

FINAL BILL REPORT

SHB 1403

C 101 L 19
Synopsis as Enacted

Brief Description: Simplifying the administration of municipal business and occupation tax apportionment.

Sponsors: House Committee on Finance (originally sponsored by Representatives Frame, Orcutt and Stokesbary).

House Committee on Finance
Senate Committee on Ways & Means

Background:

Local Business and Occupation Tax.

Washington cities are permitted to levy local business and occupation (B&O) taxes. Local B&O taxes are levied at a percentage rate on the gross receipts of a business, less some deductions. Businesses are put in different classes based on their business activity such as manufacturing, wholesaling, retailing, and services. Within each class the rate must be the same, but it may differ among classes. The maximum local B&O tax rate is 0.2 percent, unless the rate was effective prior to January 1, 1982 (grandfathered rate), or the city receives voter approval to exceed the 0.2 percent limit. The highest grandfathered or voted rate is 0.5 percent. Forty-nine of Washington's 281 cities levy local B&O taxes.

To avoid levying multiple local B&O taxes on the same income, businesses are directed to divide, or apportion, their taxable income between the taxing jurisdictions where they engage in business. By apportioning income, businesses divide their taxes among the various taxing jurisdictions in which they conduct business. Cities are required to apportion service income for B&O tax purposes using a two-factor formula based on the average of a service income factor and a payroll factor. The taxable service income for any given jurisdiction is the total service income generated by the taxpayer everywhere multiplied by the sum of the payroll factor plus the service-income factor, divided by two. The payroll factor is the total compensation the taxpayer paid in the city, divided by the total compensation the taxpayer paid everywhere. The service factor is the total service income the taxpayer generated in the city, divided by the total service income the taxpayer generated everywhere.

Local Business and Operation Model Ordinance Committee (2003).

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 2003 the Association of Washington Cities (AWC) was required to convene a committee to develop a model ordinance that would be adopted by all cities imposing B&O tax no later than December 31, 2004. The model ordinance was required to contain certain provisions, including a system of credits that prevent multiple taxation of the same income. Beginning January 1, 2008, cities that levied a B&O tax were required to allow for allocation and apportionment of taxes between cities.

Local Tax and Licensing Simplification Task Force (2015).

The Department of Revenue (Department) led a Local Tax and Licensing Simplification Task Force (Simplification Task Force) during the 2016 interim to evaluate and develop options to improve the local business licensing process and local B&O tax collection. Among their specific tasks was to examine allocation and apportionment methods and how they affect taxpayers and cities. In 2017 the Simplification Task Force prepared and presented a report to the Legislature with their findings and recommendations, including a recommendation to appoint a separate working group dedicated to exploring options for simplifying the local apportionment formula.

Local Business and Operation Tax Apportionment Task Force (2017).

The Local Business and Occupation Tax Apportionment Task Force (Apportionment Task Force) was established in 2017. Cities, towns, and identified business organizations were directed to partner in recommending changes to simplify the two-factor municipal B&O tax apportionment formula.

The Apportionment Task Force consisted of:

- three voting representatives selected by the AWC who are tax managers representing municipalities that impose a local B&O tax, including at least one jurisdiction that has performed an audit where apportionment errors were discovered;
- three voting representatives selected by the Association of Washington Business (AWB), including at least one tax practitioner or legal counsel with experience representing business clients during municipal audits that involved apportionment errors or disputes; and
- one nonvoting representative from the Department.

The Apportionment Task Force was permitted to seek input or collaborate with other parties, as it deemed necessary. The Department was required to serve as the Apportionment Task Force chair and provide staff support.

The Apportionment Task Force was required to recommend modifications to apportionment methods that rely on information typically available in commercial transaction receipts and captured by common business recordkeeping systems. The Apportionment Task Force convened 14 work sessions between August 2017 and September 2018.

The Apportionment Task Force presented the following final recommendations to the Legislature in October 2018:

- simplify the service income factor by adopting a sourcing hierarchy;
- allow income that is attributable to a jurisdiction in which the taxpayer would not be subject to tax to be excluded from the apportionment calculation; and

- establish a consistent burden of proof for taxpayers and tax administrators seeking application of an alternative apportionment method when the statutory method does not fairly represent the extent of the taxpayer's business activity in the city.

Summary:

The service-income factor is modified. Service-income is redefined to be attributable to the customer location. Customer location is defined as:

1. For a customer not engaged in business and if the service requires the customer:
 - a. to be physically present, where the service is performed;
 - b. not to be physically present:
 - i. the customer's residence; or
 - ii. if the customer's residence is not known, the customer's billing/ mailing address.
2. For a customer engaged in business:
 - a. where the services are ordered from;
 - b. if the location from which the services are ordered is not known, the customer's billing/ mailing address; or
 - c. at the customer's commercial domicile if none of the above is known.

Gross income of a business engaging in an apportionable activity is excluded from the denominator of the service-income factor if at least some of the activity is performed in the city, and the gross income is attributable to a jurisdiction in which the taxpayer is not taxable.

A taxpayer petitioning for, or an tax administrator requiring, the use of an alternative allocation and apportionment method must prove that the:

- allocation and apportionment provisions do not fairly represent the extent of the taxpayer's business activity in the city; and
- alternative to such provision is reasonable.

Votes on Final Passage:

House	96	0
Senate	47	0

Effective: January 1, 2020