

Utility Occupation Tax – Discounted Tax Rate for High Volume Customers

Issue

[Lynden Municipal Code \(LMC\) 3.28.060](#) allows for a reduction in the Utility Occupation Tax to 1% of gross revenues for any customer that is billed greater than \$5,000 in a month. For gas utilities, this further decreases to 0.5% for customers billed greater than \$50,000. This rate has not changed since 1985 and may need to be adjusted to reflect a more equitable spread of tax across all users of Utilities.

Summary & Recommendation

Considering the qualitative and quantitative factors, the Council may wish to take one of two approaches:

1. Removing the limit – increasing revenues, but with potential backlash from large volume customers. This option is the most effective for time and quick revenue generation.
2. A combined approach to capture as much of the revenues as possible, but allowing some flexibility and consideration for the change to customers. Such an approach *could* look like the steps below. This option provides some revenue growth, but will require more administrative time over the years to monitor and capture increases appropriately.
 - a. Starting in 2025 – Limit increases to \$10,000 and 3% over threshold
 - b. Starting in 2026 – Limit increases to \$10,000 and 5% over threshold
 - c. Starting in 2027 – Limit increases to \$25,000 and 5% over threshold
 - d. Starting in 2028 – Limit increases to \$50,000 and 5% over threshold
 - e. Starting in 2029 – Revisit rate to see if Industrial outlook in Lynden has changed

Analysis

- Municipalities who charge Utility Tax are authorized to do so by RCW and it is a type of Business & Occupancy tax. Staff have confirmed with Legal counsel that the current structure of the tax is legally permissible.
- While there are a several cities in Washington that provide a limit on Utility taxes, the majority offer these limits to Electricity or Natural Gas customers. The City of Lynden offers this limit to all utility types.
- Revenues generated through Utility taxes are deposited into the General Fund, affecting cash flow and balances that support General Government Services, including Police, Fire, Parks and Public Works. These taxes represent a significant one of the “big three” revenue sources for Lynden.

- While Utility taxes are a tax on the revenues of Utility (i.e. PSE, Cascade, the Water Utility, etc.), the taxes are usually passed to the customers through the rates charges, regardless of whether this is separately identified on the individual customer's bill.

It may be in the best interest of the City to increase either the tax base limit and/or the tax rate to align with the increases in taxes applied to all customers. Giving a discounted tax base rate to customers who are the highest users of the facilities may give the impression of offering volume discounts, which is counter to the wear and tear on facilities.

Options

Note – quantitative analysis below is limited to analyzing City-owned utilities where we can readily analyze both sides of the transaction. We have insufficient information available to quantify the impact on increases to other Utilities.

Refer to [Exhibit I](#) for details.

- **Remove the Tax Limit** - \$103,379 increase to General Fund
- **Increasing the tax base limit to a higher threshold:**
 - Increase from \$5,000 to \$10,000 - \$22,445 Increase to General Fund (Sc.1)
 - Increase from \$5,000 to \$25,000 - \$57,766 increase to General Fund (Sc.2)
 - Increase from \$5,000 to \$50,000 - \$84,297 increase to General Fund (Sc.3)
 - Increase from \$5,000 to \$100,000 - \$103,350 increase to General Fund (Sc.4)
- **Increasing the tax rate from 1% to 10%:**
 - Increase from 1% to 3% - \$ 22,973 increase to General fund (Sc.6)
 - Increase from 1% to 6% - \$ 57,433 (Sc.7)
 - Staggered approach – can be quantified upon request
- **Combined increase in tax base limit and tax rate:**
 - Increase from \$5,000 to \$10,000 & 1% to 5%: \$58,416 (Sc.9)
 - Increase from \$5,000 to \$25,000 & 1% to 3%: \$67,902 (Sc.10)
- **Applying the tax base limit to only specified utilities (i.e. Gas or Electricity)**
– this would realize the additional revenues in the options above, but without impacting Gas or electricity providers or customers.

From strictly a quantitative perspective, removing the tax base limit has the best financial impact for the City of Lynden

Additional Considerations

- The number of Utility accounts affected by the tax base for Water or Sewer is limited to less than ten customers that would be affected by this change. While that is a small percentage of the population, it could represent a significant financial change for these customers. In particular for the Sewer Utility, this financial burden is primarily borne by one customer.
- It is a best practice recommended by MRSC to not separate the Utility tax on customer bills as this leads entities and customers to believe it is a tax on the Customer, which is incorrect. Removing the tax base limit allows the Utility to determine easily whether to list the tax or not, and provides ease of forecasting and reporting.
- Due to limited information on non-City utilities, there could be significant revenue generated from removing the threshold on all utilities. This could also result in local businesses charging higher rates to end users for goods and services.
- Removing the limit on City operated utilities but keeping it for Electricity and Gas would allow for revenues to be generated but not negatively impact City costs. Removing the limit on Natural Gas or Electricity is likely to have a cost increase to the City for these utilities.
- Lynden is undergoing a rate study and a significant Wastewater Treatment Plant upgrade project will likely incur additional base rate increases, affecting both the revenues of this tax as well as the impact on Utility customers.

Exhibit I

Utility Tax Scenario Analysis		Base Scenario	Remove Limit	Increase Tax Base				Increase Tax Rate				Combined Approach	
				Sc 1	Sc 2	Sc 3	Sc 4	Sc 5	Sc 6	Sc 7	Sc 8	Sc 9	Sc 10
A	Tax Limit (\$)	5,000	-	10,000	25,000	50,000	100,000	5,000	5,000	5,000	5,000	10,000	25,000
B	Tax Rate over limit (%)	1%	10%	1%	1%	1%	1%	10%	3%	6%	Staggered	5%	3%
C	Water Sales Subject to Limit	260,740	528,453	126,577	-	-	-	260,740	260,740	260,740	-	126,577	-
D	Sewer Sales Subject to Limit	887,920	1,047,794	772,695	506,815	212,027	321	887,920	887,920	887,920	-	772,695	506,815
E=(N-Q)*B	Water Utility Tax Collected < Limit	26,771	(0)	40,188	52,845	52,845	52,845	26,771	26,771	26,771	52,845	40,188	52,845
F=C*B	Water Utility Tax Collected > Limit	2,607	52,845	1,266	-	-	-	26,074	7,822	15,644	-	6,329	-
G=E+F	Total Water Tax Collected	29,379	52,845	41,453	52,845	52,845	52,845	52,845	34,594	42,416	52,845	46,516	52,845
H=(O-D)*B	Sewer Utility Tax Collected < Limit	15,987	0	27,510	54,098	83,577	104,747	15,987	15,987	15,987	104,779	27,510	54,098
I=D*B	Sewer Utility Tax Collected > Limit	8,879	104,779	7,727	5,068	2,120	3	88,792	26,638	53,275	-	38,635	15,204
J=H+I	Total Sewer Tax Collected	24,867	104,779	35,237	59,166	85,697	104,750	104,779	42,625	69,263	104,779	66,145	69,302
K=G-Base	Incremental Water	-	23,467	12,075	23,467	23,467	23,467	23,467	5,215	13,037	23,467	17,138	23,467
L=J-Base	Incremental Sewer	-	79,913	10,370	34,299	60,830	79,884	79,913	17,758	44,396	79,913	41,278	44,436
M=K+L	Incremental Effect on General Fund	-	103,379	22,445	57,766	84,297	103,350	103,379	22,973	57,433	103,379	58,416	67,902
Inputs													
N	Total Water Sales in Scenario	528,453											
O	Total Sewer Sales in Scenario	1,047,794											
P	Current Tax Rate (January 1, 2025)	10%											

[Link to Excel Version](#)