

CITY OF SEATTLE

ORDINANCE _____

COUNCIL BILL 117975

AN ORDINANCE relating to taxation; repealing Seattle Municipal Code Section 5.45.085 relating to the taxation of related, controlled, or affiliated persons; and directing the Director of Finance and Administrative Services to adopt rules to determine the proper amount of business license taxes due from persons engaged in business activities or transactions with related, controlled, or affiliated persons.

WHEREAS, Seattle Municipal Code Chapter 5.45, which is based on the model ordinance in accordance with Chapter 35.102 RCW, mandates that the City of Seattle's business license tax is levied upon every person for the act or privilege of engaging in business activities within the city; and

WHEREAS, the City of Seattle desires to continue to tax businesses engaging in business activities with affiliated persons, to continue to require that taxpayers clearly reflect their true gross income attributable to business activities between affiliated persons, and prevent the avoidance of taxes related to such activities; and

WHEREAS, in 2009 the City enacted ordinance 123063, which stated how the Director of Finance of Finance and Administrative Services would determine the gross income on which the City's business license tax would be calculated when the relationship between affiliated persons was such that the reported gross income from business activities between such persons was not indicative of the true gross income attributable to those business activities; and

WHEREAS, the Washington State Legislature passed Second Engrossed Substitute Senate Bill No. 6143 during the 2010 legislative session that directed the Washington Department of Revenue to conduct a review and provide a report on the state's taxation of transactions between affiliated persons; and

WHEREAS, both the Washington Department of Revenue and the Director of Finance and Administrative Services have engaged in meetings with taxpayers to examine the taxation of businesses engaged in transactions between affiliated persons; and

WHEREAS, in order to provide the Director of Finance and Administrative Services with the ability and flexibility to establish through the rulemaking process under SMC Section 5.55.165 the best manner in which to determine the proper amount of Seattle business license tax that is attributable to business transactions between related, controlled, or

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

1 affiliated persons, and to prevent the avoidance of taxes in regards to such activities or
2 transactions; NOW, THEREFORE,

3 **BE IT ORDAINED BY THE CITY OF SEATTLE AS FOLLOWS:**

4
5 **Section 1.** Section 5.45.085 of the Seattle Municipal Code is hereby repealed.

6 ~~((5.45.085—Related person transactions.~~

7
8 ~~A.——When the relationship between related, controlled or affiliated persons is such that
9 the gross income from business activities between such persons is not indicative of the market
10 value of the activities or transactions, the Director shall determine the market value upon which
11 the Seattle business license tax shall be levied.~~

12
13
14 ~~The purpose of this section is to ensure taxpayers clearly reflect their true gross income
15 attributable to business activities or transactions between related, controlled or affiliated persons,
16 and to prevent the avoidance of taxes in regards to such activities or transactions. Business
17 activities or transactions between one related, controlled or affiliated person and another will be
18 subject to special scrutiny by the Director to ascertain whether common control is being used to
19 reduce, avoid, or escape taxes. The authority of the Director to determine true taxable income
20 extends to any case in which either by inadvertence, sham, or design the taxable income of a
21 related, controlled or affiliated person is other than it would have been had the person, in the
22 conduct of its affairs, been dealing at arm's length with an unrelated, uncontrolled or unaffiliated
23 person. The Director will consider whether the persons are motivated by business purposes other
24 than tax avoidance or are principally motivated by the desire to avoid taxes.~~

1 ~~B. The Director will consider the following to determine whether an arrangement~~
2 ~~between related, controlled, or affiliated persons results in an improper or inaccurate valuation of~~
3 ~~the activity:~~

4
5 ~~1. Whether the persons are motivated by business purposes other than tax avoidance~~
6 ~~or are principally motivated by tax avoidance. In no case shall the mere evasion or avoidance of~~
7 ~~taxation be regarded as a business purpose.~~

8 ~~2. Whether the separate businesses of the related, controlled or affiliated persons~~
9 ~~have economic substance because a reasonable possibility of obtaining a profit exists, apart from~~
10 ~~achieving tax benefits.~~

11
12 ~~3. Whether one person has a significant amount of capital gains, interest, dividend or~~
13 ~~similar income, but minimal capital, activity, or expenses, because essential business functions~~
14 ~~are performed for the person by another without arm's length consideration.~~

15 ~~4. In determining whether the related persons or entities are motivated by tax~~
16 ~~avoidance or whether they possess economic substance, the Director shall consider the~~
17 ~~following:~~

18
19 ~~a. The related person has an identifiable place of business with supporting business~~
20 ~~records.~~

21 ~~b. The related person maintains books and related accounting records.~~

22 ~~c. The related person has a staff of employees or has engaged independent~~
23 ~~contractors adequate in number and with sufficient expertise to conduct its business activities.~~
24

1 d. ~~—The controlling person so controls and dominates the finances, policy and~~
2 ~~business activities of the related person that the related person has virtually no separate~~
3 ~~existence.~~

4 e. ~~—The form employed for conducting business is a sham.~~

5 C. ~~—The Director will use the following methods to assign a value to business~~
6 ~~activities or transactions between related, controlled, or affiliated persons when the Director~~
7 ~~determines that a true or market value has not been reported on a tax return:~~

8 1. ~~—Fair market valuation. A value determined by comparing charges made for similar~~
9 ~~goods or services of like quality and character, in similar quantities, under comparable conditions~~
10 ~~of sale, to comparable unrelated party purchasers, including subsidies and bonuses.~~

11 2. ~~—Cost basis. If no comparable goods or services can guide the Director in~~
12 ~~ascertaining the value, then such value may be determined upon a cost plus margin basis. All~~
13 ~~costs—including direct and indirect overhead costs—attributable to the particular article, good or~~
14 ~~service shall be included. An appropriate profit margin shall also be added to the costs.~~

15 3. ~~—Amount of dividends or loans received. If a parent corporation or controlling~~
16 ~~person provides services that are more than general oversight duties to a subsidiary or controlled~~
17 ~~person and receives no payments, or such payments are not at market value, but then receives~~
18 ~~dividends or loans from the subsidiary or controlled person for the services rendered, the~~
19 ~~Director shall deem the dividends or loans received to be compensation for the services rendered.~~
20 ~~If the total amount received from the subsidiary or controlled person, including such dividends or~~
21 ~~loans, is less than the market value of such service, the Director will tax the services rendered at~~

1 ~~the market value. If the amount of dividends or loans can be shown to be higher than the market~~
2 ~~value of the services then the market value will be used.~~

3 ~~General oversight duties of a parent corporation include high level management direction,~~
4 ~~strategic planning, stewardship duties or assisting in the financing of the controlled persons.~~
5 ~~These duties can be provided without taxation of the dividends, loans or compensation from~~
6 ~~subsidiaries or controlled persons. However, providing services for a subsidiary's or controlled~~
7 ~~person's customers, or providing accounting and administrative services, or providing marketing~~
8 ~~services, or providing other lower level management duties for a subsidiary or controlled person,~~
9 ~~or any similar activities will be subject to a market value determination and taxation.~~

10
11
12 D. ~~The following definitions apply within this section:~~

13
14 1. ~~"Market value" or "arms length consideration" is the amount that would be paid or~~
15 ~~received for similar activities or transactions of like quantity, quality, or character under similar~~
16 ~~circumstances and conditions by other persons where no common interest exists between the~~
17 ~~persons involved in the activities or transactions.~~

18
19 2. ~~"Related, controlled or affiliated person" means a person or entity that controls, or~~
20 ~~is controlled as the case may be, through common ownership. "Related," "controlled" and~~
21 ~~"affiliated" are used interchangeably when describing a subsidiary, however, related and~~
22 ~~affiliated can also mean the parent entity. The degree of ownership is unimportant, however the~~
23 ~~ability to control or influence the related, controlled or affiliated person is important in~~
24

1 ~~establishing whether relationships and transactions serve a business purpose, produce income, or~~
2 ~~merely avoid taxes:)).~~

3
4 **Section 2.** The Seattle City Council finds that under Seattle Municipal Code Chapter
5 5.45, as amended by this ordinance, the City's business license tax continues to be levied upon
6 every person, unless specifically exempted, for the act or privilege of engaging in business
7 activities within the City, regardless of the person's affiliation to any other person. The repeal of
8 SMC Section 5.45.085 in Section 1 of this ordinance will provide the Director of Finance and
9 Administrative Services with the ability and flexibility to establish, through the rulemaking
10 process authorized under SMC Section 5.55.165, the best manner in which to calculate the
11 proper amount of the Seattle business license tax due under SMC Chapter 5.45 for business
12 activities between related, controlled, or affiliated persons, and to prevent the avoidance of taxes
13 with regard to such activities.
14

15
16 **Section 3.** The repeal of SMC Section 5.45.085 in Section 1 of this ordinance shall not
17 alter the obligation of related, controlled, or affiliated persons engaged in business activities
18 within the City to pay the City's business license tax, nor shall it affect any existing right
19 acquired, liability or obligation incurred, or any rule, order, or proceeding previously adopted
20 under that Section of the Code.
21

22
23 **Section 4.** The Director of Finance and Administrative Services shall adopt rules to
24 determine the proper amount of the Seattle business license tax due under the Seattle Municipal
25 Code from persons engaged in business activities or transactions with related, controlled or
26

1 affiliated persons. This ordinance does not alter the authority of the City to tax persons engaged
2 in business activities or transactions with related, controlled, or affiliated persons.

3
4 **Section 5.** This ordinance shall take effect and be in force 30 days after its approval by
5 the Mayor, but if not approved and returned by the Mayor within ten days after presentation, it
6 shall take effect as provided by Seattle Municipal Code Section 1.04.020.

7
8 Passed by the City Council the ____ day of _____, 2013, and
9 signed by me in open session in authentication of its passage this
10 ____ day of _____, 2013.

11
12 _____
13 President _____ of the City Council

14
15 Approved by me this ____ day of _____, 2013.

16
17 _____
18 Michael McGinn, Mayor

19
20 Filed by me this ____ day of _____, 2013.

21
22 _____
23 Monica Martinez Simmons, City Clerk

24 (Seal)

FISCAL NOTE FOR NON-CAPITAL PROJECTS

Department:	Contact Person/Phone:	CBO Analyst/Phone:
Finance and Administrative Services	Glen Lee/684-8079	Jennifer Devore/615-1328

Legislation Title: AN ORDINANCE relating to taxation; repealing Seattle Municipal Code Section 5.45.085 relating to the taxation of related, controlled, or affiliated persons; and directing the Director of Finance and Administrative Services to adopt rules to determine the proper amount of business license taxes due from persons engaged in business activities or transactions with related, controlled, or affiliated persons.

Summary of the Legislation:

This Ordinance repeals Seattle Municipal Code Section 5.45.085, which contains an unutilized procedure provided to City tax administrators to assess business and occupation tax on gross receipts from transactions between related, affiliated, or mutually controlled entities.

Background:

The business and occupation tax is assessed on the gross receipts earned by all entities conducting business in Seattle. This includes gross receipts earned from transactions between entities that are legally related to one another, such as subsidiaries. In 2009, the City enacted Ordinance Number 123063. One provision of this ordinance gave City tax administrators specific authority to estimate tax liabilities by way of assigning values to transactions between related entities as if the transactions were conducted on the open market between non-related firms.

This particular provision, however, has proven difficult to effectively implement and was made less relevant due to subsequent court decisions regarding tax liabilities of related entities. In addition, some taxpayers have complained that this provision creates confusion about how to fulfill their tax liabilities. Since 2009, the City has not used this specific authority nor has a practical means of doing so in the future.

Please check one of the following:

This legislation does not have any financial implications.

This legislation has financial implications.

Appropriations:

Fund Name and Number	Department	Budget Control Level*	2013 Appropriation	2014 Anticipated Appropriation
TOTAL				

Appropriations Notes: There are no budget appropriations or budget decreases associated with this ordinance.

Anticipated Revenue/Reimbursement Resulting from this Legislation:

Fund Name and Number	Department	Revenue Source	2013 Revenue	2014 Revenue
TOTAL			\$ 0	\$ 0

Revenue/Reimbursement Notes: The intent of the relevant sections of Ordinance 123063 was to ensure that entities would continue to identify and pay their true tax liabilities associated with gross earnings from transactions with related entities. City tax administrators perceived at the time that some businesses were developing corporate structures and tax reporting practices that would allow them to avoid paying their true tax liabilities. As a result, tax administrators did not believe that Ordinance 123063 would result in net new tax revenue to the City, but rather would allow the City to continue to collect the true tax obligations from related entity transactions paid at that time.

Since City tax administrators never utilized the related provisions provided for in Ordinance 123063, repealing this section of the Code should not result in revenue losses to the City. In addition, State of Washington court decisions regarding tax liabilities from related entity transactions affirm the City's ability to continue to assess the business and occupation tax on gross receipts from these transactions.

Total Regular Positions Created, Modified, or Abrogated through this Legislation, Including FTE Impact:

Position Title and Department	Position # for Existing Positions	Fund Name & #	PT/FT	2013 Positions	2013 FTE	2014 Positions*	2014 FTE*
TOTAL							

Position Notes: None.

Do positions sunset in the future? Not applicable.

Spending/Cash Flow:

Fund Name & #	Department	Budget Control Level*	2013 Expenditures	2014 Anticipated Expenditures
TOTAL			\$ 0	\$ 0

Spending/Cash Flow Notes: none.

Other Implications:

- a) **Does the legislation have indirect financial implications, or long-term implications?**
No.
- b) **What is the financial cost of not implementing the legislation?**
None.
- c) **Does this legislation affect any departments besides the originating department?**
No.
- d) **What are the possible alternatives to the legislation that could achieve the same or similar objectives?**
None.
- e) **Is a public hearing required for this legislation?** No.
- f) **Is publication of notice with *The Daily Journal of Commerce* and/or *The Seattle Times* required for this legislation?** No.
- g) **Does this legislation affect a piece of property?** No.
- h) **Other Issues:** None.

List attachments to the fiscal note below: None.