

SENATE BILL REPORT

SB 5900

As Reported By Senate Committee On:
Ways & Means, March 10, 2003

Title: An act relating to changing requirements regarding state and local tax to provide for municipal business and occupation tax uniformity and fairness.

Brief Description: Changing requirements regarding state and local tax to provide for municipal business and occupation tax uniformity and fairness.

Sponsors: Senators Horn, Reardon, Rossi, T. Sheldon, Mulliken, Esser and Schmidt; by request of Governor Locke.

Brief History:

Committee Activity: Ways & Means: 2/25/03, 3/10/03 [DPS, DNP].

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 5900 be substituted therefor, and the substitute bill do pass.

Signed by Senators Rossi, Chair; Hewitt, Vice Chair; Zarelli, Vice Chair; Hale, Honeyford, Johnson, Parlette, Roach and Sheahan.

Minority Report: Do not pass.

Signed by Senators Brown, Fairley, Fraser, Regala and B. Sheldon.

Staff: Terry Wilson (786-7433)

Background: Thirty-seven cities impose business and occupation (B&O) taxes. City 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.

City B&O taxes on retail sales are limited to a maximum of 0.2 percent, but higher rates are allowed if voter-approved or in effect prior to January 1, 1982. Cities first imposing a B&O tax or increasing B&O tax rates after April 22, 1983, must provide a referendum procedure for the imposition or increase.

Summary of Substitute Bill: Cities imposing a B&O tax are required to create a committee to work through the Association of Washington Cities to adopt a model ordinance that will provide a more uniform system of municipal B&O taxes. The model ordinance does not apply to utility businesses. The definitions and tax classifications in the ordinance may not be amended more frequently than every four years except to comply with state law changes.

Cities imposing a B&O tax must adopt the mandatory provisions of the model ordinance which includes: a system of credits that prevent multiple taxation of the same income; a

gross receipts threshold of at least \$20,000 for small businesses; tax reporting frequency requirements; provisions for penalties and interest; claim and refund provisions; and certain definitions, to be based on comparable definitions within the state B&O statutes. Deviations from the state B&O definitions must be noted in the model ordinance.

With the exception of the system of credits to prevent multiple taxation, cities may continue to adopt their own tax exemptions, credits, and deductions. With respect to any nonmandatory provisions, cities that deviate must make a description of the deviations available.

A city may not impose a B&O tax on a person unless that person has nexus with the city under the standards established for interstate commerce under the commerce clause of the United States Constitution.

Cities with B&O taxes must provide credits against:

- Retail or wholesaling taxes for any manufacturing or extracting taxes paid on the same products;
- Manufacturing taxes for any extracting taxes paid on the same products; and
- Retail or wholesaling taxes for any printing or publishing taxes paid on the same publications.

The model ordinance must include provisions for credits that will prevent the multiple taxation of business service income and income of any other classification of business.

Cities with B&O taxes must allow for monthly, quarterly, or annual reporting of taxes. A city may require monthly reporting only if the taxpayer also reports state B&O taxes on a monthly basis.

Cities with B&O taxes must calculate interest on assessments and refunds, claim and refund periods, in the same manner as state excise taxes.

The model ordinance must also include definitions for a number of terms. These include:

- Eligible gross receipts tax,
- Extracting,
- Manufacturing (which may not include software development as an activity),
- Retailing,
- Retail sale,
- Services (excluding retail and wholesale services),
- Wholesale sale,
- Wholesaling,
- To manufacture,
- Commercial and industrial use,
- Engaging in business, and
- Person.

Cities imposing B&O taxes must comply by December 31, 2004.

Cities must apportion income beginning January 1, 2008. Gross income derived as royalties from the granting of intangible rights is allocated to the commercial domicile of the taxpayer. Gross income from services is apportioned to a city based on a payroll factor and a service-income factor. Gross income from all other activities is allocated to the location where the activity takes place. In the case of sales of tangible personal property, the activity takes place where delivery to the buyer occurs.

The Department of Revenue must conduct a study of the net fiscal impacts on local jurisdictions and report to the Governor and Legislature by January 1, 2006.

The Department of Revenue must report by December 31, 2004, to the Governor and the fiscal committees of the Legislature on the definitions used in the proposed model ordinance. The report must note any deviations from the state definitions and the reason for such deviation. The report must also estimate the fiscal impact on taxpayers of any deviations from the state definitions.

Substitute Bill Compared to Original Bill: A number of technical amendments are made. A study of the impacts on local jurisdictions is provided. A requirement that cities retain higher small business exemption thresholds is removed.

Appropriation: None.

Fiscal Note: Available.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Testimony For: The current nonuniform system is a problem. This bill provides a uniform system and is endorsed by the Competitiveness Council. It gives cities flexibility and provides certainty to business. It reduces costs of compliance. The lack of uniformity results in inconsistencies and unfairness. There is no model ordinance now because it is voluntary.

Testimony Against: B&O taxes constitute 12 percent of the revenues of cities. AWC has already adopted a model ordinance that has been adopted by 90 percent of the cities. Another process is redundant. Apportionment has a \$25 million to \$30 million impact on the 5 largest cities and impacts the ability to provide services. A rate increase should be allowed to offset the impact. City B&O taxes are not onerous or unfair. This adds complexity. Apportionment should be studied first. A lower threshold should be allowed for small cities.

Testified: PRO: Carolyn Logue, NFIB; Jim Hedrick, Governor's Office; Mike Bernard, Mike Roben, Ron Bueing, AWB; CON: Stan Finkelstein, AWC; David Foster, City of Seattle; Frank Anderson, Everett; Randy Lewis, City of Westport; Randy Lewis, City of Tacoma.