Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Finance Committee

HB 2150

Brief Description: Reforming the business and occupation tax to provide fairness and administrative simplicity.

Sponsors: Representatives MacEwen, Smith, Walsh, Vick, Tharinger, Reykdal and Buys.

Brief Summary of Bill

- Reforming Washington's Business and Occupation Tax by allowing businesses to deduct major costs of doing business and adjusting tax rates to maintain revenue neutrality.

Hearing Date: 3/13/15

Staff: Jeffrey Mitchell (786-7139).

Background:

Washington's 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. Businesses must pay B&O tax even though they may not have any profits or may be operating at a loss. Major tax rates are 0.484 percent for manufacturing and wholesaling, 0.471 percent for retailing, and 1.5 percent for services. Several lower rates also apply to specific business activities. Altogether, there are 10 different tax rates. The four principal tax rate classifications account for approximately 98 percent of total B&O tax liability.

Businesses are taxable according to the activities in which they engage and may be subject to more than one tax rate, depending upon the source of their income. Further, firms are taxed according to their final level of activity in Washington. Thus, a firm that manufactures a product and sells it at wholesale within the state is taxed as a wholesaler, not a manufacturer.

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.

(Technically, such firms report on both the manufacturing and wholesaling tax lines but take a multiple activities tax credit for the manufacturing activity.)

Texas Margins Tax.
In 2008, Texas replaced its business tax that was essentially imposed on net worth with a tax imposed on gross margins. This excise tax is referred to as the "Texas Margins Tax." The Margins Tax is a hybrid between a tax on gross receipts and a tax on corporate net income. Generally, the tax base is the taxable entity's margin, which equals the lesser of:
- total revenue minus cost of goods sold;
- total revenue minus compensation;
- 70 percent of total revenue; or
- total revenue minus $1 million.

Cost of goods sold generally includes costs related to the acquisition and production of tangible personal property and real property. There are other cost of goods sold allowances for certain industries. Taxable entities that only sell services will not generally have a cost of goods sold deduction.

Currently, the tax rate is 0.4875 percent for entities primarily engaged in retail or wholesale trade and 0.975 percent for most other entities.

Apportionment.
Income derived from service activities and royalties is apportioned to Washington based on a single-factor receipts formula that generally looks to the location of where the customer received the benefit of the service. The receipts factor is a fraction of which the numerator is the total gross income of the business attributable to Washington for the activity, and the denominator is the worldwide gross income of the business for the activity. The total worldwide gross income from the activity is multiplied by the receipts factor to determine the amount of income apportioned to Washington for purposes of the B&O tax.

Income from the sales of goods is apportioned to Washington if the the sale occurs in Washington. A sale occurs in Washington if the buyer takes possession of the property in Washington.

Summary of Bill:

Washington's B&O Tax is modified to incorporate a number of components of the Texas Margins Tax.

With a couple of exceptions, taxpayers are subject to one of two tax rates. A 1.6 percent rate is provided for taxpayers primarily engaged in manufacturing, wholesaling, or retailing. A 3.75 percent rate applies to most other taxpayers, which includes businesses primarily engaged in service-related activities. There are several exceptions to these two primary tax rates. First, banking-related activities, which would normally be subject to the 3.75 percent rate, are subject to the 1.6 percent tax rate. Second, businesses in the telecommunications industry are subject to a tax rate of 1.2 percent. Most existing B&O tax rates are repealed and folded into one of the aforementioned tax rates.

Taxpayers, except aerospace businesses, would be eligible to claim the most beneficial option of several new deduction choices:

- cost of goods sold (service industries would not be eligible for this deduction since they typically do not have cost of goods sold);
- compensation;
- 30 percent of total revenue; or
- $500,000 (annualized amount). For taxpayers paying on a monthly basis, it would be $41,667 per month.

The taxation of the aerospace industry is not changed. In other words, gross receipts derived from the manufacturing or sale of commercial airplanes or components of airplanes would be taxed as provided under current law.

"Compensation" is defined as wages and benefits; however, it is capped at $200,000 per year per employee. Benefits includes contributions by an employer to employee health savings accounts, health care insurance, and retirement contributions.

"Cost of goods sold" is defined as all direct costs of extracting, manufacturing, or acquiring tangible person property that are reportable as cost of goods sold on the federal income tax return.

Cost of goods sold and compensation are apportioned to Washington in a manner similar to the apportionment of revenues. This would largely follow single-factor apportionment based on receipts for services. For the sale of goods, apportionment would be determined by the amount of sales transacted in Washington as a percentage of the firm's total.

Appropriation: None.

Fiscal Note: Requested on March 10, 2015.

Effective Date: The bill takes effect January 1, 2016.