
Finance Committee

ESSB 6492

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

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Pedersen, Rolfes and Wilson, C.).

Brief Summary of Engrossed Substitute Bill

- Eliminates the Workforce Education Investment Act surcharges retroactively to January 1, 2020.
- Replaces the current Workforce Education Investment Act surcharge with a 1.75 percent business and occupation (B&O) rate for most service activities beginning April 1, 2020.
- Imposes a 1.5 percent service activities B&O rate for hospitals, taxpayers subject to the advanced computing surcharge, and taxpayers with less than \$1 million in gross receipts in the preceding calendar year beginning April 1, 2020.
- Imposes an advanced computing surcharge of 1.22 percent of a business' gross service and other income beginning April 1, 2020.

Hearing Date: 2/3/20

Staff: Tracey O'Brien (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.

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.

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 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.

Workforce Education Investment Act Surcharge.

In 2019 the Legislature enacted the Workforce Education Investment Act (WEIA) from Engrossed Second Substitute House Bill 2158 (E2SHB 2158). As part of this legislation, a new three-tiered Workforce Education Investment surcharge was established.

The first tier of 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 and other activities, including, but not limited to, architecture and engineering services, legal services, insurance carriers, financial services, medical services, software publishing, scientific research, electronic shopping, and telecommunications services.

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 of 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 thereto, or provides cloud computing services, operates an online marketplace, an online search engine, or an online social networking platform.

Workforce Education Investment Account.

As part of E2SHB 2158, the Workforce Education Investment Account was created. All revenues from the Workforce Education Investment surcharges must be deposited in the WEIA. The account 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 Career Connected Learning (CCL). Expenditures from the WEIA must be used to supplement, not supplant, other federal, state, and local funding for higher education.

Summary of Bill:

The mechanics of the Workforce Education Investment surcharge (surcharge) are changed. The current surcharge rates and classifications are repealed retroactively to January 1, 2020.

Beginning April 1, 2020, the service activities B&O tax rate is changed to 1.75 percent of the gross income of the business, except for persons subject to the advanced computing surcharge, persons with a gross income of less \$1 million, and hospitals. The WEIA must receive 14.3 percent of the revenues collected from the imposition of the 1.75 B&O tax rate.

The service activities B&O exception rate is 1.5 percent of the gross income of the business for the listed exceptions. The exceptions include persons subject to the advanced computing surcharge and hospitals. The exceptions also include persons with a gross income for the immediately preceding calendar year of less than \$1 million, unless the person is affiliated with one or more other persons and the aggregate gross income of the business subject to the service B&O tax for all affiliated persons was greater than or equal to \$1 million for the immediately preceding calendar year. "Affiliate" means a person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with another person. "Control" is defined as the possession, directly or indirectly, of more than 80 percent of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting share, by contract, or otherwise.

To aid in the administration of the applicability of the 1.5 percent B&O exception tax rate based on gross income, the DOR may require a person to identify all the person's affiliates, including tax registration number or unified business identifier. If the DOR establishes by clear, cogent, and convincing evidence that a person, with intent to evade the 1.75 percent B&O tax rate failed to provide the department with complete and accurate information within 30 day of the request, the person is ineligible for 1.5 percent B&O tax exception rate for the current calendar year as well as the following four calendar years. The DOR may grant a waiver from this penalty if the DOR has not previously determined that the person failed to fully comply with the request and within 30 days of notification of additional tax due as the result of the person's failure to comply, the DOR determines that the person has come into full compliance.

If a person is subject to reconciliation when apportioning income and calculates the gross income of the business subject to the B&O tax rate for the immediately preceding calendar year, or aggregate gross income of the business subject to this tax for the immediately preceding calendar year for all affiliated persons, based on incomplete information, the person must correct the reporting for the current calendar year when complete information for the immediately preceding calendar year is available.

The tiered advanced computing surcharge is replaced with a single surcharge of 1.22 percent (surcharge) of a business' gross service and other income. The surcharge applies to advanced computing businesses with gross-income worldwide in excess of \$25 billion. This surcharge must be reported and paid on a quarterly basis. The minimum surcharge amount to be paid by all members of an affiliated group of \$4 million is eliminated and the maximum amount is increased to \$9 million.

If the DOR establishes by clear, cogent, and convincing evidence that one or members of an affiliated group, with an intent to evade the advanced computing surcharge, failed to identify all other members of the affiliated group, the DOR must assess against that person, or persons collectively, a penalty equal to 50 percent of the amount of the total surcharge payable by all member of that affiliated group for the calendar year.

If a business that is primarily engaged in business as a financial institution is not subject to the advanced computing surcharge.

The five members of Workforce Education Investment Accountability and Oversight Board (Board) must represent not only persons subject to the advanced computing surcharge, but also the new 1.75 B&O tax rate.

The changes made to the advanced computing surcharge apply both prospectively and retroactively to January 1, 2020.

The requirements of tax preference performance statements, a JLARC review, and the automatic 10 year expiration do not apply to any tax preference creating under this act.

Appropriation: None.

Fiscal Note: Requested on January 31, 2020.

Effective Date: The bill contains an emergency clause and takes effect immediately, except for Section 1 (changes to the Board membership), Section 2 (changes to the WEIA revenues), and Section 3 (new service B&O rate), take effect on April 1, 2020.