

SENATE BILL REPORT

SB 6492

As Reported by Senate Committee On:
Ways & Means, January 23, 2020

Title: An act relating to addressing workforce education investment funding through business and occupation tax reform.

Brief Description: Addressing workforce education investment funding through business and occupation tax reform.

Sponsors: Senators Pedersen, Rolfes and Wilson, C.

Brief History:

Committee Activity: Ways & Means: 1/21/20, 1/23/20 [DPS, w/oRec, DNP].

Brief Summary of First Substitute Bill

- Replaces a workforce education investment surcharge with an increase in the general service business and occupation tax rate from 1.5 percent to 1.8 percent for businesses with gross income in excess of \$1 million.
- Establishes a 1.22 percent surcharge on large advanced computing businesses.
- Expands the business and occupation tax credit for small businesses.

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 6492 be substituted therefor, and the substitute bill do pass.

Signed by Senators Rolfes, Chair; Frockt, Vice Chair, Operating, Capital Lead; Mullet, Capital Budget Cabinet; Billig, Carlyle, Conway, Darneille, Dhingra, Hasegawa, Hunt, Keiser, Liias and Pedersen.

Minority Report: That it be referred without recommendation.

Signed by Senators Wagoner and Warnick.

Minority Report: Do not pass.

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.

Signed by Senators Braun, Ranking Member; Brown, Assistant Ranking Member, Operating; Honeyford, Assistant Ranking Member, Capital; Becker, Muzzall, Rivers, Schoesler and Wilson, L..

Staff: Jeffrey Mitchell (786-7438)

Background: Business and Occupation Taxes. 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 business may have more than one B&O tax rate, depending on the types of activities conducted. Major tax rates are 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent for services, and activities not classified elsewhere. Several lower rates also apply to specific business activities. A B&O tax credit is provided for businesses whose B&O tax liability is below a certain level. The credit varies depending on the amount of B&O tax due—the total of all classifications—after all other B&O tax credits have been taken. The amount of the small business B&O tax credit for service-related business is \$840 per year, which completely exempts a service business with annual B&O income below \$56,000 and provides a partial reduction in B&O tax liability for a service business with income at or below \$112,000. For all other taxpayers, the amount of the small business B&O credit is \$420 per year, which for taxpayers subject to the 0.484 percent B&O tax rate, completely exempts a business with an annual B&O income below \$86,777 and provides a partial reduction in B&O tax liability for a business with an income below \$173,554.

Workforce Education Investment Surcharge. In 2019 the Legislature passed EHB 2158, a three-tiered workforce education investment surcharge established as part of the business and occupation tax. The first tier of the surcharge is imposed on selected businesses based on their primary business activity. An activity is considered to be a business' primary activity if more than 50 percent of the business' cumulative gross income was generated from engaging in that activity in the entire current or preceding calendar year. Selected business activities include 43 categories of service-related activities, including, but not limited to, architecture and engineering services, legal services, insurance carriers, financial services, medical services, software publishing, scientific research, electronic shopping, telecommunications services, and others.

Under the first tier of the workforce education investment surcharge, if a business is primarily engaged in one or more of the activities described, the surcharge is 20 percent of the total amount of taxes payable by the business on activities taxed under the B&O tax rate for services.

The second tier of the surcharge is imposed on advanced computing businesses that have worldwide gross revenue of more than \$25 billion, but less than \$100 billion. The surcharge is 33.33 percent of the total amount of taxes payable by the business on activities taxed under the B&O tax rate for services.

The third tier of the surcharge is imposed on advanced computing businesses that have worldwide gross revenue more than \$100 billion. The surcharge is 66.66 percent of the total

amount of taxes payable by the business on activities taxed under the B&O tax rate for services.

The total amount of surcharge paid by an affiliated advanced computing group must be at least \$4 million, but not more than \$7 million per year.

An advanced computing business is one that designs or develops software or computer hardware, including modifications, or provides cloud computing services, operates an online marketplace, an online search engine, or an online social networking platform.

The 2019 legislation also created the Workforce Education Investment Account (WEIA). All revenues from the workforce education investment surcharges are deposited in the WEIA. WEIA may be used only for higher education programs, higher education operations, higher education compensation, and state-funded student aid programs except for the 2019-21 biennium in which funds can be used for K-12 career connected learning. Expenditures from WEIA must be used to supplement, not supplant, other federal, state, and local funding for higher education.

Summary of Bill (First Substitute): Workforce Education Investment Surcharge. Except for certain advanced computing businesses, the workforce education investment surcharge is eliminated and replaced with an increase in the B&O service rate from 1.5 percent to 1.8 percent for businesses earning more than \$1 million annually in the preceding calendar year. Businesses conducting service activities, but not meeting the \$1 million threshold, continue to pay B&O tax at the 1.5 percent rate. Hospitals are excluded from the increase. For the purpose of determining whether a business has met the \$1 million threshold, the income of any affiliates of the business is also included in the calculation. An "affiliate" is any business that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with another business.

Advanced computing businesses with a worldwide gross income in excess of \$25 billion are subject to an additional 1.22 percent surcharge. These businesses would continue to pay B&O tax at the 1.5 percent rate as well. The maximum amount of surcharge that an advanced computing business is subject to is \$9 million per year.

The elimination of the surcharge is retroactive to January 1, 2020. The increase in the B&O service rate and the advanced computing surcharge take effect April 1, 2020.

Business and Occupation Tax Credit for Small Businesses. The B&O tax credit for small businesses is expanded. For businesses primarily engaged in service-related activities, the credit is increased from an annualized amount of \$840 to \$1,500. For all other taxpayers, the credit is increased from an annualized amount of \$420 to \$720. These increased B&O credits roughly correspond to a \$100,000 exclusion for all taxpayers subject to the B&O service tax rate and \$150,000 to the general B&O wholesaling, retailing, and manufacturing tax rates. The changes to the B&O small business credit take effect January 1, 2021, and are exempt from the requirements generally applicable to new tax preferences.

EFFECT OF CHANGES MADE BY WAYS & MEANS COMMITTEE (First Substitute):

- Creates a separate additional 1.22 percent surcharge for advanced computing businesses with a gross income in excess of \$25 billion with a \$9 million dollar annual cap.
- Clarifies that a business, when determining whether it is subject to the additional 0.3 percent tax, can submit a correction with the Department of Revenue in a manner similar to an existing reconciliation process for determining income apportionable to Washington.
- Makes technical corrections.

Appropriation: None.

Fiscal Note: Available.

Creates Committee/Commission/Task Force that includes Legislative members: No.

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

Staff Summary of Public Testimony on Original Bill: *The committee recommended a different version of the bill than what was heard.* PRO: Last year, the Legislature did something quite remarkable that gained the attention of the nation, which was to make a dramatic investment in higher education. There has been a lot of positive feedback around the public support for higher education provided last session; however, there has also been response that the complicated funding structure of the bill will not produce the revenue adequate to meet the needs of those institutions. The bill before the committee is easier to administer, more predictable, and will be sufficient in meeting the needs of the state's higher education institutions. This policy is critically important to students, especially the state's most vulnerable students. The bill will ensure the Legislature's continued investment in the guided pathways program. These policies provide critical funding to the Washington college grant, which now stands as a national standard for state financial aid programs, ensures educational opportunities for students across the state, and encourages expansion of high demand programs. The institutional funding under this bill is critical in recovering from cuts made during the great recession. The state needs to fund higher education. The new higher education funding structure provides educational opportunities for tens of thousands of low-income students. This bill is necessary in ensuring the state meets its promise to its students receiving the Washington college grant.

CON: The increase to minimal thresholds, acknowledgment of small business, and million dollar cap is a positive change from the bill passed last session, but it is not a practical model for most businesses. Policymakers should consider addressing potential healthcare increases resulting from this legislation. The intent was to not increase healthcare costs, so hospitals were exempted, but that did not include independent practitioners. Not all higher education institutions are receiving the benefits of this bill.

OTHER: The changes proposed in this bill make it easier for small businesses to understand and comply with the tax obligations created last year. The higher education funding bill from last session has been a nightmare on businesses in determining whether or not they are subject to the new surcharge. The new revenue threshold and small business tax credit are a positive change to the policy. The bill eliminates the surcharge on advanced computing

businesses, which leaves it unclear whether they would be paying more or less under this proposal. There may be a fairness issue with advanced computing businesses escaping tax liability. Most small businesses will not benefit under this bill. This bill is the cleanest, simplest proposal currently before the Legislature.

Persons Testifying: PRO: Senator Jamie Pedersen, Prime Sponsor; Dr. Timothy Stokes, President, South Puget Sound Community College; Herb Simon, Former UW Regent; Matthew Rounsley, Centralia College Student; Becca Kenna-Schenk, Western Washington University.

CON: Trent House, Washington State Dental Association; Brad Tower, Washington Association of Naturopathic Physicians; Sean Graham, Washington State Medical Association; John Burbank, Economic Opportunity Institute.

OTHER: Patrick Connor, NFIB; Lisa Thatcher, Washington Society of Certified Public Accountants.

Persons Signed In To Testify But Not Testifying: No one.