

SENATE BILL REPORT

SB 6176

As of February 9, 2012

Title: An act relating to improving the business climate in this state by simplifying state and local tax and licensing systems.

Brief Description: Improving the business climate in this state by simplifying state and local tax and licensing systems.

Sponsors: Senators Kilmer, Hobbs, Rolfes, Shin and Zarelli; by request of Governor Gregoire.

Brief History:

Committee Activity: Ways & Means: 2/07/12.

Brief Summary of Bill

- A new harmonized model ordinance for city business and occupation (B&O) taxes is established. Cities imposing a B&O tax must adopt either the existing Association of Washington Cities (AWC) model ordinance or the new harmonized model ordinance. The harmonized model ordinance is adopted in rule by the Department of Revenue (DOR), in consultation with an Advisory Committee. Cities that adopt the harmonized B&O tax must comply with all provisions of the model ordinance. Further, cities that adopt the harmonized B&O tax must agree in their local ordinances to follow and apply any official public guidance and interpretation issued by DOR.
- DOR may offer priority to cities in compliance with the harmonized city B&O tax over other cities in the state licensing system administered by DOR under chapter 19.02 RCW; technical advice and data requests for city B&O tax matters; the provision of audit, enforcement, and tax discovery assistance for city B&O taxes; taxpayer assistance in the form of information, education, and instruction concerning a city's B&O tax; and assistance related to the city's B&O tax as DOR deems appropriate.
- The harmonized city B&O tax requires that a city may not impose a B&O tax on a person unless that person has a nexus with the city. The harmonized city B&O provides credits to avoid multiple taxation. Further, any city that imposes a harmonized B&O tax must provide for the apportionment and allocation of gross income.

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.

- The state B&O tax code is amended by replacing reduced B&O tax rates with deductions and consolidating B&O tax classifications.

SENATE COMMITTEE ON WAYS & MEANS

Staff: Dianne Criswell (786-7433)

Background: State 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. 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. In addition to these general B&O tax rates and classifications, there are reduced rates and separate classifications for these preferential rates. In total, there are 51 different state B&O tax classifications.

Local B&O Taxes. In 2003 the Legislature enacted Engrossed House Bill 2030 (EHB 2030), which provided for a more uniform system of municipal B&O taxes. It directed the Association of Washington Cities (AWC) to adopt a model ordinance to serve as a foundation for municipal ordinances that impose a B&O tax on gross receipts. Thirty-nine cities impose their own B&O taxes, with variations in rates, exemptions, deductions, and thresholds.

The AWC model ordinance includes a system of credits that prevent multiple taxation of the same income; a gross receipts threshold for small businesses; tax reporting frequency requirements; provisions for penalties and interest; claim and refund provisions; and certain terms with definitions from the state B&O statutes or based on comparable definitions within the state B&O statutes. Cities may continue to adopt their own provisions for tax exemptions, credits, deductions, and other preferences, as well as tax classifications and tax rates. With respect to any nonmandatory provisions of the model ordinance, cities that deviate must make a description of the deviations available.

The AWC model ordinance included a de minimus business activity threshold, allowing a city B&O tax for a business that has earned gross receipts in excess of \$20,000 in the jurisdiction.

To avoid multiple taxation, the AWC model ordinance includes credits for:

- retail or wholesale taxes due on sales of products for any manufacturing or extracting taxes paid on the same products;
- manufacturing taxes on the value of products for any extracting taxes paid, or manufacturing taxes previously paid on the same products; and
- retail or wholesale taxes due on the sales of publications for any printing or publishing taxes paid on the same publications.

There must be a nexus between a business and a city in order for a city to impose a municipal B&O tax on the business activity. Nexus is defined as business activities that are sufficient to subject the business to the taxing jurisdiction of the city under interstate commerce standards.

Gross income that is subject to a municipal B&O tax is allocated and apportioned. Apportionment refers to a method of dividing the tax base among the various jurisdictions in which the taxpayer engages in business, using a formula in which the division of a business' income between jurisdictions is based on one or more factors relating to sales income, property value, and payroll amounts. Thus, the effect of such apportionment is that a jurisdiction may impose a tax only on a portion of the total income earned by a business that is attributed to the jurisdiction. Allocation refers to the assignment of income to a single jurisdiction. For activities other than services or income from royalties, income is allocated based on the location of the activity. In the case of a wholesale or retail sale, the location is based on the location of delivery to the buyer. If the location occurs in more than one jurisdiction, credit must be allowed for taxes paid on the same activity, or, in the case where not all the affected cities impose gross receipts taxes, an allocation system must be allowed. For income from royalties, income is allocated to the commercial domicile of the taxpayer. For income from services, income is apportioned to a city by multiplying total taxable income by the average of a payroll factor associated with a city and a service-income factor associated with a city. The payroll factor is equal to the ratio of the compensation paid in a city to the total compensation paid everywhere. The service income factor is equal to the ratio of all service income of the taxpayer in a city to total service income of the taxpayer everywhere.

Summary of Bill: The bill as referred to committee not considered.

Summary of Bill (Proposed Substitute): Part I: The Legislature intends to pursue a long-term vision of simplifying tax reporting to include both state and local governments. Therefore, the Legislature intends to begin the tax simplification process by reducing the number of state B&O tax classifications and encouraging greater uniformity and harmony between city B&O taxes and the state B&O tax.

Definitions for the harmonized city B&O tax are provided, many terms having the same meaning as given in chapter 82.04 RCW (state B&O tax).

The provisions of the harmonized city B&O chapter do not apply to other local taxes, such as tax on light and power businesses or natural gas distribution businesses, as defined in RCW 82.16.010; telephone businesses; cable television services; sewer or water services; drainage services; solid waste services; or steam services.

The Department of Revenue (DOR) must convene an Advisory Committee comprising the following members: the Director of DOR, or the director's designee, serving as the nonvoting chair of the committee; at least three city representatives, one each representing a large, medium, and small city without a business and occupation tax; at least three business representatives, one each representing a large, medium, and small business operating in a city or cities with a B&O tax; up to three additional members chosen by DOR; and one representative from a city representing imposing a B&O tax complying with the existing AWC model ordinance, serving as a nonvoting member of the committee.

DOR must consult the Advisory Committee on the following:

- the adoption or amendment of the harmonized city B&O tax under this act;
- the adoption of rules or interpretive guidance as authorized under this chapter;
- developing potential legislation that would affect city B&O taxes;
- addressing areas of potential conflict and inconsistency between the harmonized B&O and the AWC model ordinance; and
- other issues relating to the city B&O tax as determined by DOR or the advisory committee.

By December 1, 2012, DOR must adopt by rule a model ordinance for city B&O taxes after considering the recommendations of the Advisory Committee. DOR may amend the model ordinance by rule. In adopting rules, DOR must seek to improve uniformity and harmonize to the greatest extent with the state B&O tax and city B&O taxes while recognizing the need for local flexibility.

In order to improve uniformity and harmony between state and city B&O taxes, the model ordinance may contain provisions for the imposition of a city's B&O tax on business activities that have historically been taxed under a city's utility tax, such as cable television service and telecommunications service, to the extent that such activities are subject to state B&O tax. A city may tax business activities under both its B&O tax and utility tax. However, a city is free to exempt an activity from either or both taxes, if such activity would otherwise be subject to both taxes.

Cities that adopt the harmonized B&O tax must comply with all provisions of the model ordinance. Further, cities that adopt the harmonized B&O tax must agree in their local ordinances to follow and apply any official public guidance and interpretation issued by DOR.

A city that adopts the harmonized B&O tax must adopt the necessary local ordinances to comply with the model ordinance and notify DOR, becoming effective on the first day of the first calendar quarter following notification.

DOR may offer priority to cities which it determines are in compliance with the harmonized city B&O tax over other cities in:

- incorporating the city's business licenses into the master licensing system administered by DOR under chapter 19.02 RCW;
- providing technical advice and data requests for city B&O tax matters;
- providing audit, enforcement, and tax discovery assistance for city B&O taxes;
- offering taxpayer assistance in the form of information, education, and instruction concerning a city's business and occupation tax; and
- providing other assistance related to the city's business and occupation tax as DOR deems appropriate.

The harmonized city B&O tax may not include any classifications that are not used for state B&O tax purposes. However, DOR may combine classifications used for state B&O tax purposes to reduce the number of classifications in the harmonized business and occupation tax.

The harmonized city B&O tax is tax information that is confidential, privileged, and only subject to disclosure in the manner provided by the RCW 82.32.330 (authorized disclosures and waivers under the Secrecy Clause).

A city may not impose a B&O tax unless it has adopted and is in compliance with either the existing AWC model ordinance or the harmonized city B&O tax and imposed the tax after January 1, 2012.

The harmonized city B&O tax must provide that a city may not impose a B&O tax on a person unless that person has a nexus with the city. For the purposes of this section, the term nexus must be consistent with the nexus provisions in the AWC model ordinance.

Persons who engage in business activities that are within the purview of more than one harmonized city B&O classification are taxable under each classification. However, if the tax places an undue burden upon interstate commerce or violates constitutional requirements, a credit is allowed only to the extent necessary to preserve the validity of the tax. The following specific credits are allowed:

- persons taxable under the retailing or wholesaling classification for sales within a city are allowed a credit for any eligible gross receipts taxes the person paid for manufacturing in the city, extracting in the city, or the ingredients used in the products sold in the city;
- persons taxable under the manufacturing classification for manufacturing activity within in a city are allowed a credit for any eligible gross receipts tax the person paid for extracting the ingredients of the products manufactured in the city and with respect to manufacturing the products other than in the city; and
- persons taxable under the retailing or wholesaling classification for sales within a city are allowed a credit against those taxes for any eligible gross receipts taxes paid by the person with respect to the printing, or the printing and publishing, of the products sold within the city.

The harmonized city B&O tax must allow a deduction identical to the deduction in RCW 82.04.540(2). That deduction from the state B&O tax is provided for a professional employer organization (PEO) for the cost of wages, salaries, benefits, and other payments made to covered employees who are coemployed by PEO and a client of PEO.

A city that imposes a harmonized B&O tax must provide for the allocation and apportionment of gross income. If the location occurs in more than one jurisdiction, credit must be allowed for taxes paid on the same activity, or, in the case where not all the affected cities impose gross receipts taxes, an allocation system must be allowed. For activities other than services or income from royalties, income is allocated based on the location of the activity. In the case of a wholesale or retail sale or a download of a digital product, the location is based on the location of delivery to the buyer. The activities of printing and publishing must be apportioned to the principal place in this state from which the taxpayer's business is directed or managed. For income from royalties, income is allocated to the commercial domicile of the taxpayer. For income from services, income is apportioned to a city by multiplying total taxable income by the average of a payroll factor associated with a city and a service-income factor associated with a city. The payroll factor is equal to the ratio

of the compensation paid in a city to the total compensation paid everywhere. The service income factor is equal to the ratio of all service income of the taxpayer in a city to total service income of the taxpayer everywhere.

Part II: State B&O tax classifications and rates are consolidated to reduce complexity for taxpayers, decrease disputes between taxpayers and DOR, and to achieve uniformity between state and local B&O tax systems. The following changes are made to the state B&O tax code:

- reduced B&O tax rates are replaced with deductions;
- the manufacturing and processing for hire classifications are consolidated;
- the extracting and extracting for hire classifications are consolidated;
- public road construction and government contracting classifications are consolidated into the wholesaling classification; and
- public and nonprofit hospital and real estate broker classifications are consolidated into the catch-all service and other business activities classification.

These changes to the state B&O tax code are not intended to materially affect the tax burden of any person, except for the following:

- retail sales of interstate transportation equipment and services will be subject to B&O tax under the general retailing classification, resulting in a tax rate reduction from 0.484 percent to 0.471 percent; and
- low-level waste disposal will be subject to B&O tax under the service and other business activities classification, resulting in a tax rate reduction from 3.3 percent to 1.8 percent through June 30, 2013, and 1.5 percent beginning July 1, 2013.

Appropriation: None.

Fiscal Note: Available.

[OFM requested ten-year cost projection pursuant to I-960.]

Committee/Commission/Task Force Created: None.

Effective Date: This act takes effect July 1, 2013, except for sections 1 and 101 through 112, which take effect July 1, 2012.

Staff Summary of Public Testimony: PRO: We believed that we were heading in the right direction with this proposed substitute. This is a voluntary, harmonized local B&O system that is more consistent with the state. The proposed substitute requires a public process, involving city and business input. Cities are provided the option to use either the AWC model ordinance or the new harmonized ordinance. The cities currently imposing the B&O under the existing AWC model ordinance are not required to make any change. We would work to avoid conflicts between these systems. We are open to working with the cities. This is a compromise that needs to move forward. Small businesses need simplification: one tax system, one form, one audit, one interpretation, one appeal process. The language in the proposed substitute is not perfect; however, the bill should move forward to provide solutions for businesses, locals, and the state. Local B&O tax simplification is one of the top recommendations of our members. Small businesses are asking for this, which will help them create jobs and spur the economy. Although the cities have expressed concerns, this proposal should continue to move forward. The bill as introduced also provided licensing

streamlining. We are frustrated that there are few constructive solutions from the cities. Let's turn can'ts into more reasons why it can work. To achieve simplification, we don't just need technology solutions, we need consistency. Between different taxing and licensing systems, we have a paperwork nightmare. We need a centralized solution to simplify compliance. Keep in mind that the objective should be to have an effective system.

CON: This proposed substitute does not achieve the objective to simplify the B&O tax system in Washington. It makes the system more complex, because there will be two local B&O systems, in addition to the state's system. This could lead to more confusion. It will require the expenditure of resources, on the state and local level, at a difficult time. In the bill as introduced, Seattle had concerns about the fiscal impact; we estimate an annual loss of \$23 million to \$42 million per year from reduced local B&O revenues. Some of the largest cities imposing this tax are working on a portal to simplify payment; this could provide simplification and could help other local jurisdictions to collect their tax. In the proposed substitute, many of the aspects of the bill as introduced that caused us the greatest concerns have been eliminated. Though we have come closer together, we have not reached a solution. This takes away local control. Cities imposing this tax have tailored it to the activities and needs of the jurisdiction. Westport imposes a city B&O on fish processing; this activity is exempt from the state B&O. Technology should be used to simplify the reporting and payment of local B&O taxes. We support tax simplification for small business; the proposed substitute does not provide this. In Bellevue, 82 percent of our local businesses do not meet the minimum threshold to pay our B&O tax. A second model ordinance does not improve consistency. Any proposal should be revenue neutral. If there is an Advisory Committee process, we would like to have a stronger voice. For the cities currently imposing the B&O tax, we appreciate that we are not required to comply with a different model ordinance in the proposed substitute; however, we are concerned this could be an avenue to require it in the future. Locals have stepped up to provide government services that have devolved to them. Reduction of local resources could lead to additional layoffs or cuts.

OTHER: We have concerns over collapsing classifications and rates.

Persons Testifying: PRO: Julie Murray, Office of Financial Management; Amber Carter, Assn. of WA Business; Erin Shannon, WA Policy Center; Patrick Conner, National Federation of Independent Businesses; Carolyn Logue, WA Food Industry Assn.; Gary Smith, Independent Business Assn.

CON: Richard Conlin, city of Seattle council member; Randy Lewis, Westport City Administrator; Lucy Liu, Tax Manager, city of Bellevue; Victoria Lincoln, Assn. of WA Cities; Adrienne Thompson, Professional & Technical Employees 17.

OTHER: Brad Tower, Schnitzer Steel.