

Ordinance No. 120441

Council Bill No. 113759

The City of Seattle Council Bill/Ordinance

AN ORDINANCE relating to the taxation of distribution cooperatives and distribution affiliates, and amending Sections 5.44.022, 5.44.026, and 5.44.470 of the Seattle Municipal Code in connection therewith.

DP 2-0 (DD.RC.)

7-23-01 Pa

CF No. _____

Date Introduced:	JUL 16 2001	
Date 1st Referred:	To: (committee)	Finance, Budget & Economic Development Committee
Date Re - Referred:	To: (committee)	
Date Re - Referred:	To: (committee)	
Date of Final Passage:	Full Council Vote:	
7-23-01	9-0	
Date Presented to Mayor:	Date Approved:	
7-24-01	7/26/01	
Date Returned to City Clerk:	Date Published:	T.O. _____ P.T. <input checked="" type="checkbox"/>
7/26/01	3PR	
Date Vetoed by Mayor:	Date Veto Published:	
Date Passed Over Veto:	Veto Sustained:	

This file is complete and ready

Law Department

Law Dept. Review

The City of Seattle - Legislative Department

Council Bill/Ordinance sponsored by: _____

Jan Page

Councilmember

Committee Action:

DP 2-0 (SD, RC)

7-23-01 Passed 9-0

This file is complete and ready for presentation to Full Council.

Committee: _____

(initial/date)

Department

Law Dept. Review

OMP
Review

City Clerk
Review

Electronic
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Indexed

Jan Page
Approved
Full text loaded

ORDINANCE 120441

AN ORDINANCE relating to the taxation of distribution cooperatives and distribution affiliates, and amending Sections 5.44.022, 5.44.026, and 5.44.470 of the Seattle Municipal Code in connection therewith.

BE IT ORDAINED BY THE CITY OF SEATTLE AS FOLLOWS:

Section 1. Section 5.44.022 of the Seattle Municipal Code is amended by adding the following new subsections:

“Customer-owner” with respect to a distribution cooperative means a person 1) having an ownership interest in the distribution cooperative, 2) who purchases merchandise for sale at retail from the distribution cooperative or its distribution affiliate, and 3) who is entitled to distributions made by the distribution cooperative.

“Distribution affiliate” means a partnership, limited liability company, or other entity that sells merchandise to the customer-owners of the distribution cooperative and which is owned 50 percent or more by the distribution cooperative.

“Distribution cooperative” means a person 1) that itself sells, or owns 50 per cent or more of a distribution affiliate that sells, merchandise to its customer-owners for resale at retail, 2) in which two-thirds of the aggregate outstanding voting ownership interest is owned by its customer-owners, 3) that makes distributions to its customer-owners at least partly on the basis of patronage, and 4) that qualifies for federal income tax purposes under the provisions of subchapter T of the Internal Revenue Code as now in effect or hereafter amended.

The City’s Code Reviser is authorized and directed to insert these new subsections in alphabetical order in SMC Section 5.44.022.



1 Section 2. Subsection (6) of Section 5.44.026 of the Seattle Municipal Code is amended as
2 follows:

3 6. Notwithstanding any other definition of the term "sales at retail" or "retail sales" contained in
4 this chapter, the term shall specifically not include any network telephone services, waste collecting, and
5 other services taxed pursuant to Chapter 5.48 of the Seattle Municipal Code. Notwithstanding any other
6 definition of the term "sale at wholesale" or "wholesale sale" contained in this chapter, the term shall
7 specifically not include a distribution cooperative's or its distribution affiliate's sales of merchandise to a
8 customer-owner of the distribution cooperative for the customer-owner's resale at retail. A distribution
9 cooperative or a distribution affiliate is taxed on such sales pursuant to Section 5.44.400 F of the Seattle
10 Municipal Code.

11 Section 3. Section 5.44.470 of the Seattle Municipal Code is amended by adding a new
12 subsection as follows:

13 ***

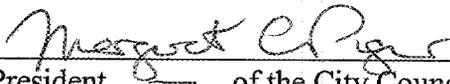
14 M. An amount equal to the actual cost of the merchandise that a distribution cooperative or its
15 distribution affiliate sells to a customer-owner of the distribution cooperative for the customer-owner's
16 resale at retail. Actual cost means the cost actually paid by the distribution cooperative or distribution
17 affiliate after taking into account all cash discounts and other price reductions.

18
19 Section 4. Any action taken consistent with the authority and prior to the effective date of this
20 ordinance is hereby ratified and confirmed.

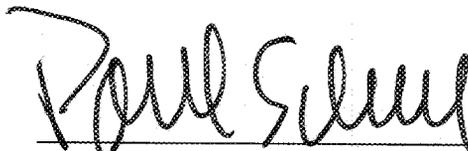


1 Section 5. This ordinance shall take effect and be in force thirty (30) days from and after its
2 approval by the Mayor, but if not approved and returned by the Mayor within ten (10) days after
3 presentation, it shall take effect as provided by Municipal Code Section 1.04.020.

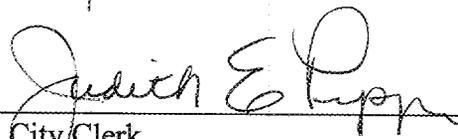
4 Passed by the City Council the 23rd day of July, 2001 and signed by me in open
5 session in authentication of its passage this 23rd day of July, 2001.

6
7 
8 President _____ of the City Council

9
10 Approved by me this 26th day of July, 2001

11
12 
13 Mayor _____

14
15
16 Filed by me this 26th day of July, 2001.

17
18 
19 City Clerk _____

20 (Seal)





City of Seattle

Paul Schell, Mayor

Department of Finance

Dwight D. Dively, Director

MEMORANDUM

Date: July 12, 2001

To: Honorable Margaret Pageler, President
Seattle City Council

From: Dwight Dively, Director
Department of Finance

Subject: AN ORDINANCE relating to the taxation of distribution cooperatives and distribution affiliates, and amending Sections 5.44.022, 5.44.026, and 5.44.470 of the Seattle Municipal Code in connection therewith.

The attached ordinance establishes a taxation methodology for Distribution Cooperatives and Distribution Affiliates that differs from that of Wholesale Sellers.

Background

Associated Grocers (AG) is a Distribution Cooperative owned by a membership consisting of independently owned grocery stores located throughout the Pacific Northwest. AG purchases goods in bulk on its members' behalf, thereby allowing its customer stores to enjoy significant price breaks. Due to AG's considerable buying power, these smaller chains and stores are better able to compete with their larger competitors.

Following an audit conducted by the City in 1998, AG requested that, for B&O taxation purposes, the City classify them as a Purchasing Agent rather than a Wholesale Seller. AG's argument was that their competitors (vertically integrated entities such as Safeway, Albertson's, Fred Meyer, etc.) enjoy tremendous volume discounts and are not taxed on the distribution of goods from their warehouses to their individual stores. AG also argued that since their member stores own AG (the distribution cooperative), they actually sell to themselves. Hence, they should not be considered a Wholesale Seller. In a settlement agreement reached between the City and AG in 1999, the City agreed to recognize AG as a Purchasing Agent for merchandise they sell to their member stores, and as a Wholesale Seller for transactions they conduct with their non-member stores. The agreement recognized AG's unique role in the industry, and the City's desire to help level the playing field between AG and the vertically integrated grocery chains with whom AG competes.

As a Purchasing Agent, AG has been taxed only on its markup (i.e., the difference between the price AG pays for an item and the price it charges its members) at the rate of .00415. In this taxation methodology, markups are viewed as "agent commissions." This taxing methodology differs from the Wholesale Seller taxation methodology, which is applied to all gross receipts at the rate of .00215.

700 Fifth Avenue, Room 4200, Seattle, WA 98104

Tel: (206) 684-0181, TDD: (206) 233-7810, Fax: (206) 684-8286, <http://www.ci.seattle.wa.us>

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Current Issue

AG recently asked the City to change its current status from a Purchasing Agent to Wholesaler, stating that it needs to use its inventory as collateral for loans in order to enhance its creditworthiness. Using inventory as collateral would not be possible in their current status since Purchasing Agents do not hold title to the goods they obtain on their member's behalf and, therefore, cannot use inventory as collateral. Even though AG would now be considered a wholesaler, AG would like to maintain its present tax treatment. AG claims that the "markup" it will continue to charge its members in its new "buy and sell" position is similar to the "agent commissions" which have been taxed by the City since the aforementioned 1999 settlement agreement went into effect. AG wishes to have the City continue to apply its current taxation method and rate on its markup to allow AG members to continue competing with the vertically integrated grocery stores.

Conclusion

After reviewing AG's request, we believe it is appropriate to establish a new tax treatment for distribution cooperatives acting as wholesalers. A distribution cooperative's markup will be taxed under the "Other" tax classification at a rate of .00415. This will allow AG to maintain its present tax treatment. AG sales to non-member stores (non-customer-owned stores) would continue to be reportable as wholesale sales and will be taxed on the gross receipts under the Wholesale Seller tax classification. The proposed ordinance also contains a provision that will allow this treatment to continue if AG combines with another Distribution Cooperative or large wholesaler in a joint venture or partnership. We are aware of only two other Distribution Cooperatives operating within Seattle and they would receive the same treatment under this ordinance. As a result, passage of the proposed ordinance is anticipated to have a very small overall effect on revenue (less than \$3,000 per year).

The City and AG agree that independently owned supermarkets are an essential element of the competitive fabric of the grocery industry, and that they contribute positively to the communities they serve. Without the tax treatment contained in this ordinance, we believe that independent grocery stores will not have the purchasing power to buy in large quantities and receive the same price breaks that the vertically integrated companies receive when they buy in large quantities and distribute goods through their own warehouses. This ordinance will protect AG's economic viability, the people AG employs, and hundreds of independently owned retailers throughout Seattle and the Pacific Northwest.

We appreciate your consideration of this ordinance. If you have any questions, or would like an individual briefing on this matter, please call Mel McDonald at 233-0071.

cc: Mel McDonald, Revenue and Consumer Affairs Director



Fiscal Note Template

Each piece of legislation that is financial in nature requires a fiscal note. The fiscal note should be drafted by department staff and should identify operating, capital, revenue, and FTE impacts of the legislation.

Department: Department of Finance	Contact Person/Phone: Mel McDonald (3-0071)	CBO Analyst/Phone: Greg Petersen (4-8075)
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Legislation Title: AN ORDINANCE relating to the taxation of distribution cooperatives and distribution affiliates, and amending Sections 5.44.022, 5.44.026, and 5.44.470 of the Seattle Municipal Code in connection therewith.

Summary of the Legislation: The legislation creates new tax code language to implement the taxation of distribution cooperatives under the "Other" classification on the markups the cooperatives charge to their member stores. This is in contrast to taxing the gross receipts from sales between the distribution cooperative and its customer owners.

Background (Include justification for the legislation and funding history, if applicable): In June of 1999, a settlement agreement was reached between the City and Associated Grocers (a distribution cooperative). The agreement was in lieu of a legal battle in court over how Associated Grocers (AG) operated and what tax was owed to the City. At that point in time, AG claimed to be acting as a purchasing agent and, therefore, their markup to their member stores was really a commission and taxable under the "other" tax classification. The City agreed to tax AG as a purchasing agent for sales they made to their member stores.

Presently, AG argues it should continue to pay tax on their markup to their member stores but, to obtain bank loans and for other financial reasons, it needs to use its inventory as collateral which can't be done if they're a purchasing agent. (Technically, Purchasing Agents don't hold title to the goods they buy and sell on behalf of their members.) AG claims that if they are actually taxed as a wholesaler on their gross sales, they are being unfairly taxed as compared to vertically integrated grocery chains such as Safeway, Fred Meyer, Albertson's, etc. These vertically integrated entities can buy in large quantities, thereby receiving volume discounts which make them very competitive. Distributions out of their warehouses are not taxed, as would be the distribution of goods out of a cooperative's warehouse. AG believes that since cooperatives are actually owned by their customer-owner stores, they are really making sales to themselves, just as a vertically integrated grocery chain does when they distribute merchandise and groceries from their warehouses to their stores.

AG will continue to be taxed at the wholesale seller rate on their gross sales for any goods it sells to non-member stores.



This legislation would not change the amount of revenue derived from AG, but would allow the two other known distribution cooperatives to reduce their tax amounts. The reduction in revenue would be less than \$3,000 per year.

Public Private Partnership Review Status:

Is the project referenced in the legislation subject to P4 review? If yes, identify P4 review to date. N/A

Is the legislation subject to public hearing requirements? If yes, what public hearings have been held to date? N/A

Sustainability Issues (related to grant awards): N/A

Estimated Expenditure Impacts:

FUND (List # and/or Account)	2001	2002	2003
None			
TOTAL			

One-time \$ _____ On-going \$ _____

Estimated Revenue Impacts:

FUND (List # and/or Account)	2001	2002	2003
General Fund (90%) Parks (10%)	(\$1,500)	(\$3,000)	(\$3,000)
TOTAL	(\$1,500)	(\$3,000)	(\$3,000)

One-time \$ _____ On-going \$ 3,000

Estimated FTE Impacts:

FUND	2000	2001	2002
None			
TOTAL			

Full Time _____ # Part Time _____ # TES _____

Do positions sunset in the future? If yes, identify sunset date? N/A

Other Issues (including long-term implications of the legislation): N/A





ASSOCIATED GROCERS, INC.

RECEIVED

JUL 16 2001

MEMBER

July 16, 2001

The Honorable Jan Drago
Seattle City Councilmember
600 Fourth Avenue, Suite 1100
Seattle, Washington 98104-1876

Dear Councilmember Drago:

I am writing to draw your attention to Ordinance 113759 which is scheduled for review before the Finance, Budget and Economic Development Committee this coming Wednesday, July 18. The ordinance has been moving through the channels quite rapidly as it is vital to the success of Associated Grocers (AG) and its 25 independent member-stores located in the Seattle area.

To continue to compete effectively with the larger, national grocery chains and, more importantly, to accommodate its debt restructuring efforts, AG needs the City of Seattle to make a minor change in its tax code that would have a zero net effect on City of Seattle revenues. It would allow AG to own its inventory, while not paying more B&O tax than it already does when it transfers inventory to its retail customers.

Over the past several weeks, we have been working very closely with Department of Finance Director Dwight Dively and his department is supportive of this ordinance. In addition, we were encouraged earlier this year when the Washington State Legislature unanimously voted to enact a similar, enabling, piece of legislation.

If you are available this week, I'd appreciate the opportunity to arrange for a more thorough briefing for you on the issue. In the meantime, I have attached a document that will provide you with more specifics about the issue as well as information about AG's background. Please feel free to contact me if you have any questions.

Sincerely,

Robert Hoyt
CEO, Associated Grocers

Enclosure

cc: The Honorable Richard Conlin, Councilmember; The Honorable Nick Licata, Councilmember; The Honorable Richard McIver, Councilmember; The Honorable Heidi Wills, Councilmember; Finance Director Dwight Dively





The Food People

ASSOCIATED GROCERS, INC.

Grocery Distribution Cooperative B&O Tax Bill

The Issue

Associated Grocers, Incorporated, (AG) is a Seattle-based grocery cooperative through which its retail-member stores purchase inventory. Acting as a purchasing agent on behalf of its member--stores, this agency relationship allows AG member-stores to compete with the large, national grocery chains in the competitive grocery industry that operates on razor-thin profit margins.

The grocery industry has seen a marked increase in consolidation in the last five years, typically resulting in more buying power for the larger, national grocery chains. For AG, the company is conducting a zero-base review of its operations and cost structure. To reorganize its debt structure, AG needs to use its inventory to enhance its creditworthiness and as collateral for loans.

To continue to compete effectively with the larger, national grocery chains and to accommodate its debt restructuring and cost reduction goals, AG needs the City of Seattle to make a minor change in its tax code that would have a zero net effect on City of Seattle revenues. It would allow AG to own its inventory, while not paying more B&O tax than it already does when it transfers inventory to its retail customers -- similar to, but still not as light as, the state tax burden of the large, national grocery chains.

Background

Associated Grocers was formed in Seattle in 1934 by a group of independent grocers who pooled their purchasing power in order to compete on fair ground with the large national grocery chains. AG is currently owned by more than 150 independent retail grocers whose operations total 25 stores in Seattle, and more than 300 stores in neighboring regions throughout the Pacific Northwest, and employs approximately 1,200 people at its facility that straddles the Seattle/Tukwila boundary.

Several years ago, the Washington Department of Revenue (DOR) issued a ruling to AG that it would not have to pay the wholesaling B&O tax of .454% on the price paid by members for goods transferred to AG members from AG's member-owned grocery warehouse. Instead, the DOR approved of AG paying B&O tax at the services B&O tax rate of 1.5% on AG's "gross margin" with respect to those sales (i.e., the difference between AG's cost of goods and the price paid by its members for those goods).

This result was an equitable one because, had the Department decided to tax the entire gross income resulting from such transfers, a grossly uneven playing field would have been created between wholesale grocery cooperatives and the large, national self-distributing chains (like



Walmart), which pay no tax on transfers from their wholesale distribution centers to their retail stores.

The DOR based its ruling on the fact that AG was acting as an agent for its members. AG acquires and stores groceries in its warehouse for the account of its retail members as their agent. Accordingly, because AG does not own or sell such products, the transfer does not trigger the wholesaling B&O tax. Instead, the services B&O tax applies to the fee received by AG for acting as an agent and such fee equals the difference between AG's cost of goods and the price for such goods paid by its members.

Proposed Amendment to City's Tax Code

AG seeks narrowly drawn legislation that will provide that sales of groceries by grocery distribution cooperatives or their affiliates are entitled to a deduction from the B&O tax equal to the actual cost incurred to purchase the goods in the wholesaler's warehouse from the vendors of those goods. Because the state and localities do not now collect revenue on this amount, the proposed amendment would not modify in any way AG's current B&O tax burden. The amendment would, however, permit AG or an affiliate of AG to dispense with acting as an agent for AG's member stores and would thereby strengthen AG's position in the private financial markets by allowing it to own and pledge as collateral one of the most valuable assets of a wholesale grocery operation: inventory.

At the state level, the Washington State Legislature has just enacted legislation that is nearly identical in nature to AG's proposed amendment to the City of Seattle's tax code.

Conclusion

Independently-owned supermarkets are an essential element of the competitive fabric of the grocery industry, and contribute positively to the personalities of the communities they serve. Because of these innovative retailers, Puget Sound consumers enjoy some of the best shopping opportunities in the country.

The proposed amendment would continue the tax result currently applicable to AG, while allowing AG to improve its financial structure. This action is necessary to protect AG's economic viability, the people AG employs and the hundreds of AG's independently-owned retailers in Seattle and the throughout the Pacific Northwest.



STATE OF WASHINGTON – KING COUNTY

--SS.

134250
City of Seattle, Clerk's Office

No. ORD IN FULL

Affidavit of Publication

The undersigned, on oath states that he is an authorized representative of The Daily Journal of Commerce, a daily newspaper, which newspaper is a legal newspaper of general circulation and it is now and has been for more than six months prior to the date of publication hereinafter referred to, published in the English language continuously as a daily newspaper in Seattle, King County, Washington, and it is now and during all of said time was printed in an office maintained at the aforesaid place of publication of this newspaper. The Daily Journal of Commerce was on the 12th day of June, 1941, approved as a legal newspaper by the Superior Court of King County.

The notice in the exact form annexed, was published in regular issues of The Daily Journal of Commerce, which was regularly distributed to its subscribers during the below stated period. The annexed notice, a

CT:120441 ORDINANCE;FULL

was published on

07/31/01

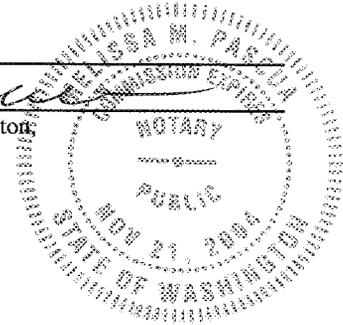
J. Stedman

Subscribed and sworn to before me on

07/31/01

Melissa M. Pasqua
Notary public for the State of Washington,
residing in Seattle

Affidavit of Publication



State of Washington, King County

City of Seattle

ORDINANCE 120441

AN ORDINANCE relating to the taxation of distribution cooperatives and distribution affiliates, and amending Sections 5.44.022, 5.44.026, and 5.44.470 of the Seattle Municipal Code in connection therewith.

BE IT ORDAINED BY THE CITY OF SEATTLE AS FOLLOWS:

Section 1. Section 5.44.022 of the Seattle Municipal Code is amended by adding the following new subsections:

"Customer-owner" with respect to a distribution cooperative means a person 1) having an ownership interest in the distribution cooperative, 2) who purchases merchandise for sale at retail from the distribution cooperative or its distribution affiliate, and 3) who is entitled to distributions made by the distribution cooperative.

"Distribution affiliate" means a partnership, limited liability company, or other entity that sells merchandise to the customer-owners of the distribution cooperative and which is owned 50 percent or more by the distribution cooperative.

"Distribution cooperative" means a person 1) that itself sells, or owns 50 per cent new subsection as follows:

M. An amount equal to the actual cost of the merchandise that a distribution cooperative or its distribution affiliate sells to a customer-owner of the distribution cooperative for the customer-owner a resale at retail. Actual cost means the cost actually paid by the distribution cooperative or distribution affiliate after taking into account all cash discounts and other price reductions.

Section 4. Any action taken consistent with the authority and prior to the effective date of this ordinance is hereby ratified and confirmed.

Section 5. This ordinance shall take effect and be in force thirty (30) days from and after its approval by the Mayor, but if not approved and returned by the Mayor within ten (10) days after presentation, it shall take effect as provided by Municipal Code Section 1.04.020.

Passed by the City Council the 23rd day of July, 2001, and signed by me in open session in authentication of its passage this 23rd day of July, 2001.

MARGARET PAGELER,
President of the City Council.

Approved by me this 26th day of July, 2001.

PAUL SCHELL,
Mayor.

Filed by me this 26th day of July, 2001.

(Seal) JUDITH E. PIPPIN,
City Clerk.

Publication ordered by JUDITH PIPPIN,
City Clerk.

Date of official publication in Daily Journal of Commerce, Seattle, July 31, 2001.
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