

SENATE BILL REPORT

SB 5967

AS REPORTED BY COMMITTEE ON WAYS & MEANS, MARCH 31, 1993

Brief Description: Implementing a comprehensive tax package.

SPONSORS: Senator Rinehart; by request of Governor Lowry

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 5967 be substituted therefor, and the substitute bill do pass.

Signed by Senators Rinehart, Chairman; Spanel, Vice Chairman; Bauer, Gaspard, Hargrove, Niemi, Owen, Pelz, Snyder, Sutherland, Talmadge, Williams, and Wojahn.

Staff: Terry Wilson (786-7715)

Hearing Dates: March 30, 1993; March 31, 1993

BACKGROUND:

SALES AND USE TAX

The state retail sales tax is imposed on each retail sale of tangible personal property and some services. Taxable services include construction, repair, telephone, and some recreation and amusement 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). This tax generally applies to purchases made outside the state.

SALES TAX DEFERRAL

Current law authorizes the deferral of sales and use tax on purchases on plant and equipment investments by manufacturing 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. A \$1,000 business and occupation tax credit is available for each new job created above a 15 percent growth rate by manufacturing and research and development firms in distressed areas as an alternative to the deferral program. These programs are due to expire July 1, 1994.

BUSINESS AND OCCUPATION TAX

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.

REAL ESTATE EXCISE TAX

The real estate excise tax applies to sales of real property and is collected when the sale document is recorded with the county. The tax rate is 1.28 percent of the selling price. Most local governments impose an additional rate of 0.25 percent. Additional local options are available. If real estate is owned by a partnership or corporation, a sale of a controlling interest in the partnership or corporation can effectively transfer control of real estate without creating tax liability. Many transactions are structured in this manner to avoid real estate excise taxes.

WASHINGTON ESTATE AND TRANSFER TAX

The state imposes a tax on the transfer of property at death. The tax is equal to the amount of tax authorized as a credit against the federal estate tax. As a result, the tax would be paid to the federal government if the state did not impose it. It therefore "picks up" the federal credit. Because the tax is tied to the federal credit, it only applies to estates valued at more than \$600,000 (or \$1,200,000 for a community property couple).

INSURANCE 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 their gross income at a rate of 1.5 percent.

INSURANCE PREMIUMS TAX CREDIT REPEAL

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 cause of 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 for income from charges to customers for capital purposes.

STATE CONVENTION AND TRADE CENTER

The state levies an excise tax in King County on the furnishing of lodging by hotels and motels to fund the state convention and trade center. The rate of tax is 7 percent in Seattle and 2.8 percent in the remainder of King County.

SUMMARY:

The original bill was not considered.

EFFECT OF PROPOSED SUBSTITUTE:

SALES AND USE TAX

The state retail sales and use tax rate is lowered from 6.5 percent to 6.0 percent.

The state retail sales tax is extended to the sale of selected personal, consumer, professional, and business services. In addition, the business and occupation tax rate will decrease from 1.5 percent to .471 percent on business income from the sale of these services.

The local tax also applies to sales of these services. Local governments will receive an estimated \$284 million for the 1993-95 biennium.

Approximately 71.9 percent of the additional state and local tax burden will fall on business, 21.2 percent on individuals, 6.2 percent on tourists, and the 0.7 percent on state and local government.

The total sales and use tax burden on businesses will increase from 32.4 percent to 36.7 percent, on households will decrease from 57.9 percent to 53.9 percent, on tourists will increase from 1.9 percent to 2.4 percent, and on government will decrease from 7.8 percent to 7.0 percent.

The following services are taxable:

Debt collection services

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

Accounting, auditing, 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, 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

Legal, arbitration, and mediation services, including paralegal services, legal research services, and court reporting services, but excluding indigent criminal defense and legal services for which no charge is made

Heavy equipment rental with operators

Boat, railroad, and air sightseeing excursions and tours

Financial management and financial consulting services

Landscape maintenance and horticultural services

Laundry, cleaning (such as coin-operated)

Beauty/barber services

Funeral services

Amusement and recreation services not otherwise taxed (includes admissions to sporting events and theatrical and cultural productions and carnival rides)

Miscellaneous personal services (the untaxed portion of health clubs, tanning salons, etc.)

The following services are EXEMPT:

Hazardous waste clean-up
Medical and dental services
Consumer services such as veterinarian and cable television
Day care, babysitting
Railroad/marine services
Lottery commissions
Employment agency services
Security broker services
Insurance company services
Insurance agents and brokers services
Real estate agents and brokers services
Financial institution fees and charges
Crop services
Indigent criminal defense and legal services for which no charge is made
Janitorial services
Travel agents and tour packages
Media advertising
The provision of temporary or permanent employees
Services donated to a public benefit nonprofit organization
Services provided by a nonprofit to a governmental agency
Services donated to a governmental agency
Nonenterprise services provided by a governmental agency to a governmental agency
Educational services (tuition)
Services provided by employees to employers
Purchases for resale

SALES TAX DEFERRAL

The state sales tax deferral and business and occupation tax credit programs are extended until July 1, 1998.

BUSINESS AND OCCUPATION TAX

The annual business and occupation tax threshold is replaced with an annual deduction. Retailers are allowed a deduction of \$144,000, service businesses are allowed a deduction of \$48,000, and all other taxpayers are allowed a deduction of \$84,000. These deductions are reduced dollar for dollar by the amount of gross income of a business in excess of the deduction. In addition, the \$15 tax registration fee is eliminated, and businesses are no longer required to file returns if they owe no taxes.

REAL ESTATE EXCISE TAX

The real estate excise tax is extended to the transfer or acquisition within any twelve-month period of a controlling interest in any entity with an interest in real property in this state. The tax is imposed on the value of the real property transferred. In addition, a graduated rate is adopted. The current rate of 1.28 percent applies to the first \$500,000, and a rate of 1.48 percent applies to the amount of the selling price that exceeds \$500,000.

WASHINGTON ESTATE AND TRANSFER TAX

The estate and transfer tax due the state of Washington is doubled. The tax would not apply to estates valued at less than \$600,000 (or \$1,200,000 for a community property couple).

INSURANCE PREPAYMENTS TAXES

Health maintenance organizations and health care service contractors are exempt from the business and occupation tax and are instead subject to a 2.0 percent tax on prepayments similar to the insurance premiums tax.

INSURANCE PREMIUMS TAX CREDIT REPEAL

Insurers can no longer offset any assessments paid to state guaranty associations against insurance premium taxes owed to the state.

RESALE CERTIFICATES

Resale certificates are limited to specific items and are valid for only four years. 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 deduction from the business and occupation tax and the public utility tax for income from charges to customers for capital purposes is eliminated.

STATE CONVENTION AND TRADE CENTER

A 20 percent surtax is imposed through June 30, 1995, on the current state convention and trade center tax to be used for operations of the state convention and trade center. The rate in Seattle will increase to 8.4 percent, and the rate in the remainder of King County would increase to 3.36 percent. Together with state and local sales taxes and other local hotel/motel taxes, the total rate of tax will be 16.6 percent in Seattle, 14.56 percent in Bellevue, and 11.56 percent in the remainder of King County.

Appropriation: none

Revenue: yes

Fiscal Note: requested

Effective Date: (1) The real estate excise tax changes and the business and occupation tax credit repeal for guaranty fund contributions take effect immediately; (2) the changes involving the sales tax on services, the deferral program extension, the business and occupation tax threshold, the estate and transfer tax, resale certificates, and contributions in aid of construction take effect July 1, 1993;

and (3) the changes involving insurance prepayments taxes take effect January 1, 1994.

TESTIMONY FOR:

This addresses many concerns of cities. Cities and counties agree on the distribution, although they would like the current taxes to automatically apply to the expanded base. The capital contributions deduction repeal should be delayed until January 1, 1994. Most retailers say there is little impact on them from extending the sales tax to services and most are not likely to bring the services in house.

TESTIMONY AGAINST:

Taxing private security services will hit small minimum wage businesses that will take the business in house or will cut back on the use of the service. It will impose a greater burden on local law enforcement. This is a tax on labor. The real estate excise tax is already high and is too volatile to fund programs. This is a tax on business sales and is a disincentive to economic growth. Insurance commissions are frozen and the tax cannot be passed on. Gambling is already subject to other taxes.

TESTIFIED: Jim Lynch, City of Wenatchee (pro); Stan Finkelstein, AWC (pro); Jan Gee, WA Retailers Assn; Steve Lindstrom, WA State Security Council; Basil Badley, AIA, ACLI, HIAA; Vito Chiechi, WA State Licensed Beverage Assn, (con); Clark Sitzes, Independent Insurance Agents, (con); Randy Ray, PSSOA/MEC/Todd/IFF&CNB, (con); Glen Hudson, WA Assn of Realtors, (con)