Seattle enacts ‘head tax’ on large employers starting in 2019

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In brief
On May 14, the Seattle City Council (Council) unanimously passed the Employee Hours Tax (EHT, or more commonly, the head tax). The $275 annual tax per full-time equivalent (FTE) employee applies to taxpayers with at least $20 million or more in annual taxable gross receipts as measured under the City’s existing Business & Occupation tax laws. The initial term of the tax is from January 1, 2019, to December 31, 2023.

Originally proposed at 26 cents per hour, or $500 per Seattle employee per year, Mayor Jenny Durkan (D) and the Council compromised at the lower rate of 14 cents per hour worked in the City or $275 for a FTE employee per year. At $275, this tax is significantly higher than other similar taxes, such as the Local Services Tax in Pittsburgh ($52 per employee per year) or Denver’s Occupational Privilege Tax ($117 per employee per year).

This is not the first Seattle head tax. From July 1, 2007, to December 31, 2009, Seattle had a similar per-employee tax. [City of Seattle Ordinance CB 119250 and Amendment 24]

In detail

Background
The Council adopted the EHT to provide revenue to the City to reduce homelessness. The Council estimates that the EHT will generate approximately $48 million in the first year.

Proponents of the tax maintain that the EHT is a beneficial alternative for the fiscally constrained city with expanding costs. One constraint is the inability of Seattle to adopt an income tax under state law. Seattle also is unwilling to raise property taxes in light of rising housing costs in the City, or to increase utility taxes, which would disproportionately affect those with fixed incomes. Opponents of the new head tax argue that Seattle’s revenue has outpaced population growth year after year, which indicates that there is not a revenue-generating problem; instead, they say the City has a spending and efficiency problem.

How does the tax work?
The tax is measured by the number of employee hours performed within the City during each quarter of the calendar year. ‘Employee’ is defined to mean any person who performs work, labor, or services for a business, is on the business’ payroll, and performs any part of their duties within the City. In determining the tax base, the law also specifically includes in the determination the payroll of related paymaster entities, members of limited liability companies, professional limited liability companies, and partners.
The amount of tax is calculated by multiplying the number of employee hours (excluding vacation and sick hours) worked within the City by the rate of $0.14323. Further, if the employee travels, the employer must track and calculate the number of hours worked within and without the City and adjust the tax base as needed.

The Council also laid out an alternative FTE calculation method. This method allows employers to forego the calculation of hours for full-time employees and to base the tax on the number of full-time (greater than 480 hours a quarter) or FTE employees. FTE employees are determined by totaling the number of hours worked by part-time employees and dividing by 480, rounded up to the nearest whole number. Each FTE then is multiplied by $68.75 to calculate the amount due under the alternative method.

Under either method, the reportable hours include those generated from full-time employees, part-time employees, temporary workers, and payroll of related companies serving as a common paymaster. The tax generally is the liability of the holder of the payroll liability, with the exception of common paymasters. The filing frequency of the tax will match the existing filing frequency for the company’s business license tax under existing Chapter 5.45, but will be administered on a separate form.

In addition to exempting businesses that do not generate at least $20 million or more in annual taxable gross receipts as measured under the City’s existing Business & Occupation tax laws, the Council carved out exemptions from the tax, including:

- insurance businesses and their agents
- businesses that only sell, manufacture, or distribute motor vehicle fuel
- businesses that only distribute or sell liquor
- federal and state government agencies and subdivisions
- non-profit organizations.

**EHT scheduled to sunset**
The initial term of the tax is from January 1, 2019, through December 31, 2023. It is expected that the Council will conduct a review of the tax beginning in 2023 to determine whether or not the EHT should be continued. If the taxes are continued, the City also will determine what the rate of tax should apply beginning in 2024.

The ordinance stipulates that in its sunset evaluation, the Council “should take into account the estimated impact of the tax on employment and wages within the City, the number of new affordable housing units constructed using revenues from the tax, the number of persons experiencing homelessness in the City, and the impact of the services funded by the tax on persons experiencing homelessness.” This same evaluation was required for the earlier version of the head tax (in 2007 to 2009), which was not renewed.

**The takeaway**
The EHT is expected to impact approximately 585 businesses located in Seattle, but has far-reaching consequences beyond the Seattle city limits. For instance, this ordinance is not limited to businesses located within the City, but applies to businesses that have $20 million or more of taxable gross receipts in Seattle. The tax can affect industries located outside of Seattle that have employees temporarily working in the City, such as temporary employment agencies, retail companies, construction companies, investment funds with Washington-based partners, or the hundreds of technology companies with limited operations in Seattle.

While the rates, exemption thresholds, and deductions are vastly different for this 2019 version of the head tax as compared to the 2007-2009 version, the mechanics of the calculation are the same.

The historical head tax had a rate of $25 per FTE or $.01302 per hour, compared to the rate of $275 per FTE or $.014323 per hour that will apply in 2019. The alternative FTE method was popular with businesses under the prior head tax due to the burdensome requirements of tracking employee hours. However, with the material difference in the rates and no available deductions, many companies may benefit by specifically tracking hours worked in Seattle. Companies likely will need to implement new processes and systems to track and document the information required under the EHT.

It is anticipated that Seattle’s Finance and Administrative Services Department will promulgate a regulation providing more guidance to taxpayers. Affected businesses also should remain aware of efforts that are currently underway to block implementation of the EHT.
Let’s Talk

If you have any questions regarding Seattle’s head tax, please contact:

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