
Finance Committee

HB 2940

Brief Description: Making the business and occupation tax more progressive.

Sponsors: Representatives Lytton, Chapman, Frame, Tarleton, Tharinger, Ormsby, Pollet and Macri.

Brief Summary of Bill

- Increases the business and occupation (B&O) tax filing threshold to \$125,000, beginning January 1, 2020.
- Implements a B&O credit and B&O surcharge based on the calculation of a taxpayer's "margin", beginning January 1, 2020.
- Repeals the small business tax credit, effective January 1, 2020.
- Creates the Task Force on Business and Occupation Tax Fairness.

Hearing Date: 1/30/18

Staff: Tracey O'Brien (786-7152).

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. Businesses must pay the B&O tax even though they may not have any profits or may be operating at a loss.

A taxpayer may have more than one B&O tax rate, depending on the types of activities conducted. Major B&O tax rates are 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent for services and for activities not classified elsewhere. Several preferential rates also apply to specific business activities.

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.

In addition, a taxpayer may be eligible to utilize other tax preferences, including credits and deductions, to reduce their tax liability. For example, a taxpayer engaging in activities subject to different B&O tax rates may be eligible for a Multiple Activities Tax Credit. A taxpayer may also be eligible for a small business credit that will either eliminate or reduce their B&O tax liability. In general, the credit is \$70 per month for service businesses and \$35 per month for all other businesses, multiplied by the number of months in the reporting period. The amount of the credit available phases out based on the business's gross receipts.

A business does not have to file an annual B&O tax return if the business does not owe other taxes or fees to the Department of Revenue (DOR) and has annual gross proceeds of sales, gross income, or value of products for all B&O tax classifications of less than \$28,000 per year, or less than \$46,667 if at least 50 percent of its taxable income is from services or activities not classified elsewhere.

Summary of Bill:

Beginning January 1, 2020, the filing threshold for B&O taxes is raised to \$125,000 for all businesses, and each taxpayer must calculate their margin in order to determine their eligibility for a B&O credit or a surcharge:

- If a taxpayer's margin is less than \$250,000, the taxpayer is eligible for a credit equal to the B&O tax otherwise owed.
- If a taxpayer's margin is \$1,000,000 or more, a surcharge of 6 percent is imposed.
- If the taxpayer's margin is equal to or greater than \$250,000, but less than \$1,000,000, no credit is allowed and no surcharge is imposed.

"Margin" for a current tax year is calculated by deducting the taxpayer's cost of goods sold and cost of labor, accrued for the immediately preceding tax year, from the greater of the taxpayer's total gross income of the business, or value of products manufactured or extracted, for that same tax year.

By October 1, 2019, the DOR must adopt rules necessary to implement the margin calculations. This includes definitions for "cost of goods sold", "cost of labor", and "new business." In addition, the rules adopted must include a method of allocating and apportioning cost of goods sold and cost of labor. The rules must also include provisions to deny taxpayers the benefits of a credit if they engage in arrangements or transactions in an attempt to unfairly avoid B&O taxes. Rulemaking to implement the margin calculation, credit, and surcharge portions of the act is exempt from significant legislative rulemaking requirements under the Administrative Procedures Act.

The surcharge of 6 percent is applied to the amount of B&O tax otherwise due if a taxpayer's margin is at least \$1,000,000. Prior to implementation, the DOR may adjust the amount of the surcharge if the DOR determines the estimated collections of B&O tax will fall below or exceed projections by at least 1 percent during the first 18 months of implementation. Within the first 12 months of the surcharge being imposed, the DOR may adjust the surcharge by emergency rule if the DOR determines the estimated collections of the B&O tax will fall below or exceed projections by at least 1 percent during the first 18 months of implementation. The latest published fiscal note on this act will serve as the projection for the calculations.

Any adjustments to the amount of the surcharge must not exceed the amount needed to achieve revenue neutrality from January 1, 2020, to June 30, 2021, and must be carried to the fourth decimal point. A surcharge change is prospective only and must take effect on the first day of the calendar quarter that is at least 60 days following the publishing of the adjusted surcharge. In addition, any surcharge adjustment must also be approved by the director of the Office of Financial Management.

If a new taxpayer files quarterly or monthly and believes they will qualify for a B&O credit, they may claim the credit on each of the returns for the initial taxable year. However, if during the initial year the taxpayer reports a gross taxable amount of at least \$250,000, the taxpayer may no longer continue to claim the credit and must correct prior tax returns to eliminate the credit election.

Effective January 1, 2020, the small business tax credit is repealed.

The Taskforce on Business and Occupation Tax Fairness (Task Force) is created. The Task Force is composed of the following 12 members:

- one representative from the Governor's Office;
- one representative from the Department of Revenue;
- one representative from the Department of Commerce;
- one representative from each of the two largest caucuses of the Senate, appointed by the President of the Senate;
- one representative from each of the two largest caucuses of the House of Representatives, appointed by the Speaker of the House of Representatives; and
- five members to be appointed by the Governor, taking into consideration representation from large businesses, small and independent businesses, advocates for economic security and social opportunity, and persons with expertise in Washington state tax law and policy.

The Task Force chair will be selected by the members from among its membership. The DOR will provide staff support. The Task Force must review existing B&O tax preferences to determine whether they are still necessary following the enactment of this act. Decisions will be made by a simple majority. A report is due to the appropriate legislative fiscal committees by January 1, 2022. The report may include recommendations for the elimination of any B&O tax preferences, options for improving the fairness of the B&O tax, options for replacing the B&O tax, and recommendations for future legislative oversight of the DOR's implementation of this act. A minority report is allowed if the Task Force does not reach complete agreement on the report contents.

This act is exempt from the tax preference performance requirements and the automatic 10-year expiration.

The act is named the "Small Business Tax Fairness Act".

Appropriation: None.

Fiscal Note: Available.

Effective Date: This bill takes effect 90 days after adjournment of the session in which the bill is passed, except for sections 2, 4, 6, and 7, which take effect January 1, 2020.