tax equalization payments a city will receive next year are a function of the sales tax the city receives in the current year, and a city needs to budget accordingly. Let's say that a city's sales tax increases due to new construction or the opening of a large retail operation. During the current year, the city is "double-dipping." It is getting this additional sales tax revenue plus it has relatively high equalization payments based on last year's lower sales tax receipts. But if the source of the robust sales tax receipts are going to disappear next year (the construction project is complete), then the city should be setting aside some of this year's sales tax revenue to be used for next year's budget to compensate for the lower equalization payments it will receive next year.

Motor Vehicle and Camper Excise Taxes

In 1937, the state legislature replaced the property tax on motor vehicles with a motor vehicle excise tax.¹⁵² Since a portion of this property tax was taken from cities, the state provided that part of the state-collected motor vehicle excise tax be shared with cities. The cities' share of the motor vehicle excise tax is 6.286 percent¹⁵³ of the total amount collected and it is placed in the city police and fire protection assistance account in the state treasury.¹⁵⁴

These revenues must be used for the purpose of police and fire protection.¹⁵⁵ This requirement is not a binding constraint because the budgets of cities for these purposes are larger than the motor vehicle excise tax money received. Cities also get 13.64 percent of the proceeds from the travel trailer and camper tax to be used for any general fund purpose.¹⁵⁶ Both these revenue sources are distributed by the state treasurer on the last days of January, April, July, and October.

Liquor Receipts – Profits and Taxes

Since cities are responsible for the policing of liquor establishments located within their limits, but are precluded from taxing them because of the state liquor monopoly,¹⁵⁷ state law provides that a share of the state-collected profits and taxes be returned to cities to help defray policing costs.

Liquor Board profits consist of the difference between revenue from state liquor stores, taxes on wine and beer, license fees, permit fees, penalties and forfeitures, and board expenditures. Except for monies from administrative fees and those attributable to Class H licenses, the profits are divided among the state, counties, and cities.¹⁵⁸ Cities get a 40 percent share.¹⁵⁹ An additional amount is distributed to border area cities.¹⁶⁰ These funds are distributed on the last day of March, June, September, and December.

Cities also receive 28 percent of the liquor excise tax receipts.¹⁶¹ These funds are distributed on the last day of January, April, July, and October.

¹⁵²Chapter 228, Laws of 1937.

¹⁵³RCW 82.44.110(1)(d). Some readers will note that this percentage share has increased from the 5.88 percent share before Referendum 49 was passed. Referendum 49 made a number of changes that affected the size of the motor vehicle excise tax "pot" from which cities get their motor vehicle excise tax revenues (and their sales tax equalization and some of their criminal justice funding). The net effect of these changes is a smaller "pot." The city share was increased from 5.88 percent to 6.286 percent to provide the same amount of revenue that would have been received if Referendum 49 had not passed.

¹⁵⁴RCW 82.44.155.

¹⁵⁵*Id.*

¹⁵⁶RCW 82.50.510.

¹⁵⁷"Locally Shared Liquor Profits and Taxes," (source unknown), July 27, 1962, mimeographed copy in MRSC files.

¹⁵⁸Class H licenses are held by establishments that sell hard liquor. Most of the fees, penalties, and forfeitures from Class H licenses go to the Liquor Board for administration, to the University of Washington and Washington State University for research in alcoholism and drug abuse, and to the Department of Social and Health Services to support alcoholism treatment facilities. RCW 66.08.180.

¹⁵⁹RCW 66.08.190(2).

¹⁶⁰RCW 66.08.190(1) and RCW 66.08.195.

¹⁶¹RCW 82.08.160 specifies that 35 percent of the total tax collected under RCW 82.08.150 shall be deposited in the "liquor excise tax fund." Per RCW 82.08.160, 80 percent of the monies in the liquor excise tax fund is distributed to cities. $.35 \times .8 = .28$.

To be eligible to receive liquor taxes and profits, a city must devote at least two percent of its distribution to support an approved alcoholism or drug addiction program.¹⁶²

Motor Vehicle Fuel Excise Tax – Gas Tax

Because the federal and state governments have preempted the taxation of gasoline, the state has provided that the state-collected gasoline tax be shared with cities. The gas tax in most of Washington is 23 cents per gallon.¹⁶³ Cities receive 10.6961 percent¹⁶⁴ of the funds, from which some small deductions are made.¹⁶⁵ Cities with a population of 15,000 or more must use 31.86 percent¹⁶⁶ of their receipts for the construction, improvement, chip sealing, seal-coating, and repair of arterial highways and city streets as defined in RCW 46.04.030 and RCW 46.04.120.¹⁶⁷ They deposit these funds in an arterial street fund. The remainder is deposited in the city street fund to be used for street maintenance.¹⁶⁸ Cities with a population of less than 15,000 may combine the two funds and use all their gas tax money for maintenance if they desire.¹⁶⁹ All payments are made on a per capita basis and are distributed on the last day of the month.

Capron Refunds

Cities located in counties composed entirely of islands receive a share of monies called Capron refunds.¹⁷⁰ All the gas tax and motor vehicle excise tax collected in such a county with neither a state highway nor a fixed connection with the mainland are returned to the county and shared with cities (in practice, one city, Friday Harbor) on the basis of their relative assessed valuations. In an island county with a state highway or a fixed connection with land, one-half of the gas tax and motor vehicle excise tax are returned and shared in same manner. Oak Harbor, Coupeville, and Langley receive a portion of Island County's funds.

¹⁶²RCW 70.96A.087.

¹⁶³Ch. 269, Laws of 1999, §16, and RCW 82.36.025. This 1999 legislation puts all the taxing authority in one statute and simplifies the distributions. The total gas tax remains the same, 23 cents, as do the permitted uses.

In three cities, the gas tax is 24 cents per gallon. Cities that are located no more than ten miles from an international border may levy an additional one cent per gallon gas tax with voter approval to mitigate the effects of tourism on their streets. RCW 82.47.020. According to the Washington State Legislative Transportation Committee's *Washington State Transportation Resource Manual*, Blaine, Nooksack, and Sumas are currently levying this tax.

¹⁶⁴Ch. 269, Laws of 1999, §2, and RCW 46.68.090(1)(i). This new legislation is revenue neutral. The 10.6961 percent share of the 23 cents gas tax provides cities the same amount of revenue as they would have received under the statutes that were repealed. Formerly, under RCW 46.68.100(1) and (2), (ch. 317, Laws of 1977, §9), cities received 6.92 percent of the base tax of 17 cents for street maintenance, plus 4.61 percent of the base tax of 17 cents to be used for capital projects in cities with a population of 15,000 or more and for any street purpose by cities with a population of less than 15,000. In addition, cities received one-half cent of an additional tax levied by the state to be used by all cities for any street purpose. Former RCW 46.68.095(5) and ch. 42, Laws of 1990, §103.

Note that there is also a requirement that cities spend at least .42 percent of all their gas tax receipts on paths and trails unless that amount is \$500 or less. Ch. 269, Laws of 1999, §§10-11, and RCW 47.30.030, 47.30.050.

¹⁶⁵Ch. 269, Laws of 1999, §3, and RCW 46.68.110(1) through (3).

¹⁶⁶This percentage produces the same number for dollars for street capital projects as under the former law, which provided an amount equal to 4.61 percent of the amount the state collected from its 17 percent base gas tax.

¹⁶⁷Ch. 269, Laws of 1999, §3, and RCW 46.68.110(4).

¹⁶⁸RCW 47.24.040 and ch. 35.76 RCW. See also RCW 35A.37.010 for code cities.

¹⁶⁹Ch. 269, Laws of 1999, §3, and RCW 46.68.110(4) specifies that the 31.86 percent portion be used for maintenance of arterial highways and city streets in cities of this size.

¹⁷⁰RCW 46.68.080. The 1930's legislation establishing these refunds was sponsored by Victor J. Capron of San Juan County. The two relevant counties are Island and San Juan.

These refunds are to compensate these cities and counties for their lack of state highways (and state highway investment).

Fire Insurance Premium Tax

The state collects a two percent tax on the premiums of all insurance policies written.¹⁷¹ Some of this money is distributed to cities and fire districts that had a pension system for firemen before the state-wide LEOFF system was initiated in 1970. Twenty-five percent of the tax collected each year on "fire only" policies is distributed on June 1.¹⁷²

Homeowner's and commercial multi-peril policies provide coverage for fire damage, but they also insure against other risks such as theft. Actual data is collected on the loss experience due to fire as a percent of total losses. These percentages are then applied to the total premium taxes collected on homeowners and commercial multi-peril policies to apportion the total taxes collected between fire and other risks. For example, if the amount paid out on homeowner's policies for fire losses was 20 percent of total value of claims paid, and if the premium tax collected on homeowner's policies was \$5,000,000, the calculation would be as follows:

$\$5,000,000 \times .2 = \$1,000,000$ of the homeowner's premiums are attributable to fire

$\$1,000,000 \times .25 = \$250,000$ is available to be distributed

A similar calculation is made for premiums from commercial multi-peril policies. A particular city's share of these taxes is a function of the number of paid firefighters in the city as a percent of total paid firefighters in all the cities and districts that qualify to receive this tax.

¹⁷¹RCW 48.14.020(1).

¹⁷²Ch. 17, Laws of 1999. Prior to the passage of this legislation, 45 percent of fire-related insurance premiums was distributed under RCW 41.16.050(2). This legislation transferred 20 percent of these funds to volunteer firefighter training.

Criminal Justice Revenues



"Taxes are what we pay for civilized society."

Justice Oliver Wendell Holmes, Jr.

During the 1990 second extraordinary session, the legislature passed a bill providing funds for criminal justice purposes for local government.¹⁷³ This legislation, which was scheduled to sunset on January 1, 1994, was reenacted, with some amendments, by the 1994 legislature.¹⁷⁴ In 1995, the legislature gave counties additional sales tax authority to fund capital and operating expenditures for jails and juvenile detention facilities.¹⁷⁵ Referendum 49, passed by the voters in November 1998, included provisions that increased funding for local government criminal justice expenditures.¹⁷⁶

Cities get two allocations of criminal justice revenue to be distributed under the terms of RCW 82.14.320 and RCW 82.14.330. Each is funded by .778 percent of the motor vehicle excise tax¹⁷⁷ and a cash transfer from the state general fund. Beginning with fiscal year 2000, the cash transfer will be \$4.6 million, growing each year by the same fiscal growth factor that governs the increase in the expenditure limit under Initiative 601.¹⁷⁸ These funds are distributed at the same time as the motor vehicle excise tax – the last days of January, April, July, and October.

Funds Distributed under RCW 82.14.320 – “High Crime”

To qualify to receive these funds a city must:

1. Have a crime rate in excess of 125 percent of the state-wide average as calculated in the most recent annual report on crime in Washington State as published by the Washington Association of Sheriffs and Police Chiefs.
2. Be levying, at the maximum rate, the second half cent of the sales tax or the extra half cent real estate excise tax.¹⁷⁹

¹⁷³“Local Criminal Justice Fiscal Assistance,” Ch. 1, Laws of 1990, 2nd ex. sess.

¹⁷⁴Ch. 21, Laws of 1993, 1st sp. sess.

¹⁷⁵Ch. 10, Laws of 1995, 2nd sp. sess. and RCW 82.14.350.

¹⁷⁶Ch. 321, Laws of 1998. The deposits into the municipal criminal justice assistance account under subsections 5(j) and (k), and sections 12 and 13, taken all together, result in increased funding.

¹⁷⁷RCW 82.44.110(1)(j) and (k).

¹⁷⁸The “fiscal growth factor” is the average, for the last three years, of the sum of state population growth and the change in the implicit price deflator. RCW 43.135.025(6) and (7). Prior to the passage of Referendum 49, the growth rate of the motor vehicle excise tax deposited in the municipal criminal justice assistance account was subject to the same fiscal growth factor cap. That cap has now been removed and the portion of the criminal justice funding coming from the motor vehicle excise tax will increase at the same growth rate as the tax.

¹⁷⁹RCW 82.14.030(2) and RCW 82.46.010(2).

3. Have a per capita yield from the first half cent of the sales tax of less than 150 percent of the state-wide average per capita yield for all cities.

Thirty percent of the funds are distributed on the basis of population to cities having a crime rate more than 175 percent of the state-wide average. The remainder is distributed to all qualifying cities solely on the basis of population. Cities have to requalify each year based on the above criteria. Cities should be aware that, each year, some cities "fall off" the list, although they make back on the following year. This variability makes budgeting difficult.

Funds Distributed under RCW 82.14.330 – Population, High Violent Crime, and CTED Programs

Sixteen percent of these funds is distributed solely on the basis of population, with each city getting a minimum of \$1,000 a year. Twenty percent is distributed, again on the basis of population, to those cities that have had an average violent crime rate in the last three years that is 150 percent of the statewide average for those three years. The remaining funds are allocated to program categories, for which cities apply to the Department of Community, Trade and Economic Development.

Fourteen percent of these funds goes to cities that have initiated innovative law enforcement strategies, such as alternative sentencing and crime prevention programs like community policing. No city may receive more than one dollar per capita. Twenty percent goes to cities that have set up domestic violence reduction programs. The maximum award is 50 cents per capita. Another 20 percent is awarded to cities that have initiated programs for at-risk children or child abuse victim response programs. Again, the maximum award is 50 cents per capita. The final program, 10 percent of the funds, is for cities that contract for law enforcement services.

Optional .1 Percent Sales Taxes

County commissioners or councils may vote to levy a county-wide .1 percent sales tax for criminal justice purposes.¹⁸⁰ The tax is subject to the same referendum provisions as the second half percent sales tax.¹⁸¹ Ten percent of the funds collected are distributed to the county, with the remainder allocated to the cities and the county on the basis of population.¹⁸²

Note that there is an additional .1 percent sales tax that all counties, other than King County, may levy for juvenile detention facilities and jails.¹⁸³ This tax must be voted on and passed by a simple majority. Permitted expenditures include design, construction, and maintenance of these facilities. This tax is not shared with cities.

¹⁸⁰RCW 82.14.340. At the time this publication was written, 29 counties are levying this tax.

¹⁸¹*Id.*

¹⁸²As an example, assume that the collections from this tax this year are \$1 million. The county gets ten percent (\$100,000) off the top, leaving \$900,000 to be shared among the county and cities. If your city has a population of 10,000 and the total population (incorporated and unincorporated) in the county is 80,000, your city's share will be $10,000/80,000 = 12.5$ percent of \$900,000, or \$112,500.

¹⁸³RCW 82.14.350. At the time this publication was written, 11 counties levied this tax.

Spending Limitations on These Funds

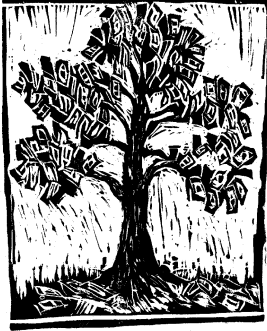
The language of the statutes state that the funds distributed have to be used "exclusively for criminal justice purposes" and cannot be "used to replace or supplant existing funding."¹⁸⁴ Since the year that establishes the base for any measure of supplanting is calendar year 1989, it is unlikely that any city needs to be concerned about supplanting now.

The legislature has defined "criminal justice purposes" to be "activities that substantially assist the criminal justice system, which may include circumstances where ancillary benefit to the civil justice system occurs, and which includes domestic violence services such as those provided by domestic violence programs, community advocates, and legal advocates."¹⁸⁵

¹⁸⁴RCW 82.14.320(6), RCW 82.14.330(1), and RCW 82.14.340.

¹⁸⁵*Id.*

Transportation Revenues



" . . . but in this world, nothing is certain
but death and taxes."

Benjamin Franklin

Recognizing that the state-shared revenue from the gas tax was insufficient for the needs of local jurisdictions, the 1990 legislature provided them with a number of local option revenue sources. The legislature also established high occupancy vehicle funding and high capacity transportation system funding options for certain counties.¹⁸⁶ Because this latter group of options is not available to many cities and because they cannot be used to alleviate the fiscal problems cities have on a daily basis, we have chosen not to discuss them in this report.

Local Option Motor Vehicle Fuel Excise Tax

Upon a vote of the people, a local option gas tax can be levied countywide at a rate equal to 10 percent of the state rate.¹⁸⁷ Since the state rate is 23 cents per gallon, 10 percent currently would be 2.3 cents per gallon.¹⁸⁸ The tax is to be collected by the state treasurer and distributed on a monthly basis to the county and its cities. For purposes of this distribution, the population in the unincorporated areas is multiplied by 1.5 and added to the population of the cities. This new total is used as the denominator in the revenue sharing formula.¹⁸⁹ For example, if the population in the unincorporated areas of a county is 40,000 and that in the incorporated areas is 90,000, the following calculations would be made.

$$\begin{aligned} \$40,000 \times 1.5 &= \$60,000 \\ \$60,000 + 90,000 &= \$150,000 \\ \$60,000 / 150,000 &= .40 \end{aligned}$$

This county would get 40 percent of the revenue being distributed. Similar calculations are made for each city, using its population in the numerator. The only counties that have attempted to levy this tax are Spokane County and Snohomish County. The ballot measures failed and, at this time, no county is levying this tax.

¹⁸⁶See ch. 81.104 RCW. RCW 81.104.170 contains the provision for the additional, voter-approved one percent sales tax mentioned on page 8. If the voters have already chosen to implement the .1 percent sales tax for criminal justice purposes, the authority under the Transportation Act is only .9 percent.

¹⁸⁷RCW 82.80.010(1).

¹⁸⁸See page 31.

¹⁸⁹RCW 82.80.080.

Local Option Vehicle License Fee

Although only King, Snohomish, Pierce, and Douglas counties have chosen to do so,¹⁹⁰ the legislative authority of any county may choose to levy up to a \$15 per vehicle license fee on all vehicles in the county,¹⁹¹ subject to a referendum.¹⁹² The legislation takes effect six months after the date of passage to give the Department of Licensing time to implement the collection of the fee.¹⁹³ The proceeds of the fee are distributed on a monthly basis after the deduction of an administrative charge. The funds are shared with each jurisdiction in the same manner as the local option gas tax.

Commercial Parking Tax

This tax may be levied by a city within its boundaries and by a county in the unincorporated areas.¹⁹⁴ There is no limit on the tax rate and many ways of assessing the tax are allowed. If the city chooses to levy it on parking businesses, it can tax gross proceeds or charge a fixed fee per stall.¹⁹⁵ If the tax is assessed on the driver of a car, the tax rate can be a flat fee or a percentage amount.¹⁹⁶ Rates can vary by any reasonable factor, including location of the facility, time of entry and exit, duration of parking, and type or use of vehicle.¹⁹⁷ The parking business operator is responsible for collecting the tax and remitting it to the city, which must administer it. This new tax, like the vehicle license fee, is subject to a voter referendum.¹⁹⁸ At the present time, Bainbridge Island, SeaTac, and Lynden are the only cities that we know are levying this tax.

Where is the Discussion of the Street Utility?

In addition to the local options discussed above, the 1990 legislation also included a street utility option for cities. The maximum amount that could be charged a business for each of its full-time equivalent employees and the owner or occupant of a residential household was two dollars a month. Although this statute¹⁹⁹ is still on the books, it was found unconstitutional in 1996.²⁰⁰ The state supreme court held that the charges being collected by the street utilities were, in fact, property taxes, and that they violated the constitutional requirement that all property taxes be uniform.²⁰¹ All seventeen cities collecting these fees repealed their ordinances after this decision. Seattle was required to rebate all the charges that had been collected.

¹⁹⁰The voters in Cowlitz County repealed this fee in 1997.

¹⁹¹RCW 82.80.020(1).

¹⁹²RCW 82.80.090. The referendum procedure is identical to that described for the sales tax in footnote 42.

¹⁹³RCW 82.80.020(2) and (4).

¹⁹⁴RCW 82.80.030(1).

¹⁹⁵RCW 82.80.030(4).

¹⁹⁶RCW 82.80.030(2)(a) and (d).

¹⁹⁷RCW 82.80.030(2)(e).

¹⁹⁸RCW 82.80.090. The referendum procedure is identical to that described for the sales tax in footnote 42.

¹⁹⁹RCW 82.80.050.

²⁰⁰*Covell v. Seattle*, 127 Wn.2d 874 (1995).

²⁰¹Art.7, §1.

How Can the Funds Be Used?

Revenue from the gas tax must be used for "highway purposes" as defined in article 2, section 40 of the state constitution.²⁰² These purposes include administrative, construction, reconstruction, maintenance, and repair costs.

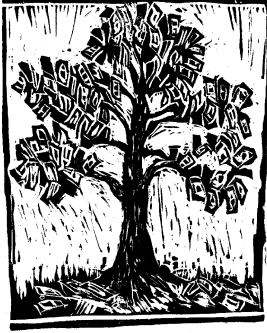
Funds from vehicle license fees and commercial parking taxes must be used for "transportation purposes," including street and road improvements, high capacity transit facilities, and public transportation.²⁰³ All funds are to be spent in a manner consistent with the city's transportation and land use plans. The act also includes some provisions for transportation planning that applies to jurisdictions with a population over 8,000 and establishes criteria that are to be used in expending the money.²⁰⁴ Any of these revenue sources may be used to pay debt service on general obligation or revenue bonds if the city issued them to raise funds for street projects.

²⁰²RCW 82.80.070(1).

²⁰³RCW 82.80.070(1).

²⁰⁴RCW 82.80.070(3).

Other Revenue Sources



"The thing generally raised on city land is taxes."

Charles Dudley Warner

Franchise Fees

Franchise fees are charges levied on private utilities to recoup city costs of administering the franchise and for the right to use city streets, alleys, and other public properties. The franchise fees on light, natural gas, and telephone utilities are limited by statute to the actual administrative expenses incurred by the city directly related to receiving and approving a permit, license, or franchise; reviewing plans and monitoring construction; and preparing a detailed SEPA document.²⁰⁵ They are not revenue generators as they are in some states.

Cable TV franchise fees are governed by federal rather than state law and are negotiated with the cable company. They may be levied at a rate of up to five percent of gross revenues, regardless of the costs of managing the franchise process.²⁰⁶

Transfer of Funds from Municipally Owned Utilities

Municipal utilities should really not have funds in excess of the amount they need to provide their services. Rates are supposed to be set only at the level necessary to cover costs.²⁰⁷ However, sometimes a utility does find itself with surplus funds. When that happens, a city may be able to transfer this surplus from the utility fund to the general fund.

RCW 35.37.020 provides that every city having a population of less than 20,000 **shall** transfer any utility fund surplus to the general fund, except for any funds the council finds necessary for (1) extending or repairing the infrastructure; (2) paying debt service; and (3) establishing a sinking fund. Note that this same statute contains symmetric language: any deficit in a utility fund **shall** be covered by a transfer from the general fund.

Towns have their own statute. RCW 35.27.510 gives a number of conditions that must be met before a utility surplus may be transferred. If the utility is free of debt, if a depreciation fund satisfactory to the state auditor has been created, if rates are the lowest possible level, and if the fixing of rates is governed by contract with the utility service supplier, then the mayor and council may transfer surplus funds with a unanimous vote. Since most towns do not contract for their utility services, this statute is not very useful.

²⁰⁵RCW 35.21.860.

²⁰⁶"Cable Communications Policy Act of 1984," §622(a),(b) (47 U.S.C. § 542(a),(b)).

²⁰⁷*Uhler v. Olympia*, 87 Wash. 1 (1915), and *Carstens v. Public Utility District No. 1*, 8 Wn.2d 136 (1941).

Transfer of Funds from the LID Guaranty Fund

A city may be able to transfer assets from the guaranty fund to the general fund.²⁰⁸ The treasurer must certify that, after the transfer, the fund will have sufficient assets to cover all outstanding obligations and any other obligations that might reasonably be expected to occur. After such a transfer is made, the cash remaining in the guaranty fund can be no less 10 percent of the outstanding obligations.

Interest on Investments

Interest earnings on investments must be credited to the fund that holds the investments. Otherwise, contrary to RCW 43.09.210, one fund will benefit another. One exception is "creatures" of the general fund. If, for example, your city makes general fund contributions at budget time to a park fund or the street fund, those funds are "creatures" of the general fund and any interest they earn may be credited to the general fund. Cities may only invest in "eligible" investments.²⁰⁹ Note that mutual funds are not permitted investments, even if the individual holdings of the mutual fund are all eligible investments.²¹⁰

Traffic and Parking Fines

Although the state supreme court establishes the schedule of fines for traffic infractions,²¹¹ cities share in the revenue from infractions committed within their boundaries. After the fines are collected by the municipal or district court, 32 percent is sent to the state. The remainder may be deposited in any city fund.²¹² Most jurisdictions put this money in the general or current expense fund.

A city has complete control over setting the fines for violation of its parking ordinances.²¹³ It may also charge a penalty of up to \$25 for failure to pay the parking ticket fine in the time prescribed by law.²¹⁴

²⁰⁸RCW 35.54.095(1).

²⁰⁹See RCW 35.39.030 and 39.59.020. A list of eligible investments may be found at http://www.wa.gov/tre/elig_inv.htm#loc1 or by calling the Cristin Wilson, LGIP Portfolio Manager, Office of the State Treasurer, at 360.902.9010.

²¹⁰An exception is made for funds that are subject to the arbitrage provisions of section 148 of the Internal Revenue Code. RCW 39.59.030.

²¹¹RCW 46.63.110(2).

²¹²RCW 3.50.100 and RCW 3.62.040.

²¹³Infraction Rules for Courts of Limited Jurisdiction (IRLJ) Rule 6.2(c) states:

This schedule does not apply to penalties for parking, standing, stopping, or pedestrian infractions established by municipal or county statute. Penalties for those infractions are established by statute or local court rule . . .

²¹⁴See RCW 46.63.110(3).

Parking Meters

In 1941, the state supreme court upheld as a valid exercise of the city's police power a Spokane ordinance providing for the installation and maintenance of parking meters for regulating traffic on the city's streets.²¹⁵

Parking meters promote parking turnover, ration space where demand exceeds supply, provide short-term parking spaces for shopping or personal errands, improve traffic circulation, and provide revenue for the city. The revenue generated is to be used to cover the costs of installing and maintaining the meters, collection of the fees, and enforcement by city officials. Revenue in excess of this amount may be used for parking studies and acquisition and operation of off-street parking facilities.²¹⁶

Other Fees and Charges

Sprinkled throughout the RCW's is authority for cities to levy fees and charges to cover the cost of providing services or programs and regulatory activities. For example, fees may be charged for animal licensing,²¹⁷ inspection of restaurants,²¹⁸ and parks and recreation programs.²¹⁹ Fees may be levied for street use permits,²²⁰ copy charges,²²¹ and fireworks stands permits.²²² Cities that are planning under the Growth Management Act can assess impact fees for fire protection facilities; schools; parks, open space, and recreation facilities; and for street purposes.²²³ The guiding principle for all these fees and charges is that they may be set at a level that recovers all the direct and indirect costs associated with the activity, including administrative overhead. However, if fees more than recover costs, they then become more like taxes, and cities need specific statutory authority to levy taxes.

²¹⁵*Kimmel v. City of Spokane*, 7 Wn.2d 372 (1941).

²¹⁶See RCW 46.90.650. In *Kimmel v. City of Spokane*, *supra*, the court did not concern itself directly with the revenue producing character of parking meters. The court said that it would not look behind the regulatory purpose declared in the ordinance, in the absence of evidence tending to show that the declaration is false and that the ordinance is actually a revenue measure.

²¹⁷RCW 35.23.440(11) and RCW 35.27.370(7).

²¹⁸RCW 70.05.060(7) and RCW 70.90.150(2).

²¹⁹RCW 35.21.020 and RCW 35A.67.010.

²²⁰RCW 35.22.280(7), RCW 35.23.440(33), RCW 35.27.370(4), and RCW 35A.11.020.

²²¹RCW 42.17.300.

²²²RCW 70.77.260.

²²³RCW 82.02.020 and RCW 82.02.050 *et seq.* *Paying for Growth's Impacts: A Guide to Impact Fees* (Olympia: State of Washington Department of Community Development, 1992) and James C. Nicholas *et al.*, *A Practitioner's Guide to Development Impact Fees* (Chicago: Planners Press, 1991) are good sources of information on impact fees.



Appendix



STATE OF WASHINGTON
DEPARTMENT OF REVENUE

October 9, 1998

TO: All Interested Parties

FROM: Sandra G. Guilfoil, Assistant Director
Property Tax Division

SUBJECT: LEVY CAPACITY OF TAXING DISTRICTS

Referendum 47 made some significant changes to the process a taxing district must use to increase revenue from property tax collections. The Department has received a number of questions about how this legislation modified the process and the protection of levy capacity. Following our initial interpretation, the Department made additional inquiries to members of the Legislature, Legislative staff, and other interested parties for further clarification.

This memorandum includes a description of the issue and our interpretation of Referendum 47, as it applies to that issue.

Issue

While several new statutes were enacted by Referendum 47, RCW 84.55.092 *Protection of future levy capacity* was not amended. The issue involves districts with populations of 10,000 or more. Can these districts pass a resolution under Section 204 of Referendum 47 (RCW 84.55.0101) with a finding of substantial need for money in excess of the rate of inflation, levy something less than this amount, and protect that unused levy capacity for future years?

An example may be useful:

District Population:	15,000
Implicit Price Deflator (inflation):	2%
Previous Highest Lawful Levy:	\$100,000

The district submits a budget in 1998 asking for a levy of \$104,000 (4% increase). The first resolution (Section 209 of the Referendum; RCW 84.55.120) is passed showing the dollar and percentage increase above the previous year's levy. The second resolution (Section 204 of the Referendum; RCW 84.55.0101), passed by a super-majority vote of the governing board of the district, states the substantial need for a six percent increase



LEVY CAPACITY OF TAXING DISTRICTS

Page 2

October 9, 1998

due to the need for "additional money to support the operation of a new jail slated for future development".

Year	Highest Lawful Levy	Amount of Actual Levy
1997	\$100,000	\$100,000
1998	\$106,000	\$104,000

Question: Has the district protected its highest lawful levy in 1998 at \$106,000 or \$104,000?

Analysis

RCW 84.55.120 was amended by Referendum 47 to say in part:

"No increase in property tax revenue, other than that resulting from the addition of new construction and improvements to property and any increase in the value of state-assessed property, may be authorized by a taxing district, other than the state, except by adoption of a separate ordinance or resolution, pursuant to notice, specifically authorizing the increase in terms of both dollars and percentage. The ordinance or resolution may cover a period of up to two years, but the ordinance shall specifically state for each year the dollar increase and percentage change in the levy from the previous year."

RCW 84.55.005 defines "Limit Factor" to mean:

- (a) For taxing districts with a population of less than ten thousand in the calendar year prior to the assessment year, one hundred six percent;*
- (b) For taxing districts for which a limit factor is authorized under RCW 84.55.0101, the lesser of the limit factor authorized under that section or one hundred six percent;*
- (c) For all other districts, the lesser of one hundred six percent or one hundred percent plus inflation;*

RCW 84.55.0101 says in part:

Upon a finding of substantial need, the legislative authority of a taxing district other than the state may provide for the use of a limit factor under this chapter of one

LEVY CAPACITY OF TAXING DISTRICTS

Page 3

October 9, 1998

hundred six percent or less. In districts with legislative authorities of four members or less, two-thirds of the members must approve an ordinance or resolution under this section. In districts with more than four members, a majority plus one vote must approve an ordinance or resolution under this section. The new limit factor shall be effective for taxes collected in the following year only.

It is clear that any district, regardless of its size, must pass a separate resolution to increase its levy above the previous year (other than the increase due to new construction, improvements to property and increase in the value of state assessed property, hereinafter referred to as "add-ons"). It is also clear that districts with a population below 10,000 may protect levy capacity for future years at a six percent increase with the adoption of an ordinance or resolution under RCW 84.55.120 (Section 209 of the Referendum) levying something less than a six percent increase.

The question is whether a large district (with 10,000 or more in population) may identify a future need for additional money and protect the "highest lawful levy" at an amount above that which is actually levied in the current year. Prior to the passage of Referendum 47, RCW 84.55.092 allowed taxing districts to voluntarily take less than a six percent increase in their levies, and yet retain the levy capacity at six percent under most circumstances. It is our opinion that the changes to chapter 84.55 RCW created by Referendum 47 have amended the meaning of RCW 84.55.092 even though the specific text of this statute was not changed. We believe a district cannot lawfully increase its levy except for add-ons without adopting a resolution. The "full amount allowed under this chapter" (RCW 84.55.092) is determined by the adoption of a resolution or ordinance. Without it the "full amount allowed" is the increase for add-ons.

Additionally, large districts can only increase their levy beyond the rate of inflation with the adoption of a second resolution by a super-majority of the governing board, which identifies a "substantial need" for additional money. The "full amount allowed under this chapter" is determined by the adoption of a resolution/ordinance that is based on substantial need. "Substantial need" is not defined by this legislation. It is our opinion that determination of substantial need is unique and specific to the governing bodies of any jurisdiction and the taxpayers they represent. The public process required in the adoption of any resolution serves as notification to the taxpayers of the district that there is need for funding in excess of the rate of inflation. The need may not be immediate but if levy capacity is not protected for the future need, the district would have to increase its current budget and set aside the money for use in later years. The purpose of RCW 84.55.092 is to prevent districts from having to levy currently in order to not lose levy capacity. Rather than levying the money now and setting the funds aside, this statute allows the district to protect the capacity to levy while not requiring the actual levy to be done until the time of need. This protection is only authorized when the governing

LEVY CAPACITY OF TAXING DISTRICTS

Page 4

October 9, 1998

board of the district has held a public hearing and adopted a resolution or ordinance stating the district's substantial need to do so.

Conclusion

It was the stated intent of Referendum 47 "...to lower the one hundred six percent limit while still allowing districts to raise revenues in excess of the limit..." (Section 208 of the Referendum). Districts can no longer automatically "bank" their levy capacity. Rather, the district must now pass a resolution/ordinance through a public hearing in order to do so. Districts with a population at or above 10,000 can "bank" levy capacity at the rate of inflation by passing one resolution/ordinance. Large districts that demonstrate substantial need by passing a resolution/ordinance by a super-majority of the governing board can also protect levy capacity above the rate of inflation up to a maximum of six percent. The actual capacity that is protected must be stated in the resolution/ordinance.

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