

City of Seattle Square Footage Business Tax Frequently-Asked Questions

What is the square footage business tax?

The square footage business tax applies to businesses located in Seattle and is based on the amount of square feet used to conduct business activities. The tax complements the business license tax. The square footage business tax is computed by applying tax rates against the square footage of a business.

Who is subject to the square footage business tax?

Businesses located outside of Seattle

The square footage business tax only applies to businesses that maintain a business location within Seattle. *Businesses whose only location(s) are outside of Seattle do not report or owe any square footage tax.* A business maintains a business location if they own or rent/lease property within the city even if for a short period of time. (If you own or rent a Seattle business location for less than a full year, prorate the square footage business tax using a ratio of rental days divided by 365.)

Businesses located within Seattle.

All businesses located within Seattle that are subject to the business license tax are subject to the square footage business tax. However, through a system of exemptions and credits, only those businesses that benefited under the new state law (RCW 35.102.130) will owe any square footage business tax.

Businesses located within Seattle with revenues below the minimum threshold (\$80,000 for 2008) or conducts no taxable business activities owe no business license tax or square footage tax. Enter your gross receipts, if any, and put in zero for the business license tax owing. Enter your square footage and compute the tax, and take 100% credit on line 11 of the tax return for any square footage business tax computed.

A business located in Seattle that conducts all of its business activities within Seattle will not owe square footage business tax after taking the allowable 100% credit. Conducting all of its business activities within Seattle means the business delivers all of your sales to persons within Seattle or customers pick up the goods inside Seattle, or the business provides all services inside Seattle. Businesses that conduct all business activities within Seattle will have to complete the square footage tax calculation on the tax form and take a 100% credit to eliminate the square footage business tax. This results in the business paying the same business license tax that it would have paid

before RCW 35.102.130 became effective. Generally these businesses include any Seattle business where the customer picks up the goods or receives the service within Seattle, including restaurants, barbers, cosmeticians, tax preparers, bookkeepers, grocery stores, convenience stores, and other retail stores where the goods are picked up at the store within Seattle.

Pursuant to RCW 35.102.130 (1)(b) and RCW 35.102.130(c) businesses that believe that the new allocation and apportionment method does not fairly represent the extent of the taxpayer's business activity within the city may petition to continue to report their B & O tax under the code sections applicable to periods prior to January 1, 2008. If businesses located in Seattle report their B & O tax under the code sections applicable to periods prior to January 1, 2008, then they are entitled to a 100% credit against their square footage tax since they have not benefited under the new allocation and apportionment method. Complete the square footage tax information on the tax return and then take a 100% credit by deducting the same amount on line 11 of the tax return.

Under the new allocation and apportionment method contained in RCW 35.102.130 a business will pay its square footage business tax on the same percentage basis as the business benefits from the new method. In other words, if the new allocation and apportionment method reduces a business' business license tax by 25%, then the business will pay 25% of its square footage business tax and take a credit for the other 75% of its square footage business tax. Worksheets have been designed to help those businesses compute the correct amount of square footage business tax.

The square footage business tax law (SMC 5.46.060) provides that a Seattle business should not pay any more total tax under the combined square footage business tax and under the new provisions of the business license tax than it would have paid before those two new tax provisions were imposed. This is accomplished through a maximum square footage business tax credit described below.

Why did Seattle impose the square footage business tax?

In 2003, the Washington State Legislature passed a law (RCW 35.102.130) that changes how cities can impose their gross receipts Business and Occupation (B&O) taxes (such as Seattle's business license tax) on certain types of business activities. (For more information, see the City of Seattle webpage "Allocation and Apportionment Rules" at <http://www.seattle.gov/rca/taxes/Appportionment.htm>) The most notable changes of the new law, which went into effect on January 1, 2008, are:

- Income from providing services will now be apportioned for tax purposes between the city where the employee providing the service is based and the place where the majority of contacts with the customer occurs.

- Income from the sale of tangible personal property will be allocated to the location where delivery to the buyer takes place.

What does the State law have to do with the City of Seattle's square footage business tax?

The change in State law reduces tax revenue for all cities that impose a gross receipts B & O tax. Based on work by the Washington Department of Revenue, the City of Seattle estimates it will lose \$21.9 million in revenue in 2008. The City hopes to recover about \$18 million of the lost \$21.9 million through the square footage business tax. The square footage business tax is designed so that those businesses receiving a tax reduction under the new State law will be obligated to pay Seattle's square footage business tax. The anticipated revenue generated by the square footage business tax will go into the General Fund, which funds basic City services, such as police, fire, libraries, and parks. Seattle businesses that do not receive a benefit under the new State law will not owe any square footage business tax.

Who is exempt from the square footage business tax?

The following businesses are exempt from the square footage business tax:

- Persons who conduct only activities which the City is preempted from taxing, pursuant to federal or state statutes, such as insurance businesses; the sale, manufacturing, or distribution of motor vehicle fuel pursuant to the RCW 82.36.440; and the selling of liquor pursuant to RCW 66.08.120. Persons engaging in these exempt activities, but also engaged in taxable activities, will use only the square feet involved in the non-exempt activity when computing the square footage business tax.
- Banks and other financial institutions, whose income is apportioned according to WAC 458.28.
- Utilities. Persons taxable under the utility tax pursuant to SMC Chapter 5.48 are exempt from the square footage business tax provided they generate no gross income from activities taxable under SMC 5.45.050 (business license tax). If utility businesses generate income subject to the business license tax, only the square footage used in generating those revenues will be included in the computation of the square footage business tax and any related credits.
- Businesses that are exempt from the business license tax pursuant to SMC 5.45.090.

Are businesses that report under the Manufacturing, Extracting, Printing, Transporting Freight For Hire, Tour Operator, or Processor For Hire classifications subject to the new allocation and apportionment method, or to the square footage business tax?

Persons whose only business activities are reported under the above classifications are not subject to the new allocation and apportionment method or to the square footage business tax. These businesses

should continue to report as they have always reported. Any square footage of the business used in the above business activities is exempt from the square footage business tax.

Persons reporting under the manufacturing, extracting, printing, transporting freight for hire, tour operator, or processor for hire classifications, and also engaging in retailing/wholesaling or activities reportable under the service and other classification are subject to the new allocation and apportionment method and will be subject to the square footage business tax on those square feet of business or other floor space used in conducting the retailing/wholesaling or service activities.

How is the square footage computed for businesses that manufacture or print products within Seattle?

Persons who manufacture or print products within the City of Seattle will be exempt from the square footage business tax on the square footage used to manufacture and sell those products. Persons who manufacture or print products and also purchase other goods to sell will need to compute the square footage business tax on the square footage used in purchasing and reselling those non-manufactured goods.

To compute the amount of square footage used in the business to buy and sell non-manufactured products subtract all square feet used solely for manufacturing and then apportion the common areas used for the management, sales, and administration of the business using a ratio of non-manufactured sales to total sales. Add any other square footage that is solely used for the purchase and sale of non-manufactured goods. Once the non-manufacturing square footage is computed, then multiply the taxable square feet by the applicable tax rate. The resulting square footage business tax is the amount that is subject to the same credits available to businesses that do not manufacture or print. The Manufacturing and Selling square footage tax credit worksheet will step you through the computation.

The sales of non-manufactured products will have to be tracked separately from the manufactured products in order to report under the new allocation and apportionment method.

An example. Company MAM manufactures 80% of the products that they sell. The company buys and sells the other 20% of their products. MAM chooses to use the new allocation and apportionment

method to compute their business license tax. MAM's manufacturing square feet are exempt from the square footage business tax. MAM should compute their non-manufacturing square feet and multiply it by the appropriate square footage tax rate. MAM had manufactured sales of \$8 million. MAM had non-manufactured sales of \$2 million. MAM had 20,000 square feet of manufacturing space, and 8,000 square feet of common management, selling, and administrative office space. The 20,000 manufacturing square feet are exempt and 20% (\$2 million non-manufactured sales over total sales of \$10 million) of the management, selling, and administrative office space is assigned to the purchasing and selling of non-manufactured products. 8,000 sq. ft. multiplied by 20% is equal to 1,600 square feet subject to the square footage business tax. 1,600 square feet multiplied by the annual square footage business tax rate of \$1.56 is equal to \$2,496 in square footage business tax. This is the amount of square footage business tax used in computing any allowable credits.

What if a business does not ship goods or provide services outside of Seattle?

Seattle businesses that do not ship goods or provide services outside of Seattle are entitled to a 100% credit of the square footage business tax, as they receive no benefit under the new allocation and apportionment rules. This would include Seattle businesses such as restaurants, barbershops, hair salons, and grocery and other retail stores where customers pick up or receive merchandise at the store.

What square footage is used to compute the tax?

Unless otherwise exempted, the following square feet are included in the tax computation:

- ***Business floor space*** is defined as rentable square feet of an office or place of business and includes the proportionate share of the building service areas such as lobbies, corridors and other common areas in a building. Generally, this is computed in the same manner as the Building Owners and Managers Association (BOMA) computes rental floor space for rental purposes. Building floor space does not include vertical spaces through the building such as stairs, elevators, or heating, ventilation, air conditioning, utility, or telecommunication systems.
- ***Other floor space*** means rentable square feet used for dining areas, exercise areas, or warehouse space.

The following square feet are exempted and not included in the computation:

- ***Headquarters space*** is the portion of business floor space and other floor space used exclusively to administer and manage other offices or

places of business located outside of Seattle. This space shall not be included in the square footage tax calculation. Space used for the administration and management of Seattle locations is included in the computation.

What is the tax rate for the square footage business tax?

There are two tax rates for the square footage business tax. "Business floor space" will be taxed at a rate of \$0.39 per square foot per quarter (\$1.56 annually). "Other floor space" is taxed at a rate of \$0.13 per square foot per quarter (\$0.52 annually). These tax rates will be adjusted annually for inflation.

If I lease or rent my space, who is responsible for the square footage tax?

Generally, the person or business occupying the space will be responsible for the square footage business tax only if the renter has exclusive right to the space, i.e., the renter controls lights, heat, maintains keys to the space, and/or controls the entrance and exit times for customers, etc. Space rented for the storage of goods in a warehouse where no walls separate the goods, and exclusive right to the space is not provided, shall be included in the other floor space of the warehouse business.

What if my floor space changes during the tax reporting period?

A person who moves during the tax reporting period will report the tax based on a ratio of days that the space was occupied to total days of the tax reporting period. A person whose business floor space or other floor space changes during the tax reporting period will prorate the square footage based on a weighted average of the floor space occupied during the different segments of the reporting period.

Example for change in floor space: A business occupied business floor space of 8,000 sq. ft. for the first 30 days and then 5,000 sq. ft. for the remaining 60 days of the quarter. To compute the number of square feet subject to tax during the tax quarter, the following weighed average calculation is made:

$(8,000 \text{ sq. ft} \times 30 \text{ days}) + (5,000 \text{ sq. ft.} \times 60 \text{ days})$ divided by 90 days = 6,000 sq. ft. The 6,000 sq. ft. would be used in computing the square footage business tax.

If I open or close my business in the middle of the year, how do I compute my square footage business tax?

Persons opening or closing their business during the middle of the year will compute their square footage business tax using a prorated number of square feet. For example, a business filing annually with 20,000 square feet of business floor space that closes at the end of March will compute their square footage business tax on 5,000 square feet (20,000 sq. ft. multiplied by 1/4 of a year). The 5,000 square feet would then be multiplied by the annual square footage business tax rate. The resultant square footage business tax would then be eligible for any credits that might apply.

A quarterly tax filer would prorate its square footage using the portion of the quarter in which the person was still in business and then multiply the resulting square footage by the quarterly tax rate. For example, a business closing May 31st represents 2/3 of the second quarter that ends June 30th. If the business maintained 15,000 square feet of business floor space, then 2/3 of the 15,000 square feet or 10,000 square feet would be subject to the square footage business tax. The 10,000 square feet would be multiplied by the quarterly square footage business tax rate. The resultant square footage business tax would then be eligible for any credits that might apply.

Businesses opening in the middle of a reporting period should perform the same ratio calculation.

When is the square footage business tax due?

The square footage business tax is due at the same time and interval that the business license tax is due. Reporting for the square footage tax is included on the business license tax return. Persons discontinuing their business activities in Seattle shall report and pay the tax at the same time as their final business license tax return.

What about royalty income?

The calculation of the square footage business tax credit does not include royalty income, which is assigned 100 percent to the headquarters or domicile of the business, as required by State law.

What credits are available?

The following credits are available to offset the square footage business tax:

- o Persons who owe no business license tax under SMC 5.45.050 due to deductions contained in SMC 5.45.100 (with the exception of subsection SMC 5.45.100W) may take a credit against the square footage business tax for the total amount of the tax. In short, if your business activities

- have remained the same and you have not paid the business license tax due to deductions then you will not owe any square footage business tax.
- Persons who pay the business license tax under SMC 5.45.050 on all of their gross income, excluding interstate sales, generated from the Seattle business location(s) may take a credit for 100 percent of their square footage business tax.
 - Retailers and wholesalers -- Persons selling tangible personal property from a Seattle business location may take a credit against the square footage business tax as determined by the ratio of adjusted gross income to total gross income. Adjusted gross income for retailers and wholesalers is the taxpayer's total gross income less those sales delivered from the Seattle business location(s) to the buyer at a location outside of Seattle, but within Washington, where a local government does not impose an eligible gross receipts tax. See Taxpayer A example below.
 - Service businesses. Persons providing services (subject to tax under SMC 5.45.050 G) from a Seattle business location(s) may take a credit as determined by the ratio of adjusted gross income to total gross income generated by the Seattle business location. Adjusted gross income for service businesses is computed by subtracting from the total gross income (subject to the service and other business license tax) the difference between the taxable service income under Seattle's method of computing taxable service income prior to January 1, 2008 (SMC 5.45.080) and under the new two-factor method of computing taxable service income (SMC 5.45.081C or RCW 35.102.130(3)) which takes effect after January 1, 2008. See Taxpayer B example below.
 - Combined retailing/wholesale and services. A business engaging in retailing or wholesaling and also in a service and other business activity shall compute the adjusted gross income for each activity and then combine the computations to arrive at the proper credit percentage to use in computing their square footage business tax as illustrated by Taxpayer C below.
 - Maximum square footage business tax credit. A taxpayer should not pay any more tax under the new tax provisions of RCW 35.102.130 and the square footage business tax than the taxpayer would have paid if both of those provisions had not taken effect. If the gross receipts business license tax and the square footage business tax combine to result in a tax increase for the taxpayer when compared to the amount of tax that would have been due prior to the implementation of RCW 35.102.130 on January 1, 2008, then an additional credit may be taken against the square footage business tax for the amount of such tax increase.

How do I compute my credits and taxes?

The Department of Executive Administration provides computation worksheets to assist taxpayers in computing their square footage business tax and applicable credits. These worksheets are contained on this website. The following are examples of different square footage business tax and tax credit computations.

Taxpayer A –Retailer or Wholesaler

Located in Seattle, Taxpayer A sells and delivers \$1 million worth of goods to customers located in unincorporated King County. Total gross income from sales is \$4 million, generated from 8,000 square feet of business floor space (all other sales are delivered within Seattle).

Computation of the adjusted gross income and credit percentage.

\$4 million (Total gross sales) less \$1 million (Unincorporated King County sales) = \$3 million (Adjusted Gross Income).

The credit percentage against the square footage is equal to:

<u>Adjusted gross income</u>	\$3 million	=	75 percent
Total gross income	\$4 million		

75 percent of the gross sales were in Seattle and subject to the business license tax; therefore Taxpayer A would pay only 25 percent of the calculated square footage business tax.

Square footage tax computation:

8,000 sq. ft (business floor space) X \$1.56 (annual business floor space tax rate) X 25 percent (percentage of tax owed) = \$3,120 (annual square footage business tax owed).

Under the business license tax, with the new deduction for sales delivered outside of Seattle, and the new square footage business tax, the total tax for Taxpayer A would equal:

Business license tax: \$3 million X .00215 (retailing tax rate) = \$6,450.
Square footage tax = \$3,120.
Total tax due under new provisions = \$9,570 (\$6,450 + \$3,120)

Under the old business license tax provisions Taxpayer A would have paid tax on the \$4 million dollars at the .00215 tax rate.

Business license tax: \$4 million X .00215 = \$8,600

Maximum square footage tax credit. When comparing the amount of tax under the new provisions Taxpayer A owes \$9,570 in tax while under the tax provisions in effect prior to January 1, 2008, Taxpayer A owes \$8,600.

$\begin{aligned} & \$9,570 \text{ minus } \$8,600 = \$970 \text{ (maximum square footage business tax credit)} \\ & \$3,120 \text{ (sq. ft. tax) minus } \$970 \text{ (maximum sq. ft. tax credit) = } \$2,150 \\ & \text{(actual square footage business tax owed after all credits)} \end{aligned}$

Total Business License Tax and Square Footage Business Tax owed by Taxpayer A after all credits.

$\$9,570 \text{ minus } \$970 = \$8,600$
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Taxpayer B –Service business

Located in Seattle, Taxpayer B received \$2 million for audit services provided to businesses located outside of Seattle but within Washington (audit work was predominately completed at customers' locations). Taxpayer B also provided audit services in Seattle totaling \$2 million. Taxpayer B's total gross income equals \$4 million. All payroll is primarily assigned to the Seattle business location. Taxpayer B maintained 10,000 square feet of business floor space. The new method under SMC 5.45.081C or RCW 35.102.130(3) requires the taxpayer to use a two-factor formula (payroll and service income) for computing the taxable service income under the business license tax. To compute the two-factor formula and amount subject to the service and other tax:

$\frac{(\text{payroll factor} + \text{service factor})}{2} \times \text{total revenue} = \text{service income subject to tax in Seattle. OR}$
$\frac{(100 \text{ percent} + 50 \text{ percent})}{2} \times \$4 \text{ million} = \$3 \text{ million subject to tax.}$

Prior to January 1, 2008, the service income generated by the Seattle office was taxable by the City of Seattle unless another eligible gross receipts tax city taxed a portion of the service income. Assuming that no other city with an eligible gross receipts tax subjected any of the gross income to tax, the entire \$4 million in service income was subject to tax. Based on these facts, the adjusted gross income and the credit percentage is calculated as follows:

\$4 million (total gross income) less \$1 million (difference between previous tax code and new tax code) = \$3 million adjusted gross income.

The credit against the square footage business tax would be:
 $\frac{\$3 \text{ million (adjusted gross income)}}{\$4 \text{ million (total gross income)}} = 75\%$ credit against sq. ft. tax

Taxpayer B would pay 25 percent of its square footage business tax.

$10,000 \text{ sq. ft} \times \$1.56 \text{ (tax rate)} \times 25 \text{ percent} = \$3,900$ in annual square footage business tax.

Under the business license tax, using the new two-factor formula, and the new square footage business tax, the total tax due by Taxpayer B would equal:

Business license tax: $\$3 \text{ million} \times .00415 \text{ (service tax rate)} = \$12,450$.
Square footage business tax = \$3,900.
Total tax = \$16,350 ($\$12,450 + \$3,900$)

Maximum square footage business tax credit.

\$4 million in service income multiplied by the service tax rate of .00415 results in a tax that would have been due under the provisions in effect prior to January 1, 2008 of \$16,600. Since this is more than the \$16,350 owed by Taxpayer B under the new provisions, there is no maximum square footage business tax credit available.

Taxpayer C –Combination business with retail/wholesale and service activities.

Taxpayer C engaged in the same activities as Taxpayers A and B above, and maintained 18,000 square feet of business floor space, and generated the same amount of sales and service income both within and outside of Seattle as Taxpayers A and B. Total gross income from all activities equals \$8 million (\$4 million in sales plus \$4 million in services). To compute the adjusted gross income:

\$4 million in sales less \$1 million delivered into unincorporated King County = \$3 million. (same as computed for Taxpayer A above).
\$4 million in services less \$1 million in service income that is excluded from the business license tax because of the two-factor formula per Taxpayer B above
Adjusted gross income = \$6 million (\$8 million less \$2 million)

To compute the square footage business tax credit.

<u>\$6 million</u>	= 75 percent credit against the sq. ft. tax.
\$8 million	25 percent of the sq. ft. tax is due.

To compute the square footage business tax due.

18,000 sq. ft X \$1.56 (tax rate) X 25 percent = \$7,020 in sq. ft. tax is due.

This is the same amount of square footage business tax due from Taxpayers A and B combined.

Calculating the maximum square footage business tax credit
 Total taxes due for Taxpayer C above (use same figures as computed for Taxpayer A and B since the sales and services amounts for A and B or are equal to Taxpayer C):

Square footage business tax	\$ 7,020
Retailing/wholesaling business license tax	6,450
Service and other business license tax	<u>12,450</u>
Total taxes due under new tax provisions	\$25,920

However, if the square footage business tax and the new requirements contained in SMC 5.45.081 and RCW 35.102.130 had not taken effect, the total taxes due would have been:

Selling business license taxes (\$4M X .00215)	\$ 8,600
Service business license taxes (\$4M X .00415)	<u>16,600</u>
Total business license taxes due	\$25,200

The increase in tax due under the square footage business tax and new business license tax provisions is as follows:

Total taxes due under new tax provisions	\$25,920
Total taxes due under SMC 5.45 without new tax provisions	<u>25,200</u>
Increase in total taxes owed—amount of maximum credit	\$ 720

\$720 would then be credited against the square footage business tax due as computed for Taxpayer C above. This would result in the following total square footage business tax due, after all credits:

Total square footage tax due for Taxpayer C above	\$7,020
Less maximum square footage business tax credit	<u>720</u>
Square footage business tax due	\$6,300