FAQ on Employee Hours Tax and Short-Term Rentals Tax

(as presented in the Chair's Initial Balancing Package on 10/31/2017)

Background

The Council is considering establishing two new taxes: (1) an Employee Hours Tax and (2) a tax on Short Term Rentals (STRs).

An Employee Hours Tax (EHT) would tax businesses with gross receipts above a specified threshold for every employee. The City administered an EHT from 2006 until 2009 to fund transportation investments. The proposed EHT would be established through the Council's budget process.

The Short-term Rental tax (STR) would tax short-term rental operators $10 per night. The Affordable Housing Neighborhoods and Finance Committee recommended approval of this tax (C.B. 119083) in September 2017. A vote on this tax is scheduled for November 13, 2017 prior to Council action on 2018 budget legislation. That legislation will be considered with C.B. 119081, which would establish a regulatory license program for short-term rental operators.

The Budget Chair's initial balancing package proposes to borrow against future proceeds from both taxes using interfund loans to fund one-time costs to set up systems to collect the taxes and to hire staff to administer the taxes. The EHT would also fund additional human services related to the City's emergency on homelessness.

This FAQ answers questions about the EHT and the STR, as well as the City's budgetary mechanisms for borrowing against future tax revenues.

EMPLOYEE HOURS TAX (EHT)

1. **How much would the EHT on businesses generate annually at $100 per Full-Time Equivalent Employee (FTE)?**
   At the currently proposed $5 million exemption level for taxable gross receipts, the EHT would generate approximately $20 million to $25 million per year in 2019. If the exemption were set for $8M in taxable gross receipts, it would generate about $22 million, and for a $10 million exemption, approximately $20 million.

2. **How did the City arrive at the estimated EHT revenue?**
   First, Council Central Staff estimated the potential EHT revenues before considering any exemptions. Puget Sound Regional Council data from 2015 provided the basis for determining the number of employees working in Seattle for whom businesses would be subject to the tax. Central Staff made a variety of adjustments to account for part-time employment, out-of-town workers subject to the tax, and job sectors not impacted by the tax (government and education). The estimated potential EHT

revenue <u>before exemptions</u> equals the number of employees multiplied this by $100 per FTE.

Second, Central Staff estimated the effect of granting exemptions using 2009 EHT receipts (the last year the City collected the tax). The percentage of 2009 EHT revenue paid by employers with over $5 million, over $8 million, and over $10 million in taxable gross receipts allowed Central Staff to determine projections of estimated revenues for an EHT starting in 2019. Staff acknowledge that Seattle's economic conditions have changed since 2019 and that the 2009 EHT contained exemptions for commuting behavior that are not part of the current proposal.

3. **When would the City start collecting EHT revenues?**
   The tax would be imposed beginning January 1, 2019. Revenue from the tax could be realized as early as the end of the first quarter of that year.

4. **How much will it cost in 2018 to stand up the EHT tax?**
   The Department of Finance & Administrative Services (FAS) estimates that tax collection and administrative systems and associated protocols ("stand-up" costs) would be $1.6 million. Starting in 2019, FAS estimates that the ongoing administration costs would be $500,000 annually.

5. **If businesses don't start paying the EHT until 2019, how will the City pay for the 2018 costs to stand up the EHT tax?**
   The funds needed to stand up the systems and processes come from an interfund loan (sometimes referred to as a "bridge loan" – see Question 6 below) of $1.6 million drawn from the Seattle Information Technology Operating Fund. This operating fund has been identified by the City's Budget Office as a fund the purpose of which has a nexus to the activity for which the money would be borrowed. The loan and accrued interest will be repaid from the EHT revenue during a three-year period beginning when the tax is collected in 2019.

6. **What is an interfund or "bridge" loan?**
   An interfund loan is a loan made from one City fund or account (the lending fund) that has fund balance beyond what is needed for immediate purposes to another City fund the (borrowing fund) that requires additional resources to support planned projects or activities. Like any other loan, an interfund loan must be repaid. Additionally, the borrowing fund must make interest payments to compensate the lending fund for interest that would have otherwise been earned through short term deposits.

   Interfund loans are most commonly used as "bridge financing" to support a capital project of some kind (such as a construction project, land acquisition, or a software system) until bonds can be sold to provide longer term financing. However, the City has also used interfund loans to provide short-term financing for setup costs associated with new or revised taxes. Once the tax is being collected, a portion of those revenues can then be used to repay the loan. For example, the City recently issued an interfund loan to pay for the costs of setting up the Sugary Beverage Tax; the proceeds of that tax will repay the loan amount plus interest.

7. **If businesses don't start paying the EHT until 2019, how will the City use EHT revenues in 2018?**
   The Chair's initial balancing package assumes that the City would borrow $11 million from the office of Housing Fund to pay for a variety of initiatives related to homelessness and human services in the balancing package (see Question #8). The loan, including interest would be repaid out of the future EHT revenues during a three-year period beginning in 2019.

8. **How would the City repay the interfund loans?**
   Council Central Staff estimates that the EHT will generate between $20 million and $25 million annually starting in 2019 (see Question #1). Until the tax revenue begins to flow, there is uncertainty about how much tax revenues will flow.

   Assuming the low end of that range ($20 million) and a three-year window to use EHT revenues to repay both the $11 million dedicated for homelessness and human services and the $1.6 million loan to stand up the tax, the following table summarizes the anticipated revenues and spending for years 2018 through 2022:

Table 1: Homelessness and Human Services Loan Revenues and Spending

	2018	2019	2020	2021	2022
Tax Revenue	$ -	$ 20,000,000	$ 20,000,000	$ 20,000,000	$ 20,000,000
Financing (loan)	$ 12,600,000	$ -	$ -	$ -	$ -
Loan repayment	$ -	$ (4,284,000)	$ (4,284,000)	$ (4,284,000)	$ -
Ongoing admin costs	$ -	$ (500,000)	$ (500,000)	$ (500,000)	$ (500,000)
Net amount	**$ 12,600,000**	**$ 15,216,000**	**$ 15,216,000**	**$ 15,216,000**	**$ 19,500,000**

9. **Could the City increase the interfund loan for homelessness and human services to an amount greater than $11 million?**
   It may be possible to increase the loan amount beyond $11 million. In the event that tax revenues from the EHT do not match expectations, it could become a General Subfund liability to repay the loan amount plus interest in the event that actual tax receipts are below projections.

10. What in the Budget Chair's Initial Balancing Package rely on EHT revenues in 2018?

a) $3,300,000 for emergency shelter services (GS 235-1-B-2);

b) $2,750,000 for permanent supportive housing services (GS 237-1-A-1);

c) $1,000,000 for expansion of the Law Enforcement Assisted Diversion (LEAD) program (GS 256-1-B-1);

d) $588,000 for transitional housing for homeless foster youth (GS 236-1-A-1);

e) $550,000 to support a safe consumptions site (GS 259-1-B-1);

f) $500,000 for the Homeless Youth Opportunity Center and Housing Project (GS 226-1-C-1);

g) $436,408 for additional staffing for the Human Services Department (HSD) to address increased workload (GS 280-1-B-1);

h) $400,000 for homeless child care programs (GS 161-1-A-1);

i) $400,000 for flexible and mobile advocates to assist domestic violence and sexual assault (DVSA) survivors (GS 268-1-B-1);

j) $400,000 for DVSA survivor advocacy contracts (GS 269-1-B-1);

k) $200,000 for emergency domestic violence (DV) shelter and DV advocacy (GS 266-1-A-1);

l) $161,000 to fund a prescriber position (such as a nurse practitioner) at a Public Health facility (GS 257-1-A-1);

m) $150,000 to fund a nurse position in Public Health to provide services for encampments (GS 258-1-A-2); and

n) $100,000 for support services (such as trash removal) at unauthorized homeless encampments (GS 234-1-B-1).

SHORT-TERM RENTAL TAX (STR)

1. **There's been news about using the potential STR revenues to replace the EHT to pay for homelessness-related budget items in the Chair's Initial Balancing Package. What is the status of the STR legislation?**
   On September 15, 2017, the Affordable Housing Neighborhoods and Finance Committee voted the STR tax bill (C.B. 119083) and the STR regulatory license bill (C.B. 119081) out of committee. Final Council action on this legislation is anticipated on November 13, 2017.

2. **How much revenue would the STR generate annually under the current legislation?**
   The estimated revenue is $6 million in 2019. This amount assumes 600,000 short-term rental nights will be booked in 2019, based on data obtained from Airdna, a company that provides data services related to the STR market, in March 2017. A more conservative estimate would be $3.6 million in revenue in 2019 (based on the City achieving 60 percent compliance in the first year of the tax).

3. **When would the City start collecting STR revenues?**
   Taxpayers filing and paying their business license tax on a quarterly basis will file and pay the short-term rental tax on a quarterly basis beginning in 2019 and taxpayers filing and paying their business license tax on an annual basis will file and pay the short-term rental tax on an annual basis.

4. **How much will it cost in 2018 to stand up the STR tax and regulatory license?**
   FAS and CBO estimate that the costs in 2018 to stand up both the short-term rental tax and the short-term rental regulatory license program in 2018 are estimated to be $4.2 million, comprised of:

   a) $2.9 million in 2018 to develop two software systems necessary to implement the STR regulatory license and tax.

   b) $1.3 million for staff and consultant resources to develop rules, procedures and processes in advance of the effective date of the new regulatory license and tax.

5. **If businesses don't start paying the STR until 2019, how will the City pay for the costs to stand up the STR tax?**
   The resources necessary for implementation in 2018 will be supported by an interfund loan that will be repaid over time with license fees and tax revenue.

6. **Recent news talks about using the STR tax to fund services for the homeless in 2018. Is this possible?**
   The $10 per night STR as proposed in C.B.119083 is expected to generate approximately $6M per year beginning in 2019. Green Sheet 351-1-B-1 would approve an interfund loan in the amount of $4.24 million to fund setup costs (including computer systems) necessary to collect the tax and to undertake related regulatory activity. The proposed loan would be repaid from STR revenues in 2019.

   Assuming the $6 million revenue forecast for the STR tax is accurate, 2019 collections would be sufficient to repay the interfund loan, ongoing administrative costs, and roughly $3.1 million of other programs in 2019. It would be possible to authorize a second loan from future STR tax collections to finance services in 2018; however, any such amount would further reduce the amount available in 2019.

   As passed out of committee and scheduled to be in front of Full Council on Monday, November 13, 2017, C.B. 119083 states that: *Services funded by the proceeds of the short-term rental tax are intended to support investments in affordable housing and to support community-initiated equitable development projects, including but not limited to projects described in* Resolution 31711*. Eligible expenditures include:*

   A. Resources necessary to (1) fund one-time expenditures to administer the tax and ongoing administration of assessing and collecting the tax, and (2) to offset the cost of implementing and administering Chapter 6.600 of the Seattle Municipal Code (SMC).

   B. The remainder of net proceeds shall be split equally to support investments in affordable housing and to support community-initiated equitable development projects.

   C. In the annual City budget or by separate ordinance, the City's legislative authority shall from year to year determine the services and funding allocations that will most effectively achieve the goals and outcomes in accordance with Chapter 35.32A RCW*.*

   To date, the affordable housing investments discussed are to retire the $29 million housing bond debt.

Table 2: STR Loan Revenues and Spending

	2018	2019	2020	2021	2022
Tax Revenue	$ -	$ 6,000,000	$ 6,120,000	$ 6,242,400	$ 6,367,250
License Fees	$ -	$ 184,000	$ 208,368	$ 233,789	$ 260,144
Financing (loan)	$ 4,237,000	$ -	$ -	$ -	$ -
Loan repayment	$ -	$ (1,440,580)	$ (1,440,580)	$ (1,440,580)	$ -
Ongoing admin costs	$ -	$ (1,650,400)	$ (1,511,856)	$ (1,543,712)	$ (1,576,523)
Net amount	**$ 4,237,000**	**$ 3,093,020**	**$ 3,375,932**	**$ 3,491,897**	**$ 5,050,871**

NOTE: The costs for implementation and ongoing administration of the tax and regulatory license reflect preliminary estimates from FAS and Seattle IT. The Applications Development-FAS CIP project is a new project that is still in Seattle IT's "Concept" phase. The total budget and staff resources needed to develop, implement, and support implementation of the short-term rental tax and regulatory license may change as the project moves from "Concept" to "Initiation" and the scope of work is further refined.

Additionally, there is risk that short-term rental revenue proceeds will not match current projections, particularly if the City does not achieve full compliance in 2019 (see question #2 above). The Convention Center is actively seeking expansion of the State's lodging tax to include short-term rental businesses. If the Convention Center is successful, that legislation could result in the City being preempted from implementing a local tax on short-term rental businesses.

Attachments:

1. Note on B&O Tax from CBO

Attachment 1 : Note on B&O Tax

B&O Basics
All businesses that engage in business in Seattle are required to secure a Business Tax License Certificate(Tax Registration) and file, report and pay B&O tax, subject to the $100,000 taxable income threshold.

What type of taxpayers are exempt?
We have entity level exemptions which means any income earned by an exempt entity is exempt, we have activity based exemptions such as Horse Racing where all income of certain activities are exempt, and we also have income level exemptions which means certain types of incomes are exempt. Exemptions are contained in SMC 5.45.090.

An example of entity level exemptions are Insurance companies, (state mandated exemption) and Governmental exemptions. We can tax our self, the City of Seattle, but we cannot tax other cities, municipalities, state or federal agencies.

Nonprofits in general are not exempt. We do have specific exemptions for nonprofits under SMC 5.45.090.

It is important to note that SMC 5.45.100 contains income that could be deducted. The difference between a *deduction* and an *exemption* is that deductible gross income must be reported and then deducted to arrive at taxable income. Exempt income is not reported to the City.

How does the tax apply to different business models?
In Seattle, each separate legal entity is separately responsible for securing a Business License Tax Certificate, and for reporting and paying Seattle B&O tax on their separate gross incomes. For example, if a business had five separate restaurants each set up as an LLC, we would not combine the gross incomes of all five to see if they meet the taxable income threshold. Each would be assessed separately.

How does the B&O apply to taxpayers with locations inside and outside the City?
Income sourcing is mandated under State Law. For example, income from retailing activities are sourced where the buyer takes delivery.

<u>How do Seattle Retail taxpayers report and pay the Seattle B&O tax?</u>
Only location in Seattle
Gross income of the business less any sales delivered to customers outside Seattle = Taxable income

Locations in Seattle and outside Seattle
Gross income of the business is income of all Seattle locations less any deductions for sales delivered outside Seattle = Taxable income

Income to locations outside Seattle not included in Gross or Taxable income.

How does the B&O apply to Services?
Gross income and Taxable income are based on a formulary apportionment method. They are not based on income by office or activity. We have a two factor formula: payroll and receipts.

How does the B&O apply to companies that have *headquarter activitie*s in Seattle?
If the business is a single entity and has its headquarters in Seattle, then the taxable income will depend on where the business' operating units are located. For example, if a company is headquartered in Seattle and also has retail activities in Seattle and outside Seattle, then the Seattle taxable income would be limited to the Seattle sales. If a company is headquartered in Seattle and has no retail stores in Seattle then Gross income or Taxable income here will likely be zero.

What type of employment information can be gathered under the proposed employee hours tax?
We would only gather information from entities that are subject to the tax, so under the current proposal approximately 90% of businesses would not report employment data at all. We would only collect information necessary to verify compliance with the proposed tax; that is, either the number of FTE's or the number of employee hours.