Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Finance Committee

ESSB 5459

Brief Description: Creating a business and occupation tax deduction for persons conducting payment card processing activity.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Mullet and Wilson, L.).

Brief Summary of Engrossed Substitute Bill

- Provides a business and occupation tax deduction for interchange fees or network fees received by a payment card processing company.

Hearing Date: 3/7/22

Staff: Tracey Taylor (786-7152).

Background:

Business & 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 (businesses with taxable income of less than $1 million) or 1.75 percent (businesses with taxable income of $1 million or more) for services and for activities not classified elsewhere. Several preferential rates also apply to specific business activities.

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.

Tax Preference Performance Statement.
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 (TPPS) 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.

Credit Card Processing.
The act of making a purchase using a credit card triggers a multistep process where data is sent from the customer's credit card to the merchant's point of sale device, and then to the cardholder's bank.

The first stage of any credit card transaction is payment authorization. The customer pays by using credit card. For in-person transactions, this may be done by swiping the magnetic strip of the card, tapping the terminal with a contactless card, or inserting their chip credit card into the terminal. The merchant's credit card terminal sends the cardholder's details, including the credit card number, expiration date, security code, and payment amount to the store's acquiring bank or payment processor. This information is forwarded to the appropriate payment network which then passes it on to the customer's issuing bank for authentication.

The second stage is payment authentication. The issuing bank receives the payment request and verifies whether the cardholder has the available balance to make the purchase. The bank will also conduct security measures to authenticate the cardholder's details. After authenticating the cardholder, the bank account approves the transaction and communicates this to the payment processor and then to the credit card reader or terminal.

The final stage is clearing. The clearing stage is when details of the transaction are sent to the cardholder and merchant services in the form of statements. At the end of every business day, the merchant sends a batch of approved credit and debit card transactions to the acquiring bank or processor. The card processing company then forwards details of each transaction to the corresponding credit card network, which then forwards it to the appropriate card-issuing bank. Funds and shares of transaction fees are moved between banks, credit card networks, and acquiring processors to keep the system running.

Summary of Bill:

A payment card processing company may take a deduction from their B&O tax interchange fees and network fees received by persons other than the payment card processing company. The deduction applies to tax periods beginning on or after July 1, 2022.

An interchange fee is set by a payment network, or by agreement between an issuing bank and a merchant or merchant bank. The issuing bank retains this fee from the amounts settled to the merchant as compensation for the services the issuing bank provides in:

- issuing a credit, debit, or prepaid card to a cardholder, advancing proceeds to settle a credit, debit, or prepaid card to a cardholder;
- advancing proceeds to settle a credit, debit, or prepaid card transaction; and
- incurring a portion of the risks relating to the transaction.

A network fee is a fee charged by a payment network and receives as compensation for its services, including facilitating the payment of a credit, debit, or prepaid card transaction from cardholders to a merchant through its network.

An issuing bank is a bank that issues payment network-branded credit, debit, or prepaid cards to cardholder. A merchant bank is a bank that is a participant in payment networks that contracts, directly or indirectly, with a merchant, enabling that merchant to accept a payment network-branded credit, debit, or prepaid card and receive cash proceeds from the sale.

A payment card processing company is a company, including a merchant bank, that:

- acquires, either directly or indirectly, credit, debit, or prepaid card transactions from merchants;
- facilitates the submission of those transactions to payment networks; and
- facilitates the payment of proceeds of those transactions to merchants.

A payment network is an operator of a system or network connecting one or more issuing banks to one or more merchant banks that facilitates financial transactions through the use of a credit, debit, or prepaid product.

Appropriation: None.

Fiscal Note: Requested on March 5, 2022.

Effective Date: The bill takes effect on July 1, 2022.