

# HOUSE BILL REPORT

## HB 2691

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### As Reported by House Committee On:

Trade & Economic Development

**Title:** An act relating to a business and occupation tax exemption for qualifying small businesses.

**Brief Description:** Providing a business and occupation tax exemption for qualifying small businesses.

**Sponsors:** Representatives Eickmeyer, Armstrong, Haigh, Bush, Sehlin, Benson, Ruderman, Skinner, McDermott, Simpson, G., Chase, Morrell, Campbell, Kessler, Woods, Linville, Edwards and Roach.

### Brief History:

#### Committee Activity:

Trade & Economic Development: 1/27/04, 1/30/04 [DPS].

#### Brief Summary of Substitute Bill

- Exempts qualified small businesses from paying business and occupation (B&O) tax if the business has gross proceeds of sales, a gross income or products valued at less than \$200,000 and the business paid B&O taxes that exceeded its net business income on its federal tax return during the 12 month base period.

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### HOUSE COMMITTEE ON TRADE & ECONOMIC DEVELOPMENT

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 13 members: Representatives Veloria, Chair; Eickmeyer, Vice Chair; Skinner, Ranking Minority Member; McDonald, Assistant Ranking Minority Member; Blake, Chase, Condotta, Kristiansen, McCoy, Ormsby, Pettigrew, Priest and Rodne.

**Staff:** Tracey Taylor (786-7196).

### Background:

Washington's business and occupation (B&O) tax is the second largest tax source for the state. In Fiscal Year 2002, B&O tax collection totaled \$1.958 billion which represented approximately 16.4 percent of state revenue sources within the state general fund.

Almost all businesses located or doing business in the state of Washington are subject to the state B&O tax, including corporations, partnerships, sole proprietors and nonprofit organizations.

Washington's B&O tax is calculated on gross income from business activities in the state. There are no deductions from the B&O tax for labor, materials, taxes or other costs of doing business. However, some businesses may qualify for certain exemptions, deductions or credits. An exempted activity is not subject to the B&O tax and is not reported on the Combined Excise Tax Return (CETR). Exempted activities include raising and selling plantation Christmas trees at wholesale; sales for fund-raising of certain nonprofit organizations; international banking facilities; and growing, raising or producing agricultural products. Unlike exemptions, deductions must first be reported on a business' CETR as part of the business' gross income, then taken as a deduction. Allowable deductions include bad debts; freight and delivery costs incurred by a Washington manufacturer for out-of-state shipments; and sales made in Washington by an out-of-state seller without activities in Washington that establish, maintain, or facilitate a market for its products or services. Credits are amounts that have been paid to the Department of Revenue which are either not due or are granted by the Legislature for a specific purpose. Credits are subtracted from the B&O tax due on the CETR and include the multiple activities tax credit; the high technology B&O tax credit and the small business B&O tax credit.

Business and occupation tax rates and classifications vary according to the type of business activity. The major B&O tax classifications are retailing, wholesaling, manufacturing and service and other activities.

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

A small business may be exempted from paying B&O tax if, during the 12 month base period, the small business meets certain criteria. First, the small business must have gross proceeds of sales, a gross income, or products valued at less than \$200,000. Second, the small business must have paid B&O taxes during the 12 month base period that exceeded the small business' net business income on its federal income tax returns for the same 12 month period. If the business is a sole proprietorship, the sole proprietor may subtract the amount of self-employment tax shown on schedule 1040 SE from the net income reported on schedule C of the federal income tax return to determine the net income for the purposes of this exemption. The amount of the exemption will be reported on the small business' tax return. Once the exemption is claimed, the person may not later change to claim to a different tax return.

The 12 month base period is 12 consecutive months chosen by the taxpayer and must end no earlier than the six months before the reporting period covered by the first return taking this exemption. The exemption is limited for monthly reporters to 12 monthly tax

reports and, for quarterly reporters to four quarterly tax reports. A business that files monthly or quarterly cannot take an exemption for any tax period that starts more than 24 months after the taxpayer first takes the exemption. An annual filer may claim the exemption on one of the two annual tax returns due following the last month of the base period.

It is fraud or misrepresentation of a material fact to a claim this small business tax exemption if not entitled to it.

The exemption is not available for any period during or after which a small business directly or indirectly purchases or otherwise acquires, in bulk and not in the ordinary course of business, the tangible or intangible assets of another taxpayer. The exemption is also not available for a period during or after which the small business is the surviving corporation of a statutory merger.

### **Substitute Bill Compared to Original Bill:**

The substitute bill clarifies that the base period is the same 12 month period that is covered by a single federal income tax return. The substitute also allows a sole proprietor to subtract the amount of self-employment tax shown on schedule 1040 SE from the net income reported on schedule C of the federal income tax return for the purposes of determining net income for the purposes of establishing eligibility for this B&O tax exemption. A person is prevented from claiming the exemption and later changing the claim to a later tax return.

The substitute clarifies that annual filers may claim the exemption on one of two annual tax returns due following the last month in the base period. Also, the substitute provides that the amount of the exemption will be reported on the small business' tax return. The substitute states that it is fraud or misrepresentation of a material fact for a person to claim the exemption if the person is not entitled to it.

The substitute prevents small businesses from claiming the exemption for a period during or after which the business purchases or acquires, directly or indirectly, in bulk and outside the ordinary course of business, the tangible or intangible assets of another taxpayer; or is a surviving corporation of a statutory merger.

The substitute eliminates the requirement that the business provide federal income tax returns to the Department of Revenue and the subsequent public disclosure of this information.

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**Appropriation:** None.

**Fiscal Note:** Available. New fiscal note requested on February 2, 2004.

**Effective Date of Substitute Bill:** The bill takes effect 90 days after adjournment of session in which bill is passed.

**Testimony For:** This bill is designed as a safety net for our small businesses. It lets them catch their breath, so that they will still be around to pay taxes later on. A frustrating element of the B&O tax is that it does not recognize profitability. The bill recognizes this flaw and allows a "Mom and Pop" business to become profitable and add an employee or two. This encourages productivity and will create secondary and tertiary job growth.

**Testimony Against:** None.

**Persons Testifying:** Representative Eickmeyer, prime sponsor; Gary Smith, Independent Business Association; Carolyn Logue, National Federation of Independent Business; and Tom Dooley, Association of Washington Business.

**Persons Signed In To Testify But Not Testifying:** None.