

HOUSE BILL REPORT

ESHB 2314

As Passed House:
April 21, 2005

Title: An act relating to revenue and taxation.

Brief Description: Modifying revenue and taxation.

Sponsors: By House Committee on Finance (originally sponsored by Representative McIntire).

Brief History:

Committee Activity:

Finance: 4/21/05 [DPS].

Floor Activity:

Passed House: 4/21/05, 50-48.

Brief Summary of Engrossed Substitute Bill

- Imposes retail sales and use taxes on sales of warranties that are not already part of the selling price of purchased tangible property.
- Exempts self-service laundry facilities from retail sales and use taxes, and reclassifies them under the business and occupation (B&O) tax as service establishments.
- Removes B&O, retail sales, and use taxes from separately stated delivery charges for direct mail.
- Imposes an additional tax of \$1.33 per liter on liquor sales, excluding purchases by restaurants.
- Exempts certain nonprofit boarding homes from B&O taxes.
- Provides B&O, sales, and use tax exemptions for comprehensive cancer centers.
- Modifies the B&O tax credit for property taxes paid by commercial airplane and component manufacturers, concerning which payments are eligible.
- Exempts leasehold interests in certain public amphitheaters from the leasehold excise tax.

- Defers the payment of sales and use taxes on the construction of a historic automobile museum.
- Phases out the Nursing Home Quality Maintenance Fee.
- Creates the Washington Main Street Program to provide technical assistance to communities that undertake downtown or neighborhood commercialization district revitalization initiatives, and provides financial assistance through B&O tax credits for a percentage of contributions made for the purposes of such initiatives.
- Modifies the B&O tax credit for high-technology research and development (R&D) to correct the formula used to determine the credit and allows firms to ultimately calculate the credit based on an increased percentage of R&D expenditures.
- Imposes an additional cigarette tax of 60 cents per pack of 20 cigarettes, and deposits net proceeds in a new account for the purpose of funding class reduction and other Initiative 728 requirements, as well as higher education purposes.
- Clarifies the deduction from estate value, for the purposes of the proposed estate tax in Senate Bill 6096, of certain farm property.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 5 members: Representatives McIntire, Chair; Hunter, Vice Chair; Conway, Hasegawa and Santos.

Minority Report: Do not pass. Signed by 4 members: Representatives Orcutt, Ranking Minority Member; Roach, Assistant Ranking Minority Member; Ahern and Ericksen.

Staff: Bob Longman (786-7139).

Background:

Business and Occupation Tax. Washington's major business tax is the business and occupation (B&O) tax. The B&O tax is imposed on the gross receipts of business activities conducted within the state, without any deduction for the costs of doing business. The tax is imposed on the gross receipts from all business activities conducted within the state. Although there are several different rates, the most common rates are 0.471 percent for retailing, 0.484 percent for wholesaling, and 1.5 percent for service activity. Businesses that are involved in more than one kind of business activity are required to segregate their income and report under the appropriate tax classification based on the nature of the specific activity.

Retail Sales Tax. The retail sales tax applies to the selling price of tangible personal property and of certain services purchased at retail. The tax base includes goods and certain services, including charges made for the use of facilities to perform services such as cleaning. The tax is levied at a 6.5 percent rate by the state. Cities and counties may levy a local tax at a rate up to a maximum of 3.1 percent; currently, local rates levied range from 0.5 percent to 2.4 percent. Sales tax is paid by the purchaser and collected by the seller.

Use Tax. The use tax is imposed on items used in the state that were not subject to the retail sales tax, and includes purchases made in other states and purchases from sellers who do not collect Washington sales tax. The state and local rates are the same as those imposed under the retail sales tax. Use tax is paid directly to the Department of Revenue.

Extended Warranties. The sales tax is paid on each retail sale of most articles of tangible personal property and certain services. Taxable services include construction, repair, telephone, lodging of less than 30 days, restaurant meals, physical fitness, and some amusement and recreation services. The use tax is imposed on the use of articles of tangible personal property when the sale or acquisition has not been subject to the sales tax. The use tax commonly applies to purchases made from out-of-state firms.

The sales tax applies to manufacturer's warranties that are included in the retail selling price of an article. The sales tax does not apply to non-manufacturer's warranties and manufacturer's warranties not included on the retailing selling price of an article.

Self-service laundry facilities. Coin-operated laundry facility services offered in apartment buildings for the exclusive use of tenants are exempt from retail sales and use taxes and are subject to the B&O tax service classification. However, stand-alone laundry establishments must collect and remit retail sales and use taxes and are subject to the B&O tax retailing classification.

Delivery charges for direct mail. For B&O, retail sales, and use taxes, the amount of tax is based on statutory definitions that apply tax to the full amount paid by the customer, without any deduction for expenses paid by the seller such as the cost of materials used, labor costs, or delivery costs. Notwithstanding the statutory provisions requiring inclusion of delivery costs, the Department of Revenue (DOR) issued administrative rules more than 30 years ago that allowed printers and mailing bureaus to deduct the cost of postage when calculating B&O and retail sales taxes, if the postage is purchased for a customer and the customer is charged for the postage. Legislation enacted in 2002 caused the DOR to review its rules on printers and mailing bureaus. The DOR discovered that it lacked the statutory authority for the portions of the rules which allow printers and mailing bureaus to deduct postage when calculating B&O and retail sales taxes.

Taxpayers are entitled to rely on rules and other written advice of the DOR until the written rules or advice are modified by the DOR. In January 2005, the DOR issued new rules for printers and mailing bureaus, effective July 1, 2005. On and after that date, printers and mailing bureaus may not deduct postage when calculating taxes.

Liquor Liter Tax. The liquor liter tax is imposed at the rate of \$2.4408 per liter. Revenues generated by the first \$1.9608 per liter are deposited in the General Fund. Revenues generated by \$0.07 per liter are dedicated to youth violence prevention and drug enforcement. The remaining \$0.41 per liter is deposited in the health services account.

Nonprofit boarding homes. A licensed boarding home is a facility that provides board and domiciliary care to seven or more residents. Domiciliary care includes assistance with the activities of daily living and assumes general responsibility for the safety and well-being of the resident. Some boarding homes offer limited nursing services and others specialize in serving people with mental health problems, developmental disabilities, or dementia.

Licensed boarding homes providing room and domiciliary care to residents pay B&O taxes at a rate of 0.275 percent. Amounts received from the Department of Social and Health Services (DSHS) for adult residential care, enhanced adult residential care, or assisted living services for medicaid recipients are deducted from income before B&O taxes are determined.

Comprehensive cancer centers. Nonprofit cancer centers are exempt from property tax, but do not qualify for B&O tax exemptions or sales and use tax exemptions.

Nonprofit blood, bone, and tissue banks are exempt from property tax. Nonprofit blood, bone, and tissue banks are exempt from B&O tax to the extent the amounts received are exempt from federal income tax. The purchase and use of medical supplies, chemicals, or specialized materials by a nonprofit blood, bone, or tissue bank is exempt from sales and use tax.

In 1999, a question arose as to whether the Fred Hutchinson Cancer Research Center qualified as a blood, bone, or tissue bank for purposes of B&O, sales, and use tax exemptions. Litigation ensued. In 2003, the Thurston County Superior Court ruled that the Fred Hutchinson Cancer Research Center was not eligible for these exemptions. The court decision also invalidated the exemptions for bone and tissue banks, because the title of the original enactment of the exemptions was limited to blood banks. In 2004, the Legislature re-enacted the exemptions for bone and tissue banks.

Property Tax. Property taxes are levied by state and local governments. Property taxes apply to both real property, which includes land, buildings, and fixtures attached to buildings, and personal property, which includes all other property, including tangible and intangible property. With regard to personal property, household items and furnishings are exempt, as are business inventories, but other business personal property is subject to tax.

Property taxes are administered by the counties at the local level for most types of property. The county assessor determines assessed value for each property. The county assessor also calculates the tax rate necessary to raise the correct amount of property taxes for each taxing district. The property tax bill for an individual property is determined by multiplying the assessed value of the property by the tax rate for each taxing district in which the property is located.

Aerospace Industry Incentives. In 2003, the Legislature enacted certain tax incentives provided to manufacturers of airplanes and airplane components. Eligible firms include subcontractors and suppliers that are manufacturers. Among the incentives enacted is a credit against the B&O tax for certain property taxes paid. The property tax payments that are eligible include:

1. property taxes paid on new buildings and the land upon which the buildings are located, or on renovations or expansions to existing buildings, if the buildings are used in the manufacturing of commercial airplanes or their components; and
2. property taxes paid on new machinery and equipment that is exempt from sales and use taxes under exemptions originally enacted in 1995 for manufacturers, and that is used in manufacturing commercial airplanes or components of such airplanes.

Leasehold Excise Tax. The leasehold excise tax applies to interests in publicly owned real or personal property. The tax is "in lieu" of property taxes that would otherwise be paid on the property if the property were privately held. The tax is generally measured by the amount of contract rent, which is the amount paid for the use of the public property. The tax is imposed at a total rate of 12.84 percent. Local governments may impose a tax of up to 6 percent that is a credit against the state tax.

The DOR has issued rules that provide that a leasehold interest is established through both possession and use, and the lessee must have some identifiable dominion and control over a defined area to satisfy the possession element.

Amphitheaters. The Clark County fairgrounds is the site of an outdoor amphitheater with seating for 18,000 persons for concerts and other events. In 2002, the Clark County Commission approved a twenty year lease for the facility with Quincunx of Washington (QOW), a subsidiary of Q-Prime, a firm that manages a number of popular entertainers. Pursuant to the agreement, Quincunx built the amphitheater with its own funds. Upon completion of construction in July 2003, ownership and title to the amphitheater vested in the County. Under the lease terms, QOW is granted both the right of possession to the amphitheater and the use of parking areas as well, including non-exclusive easement to those areas. Payments made under the lease agreement are subject to state and local leasehold excise taxes.

Historic Automobile Museum. In August of 2002, the City of Tacoma provided for the use of eight acres of land adjacent to the Tacoma Dome for the purposes of constructing a historic car museum. The agreement was made with the Harold E. Lemay museum nonprofit organization. The organization is seeking to begin construction of a museum in 2007 and to begin museum operations in 2008. Construction of the museum will be subject to retail sales and use taxes.

Nursing Home Maintenance Fee. Historically, state Medicaid programs have used a variety of mechanisms such as provider taxes, provider donations, and intergovernmental transfers to increase federal Medicaid revenues. The federal government has placed restrictions on these mechanisms, in order to limit the extent to which states may use federal funds to cover the

state share of Medicaid costs. These restrictions include requirements that provider taxes be broad-based, which means the tax must apply to all providers of the same class, regardless of whether the provider participates in Medicaid or not. Provider taxes must also be imposed at a uniform rate, and they may not include any direct or indirect "hold harmless" provision which guarantees repayment of the tax to all providers.

In 2003, the state levied a new tax of \$6.50 per patient day of care on nursing homes. The tax applies to all patient days of care, except those paid by the federal Medicare program. The tax does not apply to nursing homes owned and operated by public agencies. It also does not apply to 36 private facilities the federal government agreed could be exempted from the tax without violating Medicaid federal rules.

The tax generates approximately \$34 million per year of revenue for the State General Fund. Medicaid payment rates were increased in 2003 to cover the cost of the tax on patient days of care paid by the state Medicaid program. After accounting for the state share of that increased Medicaid payment, net state revenues from the tax total about \$22 million per year.

Washington Main Street Program. Many communities may have traditional downtown business districts or neighborhood commercial districts that are in need of revitalization. In 2002, legislation was enacted that provides assistance to communities to revitalize downtown or neighborhood commercial districts. The legislation allows such districts to receive allocations of certain incremental local retail sales and use tax revenues attributable to economic growth to pay for revitalization costs. Such allocations must be authorized by the legislative authority of the city or town in which the district is located.

The Department of Community Trade and Economic Development (DCTED) Downtown Revitalization Program (DRP) assists communities throughout the state to revitalize the economy, appearance and image of traditional business districts through training, technical assistance and the organization of local resources. Utilizing the Main Street methodology developed by the National Trust for Historic Preservation, the DRP emphasizes four critical areas of revitalization: organization, promotion, design and economic restructuring. Since July 1, 2003, 10 Washington communities have been certified as Main Street communities.

High Technology Research and Development B&O Tax Credit. The B&O tax allows a credit for certain operational research and development (R&D) expenditures in high-technology businesses. The credit is provided to businesses, including qualifying nonprofit organizations, that make R&D expenditures in excess of 0.92 percent of taxable income.

In the 2004 session, the Legislature modified the high technology R&D B&O tax credit. The amount of credit that may be taken is based on amounts spent on R&D in excess of 0.92 percent of a business' total taxable amount for the year. In addition, calculation of the credit by for-profit firms must be based on the average tax rate of the firm for the tax reporting period, rather than 1.5 percent, the requirement prior to the 2004 changes. The credit is equal to the average tax rate multiplied by the amount spent on R&D in excess of 0.92 percent of the business total taxable amount.

The 2004 changes to the high tech R&D B&O tax credit provided a definition of "average tax rate" based on a business' taxable income. However, for the purposes of the B&O tax, the measure of tax for some firms includes more than taxable income. Specifically, for firms that manufacture products, the measure of tax is based on the value of the products manufactured. The manner in which "average tax rate" is defined means that the amount of credit that may be taken by firms that engage in manufacturing activities is higher than if the calculation were based on the entire measure of tax for B&O purposes.

As part of the 2004 changes, businesses that take the high tech B&O tax credit for R&D spending must submit an annual survey. The survey, which includes employment, wage, and other information, is in addition to an annual report that must be submitted with information relating to the credit calculation. Both the survey and report are due by March 31 of the year following the year the credits were taken. The amount of taxpayer credit reported on the survey may be disclosed to the public. If the survey is not completed by the due date, the business is not eligible to take or assign the credit. No exceptions are allowed for failure to file even if the failure was for reasons beyond the taxpayer's control.

Cigarette taxes. Cigarettes are subject to tax at a rate of 142.5 cents per pack of 20 cigarettes. Retail sales and use taxes are also imposed on sales of cigarettes. Revenue from the first 23 cents of the cigarette tax goes to the General Fund. The next 8 cents are dedicated to water quality improvement programs through June 30, 2021, and to the General Fund thereafter. The next 101 cents goes to the Health Services Account. The remaining 10.5 cents are dedicated to the violence prevention and drug enforcement account.

Student Achievement Fund. I-728 was approved by voters in the November 2000 general election. Under this initiative, a portion of the state property tax is dedicated for educational purposes by transferring revenues into the Student Achievement Fund. Under I-728, allowable uses of the Student Achievement Fund include: hiring more teachers to reduce class sizes and making necessary capital improvements; creating extended learning opportunities for students; providing professional development for educators; and providing early childhood programs.

The amount of state property taxes dedicated to the Student Achievement Fund is: \$254 per full-time equivalent (FTE) student in the 2004-05 school year; \$300 per FTE student in the 2005-06 school year; \$375 per FTE student in the 2006-07 school year; and \$450 per FTE student in the 2007-08 school year. In subsequent school years, the \$450 per student amount increases by inflation measured by the implicit price deflator. The allocation rate to school districts from the Student Achievement Fund each year is equal to the per student amount of state property tax placed in the Student Achievement Fund.

Estate Tax. Transfers of property belonging to persons domiciled in Washington at the time of their death are subject to a state estate tax. As initially enacted in 1981, the amount of tax imposed was equal to the maximum allowed credit for state taxes under the federal tax. This type of tax is known as a "pick up" tax, since the burden to the taxpayer is not increased, but rather the state "picks up" a portion of the federal tax receipts. After the passage of the federal Economic Growth and Tax Relief Reconciliation Act (EGRRRA) of 2001, which phases

out the state credit against the federal tax over several years, the Washington tax was not amended by the Legislature to conform to current federal code. The Washington tax instead continued to refer to the federal code as it existed prior to EGRRA, and the state continued to collect an amount equal to the amount allowed by the federal credit prior to EGRRA. On February 3, 2005, the Washington Supreme Court ruled that Washington's tax represents solely a "pick-up" against the federal tax and that the state statute does not impose an independently operating Washington estate tax. According to the ruling, the state tax remains a pick-up tax that must be fully reimbursed by the federal credit. In effect, the ruling conforms Washington's estate tax to the changes in the federal tax made in 2001 and invalidates the state tax to the extent it exceeds the federal tax credit.

In the 2005 session, legislation was introduced that imposes an estate tax independent of the federal estate tax. The legislation includes provisions that allow a deduction from the value of the estate for the purposes of the tax, with respect to farm property. The provision allows a deduction of the value of qualified real property and the value of any tangible personal property used primarily for farming, less any value of the same property otherwise allowed as a separate deduction. The deduction is available to estates where over 50 percent of the estate value is qualified farm property. In addition, at least 25 percent of the estate value must be real property that was managed as a farm by the decedent or a member of the family.

Summary of Engrossed Substitute Bill:

Extended Warranties. Warranties that are not included in the selling price of articles of tangible personal property are included in the definition of retail sale. As a result, the sales and use tax applies to the retail sale and use of these warranties. This includes warranties sold on property the repair of which is exempt from sales and use taxes. In addition, the seller's B&O tax rate will change from the 1.5 percent service rate to the 0.471 percent retailing rate.

Self-service laundry facilities. An exemption from sales and use taxes is provided for self-service laundry facilities in addition to facilities situated in apartment complexes. The change also modifies the B&O tax classification for such facilities from retail to service, increasing the applicable B&O rate from 0.471 percent to 1.5 percent.

Delivery charges for direct mail. The B&O, retail sales, and use tax does not apply to delivery charges made for direct mail if the charges are separately stated on the billing document given to the purchaser. "Direct mail" means printed material delivered to a mass audience or a mailing list provided by the purchaser without charge to the persons who receive the mail.

Liquor Liter Tax. An additional tax is imposed on liquor at the rate of \$1.33 per liter excluding purchases by restaurants. The additional tax is distributed 97.5 percent to the General Fund, 2.3 percent to the health services account, and 0.2 percent to the violence reduction and drug enforcement account.

Nonprofit boarding homes. Nonprofit boarding homes are exempt from B&O taxes on amounts received for providing room and domiciliary care. Eligible nonprofit boarding homes are those operated by religious or charitable organizations as part of a nonprofit hospital or public hospital district and exempt from federal income tax as 501(c)(3) organizations.

Comprehensive cancer centers. Comprehensive cancer centers are exempt from property tax. Comprehensive cancer centers are exempt from B&O tax to the extent the amounts received are exempt from federal income tax. The purchase and use of medical supplies, chemicals, or specialized materials by a comprehensive cancer center is exempt from sales and use tax. A comprehensive cancer center is defined as one that is recognized by the National Cancer Institute and qualifies as an exempt organization under the federal income tax code.

Aerospace Industry Incentives. The B&O credit allowed for certain property taxes paid by manufacturers of commercial airplanes and airplane components is modified. Property taxes paid with respect to newly acquired or constructed real property are eligible only if the building is used exclusively in the manufacturing of airplanes or airplane components. Property taxes paid with respect to newly acquired machinery and equipment are eligible to the extent that the manufacturer conducts aerospace manufacturing activity relative to other manufacturing activity.

Amphitheaters. An exemption from the leasehold excise tax is provided for leasehold interests in certain public or entertainment areas of an amphitheater. To qualify for the exemption, the following conditions must be met:

1. the lessee is responsible for the entire cost of constructing the amphitheater;
2. the lessee is not reimbursed for any of the construction costs;
3. both the lessee and the lessor sponsor events at the facility on a regular basis;
4. the lessee is responsible under the lease agreement to operate and maintain the facility;
5. the amphitheater has a seating capacity of over 17,000 persons; and
6. the amphitheater is located in a county with a population of between 350,000 and 400,000 persons.

Historic Automobile Museum. Beginning July 1, 2007, a deferral of sales and use taxes is allowed on the construction of structures, fixtures that become part of the structures, and site preparation for a historic automobile museum. The museum must be nonprofit-run facility used to exhibit a collection of at least 500 vehicles. To receive the deferral, the governing board of the organization must apply to the Department of Revenue (DOR). Applications and other information received by the DOR may be disclosed to the public.

Taxes must be repaid beginning in the fifth year after the museum is operationally complete. Ten percent of the tax liability is due each year then for 10 years. If the DOR finds the project to be ineligible during the deferral period or if the project is not operational after five years from when the deferral was issued, deferred taxes must be repaid with interest.

Nursing Home Quality Maintenance Fee. The quality maintenance fee is reduced to \$5.25 for the 2005-07 biennium, \$3.00 for the 2007-09 biennium and \$1.50 for the 2009-11 biennium. After July 1, 2011, the fee is no longer imposed.

Washington Main Street Program. The Washington Main Street Program is created in the Department of Community, Trade, and Economic Development (DCTED), which will provide technical assistance to communities undertaking a comprehensive downtown or neighborhood commercial district revitalization initiative and management strategy. Financial assistance may be provided to communities for certain program costs. The DCTED will develop the criteria for selecting the recipients of assistance and will provide the designation of local projects. Priority for technical and financial assistance shall be given to downtown or neighborhood revitalization programs located in a rural county. The DCTED may not provide assistance to cities with population 190,000 or more.

The DCTED will operate the program in consultation with the advisory committee. In consultation with the committee, the DCTED must develop a plan that must describe the objectives and strategies of the Washington Main Street Program.

The program is funded through a new B&O tax credit. The B&O tax credit is available for 75 percent of the amount donated directly to a local program or 50 percent of the contribution amount to the Main Street Trust Fund. In order to receive a credit, an application must be submitted to the DOR, which may not approve credits before January 1, 2006. Total credits cannot exceed \$100,000 per calendar year for an individual program or \$250,000 per calendar year for a business, and may only be claimed against tax due in the calendar year following approval. The total amount of credits per year statewide is capped at \$1.5 million per calendar year. Credit may not be approved for cities with population of 190,000 or more.

High Technology Research and Development B&O Tax Credit. For the purposes of calculating the high technology B&O tax credit for R&D spending, the average tax rate is defined to be based on a business' total annual taxable amount, including both taxable income and the value of the products manufactured. The changes to the high tech R&D B&O credit are retroactive to June 10, 2004. Persons who owe additional tax as a result of the changes are liable for interest, and, with respect to taxes paid after 2005, penalties.

Beginning in calendar year 2007, a person claiming the high tech R&D credit may calculate the credit based on the firm's average tax rate or a specified percentage, whichever is higher. The specified percentage is 0.75 percent in calendar year 2007; 1 percent in 2008; and 1.25 percent in 2009, and 1.5 percent in 2010 and thereafter.

A business claiming the high tech R&D credit must submit the survey for the high tech B&O tax credit electronically, unless cumulative tax relief to the taxpayer from taking any of tax incentives requiring surveys or reports is \$1,000 or less. A business that fails to submit a survey as a result of circumstances beyond the control of the taxpayer may receive an extension to file of up to 30 days from the date that the Department of Revenue (Department) notifies the taxpayer of such extension.

In situations in which the amount of credit reported by a business on the survey is different than the amount reported by the business on its tax return or otherwise allowed by the Department, the Department is allowed to report the tax return amount for public disclosure purposes.

Cigarette Tax. The cigarette tax rate is increased by 60 cents per pack of 20 cigarettes on July 1, 2005, to a total tax rate of \$2.025 per pack. A portion of the revenues from the new tax, representing existing losses in tax revenues reductions resulting from an expected reduction in overall taxable sales due to the expected increased price per pack, is deposited to existing accounts that receive cigarette tax receipts. The amounts deposited are as follows: 21.7 percent to the Health Services Account, 1.7 percent to the Water Quality Account, 2.3 percent to the Violence Prevention and Drug Enforcement Account, and 2.8 percent to the General Fund. The net receipts from the new tax are deposited to a new account, the Education Legacy Trust account, for the sole purposes of making deposits into the student achievement fund and for expanding access to higher education through funding for new enrollments and financial aid, and other educational improvement efforts.

Student Achievement Fund. The amount of state property taxes dedicated to the Student Achievement Fund is set at \$254 per FTE student for school years 2004-2005 through 2007-2008, \$265 per FTE student for school year 2008-2009, \$277 for school year 2009-2010, and \$278 per FTE student for school year 2010-2011 and thereafter.

Estate Tax. for the purposes of the proposed estate tax in SB 6096, farmers may deduct farm personal property if 50 percent of the estate value is farm real or personal property. Farmers whose estates are at least 50 percent farm real and personal property but less than 25 percent real property may deduct the value of the real property as long as the real property was used for a farming purpose and managed by a member of the family.

Appropriation: None.

Fiscal Note: Requested April 20, 2005.

Effective Date: The following provisions of the bill are subject to an emergency clause and are effective immediately: Sections 110(5) and 114 through 116, concerning the excise taxation of direct mail; sections 1001, 1003, 1004, 1310, and 1311 concerning the credit against B&O tax for R&D expenditures by high-technology businesses; and section 1201, concerning the proposed estate tax in SB 6096.

The following provisions of the bill take effect January 1, 2006: Sections 401 through 403, concerning cancer centers, Section 501, concerning a credit against B&O tax for property taxes paid by commercial airplane manufacturers or their suppliers; and Section 1002, concerning the provision that requires high-tech firms that claim credit against B&O tax for R&D expenditures to file all surveys electronically.

Section 701, concerning a deferral of sales and use taxes for the construction of a historic auto museum, takes effect July 1, 2007.

Section 1106, concerning a continuation of the law that allocates to certain accounts a proportionate share of interest earned by all funds in the treasury, takes effect July 1, 2006.

The remainder of the bill is subject to an emergency clause and takes effect July 1, 2005.

Testimony For: The Association of Washington Business supports the part of this proposal concerning incentives for research and development. We appreciate the recognition of the strength of this program, and particularly the proposal to boost the percent of R&D spending for which credit can be taken to 1.5 percent.

Testimony Against: If this is enacted, Washington will have the highest spirits tax in the nation. Currently, the state is at \$16.24 per gallon, which is second highest in the nation. The top five tax states are quite a bit higher than their peers - the national average is about \$9 per gallon. In the 2003 budget the spirits industry was the only industry taxed to balance the budget, with a promise that the \$0.42 markup agreed to for the budget would be eliminated once the economy stabilized. The economy has stabilized, but the \$0.42 is still being carried over. Each time there is a tax increase or markup pursuant to legislation growth is hindered in the industry. While recent growth has been very good, Washington still suffers relative to its lower-tax neighbors. The Distilled Spirits Council believes that there is significant loss in in-state economic activity in this industry due to cross-border sales, particularly with Idaho, where the tax rate is less than \$10 per gallon. Washington is already out of step with its peers. We believe you are doing something wrong. There are opportunities for growth and these should not be squandered.

For local spirits brokers, this measure will have a downward pressure on our product. This will put us at a relative disadvantage to the beer and wine industries. This should give Oregon a sizeable advantage. We believe that we are being singled out unfairly. This gives us a very tough competitive position.

The Association of Washington Business opposes the proposed liquor and cigarette tax increases. We are concerned about the additional burden on industries that are already very heavily taxed. We are concerned that this may dampen the economic recovery that is occurring. We are worried about the competitiveness in these industries, especially with respect to border sales and internet sales. To us, this is a paradox: this is being used both to discourage certain activities and yet raise revenue. It is not sustainable.

Altria on behalf of Philip Morris USA opposes the proposed amendment. Washington is already, and will be even more so, the highest cigarette tax state in the western part of the nation. Washington borders the lowest tax state in the west, Idaho. Because of the very high tax rate, this tax source is diminishing, unreliable, and increasingly unpredictable. We worked a few years ago willingly with the state Attorney General to draft legislation, which was enacted, to stem Internet and other contraband sales. The legislation from a few years ago has indeed had an effect and is estimated to gain the state several million dollars. This compares to \$240 million in lost revenue from Internet and other contraband sales as estimated by the Department of Revenue. This is not sustainable.

Persons Testifying: (With concerns) Tom McBride, Association of Washington Business.

(Opposed) Dave Ducharme and Bill Stauffacher, Distilled Spirits Council; and Joe Daniels, Altria, Phillip Morris United States of America.

Persons Signed In To Testify But Not Testifying: None.