

## Finance Committee

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### HB 2658

**Brief Description:** Changing requirements regarding state and local tax to provide for municipal business and occupation tax uniformity.

**Sponsors:** Representatives Gombosky, Dunshee, Romero, Reardon, Berkey, Upthegrove, Edwards, Chase, Kenney, Linville, McIntire and Conway; by request of Governor Locke.

#### Brief Summary of Bill

- Requires the Association of Washington Cities to adopt a model ordinance on municipal business and occupation taxes to address issues of uniformity and multiple taxation between municipal codes.
- Requires cities that impose business and occupations taxes to comply with all requirements of the bill by December 31, 2005, or lose the authority to impose the tax.

**Hearing Date:** 1/31/02

**Staff:** Mark Matteson (786-7145).

#### **Background:**

##### *City Business and Occupation Taxes*

Thirty-seven cities impose business and occupation (B&O) taxes. City (or municipal) B&O taxes are imposed on the gross receipts of activities conducted by businesses located within cities without any deduction for the costs of doing business, or for income that is derived by activity conducted in non-taxing jurisdictions. The Legislature has limited city B&O taxes on retail sales to a maximum of 0.2 percent, but higher rates are possible if voter-approved or in effect prior to January 1, 1982. Cities first imposing a B&O tax after April 22, 1983 and cities increasing tax rates must have a referendum procedure.

A business operating in more than one city may owe gross receipt taxes to multiple cities. Although cities are not required to coordinate their taxes, some cities have enacted provisions designed to prevent multiple taxation of the same activity. Typically, these cities allow a

deduction from taxable gross receipts for income derived from activities that are taxed by another city.

Each city's municipal business code contains a number of terms and definitions, some of which are unique to that city's code. Each city determines the reporting periods for taxpayers to remit B&O taxes, the time period over which tax liabilities or refunds may be assessed, penalties, and interest rates for late payment or refunds. Each city also determines the minimum level of business activity that would make a business subject to its tax.

For several years, the business community has expressed concerns about city B&O taxes. Major concerns include the lack of uniformity among municipal tax systems and the multiple taxation of the same income by two or more cities. Legislation addressing these concerns has been introduced in recent years and supported by the business community. Representatives from cities have, in turn, expressed concern that such legislation would entail a significant loss of local autonomy and flexibility needed to address unique local circumstances.

In May 2001 the Governor directed the director of the Department of Revenue to convene a working group of city and business representatives to develop a solution regarding the municipal taxation issues. The working group's discussions were in large part centered on a model municipal B & O tax ordinance that had been developed by the Municipal Research and Services Center for the Association of Washington Cities in early 2001 to address some of the business community's concerns. The department was to submit a report by October 15, 2001 the recommended solution of the working group or, if the group could not reach consensus on a recommendation, of the department's recommendations. While consensus was reached on some issues, there was not agreement in total.

#### *State Business and Occupation Tax*

The state's major business tax is the B&O tax. This tax is imposed on the gross receipts of business activities conducted within the state. Deductions for the costs of doing business are not allowed. The tax classifies businesses into categories and applies tax rates to these categories. The state B&O tax provides for many exemptions, deductions, and tax credits.

The department assesses interest and penalties to taxpayers who are late in paying the state excise taxes. The department also refunds overpayments of tax, with interest. In the case of assessments, the interest is calculated on the late amount, beginning with the last day of the calendar year in which the tax was first late. In the case of refunds, interest is calculated on the amount owed, beginning with the time that the overpayment was initially made.

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

	<b>HB 2658</b> <b>(Rep. Gombosky, Dunshee, et. al.; by request of the Governor)</b>	<b>HB 2555</b> <b>(Reps. Reardon, Gombosky, et. al.)</b>
<b>Intent</b>	<p>Desire a more uniform system of city B&amp;O taxes that</p> <ul style="list-style-type: none"> <li>-</li> <li>- eliminates multiple taxation;</li> <li>- - Allows some continued local control and flexibility to cities.</li> </ul>	<p>Require that cities that impose a B&amp;O tax adopt a model ordinance (MO) that</p> <ul style="list-style-type: none"> <li>-</li> <li>- Creates greater uniformity;</li> <li>- - Makes taxes simpler, more predictable, easier to administer;</li> <li>- - Eliminates multiple taxation;</li> <li>- - Establish an apportionment methodology.</li> </ul>
<b>Scope</b>	Applies to all businesses, generally, but not to utility businesses.	Not specified. Presumed to apply to businesses & not utilities.
<b>Model Ordinance: Process</b>	<p>Requires AWC to adopt a model ordinance, with public process. MRSC must post MO on its web site and have hard copies.</p> <p>Cities with B&amp;O ordinances must make electronic and paper copies available upon request. Provides that AWC may amend MO to comply with changes in state law.</p> <p>Other than to comply with changes in state law, prohibits AWC from amending the definitions and tax classifications in the MO more frequently than once every four years.</p> <p>Any city that imposes a B&amp;O tax must comply with all provisions of the act by the end of CY 2005.</p>	<p>Requires DOR director to appoint a committee of tax administrators from cities that impose B&amp;O taxes. By Nov. 1, 2002, the committee shall develop a model resolution and ordinance.</p> <p>DOR shall by rule propose the formal adoption of the MO. Any deviations from the state B&amp;O shall be noted in the rule.</p> <p>By Jan. 1, 2003 any city that imposes a B&amp;O tax must adopt certain mandatory provisions of the MO. Cities that deviate from the MO non-mandatory provisions shall note the deviations and file the deviations centrally.</p> <p>If changes are made to the state B&amp;O tax , DOR director is required to coordinate the same type of process as for the original MO adoption (see above).</p>

<p><b>Model Ordinance: Mandatory Provisions</b></p>	<p>The MO must include</p> <ul style="list-style-type: none"> <li>-</li> <li>- A system of credits that prevents multiple taxation;</li> <li>-</li> <li>- A gross receipts threshold for small businesses;</li> <li>- - Tax reporting frequency requirements;</li> <li>- - Penalty and interest provisions;</li> <li>- - Claim and Refund period provisions;</li> <li>- - Certain definitions. (Any deviations from comparable definitions in 82.04 must be described in the MO.)</li> </ul>	<p>The MO must include</p> <ul style="list-style-type: none"> <li>-</li> <li>- Provisions to provide for the apportionment of gross income so as to prevent multiple taxation;</li> <li>- - A gross receipts threshold for small businesses;</li> <li>- - Uniform due dates;</li> <li>- - Reasonable penalties;</li> <li>- - Reasonable rates of interest;</li> <li>- - A uniform statute of limitation period for both assessments and refunds;</li> <li>- - Certain definitions from 82.04.</li> </ul>
<p><b>Model Ordinance: Nonmandatory Provisions</b></p>	<p>None explicitly stated, although cities that deviate from any nonmandatory provisions are required to make a description of deviations available. With the exception of the credit to address multiple taxation, cities may adopt own provisions for tax preferences (i.e., exemptions, credits, etc.), as well as classifications and rates.</p>	<p>None explicitly stated, although cities that deviate from any nonmandatory provisions are required to make a description of deviations available. Cities may continue to adopt own classification and/or rate structures and to tax an activity at the rate provided for the activity before January 1, 2002.</p>

<p><b>MO Mandatory Provisions: System of Credits to Prevent Multiple Taxation</b></p>	<p>MO must include:</p> <ul style="list-style-type: none"> <li>-</li> <li>- A credit against retailing/wholesaling taxes for extracting &amp; manufacturing taxes paid to same jurisdiction;</li> <li>- - A credit against manufacturing taxes owed for extracting taxes paid to same jurisdiction;</li> <li>- - A credit against retailing/wholesaling taxes owed for printing/publishing taxes paid to same jurisdiction</li> </ul> <p>In addition, the MO is to include credits that prevent multiple taxation on services and any other classes not specifically enumerated in the bill.</p>	<p>MO must include:</p> <ul style="list-style-type: none"> <li>-</li> <li>- a credit against manufacturing taxes owed for extracting or previous manufacturing taxes paid to any jurisdiction;</li> <li>- - A credit against retail/wholesale taxes owed for extracting or manufacturing taxes paid to any jurisdiction.</li> </ul> <p>In addition, provisions must be included beyond those specifically enumerated to prevent a circumstance that would result in multiple taxation.</p>
<p><b>MO Mandatory Provisions: De Minimus Threshold</b></p>	<p>Gross income of at least \$20,000; city must have nexus.</p>	<p>Gross income of at least \$25,000. (Nexus implied.)</p>
<p><b>MO Mandatory provisions: Reporting Frequency</b></p>	<p>Monthly (but only if reporting state B&amp;O taxes monthly), quarterly, or annually</p>	<p>(No detail on due dates included. Must be uniform in general.)</p>
<p><b>MO Mandatory Provisions: Interest</b></p>	<p>On assessments for underpaid tax and on refunds, interest is to be computed in same manner DOR does for state B&amp;O (RCW 82.32.050 and .060).</p>	<p>(No detail on rates of interest included. Must be "reasonable".)</p>

<p><b>MO Mandatory Provisions: Penalties</b></p>	<p>Modeled on the DOR administrative code (RCW 82.32.090):</p> <ul style="list-style-type: none"> <li>-</li> <li>- On late filings, 10% or 20% of tax due, depending on lateness;</li> <li>- - On late tax assessment payments, 10% of additional tax due;</li> <li>- - On warrants issued, 5% of tax due;</li> <li>- - On finding of the disregard of specific written instructions, 10% of additional tax due;</li> <li>- - On finding of intent to evade, 50% of the additional tax due.</li> </ul> <p>The aggregate penalties that may be imposed for late filings, late payments on assessments, and on warrants is 35% of the tax due. Penalties may not be issued for both evasion and disregard of written instructions.</p>	<p>Using provisions in 82.32 RCW as a guide, establish reasonable penalties for late filings, late tax assessment payments, disregard of written instructions, and evasion. The aggregate penalties that may be imposed for late filings, late payments on assessments, and disregard of written instruction is 35% of the tax due. Penalties may not be issued for both evasion and disregard of written instructions.</p>
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<p><b>MO Mandatory Provisions: Statutes of Limitations</b></p>	<p>Modeled upon the DOR administrative code (RCW 82.32.100(3) and excerpt from 82.32.060).</p> <ul style="list-style-type: none"> <li>-</li> <li>- On assessments, not more than four years after the close of the applicable tax year, unless the taxpayer is unregistered or has shown fraud, in which case there is no limitation.</li> <li>- - For refunds, No more than four years before the beginning of the calendar year in which the refund application is made.</li> </ul> <p>Waivers of the time period limitations for both assessments and refunds may be made by mutual consent of city and taxpayer.</p>	<p>For both assessments and for refunds, not more than four years in addition to the current tax year, unless:</p> <ul style="list-style-type: none"> <li>-</li> <li>- The taxpayer is unregistered, in which case no more than seven years in addition to the current tax year;</li> <li>- - The tax payer has been shown to commit fraud, in which case there is no limitation.</li> </ul> <p>Waivers of the time period limitations for both assessments and refunds may be made by mutual consent of city and taxpayer.</p>
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<p><b>MO Mandatory Provisions: Definitions</b></p>	<p>MO must include definitions for:</p> <ul style="list-style-type: none"> <li>-</li> <li>- eligible gross receipts tax <ul style="list-style-type: none"> <li>- - extracting</li> <li>- - manufacturing (software development cannot be defined as a manufacturing activity)</li> <li>- - nexus (defined using U.S. Commerce Clause standards)</li> <li>- - retailing</li> <li>- - retail sale</li> <li>- - services (excluding retail or wholesale services)</li> <li>- - wholesale sale</li> <li>- - wholesaling</li> </ul> </li> </ul> <p>The definitions in chapter 82.04 RCW are to be used as a baseline for all definitions provided in the MO.</p> <p>Any deviation from the meanings in 82.04 RCW must be described by a comment in the MO.</p>	<p>MO must include the definitions from chapter 82.04 RCW for the following:</p> <ul style="list-style-type: none"> <li>-</li> <li>- person <ul style="list-style-type: none"> <li>- - company</li> <li>- - sale</li> <li>- - casual or isolated sale</li> <li>- - sale at retail</li> <li>- - retail sale</li> <li>- - sale at wholesale</li> <li>- - wholesale price</li> <li>- - gross proceeds of sales</li> <li>- - gross income of the business</li> <li>- - value proceeding or accruing</li> <li>- - extractor</li> <li>- - manufacturer</li> <li>- - to manufacture</li> <li>- - commercial or industrial use</li> <li>- - business</li> <li>- - engaging in business.</li> </ul> </li> </ul> <p>The incorporation of these terms must be construed to include, as an extension of the definition, any state-level determination, regulation, interpretation, or court opinion pertaining to these terms.</p> <p>If the tax classification, exemption, deduction, or credit is substantially similar to that of the state within the state B&amp;O, then the definitions used for the tax classification, exemption, deduction, or credit by the city must be identical</p>
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<p><b>Model Ordinance: Provisions pertaining to Apportionment of Taxable Income</b></p>	<p>Provides that DOR continue to work with AWC and the business community on the issues of apportionment and allocation of taxable income.</p> <ul style="list-style-type: none"> <li>-</li> <li>- Must report to the Governor and Legislature by the first day of the 2003 session.</li> </ul>	<p>Provides the following:</p> <ul style="list-style-type: none"> <li>-</li> <li>- The total taxable income apportioned cannot exceed 100% of the income if it were taxed under the state B&amp;O;</li> <li>- - Federal interstate commerce provisions with respect to nexus apply in the determination of taxable income in intrastate commerce;</li> <li>- - The activities of extracting, manufacturing, and processing for hire are subject to tax in the jurisdiction where the activity occurs;</li> <li>- - Retail sales and wholesales are subject to tax where the sale takes place, generally;</li> <li>- - Service activities are subject to tax where the service is performed. If the business provides services in more than one jurisdiction, the business must apportion to each jurisdiction that portion of its income derived in that jurisdiction.</li> <li>- - For taxation purposes, a business is prohibited from apportioning any gross receipts to a jurisdiction in which it has no nexus. Takes effect January 2005.</li> </ul>
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<p><b>Other Provisions</b></p>	<p>A change is made to the Department of Revenue administrative statutes to make the interest calculation for refunds, in terms of the period of time to which the interest would apply, consistent with the interest calculation used for assessments.</p>	
<p><b>Other provisions</b></p>		<p>Restricts the potential growth in city B&amp;O tax rates. For cities that have B&amp;O ordinances as of the effective date of the bill, the maximum rate for any tax classification is 0.2%, Unless higher rates were in effect as of January 2002, in which case the higher rates are grandfathered. In cities that have B&amp;O ordinances as of the effective date, rates may increase in annual increments of 0.01% until a maximum rate equal to 25% of the January 2002 rate. Provides that cities that first enact B&amp;O ordinances after the effective date of the bill must have initial classification rates no higher than 0.1%, and may only increase by 0.01% per year up to a maximum of 0.2%. In the case of cities with more than one rate classification, a single uniform rate</p>

**Appropriation:** None.

**Fiscal Note:** Available.

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