

FINAL BILL REPORT

HB 1361

PARTIAL VETO

C 320 L 01

Synopsis as Enacted

Brief Description: Simplifying excise tax application and administration.

Sponsors: By Representatives Jackley, Cairnes and Dunshee; by request of Department of Revenue.

House Committee on Finance
Senate Committee on Ways & Means

Background:

The excise tax code contains the business and occupation tax, the retail sales and use taxes, and a number of other excise taxes, as well as administrative provisions and various other statutes pertaining to excise taxes. The code contains various definitions, tax exemptions, taxpayer requirements, and requirements of the Department of Revenue.

Definitions

Laws relating to estate taxation and probate and trust define the Internal Revenue Code as the United States Internal Revenue Code of 1986, as amended on January 1, 1999.

Business and Occupation Tax

Under the business and occupation (B&O) tax, a person who wishes to receive the B&O environmental remediation tax classification (at a tax rate of 0.484 percent) must submit to the Department of Revenue a certification with a description of the proposed environmental remedial actions to be taken as well as certain identification information. The department must rule on eligibility within 30 days of receipt of the certification.

A person who receives income from royalties is subject to a B&O tax rate of 0.484 percent. Royalties are defined as compensation for the use of intangible property, such as copyrights or licenses, but do not include compensation for any natural resource.

Retail Sales and Use Taxes

Acquisitions of passenger vehicles to be used for ride-sharing purposes are exempt from retail sales and use taxes if the vehicles are also exempt from motor vehicle excise taxes for 36 consecutive months from the time that the application is made to the Department

of Revenue for exemption from retail sales and use taxes. If the vehicle is used for ride-sharing purposes for less than the 36 consecutive months, the owner is liable for retail sales and use taxes.

Regional transit authorities are authorized to enter into sale and leaseback agreements in order provide flexibility in the acquisition and financing of equipment or facilities. A sale and leaseback agreement is an agreement in which property is sold to a buyer and then leased from the new owner to the previous owner. An exemption is provided from the use tax for the use of tangible personal property, such as vehicular equipment or facilities, if the seller or lessee under an authorized sale and leaseback agreement uses such property. A use tax exemption is also provided to a lessee for the purchase amount paid under an option to purchase at the end of a lease term, as long as the lessee owes no back retail sales and use taxes.

For any change to a local retail sales and use tax rate, including a change that would be credited against the state sales and use tax, a local jurisdiction is required to submit notice to the department. The actual rate change may not occur sooner than 75 days after the department receives notification and may only occur on the first of the month in January, April, July, or October.

Tax Status of Solid Waste Businesses

The state public utility tax (PUT) is imposed on the gross receipts of specific public service businesses, including those in the business of light and power, gas distribution, and certain other activities. The tax also applies to public service businesses other than those specifically enumerated in statute at a rate of 1.926 percent. Public service businesses are defined to include any business subject to control by the state or declared by the Legislature to be of public service in nature.

The B&O tax is imposed at a rate of 1.5 percent on the gross receipts of businesses that are not specifically taxed elsewhere within the B&O statutes.

The establishment of solid waste collection and handling businesses is authorized in several places under statute. Neither the PUT nor the B&O tax statutes refer to solid waste-related businesses specifically.

Enhanced Food Fish Tax and Tax Incidence

A tax is imposed on the first possession of an enhanced food fish in the state by an owner (at rates varying from 0.0856 percent to 5.6175 percent, depending on the type of fish), as measured by the value of the fish at the point of landing. Food fish are species of fish that may not be fished for except as authorized by rule of the director of the Department of Fish and Wildlife. For excise tax purposes, "enhanced food fish" means all food fish except for tuna, mackerel, jack, shellfish, and certain anadromous game fish.

Departmental Authorization

The director of the Department of Revenue is authorized to issue written determinations to clarify interpretation of excise tax statutes. Such determinations may serve as precedents and thus apply to future taxable activity. The department must index determinations by subject matter and must publish determinations and the corresponding index.

For the purposes of collecting and remitting sales and use taxes, the department has developed and provided technology that allows persons to calculate the appropriate amount of tax liability. Persons who use the technology properly are held harmless from any calculation errors that occur.

B&O Jobs Tax Credits

A credit against B&O tax liability (also known as the B&O jobs tax credit) is allowed for certain eligible business projects conducted by manufacturing or research and development firms in certain rural counties. Eligible business projects are defined to include manufacturing, research and development activities conducted by firms whose employment is 15 percent higher in the year the credit is sought than in the previous year. Businesses that receive a sales tax deferral for certain manufacturing, research and development activities are ineligible for the B&O jobs credit; however, the deferral was repealed in 1995 when the comprehensive sales tax exemption for manufacturing machinery was enacted.

The Department of Revenue is required to keep a running total of B&O jobs tax credits allowed for a year. The department must disallow any credit that would cause the total impact to exceed \$7.5 million for any fiscal year. Businesses may carry disallowed credits over to the next fiscal year if the tabulation does not exceed the \$7.5 million for the next fiscal year at the time the credit is claimed. Credits may not be used against taxes that have not yet been paid.

Upon receipt of a credit under the B&O jobs tax credit, a recipient is required to submit a report to the department by December 31 of each year. The report must provide the department with information to determine whether the recipient is meeting the requirements of the jobs tax credit. If the department deems the report to be inadequate, the department may require the recipient to pay taxes for which the credit was claimed.

Timber Excise Tax

Timber owners pay a 5 percent timber excise tax on the value of their timber when they cut it. The tax is based on timber stumpage values. Stumpage is the value of timber as it stands uncut in the woods. The Department of Revenue is required by law to establish timber stumpage values semi-annually. The new stumpage values may go into effect not

less than 60 days after the department notifies the Legislature.

Until the early 1990s, the department used publicly-owned timber sales as comparable sales for computing stumpage values. Since that time, the number of public sales has declined significantly. In 1994 legislation was adopted that required purchasers of more than 200,000 board feet of privately owned timber to report transaction details to the department. Under this program, purchasers of privately-owned timber who failed to report were liable for a penalty of \$250 per failure.

The original legislation expired in 1997 and was extended to July 1, 2000, by the 1997 Legislature.

B&O Deduction for Investment Income

Certain moneys may be deducted from gross income for the purposes of determining taxable income under the B&O tax. One example is a deduction for dividends received by a parent corporation from its subsidiaries. There is also a deduction for the investment of income of all persons other than those engaging in banking, loan, security, or other financial businesses. In other words, only banking, loan, security and other financial businesses pay B&O tax on investment income. Private investors are not taxed. Investment income received by nonfinancial businesses is not taxed.

The meaning of "other financial business" for B&O tax purposes has been the subject of some question and litigation. The Washington Supreme Court has defined a financial business as one that meets two requirements: (1) The business has a primary purpose of earning income through utilization of significant cash outlays; and (2) The business is comparable to a banking, loan, or security business. The court's interpretation was most recently applied in the Simpson Investment Company case decided in July, 2000. Simpson Investment gets a small portion of its income from interest on bank deposits, stock dividends, and profits from market hedging and futures trading. The Department of Revenue assessed B&O tax on this income. Simpson Investment appealed, and the Supreme Court upheld the department. The court held that Simpson Investment was a financial business.

Hotel/Motel Taxes

Counties or cities may levy hotel and motel taxes on lodging services for purposes relating to the promotion of tourism. King County levies a separate hotel and motel tax to fund a convention and trade center. Both these hotel and motel taxes are credited against the state retail sales tax.

Summary:

The excise tax code is amended to make a number of housekeeping changes, including

the clarification and simplification of definitions and exemptions; the clarifications of departmental authority and required departmental action; the modification to reporting and implementation requirements for taxpayers; and updates to statutory references.

Definitions

The definition of Internal Revenue Code for purposes of estate taxation and probate and trust laws is updated to mean the United States Internal Revenue Code of 1986, as amended as of January 1, 2001.

Business and Occupation Tax

Upon request, the Department of Revenue may provide copies of certifications made to the department to receive the business and occupation tax environmental remediation classification. In addition, the definition of royalties is updated to exclude licensing of canned software to the end user.

Retail Sales and Use Taxes

Passenger vehicles to be used for ride-sharing purposes may receive an exemption from retail sales and use taxes if the vehicles are used as ride-sharing vehicles for 36 consecutive months from the date of purchase.

The use tax exemption provided to a lessee under an option to purchase at the end of a lease term is clarified to apply to the use of tangible personal property under an exercise of the option.

A change in a local retail sales and use tax rate that is a credit against the state retail sales and use tax may take effect no sooner than 30 days after notification to the Department of Revenue and only on the first day of the month.

Tax Status of Solid Waste Businesses

A section is added to the public utility tax statute that specifically exempts the business of solid waste collection, transportation, or disposal from the tax. The section clarifies that such activities are taxable under the B&O tax general services classification that applies to persons not specifically taxed elsewhere in the B&O tax statute.

Enhanced Food Fish Tax and Tax Incidence

The tax on enhanced food fish is clarified to apply to the event in which the fish is first possessed in Washington by an owner after the fish has been landed.

Departmental Authorization

The Department of Revenue is required to publish the determinations issued by the department concerning interpretations of excise tax statutes, but is not required to publish a corresponding index.

A person is held harmless from any calculation errors that occur specifically using department-provided geographic information system technology.

B&O Jobs Tax Credit

Under the B&O jobs tax credit statute, the obsolete reference to a farmer sales tax deferral law is deleted.

The limit on allowable B&O jobs tax credits is clarified to provide that any credit disallowed for a given year may be carried over to the next to the extent that the cap for the ensuing year is not exceeded. The restriction on the use of the credit is clarified to indicate that the credit may be used against any B&O tax due and may be carried over until used. However, the credit may not be exchanged for a refund.

The reporting deadline for a business that receives a B&O jobs tax credit is extended to January 31 of the following year. In addition, the recipient is now required to keep records, such as payroll records and employment security reports, to allow the Department of Revenue to verify eligibility.

Timber Excise Tax

The reporting requirement for private timber sales is reestablished until July 1, 2004. The timber stumpage values established by the Department of Revenue may go into effect 30 days after the Legislature is notified.

B&O Deduction for Investment Income

The Department of Revenue is prohibited from imposing B&O tax on the investment income of any business that the department has not previously determined to be in the category of other financial business— for the purposes of taxability. The department may not impose B&O tax on investment income unless the investment income has been determined to be taxable as a result of either: a final court decision; an excise tax advisory issued by the department before January 1, 2001; or a departmental ruling or determination before January 1, 2001. This prohibition expires July 1, 2002.

The department is required to report to the fiscal committees of the Legislature by November 30, 2001, on progress made in working with stakeholders on future legislation that would clarify the application of the B&O deduction on investment income earned by businesses in the other financial business— category.

Hotel/Motel Taxes

Cross references are added to the hotel/motel tax statutes to refer to the amendments made in the act regarding the timing for credits against the state sales and use taxes and regarding the hold harmless provision for the use of department-provided geographic information system technology.

Votes on Final Passage:

House 93 0

Senate 47 0 (Senate amended)

House 92 0 (House concurred)

Effective: July 1, 2001

Partial Veto Summary: The Governor vetoed the section that prohibits the Department of Revenue from imposing the B&O tax on the investment income of any business that the department has not previously determined to be in the category of other financial business— for the purposes of administering the B&O tax.