

# HB 1657

## Bill Analysis

March 4, 1999

**Brief Description:** Modifying telecommunication taxes.

**Bill Sponsors:** Representative Thomas.

### Brief Summary of Bill

- Major tax restructuring for telecommunications services. Application of regular retail sales tax to telephone services is repealed. In its place is a new telecommunications sales and use tax. Other tax changes are also made.

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### Background:

#### *About Taxes Generally*

Sales tax is imposed on retail sales of most items of tangible personal property and some services. Sales tax is paid by the consumer but collected and forwarded to the Department of Revenue by the seller.

Use tax is imposed on the use of an item in this state, when the acquisition of the item or service has not been subject to sales tax. Consumers are responsible for paying use tax to the Department of Revenue.

Washington's major business tax is the business and occupation (B&O) tax. 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. Some key B&O tax rates are:

Manufacturing & wholesaling	0.484 percent
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Retailing 0.471 percent

Cities also impose taxes on the gross receipts of business activities conducted within the cities without any deduction for the cost of doing business. City gross receipts taxes are often called city B&O taxes, but cities impose higher gross receipts tax rates on utilities. These taxes with higher rates that are imposed on utilities are often called city utility taxes.

Counties have no authority to impose gross receipts taxes.

*How Telephone Services Are Taxed*

State tax rates are uniform throughout the state. Local tax rates vary from location to location. Combining state and local taxes together, the table indicates the highest current excise tax rates for telephone services.

**Highest Current Rates of Excise Taxation**

<b>Tax</b>	<b>Telephone Services</b>
Retail Sales & Use	6.5%
Gross Receipts (B&O)	0.471%
Gross Receipts (public utility)	0.0%
<b>STATE TAX SUB-TOTAL</b>	<b>6.971%</b>
Retail Sales & Use (for general funds)	1.0%
Retail Sales & Use (for dedicated funds)	1.1%**
Gross Receipts ( <i>only cities may impose</i> )	6.0%*
<b>LOCAL TAX SUB-TOTAL</b>	<b>8.1%</b>
<b>GRAND TOTAL</b>	<b>15.071%</b>

\*A city's gross receipts tax may exceed six percent with voter-approval.

\*\*Local govts. have authority to impose up to 1.8 percent in dedicated sales taxes for purposes such as transit or criminal justice, but no local govt. is using its full taxing authority. The highest current rate is 1.1 percent.

As the table indicates, the retail sales and use tax applies to sales of telephone services. The state tax rate is 6.5 percent. In addition, local sales taxes apply. For most cities, their effective local sales tax rate is 0.85 percent. Most counties impose a 1.0 percent sales tax, with the 1.0 percent rate applying in unincorporated areas and a 0.15 percent rate applying in incorporated areas. Additional local sales taxes might be imposed for dedicated purposes such as transit or criminal justice. Adding state, city, county, and dedicated local taxes together, the total retail sales tax ranges from 7.0 to 8.6 percent, depending on location.

The retail sales tax applies to all telephone services except residential phone service. For example, residential customers located in areas served by US West presently pay a basic service charge of \$12.50/month, and this charge is not subject to sales tax. However, everyone, including residential customers, pays sales taxes on charges for interstate and intrastate long distance calls.

The retail sales tax is levied directly on consumers. In addition to sales tax, the state also imposes B&O taxes on telephone businesses. The B&O rates are a 0.471 percent rate on retail revenues and a 0.484 percent rate on wholesale revenues.

In addition to state B&O taxes, telephone businesses also pay city gross receipts taxes. Generally, a city may impose up to a 6.0 percent gross receipts tax on a telephone business's gross receipts and an even higher rate with voter approval. Nonetheless, there are some restrictions. Cities cannot tax receipts earned from interstate long distance toll charges. Cities are also limited in their ability to tax network access charges.

#### *How Cable Television Is Taxed*

Cable television businesses are subject to a state 1.5 percent service B&O tax. In regards to local governments, the federal 1996 Telecommunications Act limits local cable TV franchise fees to no more than 5 percent, and both cities and counties may impose franchise fees. In addition to franchise fees, many cities impose gross receipts taxes on cable TV. Adding franchise fee rates, city and state gross receipts tax rates together, the highest current rate appears to be 16.5 percent.

#### **Summary of Bill:**

Combining state and local taxes together, the table illustrates the highest rates of excise taxation for telecommunications services. The table assumes that cities opt to impose a new telecommunications sales and use tax. However, cities and counties are not required to adopt a telecommunications sales and use tax.

### Highest Rates of Excise Taxation

Tax	Telecommunications Service
Retail Sales & Use	5.5%
Gross Receipts (B&O)	0.471%
Gross Receipts (public utility)	0.0%
<b>STATE TAX SUB-TOTAL</b>	<b>5.971%</b>
Retail Sales & Use (for general funds)	5.8%
Retail Sales & Use (for dedicated funds)	1.1% **
Gross Receipts ( <i>only cities may impose</i> )	0.2% *
<b>LOCAL TAX SUB-TOTAL</b>	<b>7.1%</b>
<b>GRAND TOTAL</b>	<b>13.071%</b>

\*A city's gross receipts tax may exceed two-tenths of one percent with voter-approval. However, a city must tax businesses making retail sales of telecommunications services at the same rate that a city taxes businesses making retail sales of tangible personal property.

\*\*Local governments have authority to impose up to 1.8 percent in dedicated sales taxes for purposes such as transit or criminal justice, but no local govt. is using its full taxing authority. The highest current rate is 1.1 percent.

Telephone services are taxed under a broader tax category of telecommunications services. The term telecommunication— is defined using language from the federal Telecommunications Act of 1996 as, the transmission between or among points specified by the user, of information of the user's own choosing, without change in the form or content of the information as sent and received.— Telecommunications services are defined, however, as excluding services provided by Internet service providers, one-way radio paging services, and cable television services.

Under this tax restructuring the regular retail sales and use tax on telephone services is repealed, and a new telecommunications sales and use tax is created. Under the new telecommunications sales and use tax there are no tax deductions or exemptions. Residential telephone service is taxed the same as business telephone service. State and local sales and use taxes apply to all telecommunications services, including long distance telephone service.

### *State Tax Changes*

In order to provide revenue neutrality for the state, the state telecommunications sales and use tax rate is set at 5.5 percent. This 5.5 percent telecommunications sales and use tax rate is slightly lower than the regular 6.5 percent sales and use tax. The reason for the reduction is a tax base expansion. With residential and business services taxed the same, there is an expansion in the state tax base.

### *City Tax Changes*

Cities are not required to adopt the tax restructuring. However, given that the application of the regular retail sales tax to telephone services is repealed, cities would automatically lose telephone tax revenues that are generated by their regular retail sales taxes (for most cities their regular effective sales tax rate is 0.85 percent for general fund purposes.) Cities would not lose any revenues, however, if they act to impose a new telecommunications sales and use tax.

Under the tax restructuring a city may impose up to a 5.8 percent telecommunications sales and use tax and up to a 0.2 percent gross receipts tax for a total general fund tax rate of 6 percent. Although this 6 percent rate is somewhat lower than a city's present general fund tax rate of 6.85 percent, there are tax base expansions. The largest tax base expansion is due to the fact that a city's telecommunications sales and use tax would apply to interstate long distance toll charges. Taxing residential and business services the same also expands the cities' tax bases.

Completely adopting the tax restructuring is one of three choices that cities have. As a second choice, a city may opt to keep their current gross receipts tax on telephone businesses which may be as high as 6 percent and even higher, if voter-approved. As a third choice, a city may impose up to a 5.8 percent telecommunications sales and use tax and keep its current gross receipts tax on telephone businesses at up to 6 percent rate or even higher if voter-approved. A city choosing this third option must credit any telecommunications sales and use tax paid against its gross receipts tax. This credit mechanism prevents an increase in the overall rate of taxation. Additionally, any city choosing the second or third options must submit its gross receipts tax to voter referenda every six years.

### *County Tax Changes*

Like cities, counties are not required to adopt the tax restructuring. However, given that the application of the regular retail sales tax to telephone services is repealed, counties would automatically lose telephone tax revenues that are generated by their regular retail sales taxes (for most counties their regular effective sales tax rate is 1 percent in unincorporated areas and 0.15 percent in incorporated areas for general fund purposes.) Counties would not lose any

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Cities currently may impose up to a 6 percent city utility tax on telephone businesses. Most cities also have a 0.85 percent regular retail sales tax that applies to telephone services. Thus, a city's total excise taxation rate for general fund purposes is presently 6.85 percent.

revenues, however, if they act to impose a new telecommunications sales and use tax.

Under the tax restructuring a county would be allowed to impose a significantly higher tax. Although a county's regular retail sales and use tax rate cannot exceed 1 percent, a county may impose up to a 5.8 percent telecommunications sales and use tax.

#### *About Local Dedicated Sales Tax Revenues*

Under the tax restructuring both cities and counties may impose up to a 5.8 percent telecommunications sales and use tax to raise revenues for general fund purposes. Additionally, special sales tax levies for dedicated purposes such as transit, the RTA, or criminal justice are permitted. Since these dedicated sales tax levies presently are imposed in addition to the regular retail sales tax, allowing them to be imposed in addition to the new telecommunications sales and use tax maintains revenue neutrality.

#### *How Cable Television is Taxed*

Cable television businesses are subject to a state 1.5 percent service B&O tax. At the local level cities may impose franchise fees and gross receipts taxes on cable television businesses, but the combined fee and tax rates cannot exceed 8 percent of gross receipts on or after the year 2004. Counties may impose up to a 5 percent franchise fee but have no authority to impose a gross receipts tax on cable television businesses. By 2004 the highest combined rate of state and local taxes will be 9.5 percent.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** January 1, 2000.

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However, the 0.017% baseball stadium tax, the 0.016% football stadium tax, and 0.04% distressed county tax that are credited against the regular retail sales tax would not be credited against the state telecommunications sales tax.