

# SENATE BILL REPORT

## SB 5041

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As of February 15, 2013

**Title:** An act relating to implementing recommendations related to the tax preference review process conducted by the joint legislative audit and review committee and the citizen commission for performance measurement of tax preferences.

**Brief Description:** Implementing recommendations related to the tax preference review process conducted by the joint legislative audit and review committee and the citizen commission for performance measurement of tax preferences.

**Sponsors:** Senators Hasegawa and Conway.

**Brief History:**

**Committee Activity:** Ways & Means: 2/14/13.

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### SENATE COMMITTEE ON WAYS & MEANS

**Staff:** Juliana Roe (786-7438)

**Background:** Part I. Ocean marine and foreign trade insurance contracts are exempt from paying a portion of their insurance premium taxes.

Persons who conduct horse racing events that are licensed by the State Horse Racing Commission are exempt from the business and occupation (B&O) tax, limited to the income received for conducting race meets or pari-mutuel wagering.

Auction sales of farming machinery and equipment owned by a farmer and conducted on a farm is exempt from the retail sales tax.

Part II. The gross income received from advertising by radio and television broadcasting is subject to the B&O tax. State law allows two deductions from gross income received from advertising by radio and television broadcasting. One deduction is based on income earned for network, national, and regional advertising and may either be deducted using a computed standard deduction reported annually by the Federal Communications Commission, or by itemizing actual network, national, and regional advertising income received by the individual broadcasting station.

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*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.*

Part III. All real and personal property of non-profit nursing homes and hospitals is exempt from property taxes. The property must be used exclusively for the purposes of the nursing homes and hospitals, and the benefits of the exemption must be retained by the non-profit organization or entity.

Part IV. A B&O tax exemption applies to wholesale income earned by farmers who sell their product at wholesale, grow agricultural products owned by others, or raise and sell poultry products and eggs.

Part V. The public utility tax is a state tax on the act or privilege of engaging within this state in any one or more specified utility or public service businesses. The base of the tax is the gross income derived from the operation of public and privately owned utilities, including the general categories of transportation, and the supply of energy and water. Income from utility or public service operations is taxed under the public utility tax in lieu of the B&O tax. A standard public utility tax rate is charged for motor transportation services.

Generally, wholly instate trips are fully subject to the public utility tax. This applies to the transportation of goods by truck, rail, and certain water transportation. The transportation of commodities from a point in Washington that goes directly to an instate port, dock, wharf, export elevator, or shipside for direct shipment by vessel outside of the state is exempt from the public utility tax.

Interstate carriers are also exempt from the public utility tax on the instate portion of their transportation activities. This applies to the instate portion of interstate transportation of goods and passengers by truck, rail, and some water transportation. The through freight portion of an interstate shipment of goods where the carrier authorizes the shipper to stop the shipment in Washington to store, manufacture, or process the goods, then continues to transport the same goods or their equivalent, in the same or converted form, to the final destination, noted under a through freight rate is also exempt.

Part VI. Certain membership dues and fees may be deducted from the B&O tax if the organization or club provides a social benefit to its members. The entity claiming the deduction must distinguish between the amounts paid for its bona fide dues and fees from the taxable amounts paid for goods and services. Under federal law, certain nonprofit social clubs are exempt from federal income tax.

Part VII. Income from utility or public service operations is taxed under the public utility tax in lieu of the B&O tax. Utilities may deduct the income derived from the distribution of irrigation water from their public utility tax. The distribution of water must be through an irrigation system for irrigation purposes.

Part VIII. A 2 percent premiums tax is imposed on insurance companies. Fraternal benefit societies that provide insurance to their members are not subject to this tax. A fraternal benefit society is an organization that functions solely for the benefit of its members and their beneficiaries, is not-for-profit, operates on a lodge system with a ritualistic form of work, has a representative form of government, and provides benefits.

Part IX. All real and personal airport property 500 acres or less in size, exclusively owned by a municipality, and in an adjoining state is exempt from property tax.

Nonprofit kidney dialysis facilities, nonprofit hospice agencies, nursing homes, and homes for unwed mothers, operated as religious or charitable organizations, are entitled to an exemption from the B&O tax for income derived from the sales of prescription drugs furnished as an integral part of services provided to patients.

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

**Summary of Bill (Proposed Substitute):** Part I. The exemption for ocean marine and foreign trade insurance contracts is repealed.

The B&O tax exemption is repealed for those who conduct horse racing events that are licensed by the State Horse Racing Commission. Amounts derived from pari-mutuel wagering remain exempt.

Sellers making tax-exempt sales at farm auction sales must submit an annual summary to the Department of Revenue (DOR) of all goods sold at a qualifying sale.

Part II. DOR must publish by rule a standard deduction that excludes network, national, and regional advertising. In order to determine the standard deduction, DOR must study radio and television broadcasting, that excludes network, national, and regional advertising, computed as a ratio of the network, national, and regional advertising revenue to the total advertising revenue of the radio or television station expressed as a percentage. The study must be completed by August 1, 2013, and repeated every fifth year thereafter by September 30. The standard deduction must be published in rule by December 1, 2013.

Part III. Non-profit homes for the sick or infirm and non-profit hospitals for the sick that claim property tax exemptions must file with DOR a community benefit report for the preceding year no later than June 30 of each year. Community benefits include, but are not limited to the following: community health improvement services; health professions education; subsidized health services; research; financial and in-kind contributions; community-building activities; community benefit operations; and charity care, including unreimbursed costs of indigent government-sponsored programs and Medicaid shortfall. Nonprofit hospitals for the sick must file a copy of the federal income tax form 990 Schedule H with DOR. Non-profit homes for the sick or infirm must file a report on community benefits, including charity care on a standardized form developed by DOR that provides data similar to that required in the federal income tax form 990 Schedule H. Reports must be filed electronically to DOR by June 30, 2014, for benefits provided during 2013, and by June 30 of each subsequent year thereafter.

Part IV. A B&O tax exemption for amounts up to \$500,000 is provided for wholesale income earned by agricultural producers who sell their product at wholesale, or to farmers who grow, raise, or produce agricultural products owned by others. Amounts greater than \$500,000 are not exempt. Farmers who raise poultry products and eggs are provided an exemption for amounts up to \$500,000. Amounts greater than \$500,000 are not exempt.

Part V. DOR, the Office of Financial Management, and other necessary agencies must conduct an economic impact study of the effects of imposing the public utility tax on the in-state portion of the currently exempt transportation activities. The report is due to the fiscal committees of the Legislature by December 1, 2013.

Part VI. Membership dues and initiation fees paid to nonprofit organizations may be deducted from the B&O tax if they are exempt from the federal income tax.

Part VII. Utilities may deduct the income they derive from the distribution of irrigation water from their public utility tax if the water is distributed for the purpose of producing agricultural products for sale.

Part VIII. Fraternal benefit societies that are organized as nonprofit organizations, corporations, or associations and serve low-income communities are exempt from the 2 percent premiums tax imposed on insurance companies as well as all other taxes other than those on real estate and office equipment.

Part IX. The property tax exemption is repealed for airport property owned by a municipality in an adjoining state.

The B&O tax exemption is repealed for those who receive compensation for patient services or attendant sales of drugs dispensed pursuant to prescription by certain nonprofit organizations.

**Appropriation:** None.

**Fiscal Note:** Available.

**Committee/Commission/Task Force Created:** No.

**Effective Date:** The bill contains several effective dates. Please refer to the bill.

**Staff Summary of Public Testimony:** PRO: The Legislature created two commissions, the Joint Legislative Audit and Review Committee (JLARC) and the Citizen Commission for Performance Measurement of Tax Preferences. The Legislature should pay attention to the recommendations of these two commissions but have so far ignored their recommendations. To go through this whole exercise of reviewing preferences and doing nothing is fruitless. These commissions are worthless if they are to be continually ignored. The Legislature should rethink how it looks at preferences. No group, agency, or individual wants to see their preferences taken away. However, you have to remember that tax exemptions are tax expenditures for the state. It amounts to money that would otherwise be available to the people and schools. The state should look toward a comprehensive reform of the tax system.

Hospitals and hospital-like services changed in 1993 when the taxation of hospitals changed. Hospitals were taxed under a different schema than kidney dialysis centers. The Legislature should look at organizations of like services and see how they were taxed in order to understand the public policy in play when it applied the tax to one group and not the other.

CON: This bill is several years old. At the time it was created, not all information was available publicly. Currently, all not-for-profit hospitals must file various tax forms with the DOR. What these hospitals already do is what this bill is requiring them to do. Therefore, this provision is unnecessary. The due date of the report should be changed. The penalty for untimely report filing is extreme. Untimely filing will lead to revocation of the exemption. This penalty does not match the crime.

The B&O tax on wholesale agricultural products would eliminate the commercial cattle feeding business in Washington. Those who have 3500 head of cattle would have a \$25,000 tax liability. They are already losing \$100 per head of cattle. This would dig a deeper hole. For many this could mean as much as \$300,000 in taxes. The tax would impact every aspect of agriculture. It will cost jobs and be the death nail to agriculture in this state.

Approximately one in five people have found it difficult to pay for food in the past year. Taxing wholesale agriculture is a tax on food. We already face many challenges in agriculture. It is bad policy to tax food. It is not good for food security in our state, nation, or world.

Recently, the IRS reexamined what it recognized as nonprofits. Now, over 100,000 nonprofits are fighting to get back their exemptions at the federal level. Most of our granges do public service, but it may not rise to the level of serving low-income communities as is required in the bill.

**Persons Testifying:** PRO: Senator Hasegawa, prime sponsor; John Woolley, JLARC; Steve Zemke, citizen.

CON: Holli Johnsons, WA State Grange; Dan Wood, WA State Dairy Federation; Jack Field, WA Cattlemen's Assn.; Lisa Thatcher, WA State Hospital Assn.