

SENATE BILL REPORT

ESHB 2658

As Reported By Senate Committee On:
Ways & Means, March 4, 2002

Title: An act relating to changing requirements regarding state and local tax to provide for municipal business and occupation tax uniformity.

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

Sponsors: House Committee on Finance (originally sponsored by Representatives Gombosky, Dunshee, Romero, Reardon, Berkey, Upthegrove, Edwards, Chase, Kenney, Linville, McIntire and Conway; by request of Governor Locke).

Brief History:

Committee Activity: Ways & Means: 3/4/02 [DPA].

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: Do pass as amended.

Signed by Senators Brown, Chair; Regala, Vice Chair; Fairley, Vice Chair; Fraser, Hewitt, Honeyford, Kline, Kohl-Welles, Rasmussen, Roach, Rossi, B. Sheldon, Snyder, Spanel, Winsley and Zarelli.

Staff: Terry Wilson (786-7433)

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. City B&O taxes on retail sales are limited to a maximum of 0.2 percent, but higher rates are allowed 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.

Major business concerns about city B&O taxes include the lack of uniformity among city tax systems and multiple taxation of the same income by two or more cities. Cities have expressed concern that legislation would entail a significant loss of local autonomy and flexibility needed to address unique local circumstances.

In May 2001 the Governor directed the Department of Revenue (DOR) to convene a work group of city and business representatives to develop a solution regarding municipal taxation. The department was to submit a report by October 15, 2001, of the recommended solution of the work 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 Excise Taxes. The state B&O tax is imposed on the gross receipts of business activities conducted within the state without deduction for the costs of doing business. Interest and penalties are assessed on taxpayers who are late in paying the state excise taxes. Refunds are made for overpayments of tax, with interest. For 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 Amended Bill: Cities imposing a B&O tax are required to work through the Association of Washington Cities (AWC) to adopt a model ordinance that will provide a more uniform system of municipal B&O taxes. The model ordinance does not apply to utility businesses. The ordinance may not be amended more frequently than every four years except to comply with state law changes.

The model ordinance must include a number of mandatory provisions: a system of credits that prevent multiple taxation of the same income; a gross receipts threshold of \$20,000 for small businesses or such higher threshold as may exist on January 1, 2002; tax reporting frequency requirements; provisions for penalties and interest; claim and refund provisions; and certain definitions, to be based on comparable definitions within the state B&O statutes. Deviations from the state B&O definitions must be noted in the model ordinance.

With the exception of the system of credits, cities may continue to adopt their own tax exemptions, credits, deductions, and other preferences, as well as tax classifications and tax rates. With respect to any nonmandatory provisions, cities that deviate must make a description of the deviations available.

Cities with B&O taxes must provide credits against:

- Retail or wholesaling taxes for any manufacturing or extracting taxes paid on the same products;
- Manufacturing taxes for any extracting taxes paid on the same products; and
- Retail or wholesaling taxes for any printing or publishing taxes paid on the same publications.

The model ordinance must include provisions for credits that will prevent the multiple taxation of business service income and income of any other classifications of businesses.

Cities with B&O taxes must allow for monthly, quarterly, or annual reporting of taxes. A city may require monthly reporting only if the taxpayer also reports state B&O taxes on a monthly basis.

Cities with B&O taxes must calculate interest on assessments and refunds in the same manner as state excise taxes.

Cities with B&O taxes must provide the following penalties, modeled on state excise taxes:

<u>Activity</u>	<u>Penalty</u>
Delinquent return payments	5, 10, or 20 percent, depending on the tardiness
Delinquent assessment payments	10 percent of additional tax due

Warrants	5 percent of tax due
Disregard of specific written instruction	10 percent of additional tax due
Intent to evade	50 percent of the additional tax due

The aggregate penalties that may be imposed for late filings, late payments on assessments, and on warrants are 35 percent of the tax due. Penalties may not be issued for both intent to evade and disregard of written instruction.

Cities with B&O taxes must provide for four-year limitations on the length of the claim periods for assessments and refunds, modeled upon state excise taxes.

The model ordinance must also include definitions for a number of terms. These include:

- Eligible gross receipts tax,
- Extracting,
- Manufacturing (which may not include software development as an activity),
- Nexus (which must be based on United States commerce clause standards),
- Retailing,
- Retail sale,
- Services (excluding retail and wholesale services),
- Wholesale sale, and
- Wholesaling.

DOR must continue to work with AWC and the business community on the issues of apportionment and allocation of income, and on the issue of the application of B&O taxes to the creation of intellectual property. The work group must report to the Governor and the Legislature by the beginning of the 2003 session. The model ordinance must include provision for the apportionment and allocation of business income by January 1, 2005.

Cities that impose B&O taxes must comply with all provisions of the bill by December 31, 2003. Cities are immediately preempted from imposing a gross receipts tax on intellectual property creating activities, including research, development, authorship, creation, or other inventive activity, unless a city imposed such a tax as of January 1, 2002. In the latter case, a city is prohibited from imposing such a tax as of January 1, 2004.

The calculation of interest on refunds for state excise taxes is changed to be consistent with the calculation of interest on assessments.

Amended Bill Compared to Substitute Bill: Cities imposing B&O taxes must adopt the ordinance working through AWC. The prohibition on taxing intellectual property creating activities is removed. Technical corrections are made.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains several effective dates. Please refer to the bill.

Testimony For: The Municipal Task Force studied this issue. This bill resulted from a collaborative process. This bill is consistent with the Competitive Council's recommendations. This bill strikes the appropriate balance on uniformity and local control. Business will know exactly what is taxed with uniform definitions. It is a concern that a business might not know something is taxed by a city because it isn't taxed by the state. Apportionment is a big issue. It should not be required until the effects are known and study is warranted.

Testimony Against: The bill does not fix the problem. The definitions should be the same as the states. The business community feels the proposed bill does not go far enough. We want fair apportionment. The Washington Software Alliance is against the bill without the intellectual property section.

Testified: PRO: Jim Hedrick, OFM/Office of the Governor; Terese Holm, City of Bellingham; Randy Lewis, City of Westport; Dwight Dively, City of Seattle; Ron Rosenbloom, Association of Washington Cities; Lew McMurrin, WSA; Mark Gripp, Real Networks; Pro with amendments: Carolyn Logue, National Federation of Independent Business; Gary Smith, Independent Business Association; CON: Ron Bueing, AWB.