

HOUSE BILL REPORT

HB 2098

As Reported by House Committee On:

Finance

Title: An act relating to providing financial assistance to counties and cities.

Brief Description: Providing financial assistance to counties and cities.

Sponsors: Representatives Grant, Jarrett, O'Brien, Chase, McIntire, Hankins, Santos and Shabro.

Brief History:

Committee Activity:

Finance: 3/4/03, 3/10/03 [DPS].

Brief Summary of Substitute Bill

- Provides that it is the intent of the Legislature to provide local communities more tools to choose the local level of public services and taxes.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 5 members: Representatives Gombosky, Chair; McIntire, Vice Chair; Conway, Morris and Santos.

Minority Report: Do not pass. Signed by 4 members: Representatives Cairnes, Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Ahern and Roach.

Staff: Mark Matteson (786-7145).

Background:

Cities and counties rely on retail sales and use taxes and on property taxes for a substantial part of general revenues. Cities also utilize business and occupation and utility taxes for a portion of their revenues.

The portfolio of revenue sources for a particular local government depends on location,

historical development, and past actions by local elected governments and by local voters. Jurisdictions that are near the Oregon border, for instance, have tended not to utilize very much of the local sales and use taxation authority that is available, in order to minimize the discrepancy in retail sales tax rates with Oregon jurisdictions, which may not impose sales tax. Instead, the border jurisdictions rely on other sources, including a special real estate excise tax. In addition, a number of municipal governments in the Puget Sound region have enacted business and occupation taxes, while no jurisdiction in the eastern part of the state has.

Local Retail Sales & Use Taxation

The retail sales tax applies to the selling price of tangible personal property and of certain services purchased at retail. The tax base includes goods and certain services purchased at retail. Sales tax is paid by the purchaser and collected by the seller. The seller remits the tax and other taxes with the combined excise tax return to the Department of Revenue.

The use tax is imposed on items used in the state that were not subject to the retail sales tax, and includes purchases made in other states and purchases from sellers who do not collect Washington sales tax. The tax rate is the same as that imposed under the retail sales tax. Use tax is paid directly by the person using the item to the Department of Revenue.

Counties and cities may impose several local sales and use taxes at various rates and for various purposes. The tax base is the same as under the state retail sales and use taxes. The most widely utilized local sales and use taxes are the basic tax at a rate of 0.5 percent and an optional tax at a rate of up to 0.5 percent, both for general purposes. In adopting ordinances to impose the taxes, counties are required to provide a credit for any city taxes imposed, so that the rate in an affected incorporated area does not exceed 1.0 percent. In calendar 2002, over \$900 million in basic and optional sales and use tax revenues were distributed by the State Treasurer to county and city governments.

County and city sales and use taxes are imposed by ordinance of the legislative authorities. Neither the basic nor optional tax for general purposes is subject to voter approval prior to imposition. However, other local sales and use taxes require a public vote prior to imposition, such as the 0.1 percent tax for the purpose of constructing correctional facilities.

For most of the sales and use taxes that counties may impose, the county government is the sole entity that receives and uses the funds, there are a few exceptions, however. For example, the receipts from the 0.1 percent tax for criminal justice programs must be shared with the cities within the county, based on population.

Property Taxation

Property taxes are levied by state and local governments. The county assessor determines assessed value for each property. The county assessor also calculates the tax rate necessary to raise the correct amount of property taxes for each taxing district. The assessor calculates the rate so the individual district rate limit, the district revenue limit, and the aggregate rate limits are all satisfied. The property tax bill for an individual property is determined by multiplying the assessed value of the property by the tax rate for each taxing district in which the property is located. The assessor delivers the county tax roll to the treasurer. The county treasurer collects property taxes based on the tax roll starting February 15 each year.

There are many districts authorized to levy property taxes. These include "senior" districts, consisting of the state, counties, county road districts, and cities (including towns), as well as "junior" districts, which include fire, library, cemetery, hospital, port, and a number of other districts. Counties are authorized to levy property taxes countywide, while county road districts are authorized to levy just within unincorporated areas of the county, for the purpose of constructing or improving roads. The state levy must be used for the support of common schools.

The sum of property tax rates is limited by the state constitution to a maximum of 1.0 percent of true and fair value, or \$10 per \$1,000 of market value. Property taxes that are subject to this 1 percent limitation are referred to as regular property taxes. Generally, there are no voting requirements with respect to regular property taxes, which are levied annually. However, there are several exceptions, including requirements for emergency medical service districts, park and recreation districts, and cultural arts, stadium and convention districts, in which regular property taxes may be levied for periods of six years or more. The regular levies for these districts require approval of 60 percent of the voters in the district. The ballot proposition that authorizes the district to impose one of these levies must include specific information, including the maximum rate to be levied, the number of consecutive years in which the levy is to be imposed, and, in the case of emergency medical service districts, whether the levy is to be made permanent.

The Legislature has established caps on individual district rates and on the aggregate rate so as to keep the total tax rate for regular property taxes within the constitutional 1 percent limit. For example, the state levy rate is limited to \$3.60 per \$1,000 of market value, county general levies are limited to \$1.80 per \$1,000 of assessed value, county road levies are limited to \$2.25 per thousand, and city levies are limited to \$3.375 per thousand. (A county may increase its general levy rate up to \$2.475 per thousand if the total combined rate for the county and the road district does not exceed \$4.05 per thousand and if no other district's rate must be reduced as a result of the increase of the county general levy rate.) Junior districts each have specific rate limits as well; for example, library districts are limited to \$0.50 per thousand dollars of assessed valuation. The tax rates for most of these senior and junior districts must fit within an overall rate limit of \$5.90 per \$1,000 of value. There is a complex system of prorating the various

levies so that the total rate does not exceed \$5.90. Under this prorationing system, senior districts are given preference over junior districts.

A few regular property tax levies are not placed into the \$5.90 aggregate rate limit for senior and junior districts: emergency medical service, affordable housing, conservation futures, and a portion of a metropolitan park district's rate. However, these districts are subject to reduction if the total aggregate rate for these districts, the state property tax, and the districts subject to the \$5.90 limit together exceed \$10 per \$1,000 of market value.

In addition to the rate limitations, a district's regular property tax levy is limited by a statutory maximum growth rate that restricts the amount of tax revenue that may be collected from year to year. The voters amended this revenue limit most recently with the passage of Initiative 747 in November 2001. The limit requires a reduction of property tax rates as necessary to limit the growth in the total amount of property tax revenue received to the lesser of 1 percent or inflation. The revenue limitation does not apply to new value placed on tax rolls attributable to new construction, to improvements to existing property, or to changes in state-assessed valuation.

Formation of New Taxing Districts

The authority to levy regular property taxes and the associated rate limitation of \$10 per \$1000 of market value derived from the State Constitution. The State Constitution does not enumerate the types of districts that may levy regular property taxes. Rather, in creating new districts with regular property taxation authority, the Legislature has expressly provided that the district derives its authority from the State Constitution.

Governmental entities, like businesses, may be structured as corporations for the purposes of existing as a single legal entity that may enter into contracts, sue and be sued and do the many other things necessary to carry on governmental functions.

Local Business and Occupation Taxation

At the inception of statehood, the Legislature granted cities certain broad powers and duties. Among these was the power to license business activities and to charge amounts for such licenses. The state court has interpreted this provision broadly, to mean that cities have the authority to not only impose fees and taxes for the purposes of regulation but for the purposes of raising revenue as well. Cities have used this authority to impose license fees and taxes upon businesses and utilities since statehood.

Cities impose business and occupation (B&O) taxes on the gross receipts of businesses located within cities without any deduction for the costs of doing business. The Legislature limited city B&O taxes on retail sales to a maximum of 0.2 percent in 1982, but allowed for higher rates if the rates are approved by the voters in the city, or if a

higher rate was in effect prior to January 1, 1982. Cities first imposing a B&O tax after April 22, 1983, and cities increasing tax rates must have a referendum procedure. Thirty-seven cities impose business and occupation (B&O) taxes based on gross receipts.

Counties' powers at statehood derived from authorities established under territorial governments and were much more limited than that of cities. The counties' powers do not include the ability to license business activities and to impose fees or taxes for the purpose of regulation or raising revenue. Counties' authority to impose taxes derive from express authorization by the Legislature to do so for a specific tax.

Utility Service Provision and Taxation

Cities have traditionally taxed utilities in a manner similar to other businesses, based on gross receipts, but at rates which were typically higher than for other businesses. In 1982 the Legislature limited the rate at which cities could tax electric, gas, steam, and telephone businesses to 6 percent. Cities with rates higher than 6 percent at the time of the change, unless the change was previously approved by the voters, were required to reduce their rates to 6 percent or less over a transitional period. Cities may also tax water, sewer, solid waste, and stormwater utilities, but there are no restrictions with respect to rates for these utilities; rates range from 2 percent to 24 percent.

Cities and counties may enter into interlocal agreements for the provision of services. For example, under the Tacoma-Pierce County solid waste management plan, Pierce County provides solid waste management services for 16 of the cities in the county and has entered into interlocal agreements with some of the cities. Under the plan, the cities may contract with one of four collection companies for the collection of solid waste. Some of these cities impose the tax on the gross receipts of the solid waste collection business within the city boundaries.

A metropolitan municipal corporation is a form of local government that may be authorized by voters to perform certain functions, including public transportation, water supply, solid waste disposal, and sewage disposal for a metropolitan area. The only such corporation in active operation at present is King County Metro, which provides transit, sewage, and wastewater treatment functions. (Under HB 1140 in 1993, the King County government was authorized to assume the functions of the corporation.) Under the authorizing statutes, cities and counties are prohibited from imposing gross receipts taxes on such corporations.

Counties are not provided the same authority that cities have to tax utilities in general. However, under the statutes governing county sewerage, water, and drainage systems, counties have the authority to impose a tax at a rate of up to 8 percent on the gross revenues of a sewerage or water system operated by a county.

Local Taxation of Telephone Service

Telephone service is statutorily divided into two categories: competitive telephone service and network telephone service. Network service is the provision of access to a local telephone network, local telephone network switching service, and includes the provision of coin telephone services; telephonic, video, data, or similar communication or transmission for hire, via a local telephone network, toll line, cable, microwave, or similar communication system. Network service includes certain interstate service, as well as faxing, paging, and wireless services. Network service does exclude cable, radio, television, or Internet access services. Competitive telephone service, on the other hand, is the provision or servicing of telephone equipment.

With respect to telephone services, statute provides certain limitations on the taxation authority of cities. With respect to the 6 percent utility tax rate, cities may tax all gross revenues derived from intrastate toll telephone services. However, cities are not allowed at the 6 percent rate those network telephone service charges made from one telephone company to another relating to connecting fees, switching, or intrastate carrier access; or charges for network service that is purchased for resale. The aforementioned activities may be taxed under a municipal business and occupation tax, instead, at a rate of 0.2 percent. Cities may not tax network service receipts earned from interstate long distance toll charges under either utility or business and occupation taxes.

Recent Structural Changes

In recent years the authority of cities and counties to raise or receive revenue has been limited by a number of statutory changes. These changes have included retail sales and use tax exemptions enacted by the Legislature; the repeal of the Motor Vehicle Excise tax; and the limitation in growth of property tax revenues that may be received from year to year. The latter two changes have been particularly difficult for local governments that do not have a significant industrial or commercial tax base.

Summary of Substitute Bill:

The bill provides that it is the intent of the Legislature to give local communities more tools to choose the level of public services and taxes that they want. It is also the intent to provide direct financial assistance to those counties and cities that are unable to provide basic governmental services without state assistance.

Substitute Bill Compared to Original Bill:

Removes the same authority granted to counties that is given to cities to impose business and utility taxes. Removes the increased maximum local utility taxation rate of 8 percent of gross income. Removes the additional general retail sales and use tax authority granted to counties of 0.2 percent. Removes the new regular property tax levy authority of up to 10 cents per thousand dollars of assessed valuation granted to counties and up to

25 cents per thousand granted to cities. Removes the authority to create a new taxing district in county unincorporated areas, and to levy regular property taxes of up to 25 cents per thousand. Removes the appropriation of \$25 million to the Department of Community, Trade, and Economic Development for financial assistance to local governments.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: (In support) This is the Tri-Association legislative package. Basically, if counties can't operate, then they can't provide core services. The old Motor Vehicle Excise Tax (MVET) provided 70 percent of Garfield County's general budget, and now they are almost non-functioning. The front-end criminal justice costs continue to grow, and almost half of the counties are at their maximum property tax rates. Most counties' expenditures actually occur within incorporated areas, such as those for prosecutors' offices, jails, and others. As incorporations have increased, sources of revenues to the counties have decreased. Counties have cut services to cope. Counties have few practical revenue tools left. In addition, failing cities impact counties since, by default, counties must assume a minimum level of service within the former city boundaries.

The Association of Washington Cities supports this bill. It is intended to provide a sufficient portfolio of revenue options to allow a local jurisdiction to tailor a package to its needs. Due to the repeal of the MVET, 134 cities lost more than 10 percent of their local general budget revenues. It is necessary to maintain a minimal level of services in cities. In eastern Washington, cities are facing a double-whammy, with the loss of MVET and property tax revenues and with the economic downturn.

Citizens have certain expectations of government, whether state or local. Citizens believe that certain core services will be delivered. The reason for this multifaceted package is that different communities have different needs and approaches to dealing with their issues. We are not asking you to pass a tax. We are asking you for the authority to do something on our own.

In the last two years, King County has cut \$90 million out of its general fund budget. At first, we cut discretionary services, but now we are cutting into core services. Without additional relief, there will be more cuts; as much as one-third of general fund core services could be eliminated in the next several years. We have done our best to streamline existing functions and find efficiencies. We have reorganized four departments, cut 130 positions, renegotiated with employees concerning benefits. But

with cuts to core services, there is a cost. For instance, our community clinics are turning away people 50 times a day. In addition, the rising criminal justice costs are outpacing any increase in revenues to programs.

The King County Alliance for Human Services supports this bill. We believe that local government plays a vital role in providing services. Costs have continued to rise. King County has thus far balanced their budget by cutting services. However, demand has increased, especially with respect to our most vulnerable population.

The directors of domestic violence victim advocacy programs support this bill. Domestic violence problems have been epidemic, and affect all types of people. The entire community pays the price of domestic violence through increased criminal justice costs, lost worker productivity, and increased health care costs. The King County support of advocacy programs has been cut and is compounded by a drop in state and federal sources of revenue. We need additional options for local governments.

We're seeing a dramatic increase in former Boeing employees and other laid-off workers seeking services. With the education and skill set they have, they require additional training to obtain new jobs. My staff is stretched to serve people. Industries that have relied on Boeing in the past are also downsizing, and these displaced persons are in need. We're asking you to let us help ourselves.

(Concerns) The Superintendent of Public Instruction is concerned about the property tax provisions of this bill. Property taxes have been an important source of revenue for common schools since before statehood. The 25 percent of property taxes that have gone to schools is used for fundamental operations.

Testimony Against: We oppose the section of the bill that allows counties to impose a new sales tax as it applies to new vehicle sales. This won't make or break the retail dealers, but the cumulative effect with all the other new sales tax bills would have a serious negative impact on the retail auto industry. New cars are not flexible in their price. We are not asking for an exemption, we just do not want the new tax to apply to new vehicle sales.

We oppose the new county utility tax authority in unincorporated areas, and the increase in the rate to 8 percent. It also appears to us that there is opportunity for double taxation. For example, if Spokane County residents vote for the tax and then get annexed by the City of Spokane, they could conceivably be subject to utility tax rates of 16 percent.

Rural electric cooperatives serve mostly residents and farmers in rural areas. We are concerned about the utility tax rate of 8 percent in rural areas. It appears this tax could be imposed without a vote of the people. We do not need additional costs added to the cost of doing business, especially at this time.

The Snohomish Public Utility District is opposed to the increased authority in cities with respect to utility taxes. In recent years, people's taxes have effectively risen because of large rate increases. We don't need further tax increases to burden our ratepayers.

There are many large industrial consumers of energy, and prices are critical to their business. They often locate in unincorporated areas because of a relatively lower tax burden. The proposed utility taxes would be extremely detrimental to their competitive position.

Testified: (In support) Harold Moss, Washington State Association of Counties; Chuck Mosher, Association of Washington Business; Greg Zemple, Washington Association of County Officials; Larry Phillips, Councilmember, King County Council; Laura Wells, King County; Terri Kimball, D.A.W.N.; Larry Cluphs; Thomas Trompeter, Community Health Centers of King County; and Mary Ellen Stone, King County Sexual Assault Resource Center.

(Concerns) Megan Atkinson, Office of the Superintendent of Public Instruction.

(Opposed) Jim Boldt, Washington State Auto Dealers Industry; Steve Gano, Aviation, Cingular Wireless; Dave Clinton, Washington Rural Electric Co-op Association; and Tim Boyd, Industrial Customers of N.W. Industries.