

HOUSE BILL REPORT

EHB 3159

As Amended by the Senate

Title: An act relating to the excise taxation of food products.

Brief Description: Modifying the excise taxation of food products.

Sponsors: By Representatives Linville, Newhouse, Grant, Kessler, Orcutt, Chandler, Dunn and Kristiansen.

Brief History:

Committee Activity:

Finance: 1/31/06, 2/7/06 [DP].

Floor Activity:

Passed House: 2/11/06, 90-5.

Senate Amended.

Passed Senate: 3/7/06, 42-3.

Brief Summary of Engrossed Bill

- Extends the Business and Occupation tax exemption, sales and use tax deferral on manufacturing facilities, and warehouse tax remittance adopted for fruit and vegetable products in 2005 to seafood and dairy products.
- Ends the tax exemptions for fruit and vegetable, seafood and dairy product manufacturing, and warehousing on July 1, 2012.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass. Signed by 7 members: Representatives Orcutt, Ranking Minority Member; Roach, Assistant Ranking Minority Member; Ahern, Condotta, Ericks, Santos and Shabro.

Minority Report: Do not pass. Signed by 4 members: Representatives McIntire, Chair; Hunter, Vice Chair; Conway and Hasegawa.

Staff: Rick Peterson (786-7150).

Background:

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 B&O tax rate depends on the activities

conducted. The most common rates are 0.471 percent for retailing activities, 0.484 percent for wholesaling and manufacturing, and 1.5 percent for services. There is a lower rate of 0.138 percent for dairy product manufacturing and seafood product manufacturing where the seafood products remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing process.

In the 2005 session the Legislature adopted tax incentives for the fruit and vegetable manufacturing industry. A B&O tax exemption was provided for the canning, preserving, freezing, processing, or dehydrating fresh fruits and vegetables, and for selling at wholesale fresh fruits and vegetables canned, preserved, frozen, processed, or dehydrated by the seller and sold to purchasers who transport in the ordinary course of business the goods out of this state.

A new sales and use tax deferral program was created for fruit and vegetable product cold storage warehousing, and related research and development businesses. This program starts July 1, 2007 and expires July 1, 2012.

Firms using the B&O exemption and the sales tax deferral are required to complete an annual survey and provide information on the amount of B&O tax exempt, sales and use tax deferred, number of jobs and the percent of full-time, part-time and temporary jobs; wages by salary band; and number of jobs with employer provided health and retirement benefits. The survey is due each year by March 31.

In addition, starting July 1, 2007, fresh and/or frozen perishable fruit or vegetable cold storage warehouses of at least 25,000 square feet are added to the warehouse tax remittance program. The remittance is 100 percent of the state sales tax on construction of the warehouse and purchases of material-handling and racking equipment. The taxpayer must initially pay all applicable taxes and then apply for reimbursement to the Department of Revenue (Department).

One of the classifications under the B&O tax is for manufacturing activity. Persons are considered manufacturers if the person owns or has title to the item or product that is being manufactured. Persons are considered processors for hire if the person does not own the item or product that is being manufactured but rather performs the manufacturing activity on behalf of the owner. Manufacturing and processing for hire are treated similarly in many instances under state tax law.

Persons who engage in manufacturing or processing for hire are eligible for several tax preferences under the B&O and retail sales and use taxes. Sales to these persons of property that becomes part of the manufactured item are considered sales for resale, since the final manufactured product is presumed to be produced for sale, and so are not subject to retail sales and use tax. In addition, packaging materials that are sold to these persons are also considered sales for resale and so retail sales and use taxes do not apply. In 1995, manufacturers and processors for hire were provided an exemption from retail sales and use taxes on the purchase or acquisition of machinery and equipment (M&E) that is used directly

in the manufacturing or processing process. The exemption is also available to persons who perform testing on products for others who are manufacturers or processors for hire.

An important distinction in the taxability of manufacturers and processors for hire is the tax base treatment under the B&O tax. Manufacturing activity is taxed based on the value of the product manufactured, whereas the processing for hire activity is based on the gross receipts of the person conducting the activity. In addition, if the owner of the product that is being processed by a processor for hire maintains a physical presence in the state, the owner is subject to the B&O tax on the value of the finished product, but if the owner has no physical presence, no tax is owed.

Several firms are located in Washington that store, inspect, test, and label canned salmon that was canned outside of Washington. These firms store in warehouses the canned salmon, owned by the out-of-state salmon-canning companies. When receiving appropriate instructions from the owner, the labeler will select a particular batch and inspect, weigh, and vacuum test the cans. The labeler will then label all cans that have passed inspection and package the cans in boxes to be shipped to customers of the salmon-canning companies.

In September 2005, the Department issued an Excise Tax Advisory (ETA) concerning firms that store, inspect, test, and label canned salmon owned by others. The ETA provides that the activity of inspecting, testing, and labeling of canned salmon falls under the general service classification of the B&O tax and so is subject to a 1.5 percent rate; the storage of the cans is subject to the warehousing rate of 0.484 percent. Before the issuance of the ETA, at least two taxpayers had been reporting the activities other than warehousing under the processing for hire classification at a 0.484 percent rate. The ETA also clarified that the firms conducting the testing activities were eligible for the M&E exemption from sales and use taxes on machinery and equipment used directly to inspect and test the cans. Finally, the ETA provided that retail sales and use taxes were due on sales of labels and packaging materials to the labelers.

Summary of Engrossed Bill:

Tax exemptions adopted for fruit and vegetable product manufacturing and cold storage warehousing in 2005 are extended to seafood and dairy manufacturing and cold storage warehousing of seafood and dairy products.

The B&O tax exemption is extended to seafood product and dairy product manufacturing. The exemption applies only to seafood products which remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing process. This exemption also applies to the selling of product to purchasers who transport the goods out of this state. These new exemptions plus the fresh fruits and vegetables exemption are ended July 1, 2012 and a tax rate of 0.138 percent is established for these activities.

The sales and use tax deferral program for fruit and vegetable processing, cold storage warehousing, and related research and development businesses is expanded to include seafood and dairy product manufacturing.

Firms using the B&O exemption and the sales tax deferral are required to complete an annual survey and provide information on the amount of B&O tax exempt, sales and use tax deferred, number of jobs and the percent of full-time, part-time and temporary jobs; wages by salary band; and number of jobs with employer provided health and retirement benefits. The survey is due each year by March 31.

The Department may extend the March 31 filing deadline for surveys by firms using the B&O exemption and the sales tax deferral if the failure to file is the result of circumstances beyond the control of the taxpayer. These firms must electronically file their forms with the Department.

Cold storage warehouses of at least 25,000 square feet that are used to store dairy and seafood products are added to the warehouse tax remittance program. The remittance is 100 percent of the state sales tax on construction of the warehouse and purchases of material-handling and racking equipment. The warehouse sales tax remittance program for cold storage warehouses used to store fruit or vegetables, dairy products, and seafood products is ended on July 1, 2012.

Firms who inspect, test, label, and store canned salmon owned by others are subject to B&O tax at a 0.484 percent rate. These firms are also exempt from paying retail sales and use taxes on materials used to label canned salmon and on materials used to package canned salmon.

EFFECT OF SENATE AMENDMENT(S):

The Senate amendment makes technical amendments related to the definition of manufacturing fresh fruits and vegetables.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect on July 1, 2006, except sections 6 through 9 and 11, related to the sales and use tax deferral program, and the warehouse sales tax remittance, which takes effect July 1, 2007; and sections 12 and 13, which reinstates prior law related to the warehouse sales tax remittance program after a scheduled expiration, which takes effect July 1, 2012.

Testimony For: The dairy industry is asking only for a tax exemption on the products that are exported. This exemption will make Washington products more competitive in out-of-state markets. These markets are very competitive. California, Utah, Oregon, and Idaho all provide tax benefits not available in Washington. Washington producers must discount prices to compete in the midwest markets. Utility costs, especially natural gas, have risen rapidly in recent years. The dairy industry faces a lot of challenges. The exemptions will provide a great incentive to the fish processors in Washington.

Testimony Against: None.

Persons Testifying: Sharon Appelt, Northwest Dairy Association and Darigold; Dan Coyne, Northwest Dairy Association; and Jim Zimmerman, Washington Fish Growers Association.

Persons Signed In To Testify But Not Testifying: None.