



## CITY OF KIRKLAND

Department of Finance & Administration  
123 Fifth Avenue, Kirkland, WA 98033 425.587.3100  
www.ci.kirkland.wa.us

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### MEMORANDUM

**To:** David Ramsay, City Manager

**From:** Tracey Dunlap, Director of Finance and Administration  
Tammy McCorkle, LG Management Fellow

**Date:** September 17, 2008

**Subject:** **Business License Fee Restructure**

#### BACKGROUND DISCUSSION:

A revenue generating regulatory license (RGRL) is a license fee on businesses that both regulates and raises revenue. Cities have the authority to charge a business license fee to regulate and generate revenue through the Revised Code of Washington (RCW), which provides:

- **RCW 35.22.280 (32):** "To grant licenses for any lawful purpose, to fix by ordinance the amount to be paid therefore ..."
- **RCW 35.23.440 (8):** "To fix and collect a license tax for the purposes of revenue and regulation ..."
- **RCW 35.27.370 (9):** "To license, for the purposes of regulation and revenue, all and every kind of business, ..."
- **RCW 35A.82.020:** "...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 businesses ..."

The RGRL is not a business and occupation (B&O) tax in the common application because it is not a tax levied on the gross receipts of a business.

On July 15, 2008, the City Council approved a budget balancing framework that included implementing a restructuring of the City's business license fee from the current license fee and surcharge to a "per FTE fee" based on the number of full-time equivalent employees (FTE). The new structure would replace the current structure and is similar to the approaches used by two of Kirkland's neighboring cities, Renton and Redmond. To evaluate the impacts, we compared the current City of Kirkland and the City of Redmond business license fee structures and identified several policy questions for Council as well as items that would need to be changed to implement a per FTE business license fee.

**Why are we considering the change?**

The City is currently facing a significant imbalance in revenues and expenditures and is reviewing existing revenue sources to identify those that may be increased as part of the strategy to balance the budget. The recently updated Tax Burden Study indicates that, while both residential and commercial taxpayers have seen increases in the taxes that they are paying, the relative contribution of the residential sector has grown faster than that of the commercial sector. As a result, the commercial share of overall tax contributions has decreased over the past ten years from 50% to 41%.

In addition, the City of Kirkland currently has a business license fee structure that does not impose a uniform fee based on size. Kirkland has seen an increase in middle to large size businesses, resulting in smaller businesses bearing a larger fee burden than larger businesses. Once a business is larger than 100 employees, their relative fee per employee begins to decrease with each new person. For example, under the current business license fee structure, for a business with annual gross receipts exceeding \$100,000, a business that has 150 employees or FTE's pays \$2,600 annually or \$17.33 per employee and a business with 2 employees pays \$325 annually or \$162.50 per employee.

By restructuring the business license fee, the burden will be more equally distributed by implementing a fee rate that increases as the size of a business increases, resulting in a more balanced business license fee burden (relative to size) for businesses.

**What is the current business license fee structure?**

The current business license fee structure was implemented in May 2003 and is summarized below.

Base Fee: \$100 (applied to all non-exempt businesses, \$25 if gross receipts less than \$2,000) Non-profits, service agencies and governments are exempt from the \$25 fee but must still register.			
Plus:			
Surcharge: Graduated flat fee based on number of employees; surcharge amount reduced if gross receipts less than \$100,000; no surcharge if gross receipts under \$50,000.			
<u># Employees</u>	<u>Full Surcharge if Gross Receipts \$100,000 or More</u>	<u>Reduced Surcharge if Gross Receipts Less Than \$100,000</u>	<u>Surcharge if Gross Receipts Less Than \$50,000</u>
1	\$ 125	\$ 75	\$0
2-5	\$ 225	\$ 150	\$0
6-20	\$ 750	\$ 500	\$0
21-100	\$1,500	\$1,000	\$0
100+	\$2,500	\$2,000	\$0

### What is the proposed structure?

In restructuring the business license fees to a per FTE basis, two alternatives (with sub-options) were evaluated (the detailed revenue calculations are shown in Attachment A).

**Option 1:** Eliminate the current \$100 base fee and surcharge; charge a straight \$90 per FTE. This option is estimated to generate \$2.4 million in 2009, an increase of almost \$1 million over the current structure.

**Option 2:** Keep the base fee of \$100 and charge a Revenue Generating Regulatory License Fee (RGRL) per FTE. Staff has analyzed three options under this RGRL structure.

**Option 2A:** Keep the base fee of \$100 and charge a \$90 RGRL per FTE. This option is estimated to generate revenue of \$2.8 million in 2009, an increase of \$1.4 million from the current structure.

**Option 2B:** Keep the base fee of \$100 and charge a \$95 RGRL per FTE. This option is estimated to generate revenue of \$3.0 million in 2009, an increase of \$1.5 million from the current structure.

**Option 2C:** Keep the base fee of \$100 and charge a \$100 RGRL per FTE. This option is estimated to generate revenue of \$3.1 million in 2009, an increase of \$1.7 million from the current structure.

In the budget strategy framework, estimated additional revenue of \$700,000 per year was based on charging a straight charge per FTE in the amount of \$90 and calculated conservatively using only businesses located inside the City of Kirkland. The estimated revenue for options 1 and 2A-C has been analyzed in more detail using businesses located inside the City of Kirkland and those doing business in the City that are located out of the City limits. The revised calculations are done under the assumption that all for-profit businesses with revenues of \$12,000 or more will be subject to both charges. Those businesses with revenues of less than \$12,000 would be subject to the base fee only (see p. 6 for further discussion of the gross revenue exemption).

**Annual Revenues From Business License Structure Options**

	Total Revenue	Add'l Revenue From Current	Add'l Revenue From Framework
Current	1,458,596	-	-
Placeholder in Framework*	2,100,000	700,000	-
Option 1 - \$90/FTE	\$2,391,120	932,524	232,524
Option 2A - Base+\$90/FTE	\$2,813,920	1,355,324	655,324
Option 2B - Base+\$95/FTE	\$2,946,760	1,488,164	788,164
Option 2C - Base+\$100/FTE	\$3,079,600	1,621,004	921,004

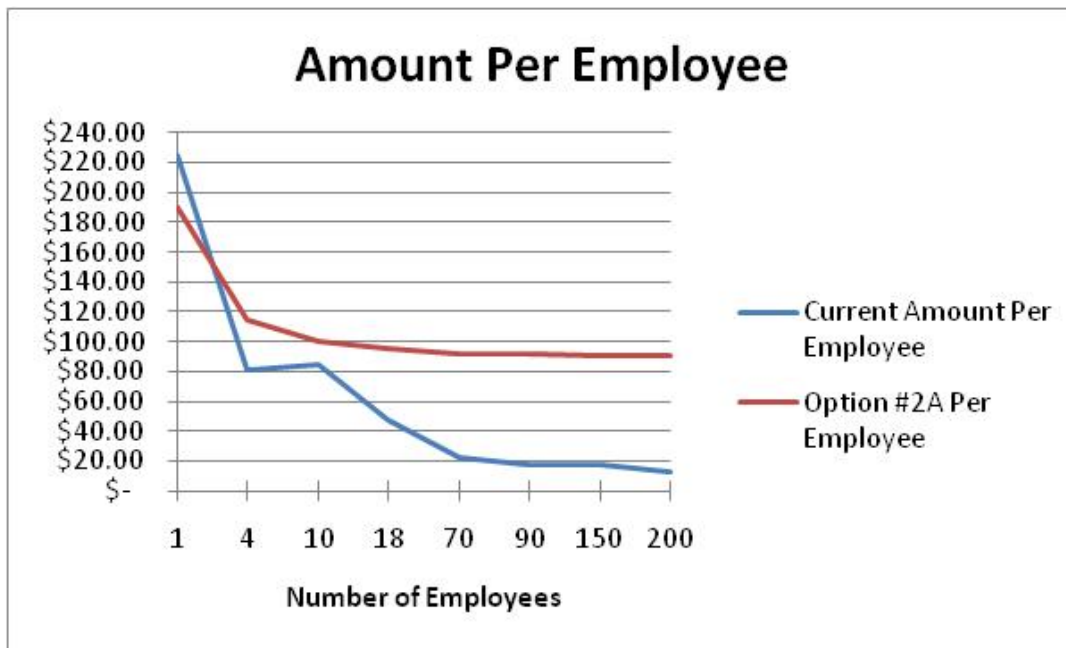
\* Initial framework estimate only included businesses inside the city.

All other options are based on a detailed analysis of businesses inside and outside the city.

The Finance Committee recommends option 2C (\$100 base fee plus \$100/FTE), with the use of the additional revenue in excess of Option 2A (271,000 per year) to be prioritized by the City Council. Based on that recommendation, Option 2A (\$100 base fee plus \$90/FTE) has been built into the basic budget, in part to help balance tax supported functions such as street maintenance and other basic budget items, and to fund the Business Retention Specialist (\$98,400) as an on-going part of the Economic Development Program.

**Why an incremental fee structure?**

Currently once an employer exceeds 100 employees the City sees no additional revenue, yet each additional person places demands on the services the City provides, such as Police, Fire, Emergency Medical, roads to drive on, clean streets and great parks. By establishing an incremental fee structure, as businesses in the City grow, the revenue collected will also grow. Each new employee in the City will generate additional funds, which could make a significant difference in the City’s ability to fund the services these employees enjoy and one of the reasons employers find Kirkland as a desirable place to locate. The cost per FTE under the current structure and using option 2A as an example is summarized in the graph below.



Note: Depending on gross revenue, a business with one employee pays between \$100 and \$225, with most paying either \$175 or \$225.

### How will different size businesses be affected?

A comparison of the impacts on selected business examples is provided below.

Business Size	Type	Kirkland Current		# EE	Option 1	Option 2A	Option 2B	Option 2C
		#EE	BL Fee					
Small	Retail	1	\$175	1	\$90	\$190	\$195	\$200
Small	Retail	1	\$225	1	\$90	\$190	\$195	\$200
Small	Retail	2-5	\$325	4	\$360	\$460	\$480	\$500
Medium	Professional	6-20	\$850	10	\$900	\$1,000	\$1,050	\$1,100
Medium	Restaurant	6-20	\$850	18	\$1,620	\$1,720	\$1,810	\$1,900
Large	Retail	21-100	\$1,600	70	\$6,300	\$6,400	\$6,750	\$7,100
Large	Retail	21-100	\$1,600	90	\$8,100	\$8,200	\$8,650	\$9,100
Large	Headquarters	100+	\$2,600	150	\$13,500	\$13,600	\$14,350	\$15,100
Large	Headquarters	100+	\$2,600	200	\$18,000	\$18,100	\$16,100	\$20,100

### What do business owners think?

The business community has been involved in the discussion and the City of Kirkland will continue seeking their input and involvement during the business license fee restructure. The City has already met with some major employers, the Chamber of Commerce, a restaurant and the Kirkland Downtown Association.

Some of the comments we have heard so far:

- Acceptable as long as there is no B&O tax.
- It can improve equity, but would not like to see any decreases for some businesses while others are increasing substantially.
- How will contract employees be handled? (a response to this question appears later in this memo)
- Some businesses are operating on a small margin with lots of part-time employees, so this will impose an additional burden.
- How will businesses that pay other taxes be treated (admissions, lodging tax, etc.)?
- Minimize the impacts on sole proprietors.

We will continue to seek input and have attempted to respond to some of these questions and comments in the information provided in this memorandum.

### How will the changes impact the recruitment and retention of businesses?

The proposed restructure is competitive with Redmond's tax structure and is much less of a burden than the B&O tax structure charged in Bellevue and Seattle. The restructure should not

discourage reasonable economic growth or place the City at a comparative disadvantage compared to other cities. The new structure should not have significant adverse effects on the recruitment and retention of businesses in Kirkland.

**ISSUES FOR DISCUSSION:**

**Should all businesses pay the base fee and RGRL?**

When reviewing the current business license fee structure, one issue that was recognized was whether the new structure should continue providing an exemption to very small businesses based on gross receipts. Under the current structure, all businesses with gross receipts less than \$50,000 are exempt from the RGRL.

Staff recommends aligning the exemption to the RGRL with the Department of Revenue license requirements, which would provide the exemption only to businesses with gross revenues of less than \$12,000, not \$50,000. These businesses would continue being subject to the \$100 business license base fee, but would not be subject to the per FTE portion. The estimated revenue on p. 3 has been reduced by approximately \$50,000 to reflect this recommendation.

**Should businesses that obtain special permits receive a break on the business license fee?**

Currently the City of Kirkland provides a credit to businesses on their business license fee in the amount of any regulatory or special permit fees they are required to pay, such as the Cabaret license fee. Redmond and other cities do not provide credits or discounts to businesses that also obtain a regulatory license or special permit as there is cost and time associated with processing and monitoring regulatory licenses. These licenses are also different than the business license and are for a specific purpose. Staff recommends that the City of Kirkland discontinue providing discounts or credits to businesses that obtain regulatory licenses or special permits.

**Should businesses that pay other taxes receive a credit?**

Currently the City of Kirkland provides a waiver of the business license fee to businesses that pay a utility occupation tax and a credit up to the amount of the tax paid for the current surcharge. The City of Redmond does not provide a waiver or credit to businesses paying a utility occupation tax for either the basic fee or surcharge. They charge all utility businesses the base fee and those located within the city the FTE surcharge and those outside the city only the base fee of \$90.

The City Attorney's Office has determined that there is no authority that prohibits the City from collecting the utility occupation tax, the full business license fee and RGRL. Staff recommends that the City discontinue providing a waiver of the base fee of \$100 and discontinue providing the credit for the RGRL.

**What about businesses that generate sales tax?**

Sales tax is collected by businesses; it is paid by the consumer in its entirety. While it is clearly a benefit to have those sales tax dollars spent at Kirkland businesses, it does not represent a burden on the business. All retail businesses cause impacts on the City's services and should continue to be subject to the business license fee and RGRL.

**Does the City want to continue prorating business license fees or providing prorated refunds to businesses that close before their one year license expires?**

Currently the City of Kirkland provides a pro rata refund of the surcharge to businesses requesting it that close or obtain exemption status before their license expires upon written request within 90 days. The City of Redmond does not pro rate or refund on a pro rata basis any license fees and providing refunds is administratively burdensome. The City Attorney's Office has concluded the City is not required to provide the refund, however, staff believes that providing the proration will encourage those businesses that plan to relocate to renew for the time period they will remain in Kirkland. Approximately 15 such refunds are processed per year which does not impose a significant administrative burden.

**Should the City continue to renew on the businesses anniversary date or go to a January renewal?**

Currently businesses are required to renew every 12 months from the approval of their business license. There has been some discussion on moving to an annual renewal with all businesses renewing the first month of the year, rather than having it spread throughout the year. After evaluating the option of moving to a January renewal, staff would recommend against it. There is currently a system in place which handles renewals on a monthly basis and moving to a January renewal would be administratively difficult. In addition, financial analysis shows no revenue gain in the year the restructure occurs should it be coupled with a move to a January anniversary date. Since one of the goals of the business license fee restructure is to increase revenue in 2009, staff recommends maintaining the current renewal system.

**How will part-time employees be addressed?**

There has been some concern expressed by businesses that employ multiple part-time employees about how the restructure might affect their business and how the fee structure will apply. It is recommended that the City continue calculating the FTE by dividing the total number of hours worked by all part-time employees by 1,920 hours to arrive at the businesses effective FTE count.

**How will contract employees be handled?**

The current City of Kirkland Municipal Code does not specifically address how businesses should handle contract or temp employees. By restructuring the business license fee to one

based on FTEs, businesses with temporary or contract employees will need to know how such employees shall be counted. The City of Kirkland will need to add a section to the KMC on temporary employees. We recommend modeling the section after Redmond which provides that temporary employees placed in service within the city through an agency shall be claimed as employees by the agency and not the business using the temporary worker(s). This approach also requires employers to notify the City of the temporary agencies they use.

**Does City Council want to change the fee for temporary businesses?**

Currently the City has a provision for businesses operating temporarily in the city, less than 35 consecutive days, to obtain a temporary business license for \$20. With the restructuring of the general business license fee should this charge also change? Staff would recommend increasing the temporary business license fee to \$50.

**Will non-profits continue to be exempt?**

Currently the City of Kirkland provides a business license fee exemption to non-profit entities, which also exempts the entity from paying the surcharge (including civic groups). There are more than 200 entities that fall under this exemption category. The current structure results in a subsidy to these entities of approximately \$70,000. Under the proposed alternatives, it is estimated that roughly \$450,000 to \$500,000 would be subsidized for the non-profit community through this exemption. Staff recommends that this exemption continue.

**How would the new structure work for a sole proprietor?**

The new structure will work the same for all businesses whether a sole proprietor or corporation. A sole proprietorship is considered to have one FTE (the sole proprietor) under both the current and proposed structures. A one employee business would currently pay \$100 (base fee and no surcharge if their revenue is less than <\$50,000), or \$175 (the base fee plus \$75 if their revenue is between \$50,000 and \$100,000), or \$225 (base fee plus \$125 if their revenue is >\$100,000). Under Option 2A, the sole proprietor would pay the base fee plus surcharge based on number of employees, a total of \$190 (\$100 base fee and \$90 RGRL). So the potential impact varies depending on what they are currently paying, but in some cases it could actually be a decrease.

**Is this change in the business license fee structure permanent?**

The business license fee is important to creating a diversified revenue base. This new structure recognizes the importance of employment in the City of Kirkland economy and equally distributes the fee burden (relative to size) for businesses. Staff recommends that City Council recognize the new structure as a permanent feature of the City's revenue profile.



## Summary of Recommendations

The following is a summary of staff recommendations for the restructuring of the business license fee.

- 1) Implement Option 2: Keep the base fee of \$100 and charge a RGRL per FTE. The basic budget has been built assuming Option 2A - \$100 base fee plus \$90/FTE, with the Finance Committee recommending option 2C. Any additional revenue generated by an RGRL above \$90 per FTE would be used for other purposes as determined by Council.
- 2) Align the exemption to the RGRL with the Department of Revenue license requirements, which would provide the exemption only to businesses with gross revenues of less than \$12,000. These businesses would continue being subject to the \$100 base business license fee, but would not be subject to the RGRL.
- 3) Discontinue providing discounts or credits to businesses that obtain regulatory licenses or special permits.
- 4) Discontinue providing a waiver of the base fee of \$100 and crediting the RGRL for businesses that pay the Utility Occupation Tax.
- 5) Continue providing prorated business licensing refunds.
- 6) Continue with the current business license renewal operations requiring annual renewals based on the date the business license was granted.
- 7) Continue calculating the FTE by dividing the total number of hours worked by all employees by 1,920 hours.
- 8) Add a section in the Kirkland Municipal Code on temporary employees.
- 9) Increase the temporary business license fee from \$20 to \$50.
- 10) Continue providing a business license fee exemption to non-profit entities.
- 11) Recognize the new structure as a permanent component of the City's tax structure.

The Finance Committee's feedback has been incorporated into this memo and they concur with the recommendations presented. The committee recommends that the City adopt Option 2C - \$100 base fee plus \$100/FTE and determine the appropriate use for the funds in excess of Option 2A (approximately \$265,000).

MONTH	RENEWALS			EMPLOYEES			BASE FEE + RGRL^	OPTION 1				OPTION 2A			
	Inside City	Outside City	Total	Inside City	Outside City	Total	Total	Eliminate Base Fee /Charge \$90/FTE				Keep Base Fee \$100 + Charge \$90/FTE			
								Inside City	Outside City	Total	Add'l Revenue	Inside City	Outside City	Total	Add'l Revenue
January 1, 2009	290	114	404	2038	323	2361	\$129,970	\$ 183,420	\$ 29,070	\$ 212,490	\$ 82,520	\$ 212,420	\$ 40,470	\$ 252,890	\$ 122,920
February 1, 2009	241	103	344	2010	375	2385	\$141,550	\$ 180,900	\$ 33,750	\$ 214,650	\$ 73,100	\$ 205,000	\$ 44,050	\$ 249,050	\$ 107,500
March 1, 2009	243	120	363	2448	299	2747	\$113,825	\$ 220,320	\$ 26,910	\$ 247,230	\$ 133,405	\$ 244,620	\$ 38,910	\$ 283,530	\$ 169,705
April 1, 2009	315	101	416	2735	36	2771	\$151,966	\$ 246,150	\$ 3,240	\$ 249,390	\$ 97,424	\$ 277,650	\$ 13,340	\$ 290,990	\$ 139,024
May 1, 2009	287	129	416	2340	407	2747	\$123,585	\$ 210,600	\$ 36,630	\$ 247,230	\$ 123,645	\$ 239,300	\$ 49,530	\$ 288,830	\$ 165,245
June 1 2009	219	87	306	1286	252	1538	\$128,675	\$ 115,740	\$ 22,680	\$ 138,420	\$ 9,745	\$ 137,640	\$ 31,380	\$ 169,020	\$ 40,345
July 1, 2009	240	95	335	1961	314	2275	\$154,805	\$ 176,490	\$ 28,260	\$ 204,750	\$ 49,945	\$ 200,490	\$ 37,760	\$ 238,250	\$ 83,445
August 1, 2009	223	90	313	1900	287	2187	\$118,250	\$ 171,000	\$ 25,830	\$ 196,830	\$ 78,580	\$ 193,300	\$ 34,830	\$ 228,130	\$ 109,880
September 1, 2009	207	105	312	1801	330	2131	\$89,795	\$ 162,090	\$ 29,700	\$ 191,790	\$ 101,995	\$ 182,790	\$ 40,200	\$ 222,990	\$ 133,195
October 1, 2009**	223	138	361	2039	340	2379	\$134,205	\$ 183,510	\$ 30,600	\$ 214,110	\$ 79,905	\$ 205,810	\$ 44,400	\$ 250,210	\$ 116,005
November 1, 2009	205	111	316	1667	232	1899	\$94,835	\$ 150,030	\$ 20,880	\$ 170,910	\$ 76,075	\$ 170,530	\$ 31,980	\$ 202,510	\$ 107,675
December 1, 2009 ***	228	114	342	1350	306	1656	\$77,135	\$ 121,500	\$ 27,540	\$ 149,040	\$ 71,905	\$ 144,300	\$ 38,940	\$ 183,240	\$ 106,105
<b>Sub-Total 2009</b>	<b>2921</b>	<b>1307</b>	<b>4228</b>	<b>23,575</b>	<b>3,501</b>	<b>27,076</b>	<b>\$1,458,596</b>	<b>\$2,121,750</b>	<b>\$315,090</b>	<b>\$2,436,840</b>	<b>\$978,244</b>	<b>\$2,413,850</b>	<b>\$ 445,790</b>	<b>\$2,859,640</b>	<b>\$1,401,044</b>
Less subsidy to businesses with gross revenues less than \$12,000			508			508				\$45,720	\$45,720			\$45,720	\$45,720
<b>Total 2009</b>			<b>3720</b>			<b>26,568</b>				<b>\$2,391,120</b>	<b>\$932,524</b>			<b>\$2,813,920</b>	<b>\$1,355,324</b>

MONTH	OPTION 2B				OPTION 2C			
	Keep Base Fee \$100 + Charge \$95/FTE				Keep Base Fee \$100 + Charge \$100/FTE			
	Inside City	Outside City	Total	Add'l Revenue	Inside City	Outside City	Total	Add'l Revenue
January 1, 2009	\$ 222,610	\$ 42,085	\$ 264,695	\$ 134,725	\$ 232,800	\$ 43,700	\$ 276,500	\$ 146,530
February 1, 2009	\$ 215,050	\$ 45,925	\$ 260,975	\$ 119,425	\$ 225,100	\$ 47,800	\$ 272,900	\$ 131,350
March 1, 2009	\$ 256,860	\$ 40,405	\$ 297,265	\$ 183,440	\$ 269,100	\$ 41,900	\$ 311,000	\$ 197,175
April 1, 2009	\$ 291,325	\$ 13,520	\$ 304,845	\$ 152,879	\$ 305,000	\$ 13,700	\$ 318,700	\$ 166,734
May 1, 2009	\$ 251,000	\$ 51,565	\$ 302,565	\$ 178,980	\$ 262,700	\$ 53,600	\$ 316,300	\$ 192,715
June 1 2009	\$ 144,070	\$ 32,640	\$ 176,710	\$ 48,035	\$ 150,500	\$ 33,900	\$ 184,400	\$ 55,725
July 1, 2009	\$ 210,295	\$ 39,330	\$ 249,625	\$ 94,820	\$ 220,100	\$ 40,900	\$ 261,000	\$ 106,195
August 1, 2009	\$ 202,800	\$ 36,265	\$ 239,065	\$ 120,815	\$ 212,300	\$ 37,700	\$ 250,000	\$ 131,750
September 1, 2009	\$ 191,795	\$ 41,850	\$ 233,645	\$ 143,850	\$ 200,800	\$ 43,500	\$ 244,300	\$ 154,505
October 1, 2009**	\$ 216,005	\$ 46,100	\$ 262,105	\$ 127,900	\$ 226,200	\$ 47,800	\$ 274,000	\$ 139,795
November 1, 2009	\$ 178,865	\$ 33,140	\$ 212,005	\$ 117,170	\$ 187,200	\$ 34,300	\$ 221,500	\$ 126,665
December 1, 2009 ***	\$ 151,050	\$ 40,470	\$ 191,520	\$ 114,385	\$ 157,800	\$ 42,000	\$ 199,800	\$ 122,665
<b>Sub-Total 2009</b>	<b>\$2,531,725</b>	<b>\$ 463,295</b>	<b>\$2,995,020</b>	<b>\$ 1,536,424</b>	<b>\$2,649,600</b>	<b>\$ 480,800</b>	<b>\$3,130,400</b>	<b>\$1,671,804</b>
Less subsidy to businesses with gross revenues less than \$12,000			\$48,260	\$48,260			\$50,800	\$50,800
<b>Total 2009</b>			<b>\$2,946,760</b>	<b>\$1,488,164</b>			<b>\$3,079,600</b>	<b>\$1,621,004</b>

The above numbers list every employee in Kirkland excluding all exempt businesses such as Hospital, Non-Profit, Telecomm Companies, etc.

Examples of those excluded include:

\*\* October months exclude the Hospital w/2850 employees, Lake Washington TechCollege w/200 and City of Kirkland w/581 employees

\*\*\* December months exclude Northwest University at 160 employees

^RGRL = Revenue Generating Regulatory License Fee

Estimate is based on renewal actuals January-June 2008 and July-December 2007