

# HOUSE BILL REPORT

## HB 1361

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### As Passed Legislature

**Title:** An act relating to simplifying excise tax application and administration.

**Brief Description:** Simplifying excise tax application and administration.

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

**Brief History:**

**Committee Activity:**

Finance: 2/6/01, 2/21/01 [DP].

**Floor Activity:**

Passed House: 3/9/01, 93-0.

Senate Amended.

Passed Senate: 4/12/01, 47-0.

House Concurred.

Passed House: 4/17/01, 92-0.

Passed Legislature.

### Brief Summary of Bill

- The excise tax code is amended to make a number of housekeeping changes, including:
  - Clarification and simplification of definitions and exemptions;
  - Clarification of departmental authority and required departmental action;
  - Modification to reporting and implementation requirements for taxpayers;
  - and
  - Updates to statutory references.
- The Department of Revenue is prohibited for one year from imposing the business and occupation tax on investment income of certain financial businesses.

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### HOUSE COMMITTEE ON FINANCE

**Majority Report:** Do pass. Signed by 10 members: Representatives Cairnes, Republican Co-Chair; Morris, Democratic Co-Chair; Berkey, Democratic Vice Chair; Roach,

Republican Vice Chair; Carrell, Conway, Pennington, Santos, Van Luven and Veloria.

**Staff:** Mark Matteson (786-7145).

**Background:**

*Definitions:*

The Internal Revenue Code is defined under titles 11 and 83 RCW to mean 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, persons who wish to receive the B&O environmental remediation tax classification (at a tax rate of 0.484 percent) must submit certification to the department 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. Persons who receive income from royalties are 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:*

Passenger vehicles to be used for ride-sharing purposes may receive an exemption from retail sales and use taxes if the vehicles are exempt from motor vehicle excise taxes for 36 consecutive months from the time that the application is made to the department for exemption from retail sales and/or 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/or 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 or 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 services 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 state business and occupation (B&O) tax is imposed at a rate of 0.484 percent on the gross receipts of businesses that build, repair, or improve any street, road or right-of-way which is owned by a political subdivision of the state.

The establishment of solid waste collection and handling businesses is authorized in several places under statute. Neither the PUT nor the B&O tax refers 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 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 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 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 is to provide the department with information to determine whether the recipient is meeting the requirements of the chapter. If the department deems the report to be inadequate, it 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 of Revenue 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 of Revenue. Under this program purchasers of privately-owned timber who failed to report were liable for a penalty of \$250 for each failure to report.

The original legislation expired in 1997 and was extended to July 1, 2000 by the 1997 Legislature. The July 1, 2000 ending date was not extended.

#### *B&O Deduction for Investment Income:*

Certain moneys may be deducted from gross income for the purposes of determining taxable income under the business and occupation (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 state 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.

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**Summary of Bill:**

*Definitions (Sections 1 and 15 of bill):*

The definition of Internal Revenue Code is updated to mean the U.S. Internal Revenue Code of 1986, as amended as of January 1, 2001.

*Business and Occupation Tax (Sections 1 and 3):*

Upon request, the department may provide copies of certifications made to the department to receive the B&O environmental remediation tax classification. (Section 2) The definition of royalties is updated to exclude licensing of canned software to the end user.

*Retail Sales and Use Taxes (Sections 4 through 7):*

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 and only on the first day of the month.

*Tax Status of Solid Waste Businesses (Section 8):*

A section is added to the public utility tax that specifically exempts the business of solid waste collection, transportation, or disposal from the tax and clarifies that such activities are taxable under the B&O tax classification that applies to persons in the business of street and road improvement (at a rate of 0.484 percent).

*Enhanced Food Fish Tax and Tax Incidence (Section 9):*

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 (Sections 10 and 11):*

The department is required publish determinations but not a corresponding index.

Persons are held harmless from any calculation errors that occur specifically using department-provided geographic information system technology.

*B&O Jobs Tax Credit (Sections 12 through 14):*

Under the chapter that allows a credit against B&O tax liability for certain eligible business projects conducted by manufacturing or research and development firms (the "B&O jobs tax credit"), the obsolete reference to a sales tax deferral law that was repealed in 1995 is deleted.

The section that limits allowable B&O jobs tax credits to the \$7.5 million for a fiscal year is clarified, providing 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 to verify eligibility.

*Timber Excise Tax (Sections 16 and 17):*

The reporting requirement for private timber sale is reestablished until July 1, 2004. The timber stumpage values may go into effect 30 days after the Legislature is notified.

*B&O Deduction for Investment Income (Sections 18 through 20):*

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. The 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 other financial businesses.—

*Hotel/Motel Taxes (Section 21):*

Cross references are added to the RCW chapters under hotel/motel taxes to refer to the amendments made regarding the timing for credits against the state sales and use taxes (sec. 7) and regarding the "hold harmless" provision for the use of department-provided geographic information system technology (sec. 11).

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect on July 1, 2001.

**Testimony For:** This clarifies a number of provisions in the excise tax code. The objective is to make the code more straightforward. There is no intention to do anything that would surprise or alarm people.

**Testimony Against:** None.

**Testified:** Tim Sekerak, Department of Revenue.