

**SENATE BILL REPORT**

**2ESSB 5967**

**AS PASSED SENATE, MAY 6, 1993**

**Brief Description:** Increasing state revenues.

**SPONSORS:** Senate Committee on Ways & Means (originally sponsored by Senator Rinehart; by request of Governor Lowry)

**SENATE COMMITTEE ON WAYS & MEANS**

**Majority Report:** That Substitute Senate Bill No. 5967 be substituted therefor, and the substitute bill do pass.

Signed by Senators Rinehart, Chairman; Spanel, Vice Chairman; Bauer, Gaspard, Hargrove, Niemi, Owen, Pelz, Snyder, Sutherland, Talmadge, Williams, and Wojahn.

**Staff:** Terry Wilson (786-7715)

**Hearing Dates:** March 30, 1993; March 31, 1993

**HOUSE COMMITTEE ON REVENUE**

**BACKGROUND:**

**SALES AND USE TAX**

The state retail sales tax is imposed on each retail sale of tangible personal property and some services. Taxable services include construction, repair, telephone, and some recreation and amusement services. The tax rate is 6.5 percent and is applied to the selling price of the article or service. The use tax is imposed on the use of tangible personal property when the sale of the property has not been subject to the sales tax. The tax rate is 6.5 percent and is applied to the value of the article used (generally the selling price). The use tax generally applies to purchases made outside the state. In addition, local sales and use taxes also apply.

**SALES TAX EXEMPTIONS**

Currently sales of feed, seed, seedlings, fertilizer, and spray materials to farmers are exempt from the sales and use tax when the products are used to grow any agricultural product for sale at wholesale.

The sales and use tax does not apply to sales of prescription drugs.

Residents of a state, possession, or Canadian province that does not impose a sales tax of 3 percent or more are exempt from Washington sales tax on purchases in this state of tangible personal property for use outside this state.

## SALES TAX DEFERRAL

Current law authorizes the deferral of sales and use tax on plant and equipment investments by manufacturing and research and development firms in distressed counties and by new manufacturers and aluminum firms statewide. These firms are allowed to defer sales and use tax for three years after completion of the project followed by repayment over five years. Sales tax on labor in distressed areas is not repaid. A \$1,000 business and occupation tax credit is available for each new job created above a 15 percent growth rate by manufacturing and research and development firms in distressed areas as an alternative to the deferral program. These programs are due to expire July 1, 1994.

## BUSINESS AND OCCUPATION TAX

The business and occupation tax is imposed on the gross receipts of all business activities (other than public utilities) conducted within the state. There are no deductions for the costs of doing business. Although there are 10 separate rates, the 3 principal rates are:

Manufacturing, wholesaling, & extracting	0.484%
Retailing activities	0.471%
Service activities	1.50%

Magazine and periodical publishing is taxed at a business and occupation tax rate of 0.484.

## REAL ESTATE EXCISE TAX

The real estate excise tax applies to sales of real property and is collected when the sale document is recorded with the county. The tax rate is 1.28 percent of the selling price. Most local governments impose an additional rate of 0.25 percent. Additional local options are available.

If real estate is owned by a partnership or corporation, a sale of a controlling interest in the partnership or corporation can effectively transfer control of real estate without creating tax liability. Many transactions are structured in this manner to avoid real estate excise taxes.

## INSURANCE PREPAYMENTS TAXES

Health maintenance organizations with their own employee medical staff (such as Group Health) and health care service contractors without medical staff (such as Blue Cross) are subject to the business and occupation tax on their gross income at a rate of 1.5 percent. The health care reform bill, E2SSB 5304, exempted health maintenance organizations and health care service contractors from the business and occupation tax and subjected them to a 2 percent tax on prepayments similar to the insurance premiums tax, effective January 1, 1996.

## INSURANCE PREMIUMS TAX CREDIT

The Washington Insurance Guaranty Association Act and the Washington Life and Disability Insurance Guaranty Association Act each created an insurance guaranty association that provides for the payment of claims under policies and contracts of insolvent insurers. Insurance companies that contribute to one of these associations may offset the amount of their contributions against their insurance premium taxes owed to the state over a five-year period.

## RESALE CERTIFICATES

Sales for resale are exempt from sales tax if the buyer has a resale certificate. A significant cause of sales tax avoidance is the abuse of resale certificates by persons in business who purchase items for their own use free of tax.

## CONTRIBUTIONS IN AID OF CONSTRUCTION

The state subsidizes the capital costs of public entities by allowing a deduction from the business and occupation tax and the public utility tax for income from charges to customers for capital purposes.

## **SUMMARY:**

### SALES AND USE TAX

State and local retail sales taxes are extended to the sale of selected personal services. Services subject to tax include the use of coin operated laundry facilities in apartment houses, hotels, trailer camps, and tourist camps, landscape maintenance and horticultural services other than horticultural services provided to farmers, service charges associated with tickets to professional sporting events, guided tours and guided charters, physical fitness services, tanning salon services, tattoo parlor services, massage services, steam bath services, turkish bath services, escort services, and dating services. In addition, the rental of equipment with an operator is also subject to sales tax. Because these services are subject to sales tax, the service provider's business and occupation tax will decrease from the services rate of 1.50 percent to the retailer's rate of 0.471 percent.

### SALES TAX EXEMPTIONS

The sales tax exemption for sales of feed, seed, seedlings, fertilizer, and spray materials to farmers is expanded to include enhanced pollination agents (bees) and applies whether or not the products are used to grow agricultural products for sale at wholesale.

The sales and use tax exemption for prescription drugs is expanded to include drugs used for the prevention of conception.

The nonresident sales tax exemption is limited to residents of a state, possession, or Canadian province that is contiguous to the state of Washington.

#### SALES TAX DEFERRAL

The state sales tax deferral and business and occupation tax credit programs are extended until July 1, 1998.

Neighborhood reinvestment areas are added to the areas in which sales and use tax deferrals are available under the distressed county deferral program and the business and occupation tax credit program. Neighborhood reinvestment areas are defined as areas that are designated to receive federal, state, or local assistance to increase economic activity, have high unemployment rates, and have a preponderance of low-income households.

Eligibility under the statewide deferral program is expanded to include pulp and paper plants that were in operation before 1960 and located in a county with a population between 40,000 and 70,000.

Eligibility under the business and occupation tax credit program is also expanded to include subcounty areas that are timber distressed areas.

#### BUSINESS AND OCCUPATION TAX

The business and occupation tax rate on selected business services is increased from 1.5 percent to 2.5 percent, the business and occupation tax rate on banking, loan, security, investment management, investment advisory, or other financial businesses is increased from 1.5 percent to 1.7 percent, and the business and occupation tax rate on all other services is increased from 1.5 percent to 2.0 percent. Services subject to the tax on selected business services include the following:

- Stenographic, secretarial, and clerical services
- Computer services, including computer programming, custom software modification, custom software installation, custom software maintenance, custom software repair, training in the use of custom software, computer systems design, and custom software update services
- Data processing and information services, but excluding information services to the media through an information network
- Legal, arbitration, and mediation services, including paralegal services, legal research services, and court reporting services
- Accounting, auditing, actuarial, bookkeeping, tax preparation, and similar services
- Design services whether or not performed by persons licensed or certified, including engineering services and architectural services
- Business consulting services, including administrative management consulting, general management consulting,

human resource consulting or training, management engineering consulting, management information systems consulting, manufacturing management consulting, marketing consulting, operations research consulting, personnel management consulting, physical distribution consulting, site location consulting, economic consulting, motel, hotel, and resort consulting, restaurant consulting, government affairs consulting, and lobbying

Business management services, including administrative management, business management, and office management, but excluding property management or property leasing, motel, hotel, and resort management, or automobile parking management

Protective services, including detective agency services and private investigating services, armored car services, guard or protective services, lie detection or polygraph services, and security system, burglar, or fire alarm monitoring and maintenance services

Public relations or advertising services, including layout, art direction, graphic design, copy writing, mechanical preparation, opinion research, marketing research, marketing, or production supervision, but excluding services provided as part of broadcast or print advertising

Aerial and land surveying, geological consulting, and real estate appraising

In addition to the permanent tax increases, a 6.5 percent surtax is imposed for four years on all business and occupation tax classifications except selected business services, financial services, and retailing.

The special business and occupation tax rate of 0.484 on magazine and periodical publishers is eliminated.

#### REAL ESTATE EXCISE TAX

The real estate excise tax is extended to the transfer or acquisition within any twelve-month period of a controlling interest in any entity with an interest in real property in this state. The tax is imposed on the value of the real property transferred.

#### INSURANCE PREPAYMENTS TAXES

Health maintenance organizations and health care service contractors are exempted from the business and occupation tax and subjected to a 2 percent tax on prepayments similar to the insurance premiums tax, effective January 1, 1994, instead of January 1, 1996, and the revenues are deposited into the state general fund for this period.

#### INSURANCE PREMIUMS TAX CREDIT

Insurers will not be able to claim the insurance premium tax offset for any assessments made by state guaranty associations after April 1, 1993.

## RESALE CERTIFICATES

Resale certificates are limited to specific items and are valid for only four years. The abuse of a resale certificate is subject to a penalty of 50 percent of the amount of tax due.

## CONTRIBUTIONS IN AID OF CONSTRUCTION

The deduction from the business and occupation tax and the public utility tax for income from charges to customers for capital purposes is eliminated.

## MISCELLANEOUS

The State Treasurer, based on information provided by the Department of Revenue, is required to transfer revenues generated under this act during the biennium that exceed the amounts projected to be generated.

**Appropriation:** none

**Revenue:** yes

**Fiscal Note:** requested

**Effective Date:** The bill takes effect July 1, 1993, except the limit on the insurance premiums tax credit for guaranty fund contributions takes effect immediately and the changes involving insurance prepayments taxes take effect January 1, 1994.

## TESTIMONY FOR:

This addresses many concerns of cities. Cities and counties agree on the distribution, although they would like the current taxes to automatically apply to the expanded base. The capital contributions deduction repeal should be delayed until January 1, 1994. Most retailers say there is little impact on them from extending the sales tax to services and most are not likely to bring the services in house.

## TESTIMONY AGAINST:

Taxing private security services will hit small minimum wage businesses that will take the business in house or will cut back on the use of the service. It will impose a greater burden on local law enforcement. This is a tax on labor. The real estate excise tax is already high and is too volatile to fund programs. This is a tax on business sales and is a disincentive to economic growth. Insurance commissions are frozen and the tax cannot be passed on. Gambling is already subject to other taxes.

**TESTIFIED:** Jim Lynch, City of Wenatchee (pro); Stan Finkelstein, AWC (pro); Jan Gee, WA Retailers Assn; Steve Lindstrom, WA State Security Council; Basil Badley, AIA, ACLI, HIAA; Vito Chiechi, WA State Licensed Beverage Assn, (con); Clark Sitzes,

Independent Insurance Agents, (con); Randy Ray,  
PSSOA/MEC/Todd/IFF&CNB, (con); Glen Hudson, WA Assn of  
Realtors, (con)