

FINAL BILL REPORT

ESB 6635

C 6 L 12 E 2

Synopsis as Enacted

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

Sponsors: Senators Murray and Kline.

Senate Committee on Ways & Means

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 JLARC of each tax preference at least once every ten years.

B&O 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.

B&O Tax Exemption for Manufacturers of Certain Agricultural Products. B&O tax exemptions are provided for manufacturing of fruits or vegetables, dairy, and seafood. These

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.

exemptions expire July 1, 2012, and are replaced by a preferential B&O tax rate of 0.138 percent.

Sales and Use Tax Exemption for Eligible Server Equipment. In 2010 ESSB 6789 provided a sales and use tax exemption for eligible server equipment and power infrastructure for eligible 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.

Commencement of construction means the date that a building permit is issued under the building code for construction of a computer data center. Construction of a data center includes the expansion, renovation, or other improvements made to existing facilities, including leased or rented space.

Eligible server equipment is the original server equipment installed in an eligible data center after April 1, 2010, and replacement server equipment which replaces servers originally exempt under this law and is installed prior to April 1, 2018.

B&O 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 of the business, including 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 web-based materials was subject to B&O tax under the service classification at a rate of 1.5 percent – currently the rate is 1.8 percent until July 1, 2013.

In 2008 the Legislature amended the definition of newspaper for B&O tax purposes to include any newspaper-labeled supplement and the Internet-based version of printed newspapers. As a result, income from publishing newspaper supplements and advertising income related to Internet-based newspaper material is subject to the 0.2904 percent printing and publishing newspaper tax rate, instead of the 1.8 percent service rate. However, the reduced tax rate was only applicable for a three-year period, from July 1, 2008, until June 30, 2011.

Sales Tax Exemption for Certain Phone Services. Under current law, an exemption from retail sales tax is allowed for local calls made by residential telephone customers, calls made from coin-operated payphones, and calls made from cell phones by a customer whose primary place of use is outside the state.

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 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, DOR determined that preferential use leases provided substantial possession, use, and control of the property to these tenants. Thus, DOR concluded that these types of leasehold interests were subject to LET, since they provided substantial control of the property.

Summary: A financial business that is located in more than ten 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 are extended to July 1, 2015, and are then replaced by a preferential B&O tax rate of 0.138 percent.

The time is extended for eligible data centers and qualifying tenants of data centers to qualify for the sales and use tax exemption on server equipment and power infrastructure to those that commenced construction between April 1, 2012, and July 1, 2015. The exemption time is extended for eligible replacement server equipment placed in new data centers and for qualifying tenants until April 1, 2020.

Exempts craft distilleries 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 definition of a newspaper is amended to include the Internet version of printed newspapers and newspaper supplements. The effect of this is to tax advertising revenue from the online versions of newspapers and newspaper supplements at the same rate as the traditional newspaper. The B&O tax rate for printing and publishing a newspaper, or both, is increased from 0.2904 percent to 0.365 percent until June 30, 2013, and 0.35 percent until July 1, 2015.

Votes on Final Passage:

Second Special Session

| | | |
|--------|----|----|
| Senate | 35 | 10 |
| House | 74 | 24 |

Effective: May 2, 2012 (Part III, data centers, and Part IV, craft distilleries)
July 1, 2012