FINAL BILL REPORT
ESHB 1462

C 69 L 03
Synopsis as Enacted

Brief Description: Prohibiting local governments from imposing business and occupation tax on intellectual property.

Sponsors: By House Committee on Finance (originally sponsored by Representatives Morris, Cairnes, Gombosky, Ruderman, Nixon, Ericksen, Miloscia, Anderson, Wallace, Benson, Newhouse, Tom, Chandler, Orcutt, Woods, McMahan, Talcott and Campbell).

House Committee on Finance
Senate Committee on Ways & Means

Background:

Thirty-seven cities impose business and occupation (B&O) taxes on the gross receipts of activities conducted by businesses without any deduction for the costs of doing business. The Legislature limited city B&O taxes to a maximum rate of 0.2 percent in 1982, but higher rates are allowed if approved by the voters in the city, or if a higher rate was in effect prior to January 1, 1982. Many city B&O taxes include more than one rate classification and common classifications include manufacturing, wholesaling, retailing, and services. Cities imposing a B&O tax for the first time after April 22, 1983, and cities increasing tax rates, must provide for a referendum procedure to apply to the ordinance imposing or increasing the tax.

Like a number of other municipalities with B&O taxes, the City of Seattle (City) imposes its B&O tax on several classifications, including manufacturing. As an aspect of its tax on manufacturing, the City also taxes software development. In 1999 the King County Superior Court, ruling in favor of 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 In response, the City modified its definitions, and in 2001, the City Council repealed its existing B&O ordinance entirely and adopted a revised version.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.

Intellectual property is a form of intangible property in which the product represents the manifestation of creative activity, such as in the case of software programs, music, or product designs. The activity of creating intellectual property may involve research,

development of ideas, and other inventive processes. The use of intellectual property is typically allowed through license, and the creator of such property may receive royalties or other compensation for licensing the product.

Summary:

Cities are prohibited 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, 2002. In the latter case, a city is prohibited from imposing this tax beginning January 1, 2004.

Cities may impose gross receipts taxes on royalty income, except for royalty income from casual or isolated sales, grants, capital contributions, donations, or endowments. The taxes may only be imposed on taxpayers whose principal business location is within the city imposing the tax.

Cities are not prohibited from imposing gross receipts taxes on gross income derived from manufacturing, sales, or services, even if the processes might have involved intellectual property creating activity. Intellectual property creating activity may not be considered a manufacturing activity, however.

Votes on Final Passage:

House 96 0
Senate 41 4

Effective: July 27, 2003