HOUSE BILL REPORT
ESB 6635

As Passed House:
April 11, 2012

Title: An act relating to improving revenue and budget sustainability by repealing, modifying, or revising tax preference and license fees.

Brief Description: Improving revenue and budget sustainability by repealing, modifying, or revising tax preference and license fees.

Sponsors: Senators Murray and Kline.

Brief History:
Committee Activity:
None.
Second Special Session
Floor Activity:
Passed House: 4/11/12, 74-24.

Brief Summary of Engrossed Bill

- Excludes financial businesses located in more than 10 states from taking the business and occupation (B&O) tax deduction for amounts received from interest earnings on loans secured by first mortgages on residential properties.
- Extends the B&O tax exemptions for manufacturing and sales activities related to fruits or vegetables, dairy, and seafood products to July 1, 2015.
- Exempts craft distilleries from the liquor license issuance fee of 17 percent of spirits sales.
- Exempts from the leasehold excise the preferential use of certain port district property.
- Applies a uniform B&O tax rate to the advertising revenue of printed newspapers, the Internet version of printed newspapers, and newspaper supplements.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

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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. Revenues are deposited in the State General Fund. A business may have more than one B&O tax rate, depending on the types of activities conducted. There are a number of different rates. The main rates are: 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.8 percent for professional and personal services, interest earned on loans by financial institutions, and activities not classified elsewhere.

Citizen Commission for Performance Measurement of Tax Preferences. Legislation enacted in 2006 requires a periodic review of most excise and property tax preferences to determine if their continued existence or modification serves the public interest. The enabling legislation assigns specific roles in the review process to two different entities. The job of scheduling tax preferences, holding public hearings, and commenting on the reviews is assigned to the Citizen Commission for Performance Measurement of Tax Preferences (Commission). The responsibility for conducting the reviews is assigned to the staff of the Joint Legislative Audit and Review Committee (JLARC). The Commission develops a schedule to accomplish a review by the JLARC of each tax preference at least once every 10 years.

Business and Occupation Tax Deduction for First Mortgage Interest. A B&O tax deduction is available to financial institutions for interest earnings on loans secured by first mortgages or deeds of trust on residential properties. An originating lender that sells mortgage loans onto the secondary market, but continues to service the loans, may deduct the fees for servicing these loans.

Business and Occupation Tax Exemption for Manufacturers of Certain Agricultural Products. Business and occupation tax exemptions are provided for manufacturing of fruits or vegetables, dairy, and seafood. These exemptions expire July 1, 2012. These manufacturers will be subject to a preferential B&O tax rate of 0.138 percent.

Sales and Use Tax Exemption for Eligible Server Equipment. In 2010 Engrossed Substitute Senate Bill 6789 provided a sales and use tax exemption for server equipment and power infrastructure for computer data centers. The exemption expires on April 1, 2018. In order to qualify, a data center must be located in a rural county, have at least 20,000 square feet dedicated to housing servers, and have commenced construction between April 1, 2010, and before July 1, 2011.

Additionally, within six years of construction, a qualifying business must have created 35 family wage employment positions or three family wage jobs per 20,000 square feet of space. Construction of a data center includes the expansion, renovation, or other improvements made to existing facilities, including leased or rented space.

The exemption applies to the original server equipment installed after April 1, 2010, and replacement server equipment which replaces servers originally exempt from tax and installed prior to April 1, 2018.

Craft Distillers. Craft distillers may sell spirits of its own production directly to consumers for off-premises consumption, provided that the sale occurs when the customer is physically present on the licensed premises. A craft distiller may sell no more than two liters per customer per day. Initiative 1183, adopted in November 2011, phases out the state owned retail and wholesale liquor distribution system and creates a new system of private sector wholesalers and retailers. Initiative 1183 establishes new fees for wholesalers and retailers. The fee for retail sellers is 17 percent of gross spirits sales.

Leasehold Excise Tax. Government-owned property is exempt from property tax. However, private lessees of that property may be subject to a leasehold excise tax (LET), levied at 12.84 percent of the rent. Historically, pursuant to a 1979 determination by the Washington State Department of Revenue (DOR), port districts have not been required to collect the LET from port tenants leasing wharf facilities on a non-exclusive, preferential use basis. Recently, the DOR determined that preferential use leases provided substantial possession, use, and control of the property to these tenants. Thus, the DOR concluded that these types of leasehold interests were subject to LET, since they provided substantial control of the property.

Business and Occupation Taxation of Newspapers. The printing and publishing of newspapers is subject to the B&O tax at a rate of 0.2904 percent. (The Legislature, in 2009, lowered the tax rate from 0.484 percent to 0.2904 percent, effective July 1, 2009.) The tax applies to the gross receipts from subscription sales, newsstand sales, advertising income, and other income. In recent years newspapers have begun to post materials from their hard copy editions to the Internet. Until July 1, 2008, income derived from this activity did not constitute printing or publishing. Thus, advertising income received by newspapers for their website-based materials was subject to B&O tax under the service classification at a rate of 1.5 percent and not the preferential rate available for physical newspapers.

In 2008 the Legislature extended the 0.2904 percent printing and publishing newspaper tax rate to include newspaper-labeled supplements and the Internet-based versions of printed newspapers. However, the reduced tax rate was only applicable for a three-year period, from July 1, 2008, until June 30, 2011.

Summary of Bill:

A financial business that is located in more than 10 states may not deduct from B&O tax amounts received from interest earnings on loans secured by first mortgages or deeds of trust on residential properties. The JLARC is directed to review the first mortgage deduction by June 30, 2015, as part of its tax preference review process.

The B&O tax exemptions for manufacturing of fruits or vegetables, dairy, and seafood products are extended to July 1, 2015, and are then replaced by a preferential B&O tax rate of 0.138 percent.

Craft distilleries are exempted from the license issuance fee of 17 percent of all spirits sales revenues under such a license.

Leasehold interests subject to LET do not include the preferential use of publicly-owned cargo cranes and docks and associated areas used in loading and discharging of cargo at a port district marine facility. Preferential use means use by a private party under a written agreement with the public owner in which the public owner or a third party maintains a right to use the property when it is not being used by the private party.

The advertising and other revenue from the online versions of printed newspapers and newspaper supplements is taxed at the same rate as the traditional printed newspaper. The B&O tax rate for printing or publishing a newspaper is increased from 0.2904 percent to 0.365 percent until June 30, 2013, and 0.35 percent until July 1, 2015. After July 1, 2015, the revenue from the Internet version of a printed newspaper and newspaper supplements returns to the B&O rate for service and other activity (1.5 percent rate) and the revenue from the printed newspaper returns to the 0.2904 percent rate.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill contains an emergency clause and takes effect on July 1, 2012, except for Part III, related to data centers, and Part IV, related to craft distillers, which contain an emergency clause and take effect immediately.