

# HOUSE BILL REPORT

## ESB 6016

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**As Passed House - Amended:**  
April 27, 2019

**Title:** An act relating to the taxation of international investment management companies.

**Brief Description:** Concerning the taxation of international investment management companies.

**Sponsors:** Senators Liias, Rolfes and Hunt.

**Brief History:**

**Committee Activity:**

Finance: 4/27/19 [DPA].

**Floor Activity:**

Passed House - Amended: 4/27/19, 76-22.

**Brief Summary of Engrossed Bill  
(As Amended by House)**

- Reauthorizes and expands the sales and use tax exemption for the purchase of standard financial information by qualifying investment management companies and their affiliates.
- Modifies the qualifications for the international investment management services business and occupation preferential tax rate.

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### HOUSE COMMITTEE ON FINANCE

**Majority Report:** Do pass as amended. Signed by 8 members: Representatives Tarleton, Chair; Walen, Vice Chair; Chapman, Morris, Orwall, Springer, Vick and Wylie.

**Minority Report:** Without recommendation. Signed by 4 members: Representatives Orcutt, Ranking Minority Member; Young, Assistant Ranking Minority Member; Frame and Macri.

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

**Background:**

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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.*

### Retail Sales and Use Tax.

Retail sales taxes are imposed on retail sales of most articles of tangible personal property, digital products, and some services. A retail sale is a sale to the final consumer or end user of the property, digital product, or service. If retail sales taxes were not collected when the user acquired the property, digital products, or services, then use tax applies to the value of property, digital product, or service when used in this state. The state, all counties, and all cities levy retail sales and use taxes. The state sales and use tax rate is 6.5 percent; local sales and use tax rates vary from 0.5 percent to 3.9 percent, depending on the location.

### 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.

### Tax Preferences.

State law provides for a range of tax preferences that confer reduced tax liability upon a designated class of taxpayer. Tax preferences include: tax exclusions, deductions, exemptions, preferential tax rates, deferrals, and credits. Currently, Washington has over 650 tax preferences, including a variety of sales and use tax exemptions. Legislation that establishes or expands a tax preference must include a tax preference performance statement that identifies the public policy objective of the preference, as well as specific metrics that the Joint Legislative Audit and Review Committee (JLARC) can use to evaluate the effectiveness of the preference. All new tax preferences automatically expire after 10 years unless an alternative expiration date is provided.

### Standard Financial Information Tax Preference.

In 2013 the Legislature enacted a retail sales and use tax exemption for the sale of standard financial information to qualifying international investment management companies. "Standard financial information" (SFI) is defined as financial data, facts or information, or financial information services, that is developed for more than one customer. Standard financial information includes, but is not limited to, financial market data, bond ratings, credit ratings, and deposit, loan, or mortgage reports. A "qualifying international investment management company" (QIIMC) is defined as a person who is primarily engaged in the business of providing investment management services, with at least 10 percent of the gross income derived from such services to persons or collective investment funds outside of the United States, or collective investment funds with at least 10 percent of their investments positioned outside of the United States. The amount of deductible purchases is limited to \$15 million per year.

The standard financial information may be provided in hard copy, in a storage medium, or as a digital product transferred electronically. To receive the tax exemption, the seller must obtain an exemption certificate from the buyer or maintain relevant data of sales as

authorized by the Streamlined Sales and Use Tax Agreement. This tax exemption expires July 1, 2021.

In 2017 the JLARC reviewed this tax exemption. The Legislative Auditor recommended that the Legislature clarify what is meant by "reasonably conform" and require taxpayers to determine the preference's fiscal impact.

#### Preferential Tax Rate for International Investment Management Services.

Businesses conducting international investment management services (IIMS) are provided a preferential B&O tax rate of 0.275 percent. Without this tax preference, such businesses would be taxed at the general services rate of 1.5 percent.

#### **Summary of Amended Bill:**

The preferential tax rate for qualifying IIMS is narrowed and applies only to businesses that have more than 25 percent of its employees in the state and are a member of an affiliated group that collectively has:

- 10 or more offices located in at least eight foreign countries;
- at least 500 full-time employees worldwide;
- worldwide gross revenue of more than \$400 million during the entire current or immediately preceding calendar year; and
- average assets of more than \$200 billion during the entire current or immediately preceding calendar year.

If a qualifying IIMS business no longer meets the Washington employment eligibility requirements, then a claw back provision is triggered. The claw back amount is equal to the entire economic benefit accruing to the taxpayer as the result of the preferential rate for the current calendar year and the immediately prior nine consecutive calendar years, or the consecutive calendar years since the effective date of this act, whichever is less, and becomes immediately due and payable.

The retail sales and use tax exemption for the sale of standard financial information to a QIIMC is extended until July 1, 2031. In addition, the tax exemption is expanded to include the sales of SFI to a person affiliated with a QIIMC. The annual amount of deductible purchases for this exemption continues to be \$15 million.

An affiliate is deemed to be engaged in the business of providing qualifying IIMS if the affiliate primarily provides portfolio management, fund administration, fund distribution, or transfer agent services, or any combination of these activities, either directly or indirectly.

"Affiliate" and "affiliated" is defined as a person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with another person.

"Control" is defined as the possession, directly or indirectly, of more than 50 percent of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise.

"Affiliated group" is defined as any group of two or more persons all affiliated with each other.

"Indirect ownership interest" means an ownership interest in a person by virtue of an ownership interest in an entity that has an indirect ownership in the person. "Ownership interest" means the possession of equity in the capital, stock, or profits of the other person.

The tax preference performance statement states that this tax preference is designed to improve industry competitiveness and reduce structural inefficiencies. The Legislature's specific public policy objective is to maintain a viable financial cluster. The Legislature intends to extend the expiration date of the tax preference if there is at least one IIMS firm headquartered in Washington with at least \$200 billion of assets under management.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Amended Bill:** This bill takes effect 90 days after adjournment of the session in which the bill is passed, except for sections 2 and 3, relating to the preferential B&O rate, which contain an emergency clause and takes effect on July 1, 2019.

**Staff Summary of Public Testimony:**

(In support) The bill would maintain tax incentives for the largest international investment firm in the state. The firm employs hundreds of Washington residents. The sales and use tax exemption pertains to SFI that is of critical importance to the industry and was never intended to be subject to tax. No other state imposes a sales and use tax on SFI. Removing the sales and use tax exemption on purchases of this information would hinder the state's competitive advantage in attracting and retaining intentional investment business.

(Opposed) None.

(Other) Section 3 narrows the preferential B&O rate substantially to only a select number of taxpayers. It excludes taxpayers that have a significant impact on Washington's economy. Moreover, the claw back period of nine years is too long. In effect, the taxpayers impacted by this bill will experience an immediate increase in taxes of 450 percent. In addition, a change in corporate structure at the international or national level for a taxpayer may result in a change in the percentage of employees located in Washington; thus, making a taxpayer suddenly ineligible for the preferential rate. The reauthorization of the sales and use tax exemption for the purchase of SFI is important. An appropriate modification of the eligibility of the preferential B&O rate may be needed; however, it seems that a 10-year look-back period is excessive. The length of time is so extreme that it probably is simply a placeholder and should be clarified to only apply retroactively to the effective date of the act. In addition, the claw back should only be for one to two years of economic benefit.

**Persons Testifying:** (In support) Leanne Webber, Frank Russell Investments.

(Other) Clay Hill, Association of Washington Business; and Tom McBride, Ameriprise Financial.

**Persons Signed In To Testify But Not Testifying:** None.