
Business & Financial Services Committee

HB 1751

Brief Description: Providing for equal tax treatment of investment securities for in-state and out-of-state banks.

Sponsors: Representatives Springer, Chandler, Ryu, Harris, Reykdal, Orcutt and Santos.

Brief Summary of Bill

- Modifies the apportionment formula for calculation of a financial institution's business and occupation taxes by treating investment securities as loans.

Hearing Date: 2/13/13

Staff: Alexa Silver (786-7190).

Background:

Business and Occupation Taxes.

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 tax is imposed on the gross receipts from all business activities conducted within the state. Revenues are deposited in the State General Fund. There are several rate categories, and a business may be subject to more than one B&O tax rate, depending on the types of activities conducted.

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 a sales tax collection duty on out-of-state businesses doing business in the state. A state tax is constitutional under the U.S. Commerce Clause if it is assessed against a taxpayer with whom the state has a substantial nexus, is fairly apportioned, is nondiscriminatory, and is fairly related to the services provided by the state.

Apportionment.

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.

Generally, a business performing service-taxable activities inside and outside the state must apportion to Washington the gross income derived from Washington activities as determined by a separate accounting method. However, if a separate accounting is impractical or inaccurate, Washington law provides an apportionment formula based on the cost of doing business in Washington versus the cost of doing business everywhere.

The Multistate Tax Commission (MTC) develops uniform rules for apportionment. By statute, the Department of Revenue (DOR) is directed to establish an apportionment formula for financial institutions that is consistent with the MTC rules, except the rule must provide for a single factor apportionment method based on the receipts factor, and the definition of "financial institution" in the MTC rule is advisory only.

The DOR rule provides that the receipts factor is a fraction, the numerator of which is the apportionable income of the taxpayer in Washington and the denominator of which is the apportionable income of the taxpayer inside and outside Washington. The amount of the financial institution's income subject to Washington's B&O tax is determined by multiplying the receipts factor by the institution's total apportionable income.

The DOR rule specifies how to treat for apportionment purposes interest from loans, as well as receipts from investment and trading assets and activities. For loans not secured by real property, apportionable income includes interest from the loans if the borrower is located in Washington. For receipts from investment and trading assets and activities, the amount of income attributable to Washington is determined by multiplying the income by a fraction, the numerator of which is the average value of the assets properly assigned to the regular place of business of the institution within Washington and the denominator of which is the average value of all such assets. The receipts from investment assets and activities are assigned outside Washington if the financial institution can show that day-to-day decisions regarding the asset or activity occurred outside Washington.

"Loan" is defined in the rule as an extension of credit resulting from direct negotiations between the financial institution and its customer or the purchase of such extension of credit from another. "Loan" does not include securities, futures, options, swaps, federal funds sold, interests in a mortgage-backed or asset-backed securities, and other similar items. "Financial institution" is defined to include: state-chartered banks, trust companies, savings banks, and savings and loan associations; national banks, federal savings banks, and federal savings associations; out-of-state state-chartered banks or thrifts; and any credit union, other than a state or federal credit union exempt under state or federal law.

Summary of Bill:

The Legislature finds that:

- financial services are delivered electronically by institutions headquartered outside of Washington;
- the Legislature has adopted a principal for taxation of financial institutions that relies on the borrower's location to determine whether interest payments are subject to excise tax; and

- for financial institutions, interest income should be treated consistent with this principle, regardless of the nature of the instrument through which the interest payments are secured.

The Legislature intends to provide a stable tax base that does not encourage Washington-based taxpayers to move their treasury function and the associated jobs outside Washington to benefit from a lower tax liability on interest income.

For the Department of Revenue's apportionment formula for financial institutions, the definition of "loan" in the Multistate Tax Commission's recommended formula must also include investment securities that are permissible for financial institutions and that are issued by the person obligated to pay the principal and interest on the securities.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.