

Finance Committee

HB 1853

Brief Description: Clarifying a supreme court decision on taxes.

Sponsors: Representatives Morris, Cairnes, Pennington, Miloscia, Roach, Benson, Van Luven, Veloria, Carrell, Kessler and Linville.

Brief Summary of Bill

- *Defines financial businesses for Business & Occupation tax purposes.*

Hearing Date: 2/20/01

Staff: Bob Longman (786-7139).

Background:

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. All business activities are subject to B&O tax unless there is a specific exemption or deduction. (A "deduction" for the B&O means a deduction from gross receipts before tax is applied. Therefore, a deduction is essentially the same as an exemption for purposes of determining taxability.) There is a B&O 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.

There has been some question and litigation over what "other financial business" means for B&O tax purposes. The state Supreme Court has defined a financial business as one that meets both of these 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. This interpretation was most recently applied in

the Simpson Investment Company case decided in July, 2000. The Simpson Investment Company is a parent holding company of four corporations: Simpson Timber Company and its subsidiaries; Simpson Paper Company and its subsidiaries; Simpson (formerly Western Pacific) Extruded Plastics and its subsidiary; and Simpson Foreign Sales Company. Simpson Investment gets the majority of its income as dividends from its subsidiaries. These dividends are exempt from tax and were not at issue in the case. Simpson Investment also 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.

Summary of Bill:

Investment income is exempt from B&O tax unless it is received by one of the following types of business:

- (1) Businesses holding themselves out to the public as a banking, loan, or other financial institution, and chartered as such under law.*
- (2) Holding companies of banking, loan, or other financial institutions.*
- (3) Businesses holding themselves out to the public and engaged in business as a subsidiary or affiliate of a banking, loan, or other financial institution.*
- (4) Businesses holding themselves out to the public and engaging in business as a housing lender, securities underwriter, securities broker, provider of revolving credit accounts, or provider of installment sales contracts. The legislation provides specific definitions and descriptions of each of these types of business.*

Appropriation: *None.*

Fiscal Note: *Requested on February 07, 2001.*

Effective Date: *Ninety days after adjournment of session in which bill is passed.*