Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Finance Committee

HB 1747

Brief Description: Making the local government tax treatment of software businesses uniform.

Sponsors: Representatives McIntire, Santos, Conway, McDermott and Kenney.

Brief Summary of Bill

- Provides common requirements for cities with business and occupation taxes, with respect to the tax treatment of software development, production, and sale.

Hearing Date: 2/18/03

Staff: Mark Matteson (786-7145).

Background:

City Business and Occupation Taxes

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, or for income that is derived by activity conducted in non-taxing jurisdictions. 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 have a referendum procedure. Any activity may be taxed as long as there is no express statutory or constitutional prohibition against doing so.

The manner in which cities with B&O taxes impose such taxes on software sales and development may vary from jurisdiction to jurisdiction. Several jurisdictions have specific provisions in their tax ordinances concerning software, but many do not.

In recent years, the Association of Washington Cities has developed a model B&O ordinance that includes definitions relating to software and provisions for the tax treatment of software that are similar to those under the state excise tax code. A number of jurisdictions, including Seattle, Bellevue, Tacoma, Bellingham, Everett, Bremerton, Shelton, Burien, North Bend, and Longview, have or are planning to adopt the model ordinance.

Software and State Excise Tax Treatment

Computer software designed for use by many people without modification is known as canned software. Custom software is software designed for use by a single consumer. Canned software may be customized for an individual consumer's use. Persons that develop software may create master copies of the software, from which the person may make additional copies for sale or license. Software developers typically retain rights through copyrights or patents when licensing or contracting the software for use.

In 1998, the Legislature enacted ESB 6470 to clarify the excise tax treatment of software. Prior to the passage of the law, the customization of canned software was considered a retail sale, while customization of other software was considered a service. The law modified this treatment, providing that all customization was to be considered a service and so exempt from retail sales and use taxes. The law also provided definitions for canned software, custom software, master copies, and retained rights.

Summary of Bill:

All cities that impose business and occupation taxes as measured by rates against the gross receipts of businesses subject to tax and that impose such tax on software businesses must meet certain standard tax classification and definitional requirements. The sale of canned software, including the licensing of such software, if taxed under a municipal B&O tax, must be considered a retail sale, unless the buyer presents a resale certificate, in which case the sale must be considered a wholesale. The production of canned software must be considered a manufacturing activity. The production and sale of customized software must be considered a service activity. Definitions are provided for canned software, custom software, master copies, and retained rights.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect ninety days after adjournment of session in which bill is passed.