

HOUSE BILL REPORT

ESSB 5967

As Passed House - Amended
April 17, 1993

Title: An act relating to taxation.

Brief Description: Increasing state revenues.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senator Rinehart; by request of Governor Lowry).

Brief History:

Reported by House Committee on:
Revenue, April 14, 1993, DPA;
Passed House - Amended, April 16, 1993, 50-48.

HOUSE COMMITTEE ON REVENUE

Majority Report: Do pass as amended. Signed by 11 members: Representatives G. Fisher, Chair; Holm, Vice Chair; Anderson; Brown; Cothorn; Leonard; Morris; Romero; Rust; Thibaudeau; and Wang.

Minority Report: Do not pass. Signed by 5 members: Representatives Foreman, Ranking Minority Member; Fuhrman, Assistant Ranking Minority Member; Silver; Talcott; and Van Luven.

Staff: Robert Longman (786-7139).

Background:

Sales and Use Tax: The state retail sales tax is imposed on each retail sale of tangible personal property and some services. The tax rate is 6.5 percent and is applied to the selling price of the article or service. The use tax is imposed on the use of tangible personal property when the sale of the property has not been subject to the sales tax. The tax rate is 6.5 percent and is applied to the value of the article used, generally the selling price. The use tax generally applies to purchases made outside the state.

Currently, some services are subject to sales and use taxes. Taxable services include construction, repair, automobile parking and storage, telephone services, some recreation and

amusement services, and services provided by abstract, title insurance, escrow, and credit bureau businesses.

Local Option Sales Taxes and Criminal Justice Funding: Legislation was enacted in 1990, funding criminal justice activities of counties, cities, and towns and creating the Task Force on City and County Finances.

State motor vehicle excise tax receipts are distributed to counties, cities, and towns for criminal justice purposes under several distribution formulas. Counties receive 5.9686 percent of the state motor vehicle excise tax receipts for distribution under this program. Cities and towns receive 2.3874 percent of the state motor vehicle excise tax receipts for distribution under this program. Distributions under these programs cease on January 1, 1994.

Distributions to counties are made under a single formula based upon population, crime rate, and the annual number of criminal cases filed in Superior Court.

Two separate distributions are made to cities and towns. One half of the total amount is distributed to cities and towns on the basis of population without consideration of crime rates. The other half of the total moneys is distributed to cities and towns with high crime rates primarily on a per capita basis under two separate formulas, one for cities and towns with extremely high crime rates and the other for cities and towns with high crime rates.

As determined by various population and geographic factors, a few counties were authorized to impose a 0.1 percent sales and use tax for criminal justice purposes, if a ballot proposition authorizing the tax was approved by county voters. Distributions of these tax receipts are made to the county and to cities and towns within the county to be used for criminal justice purposes. The authority to impose this additional tax ceases on January 1, 1994.

Sales Tax Deferral and Business and Occupation (B&O) Tax Credit Programs: Current law authorizes the deferral of sales and tax on purchases on plant and equipment investments by manufacturing firms and research and development firms in distressed counties, and by new manufacturers and aluminum firms statewide. These firms are allowed to defer sales and use tax for three years after completion of the project followed by repayment over five years. Sales tax on labor in distressed areas is not repaid. Also, a \$1,000 business and occupation tax credit is available for each new job created above a 15 percent growth rate by manufacturing firms and research and

development firms in distressed areas as an alternative to the deferral program.

B&O Taxes: The business and occupation tax is imposed on the gross receipts of business activities conducted within the state. There are no deductions for the costs of doing business. Although there are 10 separate rates, the three principal rates are:

Manufacturing, wholesaling, & extracting	0.484 percent
Retailing activities	0.471 percent
Service activities	1.50 percent

The business and occupation tax applies to the total income of businesses whose gross income is greater than the tax threshold. The current threshold is \$12,000 per year. Businesses whose incomes are less than the threshold are not subject to tax. Businesses whose incomes are greater than the threshold are subject to tax on their entire incomes.

Health Care Prepayments Taxes: Health maintenance organizations with their own employee medical staff, such as Group Health, and health care service contractors without medical staff, such as Blue Cross, are subject to the business and occupation tax on a portion of their gross income at a rate of 1.5 percent. They are not subject to the 2 percent insurance premiums tax.

Insurance Premiums: The Washington Insurance Guaranty Association Act and the Washington Life and Disability Insurance Guaranty Association Act each created an insurance guaranty association that provides for the payment of claims under policies and contracts of insolvent insurers. Insurance companies that contribute to one of these associations may deduct the amount of their contributions against their insurance premium taxes owed to the state over a five-year period.

Resale Certificates: Sales for resale are exempt from sales tax if the buyer has a resale certificate. A significant factor in sales tax avoidance is the abuse of resale certificates by persons in business who purchase items for their own use free of tax.

Contributions in Aid of Construction: The state subsidizes the capital costs of public entities by allowing a deduction from the business and occupation tax and the public utility tax of income from charges to customers for capital purposes. This deduction was enacted in 1969, when the estimated fiscal impact was about \$80,000 for cities and public utility districts. Current estimates indicate that the deduction may cost as much as \$45 million per biennium

if public entities continue to find additional expenses that are eligible for this deduction.

Summary of Bill:

Sales and Use Tax: The state retail sales and use tax rate is lowered from 6.5 percent to 6.25 percent.

The state retail sales tax is extended to the sale of selected business services. In addition, the business and occupation tax rate on business income from the sale of these services will automatically decrease from 1.5 percent to 0.484 percent as a result of classifying these services as retail sales.

The following additional services are taxable:

- Stenographic, secretarial, and clerical services;
- Computer services, including computer programming, software modification, software installation, software and hardware maintenance, and repair and software update services;
- Data processing and information services, but excluding provision of information to the media through an information network and transportation reservation systems;
- Legal, arbitration, and mediation services, including paralegal services, legal research services, and court reporting services, but excluding indigent criminal defense, personal injury representation, and legal services for which no charge is made;
- Accounting, auditing, actuarial, bookkeeping, tax preparation, and similar services;
- Engineering and architectural services, including landscape architecture, geology services, and surveying;
- Business consulting services, including administrative management, business management, construction management, motel management, office management, human resource consulting or training, management engineering consulting, management information systems consulting, manufacturing management consulting, marketing consulting, operations research consulting, personnel management consulting, physical distribution consultants, site location consultants, and lobbying;
- Protective services, including detective agency services and private investigating services, armored car services, guard or protective services, lie detection or polygraph services, and security system, burglar, or fire alarm monitoring and maintenance;
- Public relations and advertising services, including layout, art direction, graphic design, copy writing, mechanical

preparation, and production supervision, but not including any amounts paid for actual broadcast or print advertising; and
Rental of equipment with operators.

Sales of prescription birth control is exempted from sales and use tax.

The definition of farmer is clarified for purposes of the sales tax exemption of purchases of feed, seed, seedlings, and fertilizer. Bees used for pollination are exempted from sales and use tax.

Local Option Sales Taxes and Criminal Justice Funding: The existing local option sales taxes do not apply to the business services added to the state sales tax. Instead, the state will impose an additional 1 percent sales tax on these services, if requested to do so by the governing bodies of at least 26 counties. Revenue from this additional tax would be deposited in a newly-created local sales tax on services account.

Monies in the account will be distributed in three parts. Only counties that have adopted resolutions requesting the tax will share in the distribution of the tax. Part A replaces the existing distribution of motor vehicle excise tax (MVET) revenue for criminal justice purposes, using the apportionment formulas already in law. These formulas are based on per capita revenue, population, and crime rates. Approximately \$67 million will be distributed under this part for 1993-95, along with \$21 million from the MVET distribution until its expiration on January 1, 1994.

Part B is defined as the amount remaining in the account after the Part A distributions, but not to exceed 20 percent of the account balance before the Part A distribution. The Part B amount will be paid into the Public Works Assistance Account. An equivalent amount of Public Works Assistance Account revenue is redirected to the state general fund.

Under Part C, \$1 million will be distributed to each county. The amount of \$3.9 million will be distributed to cities and towns ratably according to population. The balance, approximately \$30 million for 1993-95, will be distributed to the counties based on population, and distributed within the counties based on interlocal agreements between the cities and counties.

The January 1, 1994 expiration date for existing local option criminal justice sales taxes is repealed. The voter authorization requirement for 0.1 percent sales taxes for criminal justice is replaced by a referendum procedure.

Sales Tax Deferral and B&O Tax Credit Programs: These programs, which are due to expire July 1, 1994, are extended to July 1, 1998.

Neighborhood reinvestment areas are added to the areas in which sales and use tax deferrals are available. Neighborhood reinvestment areas are defined as areas that are designated to receive federal, state, or local assistance to increase economic activity, have high unemployment rates, and have a preponderance of low-income households.

Eligibility under the sales tax deferral programs is also expanded to include pulp and paper plants that were in operation before 1960 and located in a county with a population between 40,000 and 70,000.

B&O Taxes: The business and occupation tax rate on service business is increased from 1.5 percent to 1.9 percent, except for business services subject to sales tax and money-lending operations of banking and similar financial businesses.

The retailing B&O rate is equalized with manufacturing and wholesaling at 0.484 percent.

The annual deduction is the annual threshold replaced with an annual credit. The credit will have the effect of eliminating B&O taxes for retailers with annual gross incomes of \$144,000 or less and service businesses with annual gross incomes of \$46,400 or less. Above these amounts, taxes are phased in so that full tax rates do not apply until gross incomes reach twice the threshold amounts. Approximately 86,000 of the 180,000 businesses in the state will be completely exempt from B&O tax under this change.

Health Care Prepayments Taxes: Health maintenance organizations and health care service contractors are exempt from the business and occupation tax and are instead subject to a 2 percent tax on prepayments similar to the insurance premiums tax. A credit is allowed for any similar tax paid under the health care reform legislation (ESSB 5304). This credit will eliminate the possibility of double taxation under this bill and ESSB 5304.

Insurance Premiums: Insurers will not be able to claim the insurance premium tax offset for any assessments made by state guaranty associations after April 1, 1993.

Resale Certificates: The Department of Revenue may prohibit blanket resale certificates for certain business

classifications and require certificates to specify categories of items to be purchased without payment of sales tax. The certificate must also provide specific information about the buyer. The abuse of a resale certificate is subject to a penalty of 50 percent of the amount of tax due.

Contributions in Aid of Construction: The B&O and public utility tax deduction for capital contributions is eliminated.

Fiscal Note: Available. New fiscal note requested April 15, 1993.

Effective Date: The amended bill contains an emergency clause and takes effect July 1, 1993, except for sections 401 and 402, relating to the health care prepayments taxes, which take effect January 1, 1994, and sections 701 and 702, relating to insurance premiums tax credits, which take effect immediately.

Testimony For: This bill would broaden our states tax base, thereby making it more progressive. This bill would have less impact on typical families than other proposals.

Testimony Against: It is time for the state to start living within its means, just like private business must do. Service taxes in other states have been shown to be regressive. Enactment of this bill will mean loss of jobs because small business people will have to lay off employees or cut back their hours. Small businesses can't pass on these costs to customers because there is too much competition with out-of-state firms. Additionally, smaller service companies, e.g., security, accounting, and landscape architecture, will lose contracts with larger firms who, in order to save money, will expand their in-house operations to cover these services. Additional taxation on advertising will have a negative impact on our economy because advertising drives people's discretionary spending, which is the strength of our economy. Availability of affordable housing could be negatively impacted by this bill because lending institutions are often quite specific about funding limits. Concerns were raised about non-negotiable contracts which are currently in effect. Washington's tax structure already contains too many disincentives for small business. This bill will have a negative effect on trade and economic development in our state. There were many concerns expressed about pyramiding of tax burdens under a sales tax on services.

Witnesses: (In favor) Ed Tveden, People for Fair Taxes; Ken Bertrand, Group Health Cooperative; James H. Noel, Washington Interment Association; and B. David Daly,

Washington State Funeral Director's Association. (Opposed)
Graham Fernald, Citizens Opposed to Sales Tax on Services
(C.O.S.T.S.) and Seattle Chamber of Commerce; Bill Dickinson
and John Schenck, Building Owners Managers Association;
Steve Hunter and Nancy Swaffield, Washington Collector's
Association; Candace Olsen, small-business owner; Bill
Cottringer, Jeff Kelly, Cindy Hauerfield and Darlene Larson,
Washington State Security Council; Jan Sams, Institute of
Real Estate Management; Linda Osterich, Mark Paulson and
Peggy Ganson, Washington Apartment Association; Darrell
Doepke, Tacoma Ad Club; Mark Monlux, Society of Professional
Graphic Artists; Frank Dinsmore, Archos; Ken McGowen,
CECW/WSPE; Fred Herzberg, W&H Pacific Engineering; Victor
Bishop, TP&E, Inc.; Steve Cavit and Andrew Barzone, Charles
A. Gove and Associates; Paul Gregory, CECW; Rob Widmeyer,
Thom Emrich and Bruce Mouser, American Institute of
Architects; Dr. Jerry Smedes, environmental consultant; Gene
McKay, Boray Northwest, Inc.; Tony Meinhardt, Independent
Business Association; Dan Graves and Erik Peterson,
Communications Northwest; Jan Gee, Washington Retail
Association; Jack Fearey, The Fearey Group; Kay Herring, Kay
Herring Communications; Aaron Jones and Dick Rosenberg,
Washington Rural Electric Co-op Association; Steve DeForest
and Gary Fujita, Washington State Bar Association; Dave
Hoedemaker, NBBJ; Larry Humphrey, Bovillon, Christofferson &
Schairer; John Magnusson, Skilling, Ward, Magnusson &
Barkshire; Darlene Sobieck, citizen; Donald Wright, CH2M
Hill; John McCracken, Westcoast Hotels; Kenneth Neal,
Association of Engineering Geologists; Kathy Troost and
Dennis Goss, Shannon & Wilson; John Newby, Applied
Geotechnology Inc.; Andrea Durvas, Wayne Lieb and Jim Brown,
Washington Trial Lawyers Association; Max Vekich,
Longshoreman's Union; Randy Ray and Scott Jones, Puget Sound
Steamship Operator's Association; Jim Passage, Harza
Northwest; Wendal Johnson, Reid Middleton, Inc.; Basil
Badley, American Insurance Association; Dan Wolfe, SAFECO;
Jean Leonard, State Farm Insurance Companies & Washington
Insurers; Len Zickler, Washington Chapter of the American
Society of Landscape Architects; Patrick Beehler, Kroger and
Associates; John Warren, Washington Association of Land
Surveyor's; Alexander Popoff, ABAM Engineering; and Rod
Bailey, citizen.