
**Technology, Telecommunications
& Energy Committee**

SB 5464

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

Sponsors: Senators Finkbeiner, Fairley, Esser, Reardon, Schmidt, Doumit, West, Rossi and T. Sheldon.

Brief Summary of Bill

- Prohibits cities from imposing business and occupation taxes on intellectual property creating activity.

Hearing Date: 3/21/03

Staff: Pam Madson (786-7166).

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 sales to a maximum of 0.2 percent, but higher rates are possible if voter-approved or if in effect prior to January 1, 1982.

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. In 1997, the city imposed its B&O tax on software development companies who challenged this application of the tax. The King County Superior Court determined that software development was not consistent with the city's definitions of "manufacturing" and therefore not taxable. In response, the city modified its definitions, and in 2001, the city council repealed its existing B&O ordinance entirely and adopted a revised version.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, music, and product designs. The activity of creating intellectual property may involve research, thought development, and other sorts of inventive activity. 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.

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 may not impose a business and occupation tax on the activity of creating intellectual property, unless that city had such a tax on January 1, 2002. As of January 1, 2004, all cities are prohibited from imposing a gross receipts tax on any intellectual property creating activity.

Appropriation: None.

Fiscal Note: Available.

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