SENATE BILL REPORT
SB 5838

As of February 24, 2011

Title: An act relating to making changes to laws administered by the department of revenue that do not create any new or, except for the deduction in RCW 82.04.4297, broaden any existing tax preference as defined in RCW 43.136.021 or increase any person's tax burden

Brief Description: Making changes to laws administered by the department of revenue that do not create any new or, except for the deduction in RCW 82.04.4297, broaden any existing tax preference as defined in RCW 43.136.021 or increase any person's tax burden.

Sponsors: Senators Hargrove and Murray; by request of Department of Revenue and Department of Social and Health Services.

Brief History:
Committee Activity: Ways & Means: 2/23/11.

SENATE COMMITTEE ON WAYS & MEANS

Staff: Dianne Criswell (786-7433)

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, and activities not classified elsewhere until June 30, 2013 (at which time the 0.3 percent rate surcharge expires and the B&O rate for service and other category is 1.5 percent thereafter).

Nexus. Nexus is the level of connection with a state necessary under the U.S. Commerce Clause to permit a state to impose a tax or collection duty on out-of-state businesses doing business in the state.

In 2010 the Legislature enacted Engrossed Substitute Senate Bill 6143, specifying that for service-type activities, a business will have substantial nexus in Washington if it has a certain threshold amount of property, employees, or income in the state. The 2010 changes also

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provide that a business with substantial nexus in the current year is deemed to have substantial nexus the following year. This is referred to as trailing nexus.

Sales and Use Taxes. Retail sales and use taxes are imposed by the state, most cities, and all counties. Retail sales taxes are imposed on retail sales of most articles of tangible personal property, digital products, and some services. The use tax applies to the acquisition of tangible personal property, digital products, and some services that were not subject to sales tax. Generally, a person or business acquiring property in another state is responsible for the payment of Washington use tax when the property is brought into the state. However, under certain circumstances, an out-of-state seller may be required to collect and remit use tax to Washington even if the property is transferred to the buyer outside the state. This requirement would apply only where the seller has some connection to the state.

B&O Deduction for Health and Social Welfare. A deduction from B&O tax is allowed for nonprofit organizations or local government entities for amounts from federal, state, or local governments for the support of health or social welfare services. Examples of services include mental health, drug, or alcoholism counseling or treatment; family counseling; health care services; services for the care of the sick, aged, or physically, developmentally, or emotionally-disabled individuals; the prevention of juvenile delinquency or child abuse; care of orphans or foster children; daycare of children; and employment development, training, and placement. The legislative intent of the deduction is to provide government with greater purchasing power when the government provides financial support for the provision of health or social welfare services.

The Department of Social and Health Services (DSHS) contracts with multiple private providers for the purchase of various child welfare services, including: voluntary and in-home services, out-of-home care, case management, and adoption services. These services are intended to (1) resolve problems which may result in families in conflict, or neglect, abuse, exploitation, or criminal behavior of children; (2) care for dependent, abused, or neglected children; (3) assist parents and children in conflict; and (4) promote the welfare of children by strengthening their own homes or providing, where needed, adequate care of children away from their homes.

In 2009 the Legislature enacted Second Substitute House Bill 2106, which, among other things, requires DSHS to consolidate and convert its existing child welfare services to performance based contacts. DSHS has chosen a lead-agency model to address the legislative directive to reduce the number of contracts. DSHS currently has approximately 1600 separate contracts for services. Under the lead-agency model services may be provided directly by the lead agency or through subcontracts and agreements with service providers.

Tax Incentive Reporting Requirements. The Citizen Commission for Performance Measurement of Tax Preferences (Commission) was established by the 2006 Legislature (Engrossed House Bill 1069). The Commission develops a schedule to review nearly all tax preferences at least once every ten years. The Commission also schedules preferences with expiration dates for reviews two years before the tax preference expires. Tax preference reviews are conducted by the Joint Legislative Audit and Review Committee (JLARC) according to the schedule established by the Commission. For each tax preference, JLARC

provides recommendations to continue, modify, schedule for future review, or terminate the preference. The Commission reviews and comments on the JLARC report.

In 2005 the Legislature created a Cost-Recovery Incentive Payment Program to promote renewable energy systems that produce electricity from solar, wind, or anaerobic digesters. The Department of Revenue (DOR) must measure the impacts of the program and provide a report to the Legislature by December of 2014. JLARC is also scheduled to review the tax incentive in 2013.

Businesses claiming tax incentives are required to provide data on annual accountability reports or surveys filed with DOR. In general, accountability reports and surveys require information about employment and economic activities related to the tax incentives. In prior years, it was common to create an entirely new accountability report or survey statute for each new tax incentive even though the requirements of each new annual report or survey largely duplicated existing report or survey statutes. In 2010 Substitute House Bill 3066 repealed most of these duplicative tax incentive annual report and survey statutes and replaced them with a uniform annual survey and a uniform annual report. However, duplicative annual report and survey statutes were also amended in other bills that passed during 2010.

Tax Studies and Reports. Beginning in January 1984, the DOR was required to submit to the Legislature a study on tax exemptions, detailing the revenue lost or taxes shifted as a result of tax preferences. In 1999 the frequency of the study was changed from every even-numbered year to every four years. The most recent study was published in January 2008, and the next study is due in January of 2012.

Summary of Bill: The trailing nexus statute is clarified by specifying that a person who has a substantial nexus with this state in any tax year is deemed to have a substantial nexus with the state for the following tax year.

Two redundant annual tax incentive accountability report and survey statutes are repealed.

For purposes of collecting use taxes, it is explicitly clarified that a seller has no obligation to collect use tax if Washington is prohibited under the U.S. Constitution or federal law from requiring the person to collect use tax.

A deduction from B&O tax is provided to nonprofit health or social welfare organizations for amounts received as compensation for providing child welfare services provided under a government funded program, including amounts received for performance contract management.

The due date for the next tax exemption study is moved from January 2012 to January 2014.

Appropriation: None.

Fiscal Note: Requested on February 20, 2011.

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days, except for sections 4 and 5 of the act which take effect on August 1, 2011.

Staff Summary of Public Testimony: PRO: This bill will help Childrens and DSHS to better facilitate the implementation of performance contracting. Private non-profits do not currently pay B&O on services because they contract directly with the state.

We would like the same treatment after performance contracting. We would like an amendment to allow for deduction for-profit pass through amounts. Without this amendment, there will be fewer candidates in the request-for-proposal process. The amendment is also necessary because, without provision for the for-profits, there will be increased overhead for the for-profit lead agencies and fewer resources for subcontractors and clients. There should be similar treatment of for-profits and nonprofits and could lead to a competitive advantage for the nonprofits. Sections 1 through 3 of the bill reduce ambiguity, reduce administration, and reduce costs in ways that do not impact taxpayers. Section 6 allows the suspension of the exemption study, which will help DOR achieve its required budget savings.

Persons Testifying: PRO: John Hill, Maple Star Washington; Mary Fischer; Institute for Family Development; Laurie Lippold, Childrens' Home Society; Drew Shirk, DOR; Rich Pannkuk, DSHS.