

## POLICY NOTE

### Key Findings

1. The current business licensing process is overly complicated and expensive for small business owners.
2. Municipalities have different licensing requirements that are time-consuming and expensive to comply with.
3. Business and Occupation taxes can be assessed by local municipalities creating multiple tax filing requirements on business.
4. In some cases, business income within a jurisdiction is insufficient to cover the cost of the employer's time and the cost to obtain a business license.
5. The government agency staff time to process a license for a business that doesn't generate a significant amount of revenue can cost more than the license fee collected.
6. Applying for a license has improved with the state centralized system, but the remaining cities, not currently in the system, need to be added to the program.
7. A statewide threshold for economic nexus needs to be established to exempt insignificant levels of business activity from licensing requirements within a municipal jurisdiction.
8. Municipal Business and Occupation taxes should be collected by the state and distributed to local municipalities.

# The need for license and Business and Occupation tax collection simplification in Washington State

*Streamlining Washington's costly and complex business licensing and Business and Occupation tax collection system would increase fairness, promote voluntary compliance, and free small business owners to create jobs, services, and economic growth.*

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## Introduction

Municipalities in Washington State are authorized to issue business licenses and charge a fee to regulate and identify business activity within the municipality's jurisdiction.<sup>1</sup>

The current licensing system is confusing, wasteful, and expensive, as successful businesses find they must comply with, and pay for, a wide array of local rules and fees simply to carry out legal economic activity.

Several attempts have been made over the last few legislative sessions to streamline and simplify the application, processing, and issuance of a business license. The changes culminated in the passage of House Bill 2005 in the 2017 legislative session.<sup>2</sup>

House Bill 2005 created a centralized licensing system, which, for smaller jurisdictions, made the license application process more cost-effective and easier for business owners to follow. An additional option, for larger municipalities to use a third-party processor, called FileLocal.gov, was also allowed under House Bill 2005.

For business owners who operate in multiple jurisdictions, a license must be purchased in each jurisdiction. This overlap results in thousands of dollars in license fees, all so the business owner can carry out the same job-creation and economic activity in different communities.

Many business owners, because of the difficult and expensive licensing process, do not bother to apply for a license, particularly if the work being performed is minimal, or infrequent within a jurisdiction's boundaries.

Some local officials also impose their own local Business and Occupation (B&O) taxes on business owners that are required to be paid directly to the jurisdiction. This creates an additional filing requirement for business owners. While there are minimum thresholds on the

1 "Municipal Business Licensing," State of Washington, accessed on November 15, 2021, at <https://app.leg.wa.gov/RCW/default.aspx?cite=35.90>.

2 "Improving the business climate in this state by simplifying the administration of municipal general business licenses," effective date July 23, 2017, accessed on November 15, 2021, at <https://app.leg.wa.gov/billssummary?BillNumber=2005&Initiative=false&Year=2017>.

gross revenue amount on which the taxes are assessed, the business owner is still required to file a tax return in each jurisdiction on a regular basis, even if he owes no tax at all.

### **Simplification of the license and Business and Occupation tax collection process**

Simplification of the collection process will reduce the amount of time and cost to apply for a license.

For businesses that offer services primarily in a single jurisdiction, the business license application is relatively easy since the business owner either applies directly to the municipality or uses the state online system to receive a license. For businesses that operate in multiple jurisdictions, the process is complex and expensive, which results in thousands of dollars in license fees that cost more than the services the business provided inside the jurisdiction limits.

The existing centralized state licensing system, created by HB 2005 and managed by the Secretary of State, should be expanded to cities that are not currently in the system, including larger cities that are currently exempt. House Bill 2005 allowed cities that were using a third-party provider, like FileLocal.gov, to be exempt from the state system. While this makes the process of tax collection and license issuance easier for a municipality, it does not solve the underlying problem that businesses are required to file for a license in multiple places.

### **Washington has multiple Business and Occupation Tax rates**

Washington state law allows municipalities and political jurisdictions to impose B&O taxes on business activities within their jurisdictional boundaries, independent of the additional B&O taxes imposed by state lawmakers and enforced by the Washington State Department of Revenue (DOR). This creates differing B&O tax rates based on where business activity occurs. There are multiple B&O tax rates, based on location, in Washington. The connection between the business activity and location is referred to as the “economic nexus”.

For a business attempting to calculate the correct B&O for products or services, the multiple filing location problem is made worse by municipalities that require taxes to be paid to them directly. Officials in the cities of Seattle and Everett are an example of jurisdictions that require B&O tax payments made directly to themselves, separate from state B&O payments.<sup>34</sup>

The tax collection reporting to DOR and for each municipality or jurisdiction, completed monthly or quarterly, takes a considerable amount of time to complete, in addition to the time needed to calculate the sales tax required by each location. FileLocal.gov is authorized to collect local municipal B&O taxes, creating a second

3 “The City of Everett, Business and Occupation Tax,” accessed on November 15, 2021, at <https://everettwa.gov/166/Business-Occupation-Tax>.

4 “The City of Seattle, Business and Occupation Tax,” accessed on November 15, 2021, at <https://www.seattle.gov/license-and-tax-administration/business-license-tax>.

requirement on business to file taxes in two different places, irrespective of whether taxes are owed or not.

For small businesses and individual business owners, operating in multiple locations, the reporting requirement and collection of the B&O tax based on location requires a significant amount of wasted time, work, and expense. None of this wasteful compliance activity adds any revenue to the state, or benefits job-creation or economic services in the community.

## **Recommendation**

Simplification of licensing and municipal B&O tax collection is badly needed. The complexity lawmakers have imposed provides no benefit to business or the state, and directly punishes business owners who create jobs, services, and economic growth.

House Bill 2005 requires all municipalities to be part of the centralized state licensing system or FileLocal.gov by 2028. The legislation should be updated to require all municipalities to use the centralized state system and move away from the FileLocal.gov platform.

This would create one location for all business licensing in Washington and eliminate thousands of hours of wasteful compliance work.

The Department of Revenue should collect B&O taxes on behalf of the municipalities that impose individual B&O taxes and then distribute the required tax revenue to the municipality directly. This would replace the current requirement that business owner pay the municipality directly for B&O taxes.

Instead, the state would calculate the B&O tax rate for the work performed in a jurisdiction and collect the tax on behalf of the municipality. This is similar to the process used by the state for proportional sales tax collection. This would reduce the work required to process the tax payment both for the local municipality and businesses, while only marginally increasing the work the state must-do for the tax payment distribution.

The requirement to file tax returns directly to the municipality would no longer be required as the state can now remit the payment directly to the municipality.

The definition for business “economic nexus” within a municipality should be expanded to exempt businesses with less than \$100,000 in annual gross revenue generated within the jurisdiction borders. The City of Seattle currently has a \$100,000 annual gross revenue threshold below which a business does not have to pay B&O tax.<sup>5</sup> This commonsense exemption should be applied statewide.

A similar “economic nexus” threshold for a license requirement should be set at the Internal Revenue Service (IRS) definition of a hobby, currently \$12,220 gross

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<sup>5</sup> “The City of Seattle, Business and Occupation Tax,” accessed on November 15, 2021, at <https://www.seattle.gov/license-and-tax-administration/business-license-tax>.



**Mark Harmsworth** joined WPC as its Center for Small Business director in 2020 after serving two terms in the Washington State House of Representatives. His focus was on transportation and technology, including serving as the ranking member on the House Transportation Committee.

Prior to the legislature, Mark served two terms on the Mill Creek City Council and was elected Mayor Pro-Tem in his last year.

He recently finished serving as a Director on the Everett Community College Foundation Board and currently serves as a Director on the Boys and Girls Club of Snohomish County.

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income for an individual.<sup>6</sup> For business activity under the threshold, there should be no requirement to obtain a license to operate in a jurisdiction.

A municipal \$100,000 in annual gross revenue threshold would result in no change in collected B&O tax for the state.

## **Conclusion**

Washington's current system of collecting B&O taxes and regulating business activity is wasteful and inefficient. Having one, centralized license system would reduce costs, simplify the license application and renewal process, and improve license compliance.

By providing a reasonable dollar threshold below which no business license would be required, business owners would save thousands of dollars a year, reduce the work for government agencies and improve license compliance.

A small business owner would be free to use the time and money saved from filing complex tax reports to generate additional business income, jobs, and sales. The result would be increased economic activity, broader benefit to the community, and higher state and local tax revenues. This would also make the tax system fairer, save on enforcement costs and would increase voluntary compliance.

Small business owners would see a significant reduction in the amount of complexity, cost and effort required to report and pay the correct B&O tax amounts to the state.

B&O tax revenues would likely increase, while a fairer tax system and expanded economic activity would directly benefit everyone in our state.

<sup>6</sup> "Publication 17 (2020), Your Federal Income Tax, Internal Revenue Service," accessed on November 15, 2021, at <https://www.irs.gov/publications/p17>.