

HOUSE BILL REPORT

HB 1853

As Reported by House Committee On:
Finance

Title: An act relating to clarifying the decision of the Washington state supreme court in Simpson Investment Co. v. Dept. of Revenue.

Brief Description: Clarifying a supreme court decision on taxes.

Sponsors: Representatives Morris, Cairnes, Pennington, Miloscia, Roach, Benson, Van Luven, Veloria, Carrell, Kessler and Linville.

Brief History:

Committee Activity:

Finance: 2/20/01, 4/2/01 [DP].

Brief Summary of Bill

- Defines financial businesses for Business & Occupation tax purposes.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass. Signed by 6 members: Representatives Cairnes, Republican Co-Chair; Morris, Democratic Co-Chair; Berkey, Democratic Vice Chair; Roach, Republican Vice Chair; Carrell and Conway.

Minority Report: Without recommendation. Signed by 2 members: Representatives Santos and Veloria.

Staff: Bob Longman (786-7139).

Background:

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. All business activities are subject to B&O tax unless there is a specific exemption or deduction. (A "deduction" for the B&O means a deduction from gross receipts before tax is applied. Therefore, a deduction is essentially the same as an exemption for purposes of determining taxability.)

There is a B&O deduction for dividends received by a parent corporation from its subsidiaries. There is also a deduction for the investment of income of all persons other than those "engaging in banking, loan, security, or other financial businesses." In other words, only banking, loan, security and "other" financial businesses pay B&O tax on investment income. Private investors are not taxed. Investment income received by nonfinancial businesses is not taxed.

There has been some question and litigation over what "other financial business" means for B&O tax purposes. The state Supreme Court has defined a financial business as one that meets both of these requirements: (1) The business has a primary purpose of earning income through utilization of significant cash outlays, and (2) The business is comparable to a banking, loan, or security business. This interpretation was most recently applied in the Simpson Investment Company case decided in July, 2000. The Simpson Investment Company is a parent holding company of four corporations: Simpson Timber Company and its subsidiaries; Simpson Paper Company and its subsidiaries; Simpson (formerly Western Pacific) Extruded Plastics and its subsidiary; and Simpson Foreign Sales Company. Simpson Investment gets the majority of its income as dividends from its subsidiaries. These dividends are exempt from tax and were not at issue in the case. Simpson Investment also gets a small portion of its income from interest on bank deposits, stock dividends, and profits from market hedging and futures trading. The Department of Revenue assessed B&O tax on this income. Simpson Investment appealed, and the Supreme Court upheld the department. The court held that Simpson Investment was a financial business.

Summary of Bill:

Investment income is exempt from B&O tax unless it is received by one of the following types of business:

- (1) Businesses holding themselves out to the public as a banking, loan, or other financial institution, and chartered as such under law.
 - (2) Holding companies of banking, loan, or other financial institutions.
 - (3) Businesses holding themselves out to the public and engaged in business as a subsidiary or affiliate of a banking, loan, or other financial institution.
 - (4) Businesses holding themselves out to the public and engaging in business as a housing lender, securities underwriter, securities broker, provider of revolving credit accounts, or provider of installment sales contracts. The legislation provides specific definitions and descriptions of each of these types of business.
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Appropriation: None.

Fiscal Note: Available.

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

Testimony For: There is a great deal of uncertainty as to who must pay tax as a financial business. The statutory phrase "other financial business" is vague. Every taxpayer wants certainty. One solution some firms use, is to move out of state. This bill restores the status quo before the Simpson case. This bill accomplishes three objectives: it provides certainty to taxpayers; it leaves the policy decision as to who receives the deduction with the Legislature; and it relieves the Department of Revenue and the courts the burden of determining who qualifies for the deduction on a case-by-case basis.

Testimony Against: This bill is premature. The department is working with stakeholders to find a solution and this bill would destabilize that process. This bill has unintended consequences. It does not provide more certainty. It just substitutes new problems in defining taxable financial businesses.

Testified: (In support) Garry Fujita, Association of Washington Businesses/Davis Wright Tremaine; Charles Pietka, Moss Adams Ltd.; Gregg Barton, Perkins Coie, Association of Washington Businesses; Tracy Day, American Electronic Association; Mike Kelley, Deloitte Touche; and John Poffenburger, Stoel Rives LLP.

(In opposition) Fred Kiga, Department of Revenue; and Claire Hasselholt, Department of Revenue.