
Finance Committee

HB 2602

Brief Description: Simplifying tax administration.

Sponsors: Representatives Chase, Gombosky, Cairnes, Kenney, Jackley and Simpson; by request of Department of Revenue.

Brief Summary of Bill

Makes changes to the excise tax code in order to simplify administration, including:

- Repeal or elimination of obsolete language;
- Update of outmoded language to be consistent with more current language used commonly in the excise tax statutes;
- Update of obsolete references;
- Modification of definitions and other provisions to provide consistency with recent changes in law or current administrative practices; and
- Change to certain substantive provisions to conform to original legislative intent

Hearing Date: 1/29/02

Staff: Mark Matteson (786-7145).

Background:

The excise tax code includes the business and occupation tax, the retail excise tax, and a number of other taxes as well as administrative provisions and various other ancillary statutes. The code contains various definitions, tax provisions, tax exemptions, taxpayer requirements, and administrative requirements.

Section 1; Unclaimed property. In 1992 the Legislature enacted a law that authorized the state to receive unclaimed intangible property held by out-of-state brokers when the issuer of the intangible property is located in Washington. The effectualness of the law was ultimately contingent upon a 1993 United States Supreme Court ruling in a case concerning the basis of the right of a state to unclaimed property. The court ruled that the right to unclaimed intangible property is that of the state of the broker's incorporation and not that of the state of the principle place of business. The ruling made the Washington law moot.

Sections 2 and 3; Hotel/motel taxes; credit against state taxes. Cities and counties are

allowed to assess a tax of up to 2 percent on hotel and motel lodging charges. The tax is then credited against state sales tax of 6.5 percent due on the same charge, so that the hotel/motel tax is not an additional tax for the customer but represents sharing of the state retail sales tax with cities and counties.

Sections 4, 11 and 28; Business & Occupation Tax statutes definitions. The Business & Occupation tax (B & O) statutes contain a number definitions that apply throughout the chapter, except in certain sections where the context provides otherwise.

The definitions under the B&O tax also apply generally to the retail sales tax statutes and to the public utility tax as well, although no provision that the B&O definitions apply is explicitly made in either case.

Section 5; Definition of retail sale within the Business & Occupation Tax statutes. The B & O tax contains a definition of "retail sale". Under the administration of the B&O tax, for the purposes of determining taxability, retail sales for services performed are deemed to occur at the place where services are performed within the state. In 2000 the Legislature modified the retail sales tax to provide that a retail sale for the provision of linen and uniform supply services is deemed to occur at the place where delivery is made to the customer.

The definition of retail sale within the B&O tax also provides that the charges for the provision of horticultural services are deemed to be retail sales, except when such services are provided to farmers or are conducted near transmission lines at the behest of a utility. No specific definition of "horticultural services provided to farmers" is given in statute. The Department of Revenue (DOR) has issued rules and notices that elaborate on the exemption of such services to farmers.

Sec. 6: Business and Occupation Tax on Food Processors. In 2001 the Legislature modified the B & O tax classification for food processors at the rate of 0.138 percent to include businesses that manufacture certain dairy products and/or who sell certain manufactured dairy products. The modification provides that the tax base for these products is the value of the manufactured products.

Sec. 7: Business and Occupation Tax on the warehousing of prescription drugs. Under the B & O tax, most wholesaling activities are taxed at a rate of 0.484 percent. In 1998, the Legislature provided a differential rate for persons that warehouse and resell prescription drugs, at 0.138 percent. The differential rate applies to any person who buys prescription drugs from a manufacturer or another wholesaler and resells the drugs at retail or at wholesale to a provider of health care services. There is no restriction as to whether the warehousing operations are actually located within Washington.

Secs. 8, 9: Business and Occupation Tax on services. The statute in which the B & O tax is assessed on services defines services as activities that are not taxable under the other sections of the chapter, which are specifically enumerated..

Sec. 10: Resale certificates. Persons that make wholesale purchases are required, when originally purchasing goods, to present a resale certificate. A resale certificate is defined as documentation that provides that the purchase is for resale or provides that the buyer is

exempt from retail sales tax. Under various exemptions under the retail sales tax, the buyer is required to present the seller with an exemption certificate in a form and manner prescribed by the DOR.

Sec. 11: Business & Occupation Tax definitions. See background for Section 4.

Sec. 12 and 13: Watercraft and vessel sales tax exemption for nonresidents.. The language in the retail sales tax exemption for sales of vessels to out-of-state residents includes the terms "purchaser" and "dealer.– Analogous terms used within the retail sales tax statutes, by and large, are "buyer" and seller–

Sec. 14: Sales tax exemption - agricultural housing. The provision within the retail sales tax that concerns an exemption for the construction or repair of agricultural employee housing requires that the buyer provide the seller with an exemption certificate that is prescribed by the DOR by rule. The exemption also contains an obsolete reference to a section of law concerning temporary agricultural employee housing.

Other exemptions within the retail sales tax also call for such a certificate but do not require that the department develop a specific rule for the certificate.

Secs. 15 and 22: Sales and use tax exemption - medical devices. Under the retail sales tax, an exemption is provided on sales of insulin, orthotic, and certain other medical devices. The exemption also includes sales of medically prescribed oxygen for individuals.

Generally, persons who use oxygen under prescription at hospitals purchase the oxygen not at retail, but as part of the medical services that the hospital provides. Consequently, under the definition of retail sale, the hospital is technically the consumer and is required to pay retail sales tax on the oxygen that it gets from the oxygen vendor, even though the oxygen is ultimately used by an individual under prescription.

The same exemption also applies to orthotic devices prescribed by physicians, osteopaths, podiatrists, and chiropractors. The exemption does not explicitly apply to prescribed components of orthotic devices.

Sec.16: Sales tax remittance - warehouse construction and equipment. Under the sales tax exemption allowed for certain warehouse construction and equipment purchases, "finished goods" is defined to exclude logs, minerals, petroleum, or other extracted products stored as raw materials or in bulk. In 1999 the Legislature provided that under the machinery and equipment exemption for manufacturers, logs are a manufactured (not extracted) product.

Sec. 17:Sales tax exemption - dairy nutrient management equipment. An exemption from the retail sales tax is provided for the purchase or repair of dairy nutrient management equipment. Under the exemption, sales for a facility are eligible only after the facility's corresponding dairy nutrient management plan has been certified. The Department of Agriculture is required to submit a list of eligible persons to the DOR. However, the Department of Ecology is responsible for administering the Dairy Nutrient Management Act.

Sec. 18: Use tax exemption - machinery and equipment used in manufacturing. Under the use tax statutes, use tax is due when property that would otherwise be subject to the retail sales tax is used in Washington. The exemption compliments the retail sales tax on, for example, items that are purchased out-of-state where no retail sales tax has been paid. Use tax is owed by the person actually using the property, donating the property, or by the bailor. A bailor is someone who owns property but entrusts its use to another person. In the case of bailment, the activity itself triggers the use tax.

An exemption from the use tax is provided with respect to the use of machinery and equipment when used directly in a manufacturing operation. However, no provision is made to exempt the bailment of machinery or equipment when used directly in a manufacturing operation.

Sec. 19: Direct pay permit. In 2001 the Legislature passed legislation at the request of the DOR that authorizes a direct-pay program for the payment of retail sales and use taxes. Under the program, a taxpayer remits state and local retail sales and use taxes directly to the department rather than through the seller. The act provides that the legislative intent of the program, in part, is to reduce the impacts of the current system on buyers and sellers.

Sec. 20: Use tax definitions - "use." Under the use tax, "use" is defined as the first act within Washington in which a person assumes dominion or control over personal property, and includes installation, storage, and withdrawal from storage in preparation of actual use within the state. If an item is acquired and stored in preparation for out-of-state use, use tax is not due.

Under the direct-pay program, enacted in 2001, that authorizes the direct remittance of sales and use taxes to the DOR by the taxpayer, property may be purchased and taxes paid at a later time. Under this situation, the taxes to be paid are technically use taxes. If the property were to be immediately stored upon acquisition and then later used out-of-state, no tax would be due. If, on the other hand, the buyer is not part of the program and buys directly from a retailer, the buyer would pay retail sales tax.

Sec. 21: Use tax exemption - fuel cells. In 2001 the Legislature extended the sales tax exemption for machinery and equipment used in generating alternative energy to include that energy generated by fuel cells. However, no extension was made under the corresponding use tax exemption.

Sec. 22: See background under Section 15.

Sec. 23: Use tax collection regarding vehicles. Under the use tax statutes, tax is due upon the use of personal property within the state and for which sales tax has not been paid. Statutes provide that county auditors may be designated as collection agents for use tax payments on motor vehicles when title is transferred. Motor vehicles are defined as vehicles to be used on public streets and highways. In collecting use tax on off-road vehicles, snowmobiles, and boats, the DOR also utilizes county auditors, even though a designation as collection agents for these types of property is not explicitly provided under statute.

Secs. 24-27: Local option sales taxes. The DOR is authorized to collect local sales and use

taxes at the same time the state taxes are collected. In several instances, statute provides that the local tax must be deducted from the amount of state tax to be collected. In these cases, the local tax is actually a credit against the state tax, meaning that the local tax is not an additional tax, but is taken from part of the proceeds to the state. Under Washington tax law, deduction is a term that typically refers to an action taken to reduce taxable income, while credit is an action taken to reduce actual liability.

Sec. 29: Solid waste collection business certification. An exemption under the solid waste collection tax is provided to solid waste collection businesses that use the services of another solid waste collection business. To be eligible, the business must be certified by the DOR. In other excise tax statutes that involve exemptions, businesses wishing to be eligible must obtain an exemption certificate from the DOR.

Sec. 30: Interest rates on assessments and refunds. The DOR is required to assess penalties and interest against taxpayers who underpay taxes. The rate of interest to be charged for any given year is an average of the federal short-term interest rate plus two percentage points. The average federal rate is determined by calculating the arithmetic average of each of the rates (compounded annually) published for January, April, July, and October of the preceding calendar year. While the October rate is typically published by mid-October, the timing is not early enough for the DOR to program and calculate the interest rate in time to make assessments.

Sec. 31. Government contractors. In the administrative provisions of the excise tax code, the DOR is required to refund taxes to a taxpayer that is a contractor of the United States government, if the taxpayer is required under the contract with the U.S. government to refund any part of the price of the contract associated with the taxes levied by the state.

In 1983 Washington won a case in federal court against the U.S. government over the issue of whether the state could tax U.S. government contractors. Since the decision, federal agencies have ceased to include the provision in their contracts to require contractors to refund any taxes imposed by the state.

Secs 32-34. Mobile home definition. Under the real estate excise tax, the B&O tax, and the property tax, mobile homes that are being used as permanent dwellings are taxable. A mobile home is considered a permanent dwelling if it is in a fixed location, on a foundation, with fixed connections to sewer, water, or other utilities, and on land that is owned or leased by the mobile home owner. In the 2001 legislative session, the Legislature provided a definition for used park model trailers that are being used for permanent dwellings in order to provide the same tax treatment as used mobile homes that are permanent. A park model trailer is considered a permanent dwelling if it is permanently sited in location, placed on a foundation, with connections to sewer, water, or other utilities for the operation of installed fixtures and appliances.

Summary of Bill:

A number of changes are made to excise tax statutes in an attempt to simplify administration.

Sec. 1 - Unclaimed property. An obsolete section concerning unclaimed property held by out-of-state brokers is repealed.

Secs. 2 and 3 - Local hotel/motel taxes; credit against state taxes. Technical changes are made to statutory language construction.

Secs. 4, 11, and 28 - Business & Occupation Tax definitions. The B&O, retail sale, and public utility taxes are amended to provide that the definitions under the B&O statute apply throughout each of the separate tax chapters.

Sec. 5 - Definition of retail sale. Under the definition of retail sale, for the purposes of determining the taxability of linen and uniform supply services, the sale is deemed to occur at the place of delivery to the customer. In addition, under the exclusion for horticultural services provided to farmers, such services are defined to include soil preparation, weed control, stump removal, certain cultivation activities, and harvesting activities.

Sec. 6 - Business & Occupation Tax on food processors. Persons who sell certain manufactured dairy products are taxed at the B&O tax rate of 0.138 percent, based on the selling price of the products, if the products are sold to someone who is transporting the products out of the state.

Sec. 7 - Business & Occupation Tax on the warehousing of prescription drugs. Businesses that warehouse and resell prescription drugs are classified under the B&O tax rate of 0.138 percent only if the warehousing operations are within Washington.

Sec. 8 and 9 - Business & Occupation Tax on services. The B&O services category classification is modified to provide that the service classification rate of 1.5 percent applies to any business not explicitly taxed elsewhere in the chapter.

Sec. 10 - Retail certificates. References to the retail sales tax exemption certificate are removed from the definition of resale certificate.

Sec. 11. See Sec. 4 summary above.

Sec. 12 and 13 - Watercraft and vessel sales tax exemption for nonresidents. Outdated terminology is updated.

Sec. 14 - Sales tax exemption - agricultural housing. Language that requires the department to promulgate a rule in order to issue an exemption certificate is deleted. An obsolete statutory reference is updated.

Secs. 15 and 22 - Sales and use tax exemption - medical devices. The sales and use tax exemption provided for prescribed purchases of oxygen for individuals is modified to provide that oxygen and portable oxygen systems are exempt if ultimately used by individuals under a prescription.

Prescribed components of orthotic devices are exempt from sales and use taxes.

Sec. 16 - Sales tax remittance - warehouse construction and equipment. Language that incorrectly defines logs as an extracted product is deleted.

Sec. 17 - Sales tax exemption - dairy nutrient management equipment. The authority to provide a list of eligible persons is corrected to refer to the Department of Ecology.

Sec. 18 - Use tax exemption - machinery and equipment used in manufacturing. The use tax exemption on the use of machinery and equipment by manufacturers is modified to also exempt bailments of equipment from one manufacturer to another, as long as the equipment that has been bailed is eligible under the terms of the exemption.

Sec. 19 - Direct pay permit. The intent provision of the 2001 legislation to provide the department to operate a direct pay permit program is modified to provide that it is the intent of the Legislature that the program would reduce expenses of buyers, but does not necessarily reduce the tax burden of buyers.

Sec. 20 - Use tax definition - "use". The definition of use tax is amended to provide that the tax applies to any item that is purchased under the direct pay permit program and then stored in the state prior to subsequent use outside the state.

Sec. 21 - Use tax exemption - fuel cells. The use tax exemption for machinery and equipment used in generating alternative energy is updated to include energy generated by fuel cells.

Sec. 22 - See summary on Sec. 15.

Sec. 23 - Use tax collection regarding vehicles. The provision under the use tax that allows the department to designate county auditors as collection agents for use tax on motor vehicles is modified to explicitly provide that county auditors are collection agents for tax on off-road vehicles, snowmobiles, and boats. Technical changes are made to terminology and references.

Sec. 24-27 - Local option sales taxes. Statutory language is updated to refer to the process of withholding local tax revenues from state revenues as credits.

Sec. 29 - Solid waste collection business certification. The exemption under the solid waste collection tax is corrected to provide that the department must certify the exemption.

Sec. 30 - Interest rates on assessments and refunds. The basis of the rate of interest to be charged on unpaid taxes for any given year is modified to be based on the average of the federal short-term rates for the prior January, April, and June of the preceding year, and for October of the year prior to the preceding year.

Sec. 31 - Government contractors. An obsolete subsection regarding refunds on taxes paid by contractors of the federal government is deleted.

Secs. 32-34 - Mobile home definition. The definition of "used mobile home" is updated to reflect comparable language for used park model trailers.

Sec. 35. Provides that the amendment under Sec. 8 expires at the same time the underlying statute expires.

Sec. 36. Provides that the amendment under Sec. 9 becomes effective at the same time as the underlying statute.

Sec. 37. Provides that the correction to the use tax exemption for machinery and equipment used in generating alternative energy is retroactive to the date that the 2001 legislation was enacted.

Appropriation: None.

Fiscal Note: Available.

Effective Date: Ninety days after adjournment of session in which bill is passed.