

# HOUSE BILL REPORT

## ESHB 1459

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### As Passed House:

January 15, 1996

**Title:** An act relating to exempting from business and occupation tax reimbursements and advances received by property management companies for the payment of wages to on-site employees.

**Brief Description:** Exempting from business and occupation tax reimbursements and advances received by property management companies for the payment of wages and benefits to on-site employees.

**Sponsors:** By House Committee on Finance (originally sponsored by Representatives Van Luven and Sheldon).

### Brief History:

#### Committee Activity:

Finance: 2/8/95, 2/27/95 [DPS].

#### Floor Activity:

Passed House: 3/9/95, 91-4;

Passed House: 1/15/96, 93-0.

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## HOUSE COMMITTEE ON FINANCE

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 12 members: Representatives B. Thomas, Chairman; Boldt, Vice Chairman; Carrell, Vice Chairman; Morris, Ranking Minority Member; Dickerson, Assistant Ranking Minority Member; Hymes; Mason; Mulliken; Pennington; Schoesler; Sheldon and Van Luven.

**Staff:** Bob Longman (786-7139).

**Background:** Washington's major business tax is the business and occupation (B&O) tax. Although there are several different rates, the principal rates are:

Manufacturing, wholesaling, & extracting - 0.506 percent

Retailing - 0.471 percent

Services:

- Business Services - 2.5 percent

- Financial Services - 1.7 percent

- Other Activities - 2.09 percent

The B&O tax is imposed on the gross receipts of business activities conducted within the state, without any deduction for the costs of doing business. Thus, the tax pyramids at each level of activity. For example, retailers are not allowed to deduct amounts paid to wholesalers; and contractors are not allowed to deduct amounts paid to a subcontractor. An exception to this rule is allowed for real estate brokers who may deduct commissions paid to another brokerage. Another exception is when a business acts as its client's agent. B&O tax does not apply to money received from the client as an advance payment for paying the client's bills. The B&O tax also does not apply when the business receives reimbursement for payments made on behalf of the client.

When a business hires and pays workers on behalf of a client, the question often arises of whether these payments to the business are subject to B&O tax. The answer depends upon whether the workers are considered employees of the business or employees of the client. If the client has control over the workers, then the workers are considered employees of the client and the payments to the hiring business are considered advance payments or reimbursements and are not subject to B&O tax. Otherwise, the hiring business pays B&O tax at the Other Activities rate of 2.09 percent on these payments.

Who has control over the workers is determined by who decides on the hiring and firing the worker; the duration of employment; the rate, amount, and other aspects of compensation; the worker's job assignments and instructions; and other factors.

Property owners often hire property management companies to manage their real property. Frequently, the property management companies also manage the personnel who perform the necessary services at the property location. The property owners may pay the on-site personnel through the property management company. Property managers have been assessed B&O tax on these payments for on-site workers.

**Summary of Bill:** Business and occupation tax does not apply to amounts received by a property management company for the payment of gross wages or benefits to on-site personnel when paid from property management trust accounts. Workers are on-site personnel when they work at the owner's property; have duties that include leasing property units, maintaining the property, collecting rents, or similar activities; and are compensated by the property owner under a written property management agreement.

**Appropriation:** None.

**Fiscal Note:** Available. New fiscal note requested on February 28, 1995.

**Effective Date of Bill:** The bill contains an emergency clause and takes effect immediately.

**Testimony For:** Property owners make all the important employment decisions about on-site workers. Wages and benefits for on-site workers are specific budget items for property owners. The property manager merely acts as a conduit for money flowing from the property owner to the on-site workers. These payroll expenses are not part of the income of the property manager. Property managers should not have to pay B&O tax on amounts that are not part of their gross income.

**Testimony Against:** None.

**Testified:** (Pro) Representative Steve Van Luven, prime sponsor; Mark Gjurasic, Institute of Real Estate Management; John Magnuson, Wellsford Property Trust; Terri Hotvedt, Washington Association of Realtors; and Jeff Powell, Institute of Real Estate Management.