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**Finance Committee**

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**HB 1364**

**Brief Description:** Prohibiting municipal taxation of intellectual property creating activities.

**Sponsors:** Representatives Morris, Anderson and Nixon.

**Brief Summary of Bill**

- Prohibits cities from imposing Business and Occupation taxes on intellectual property creating activity.

**Hearing Date:** 2/6/03

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

**Background:**

Thirty-seven cities impose Business and Occupation (B&O) taxes. Municipal B&O taxes are imposed on the gross receipts of activities conducted by businesses located within cities without any deduction for the costs of doing business. The Legislature has limited city B&O taxes on retail sales to a maximum of 0.2 percent, but higher rates are possible if voter-approved or in effect prior to January 1, 1982. Cities first imposing a B&O tax after April 22, 1983, and cities increasing tax rates must first receive voter approval.

Like a number of other municipalities with B&O taxes, the City of Seattle imposes its B&O tax on several classifications including manufacturing. As an aspect of its tax on manufacturing, the city also taxes software development; this imposition has been the subject of dispute. In 1999 the King County Superior Court, ruling in favor of Walker, Richer & Quinn, Inc., a software developer, found that the city's definitions of "manufacturing" and "manufacturer" were inconsistent and that software development was not taxable under the definition of manufacturing. In response, the city modified its definitions, and in 2001, the city council repealed its existing B&O ordinance entirely and adopted a revised version. The revised ordinance provides that manufacturing includes "persons engaged in the business of developing, or producing custom software or of customizing canned software." The revised ordinance also includes a partial credit against the tax for certain research and development expenditures conducted by high-technology industries, including software developers.

In the 2002 Legislative session, several bills were considered that would have prohibited the

municipal taxation of "intellectual property creating activity", including software development.

**Summary of Bill:**

Cities are preempted as of July 1, 2003, from imposing a gross receipts tax on intellectual property creating activities, including research, development, authorship, creation, or other inventive activity, unless a city imposed such a tax as of January 1, 2003. In the latter case, a city is prohibited from imposing such a tax as of January 1, 2005.

**Appropriation:** None.

**Fiscal Note:** Requested on January 28, 2003.

**Effective Date:** The bill contains an emergency clause and takes effect on July 1, 2003.