

HOUSE BILL REPORT

HB 2186

As Reported by House Committee On: Finance

Title: An act relating to investing in Washington families by improving the fairness of the state's excise tax system by narrowing or eliminating tax preferences, imposing a business and occupation tax surcharge while eliminating tax liability for small businesses, enacting an excise tax on capital gains, modifying the real estate excise tax, making administrative changes, and implementing marketplace fairness in Washington.

Brief Description: Concerning investing in Washington families by improving the fairness of the state's excise tax system by narrowing or eliminating tax preferences, imposing a business and occupation tax surcharge while eliminating tax liability for small businesses, enacting an excise tax on capital gains, modifying the real estate excise tax, making administrative changes, and implementing marketplace fairness in Washington.

Sponsors: Representatives Lytton, Jinkins and Macri.

Brief History:

Committee Activity:

Finance: 4/3/17, 4/4/17 [DPS].

Brief Summary of Substitute Bill

- Imposes a 7 percent tax on adjusted Washington capital gains.
- Makes changes to the business and occupation tax (B&O), including imposing a 20 percent surtax on certain activities, increasing the filing threshold, repealing the small business credit, creating a new deduction of \$250,000, and repealing several preferential rates.
- Eliminates or narrows several tax preferences.
- Reforms the real estate excise tax.
- Requires the reporting of subcontractor information to the Department of Revenue.
- Requires marketplace facilitators, referrers, and their sellers to collect and remit sales or use tax, or comply with notice and reporting requirements.
- Expands liability for unpaid tax obligations for sales and use taxes, B&O tax, cigarette taxes, and other tobacco product taxes.

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.

- Sets a new interest rate for tax refunds.
- Makes transfers of new revenue to the Education Legacy Trust Fund.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 6 members: Representatives Lytton, Chair; Frame, Vice Chair; Dolan, Pollet, Springer and Wylie.

Minority Report: Do not pass. Signed by 5 members: Representatives Nealey, Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Condotta, Stokesbary and Wilcox.

Staff: Tracey O'Brien (786-7152).

Background:

Capital Gains.

Most property owned by an individual for personal purposes is a capital asset, including a house, furniture, car, stocks, and bonds. The sale of these items may result in a capital loss or a capital gain. At the federal level, the gains on some of these capital assets may be subject to taxation, and the losses may be deducted, plus \$3,000 if filing jointly, when computing an individual's net capital gain for tax liability purposes. The holding period for short-term capital gains or losses is less than one year. The holding period for long-term capital gains or losses is more than one year.

At the federal level, some property is exempted from capital gains. This includes stock in trade and other inventory, accounts or notes receivable, depreciable property, real estate used in a trade or business, and certain hedging transactions. In addition, an individual may not need to report the sale or exchange of a main home.

An individual filing a 1040 federal return will calculate any capital gains or losses on Form 8949 and report the gain or loss on Schedule D. Capital gains are taxed generally at a lower rate than the tax rates that apply to other income. The rates are determined by the source of the net capital gain. For tax year 2016, the six maximum capital gains rates are 0 percent, 15 percent, 20 percent, 25 percent, and 28 percent. If the net capital gain resulted from the sale of collectibles, the 28 percent rate applies; however, if the gain is not from the sale of collectibles, small business stock, or unrecaptured section 1220 gain, and the regular tax rate that would apply is 10 or 15 percent, then the capital gains rate is 0 percent.

Business and 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.

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 activities not classified elsewhere. Several preferential rates also apply to specific business activities.

In addition, there are other tax preferences, including credits and deductions, that a business may be eligible to utilize 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, credit is \$35 per month multiplied by the number of months in the reporting period.

A business that does not owe other taxes or fees to the Department of Revenue (DOR) and that has annual gross proceeds of sales, gross income, or value of products for all B&O tax classifications less than \$28,000 per year, or \$46,667 if at least 50 percent of their taxable income is from certain activities, does not have to file an annual B&O tax return.

Real Estate Excise Tax.

The sale of real property is subject to the real estate excise tax (REET). The tax base is the selling price of the real property, without any deduction for mortgages, liens, or other debts. The tax is typically paid by the seller. A transfer of controlling interests in entities that own property in Washington is also subject to the REET.

The state REET rate is a flat 1.28 percent. The state revenue is distributed, through June 30, 2019, as follows: 98 percent to the State General Fund, 2 percent to the Public Works Assistance Account, 4.1 percent to the Education Legacy Trust Account (ELTA), and 1.6 percent to the City/County Assistance Fund. Any penalties assessed for delinquent tax payments are deposited into the Housing Trust Fund. In addition, counties retain 1.3 percent of the state tax collected to cover administrative costs. In fiscal year 2016, the state REET resulted in \$959,492,000 in revenue, which was a 18.6 percent increase; however, during the recession in 2008-2011, REET revenues experienced negative growth.

Local governments are also authorized to impose a REET. Cities and counties are authorized to impose a 0.25 percent REET to finance capital improvements or capital projects specified in a comprehensive plan. A city and county may also impose a 0.5 percent REET for general purposes, so long as the city or county does not impose the optional 0.5 percent retail sales tax. In addition, a county may impose a 1 percent REET to finance the acquisition and maintenance of conservation areas, and 0.5 percent to finance the acquisition, construction, and operation of affordable housing for low to moderate income persons, or persons with special needs.

Sales and Use Tax.

Retail sales taxes are imposed on retail sales of most articles of tangible personal property, digital products, and some services. A retail sale is a sale to the final consumer or end user of the property, digital product, or service. If retail sales taxes were not collected when the user acquired the property, digital products, or services, then use taxes apply to the value when used in this state. The state, most cities, and all counties levy retail sales and use taxes. The

state sales and use tax rate is 6.5 percent. Local sales and use tax rates vary from 0.5 percent to 3.1 percent, depending on the location.

Nexus.

Nexus is required before a taxing jurisdiction can impose taxes on an entity. In the case of sales or use taxes, nexus is necessary in determining whether an out-of-state business selling products into a state is liable for the collection of sales or use taxes for that state. A legal analysis of nexus involves the Dormant Commerce Clause and the Due Process Clause in the United States Constitution. If a tax violates either, it will be invalid. The Dormant Commerce Clause analysis focuses on the structural concerns on the national economy, and whether the tax inhibits interstate commerce. The Due Process Clause analysis focuses on the authority of a state to impose the tax on a particular taxpayer.

In 2015 Washington adopted "click through" nexus. Under this nexus standard, certain remote sellers are required to collect and remit Washington sales tax for sales made into the state, and may also have to pay B&O tax on their Washington sales. A remote seller is covered by "click through" nexus if the remote seller: enters into agreements with Washington residents who, for a commission or other consideration, refers potential customers to the remote seller, such as by a link on a website; and generates more than \$10,000 in gross receipts during the prior calendar year under such agreements from sales into this state.

Interest Rate on Refunds.

The DOR must pay interest on refunds, and must impose interest on assessments. The Legislature determines the method for calculating the interest rates. The method of calculation, and the rates themselves, have changed over the years.

The current calculation for the interest rate is the federal short-term rate, plus 2 percent. For calendar year (CY) 2017, the rate for both assessments and refunds is 3 percent. The rates for refunds and assessments have been identical since CY 1998.

Summary of Substitute Bill:

Part I – Capital Gains.

A 7 percent tax is imposed on the adjusted capital gain of an individual for the privilege of selling or exchanging long-term capital assets, or receiving Washington capital gains. This tax is in addition to any other taxes imposed by state and local governments. This tax also applies to beneficial owners who are individual owners of long-term capital assets held by pass through, or other disregarded entity, to the extent the individual's ownership interest in the entity is reported for federal tax purposes.

A "Washington capital gain" is defined as an individual's adjusted capital gains allocated to this state less \$25,000 for an individual, or \$50,000 if filing jointly. "Adjusted capital gain" is defined as the net federal long-term capital gain plus any loss from a sale or exchange that is exempt from the tax imposed in this chapter, and less any gain from a sale or exchange that

is exempt from the tax imposed in this chapter, to the extent such gain or loss was included in calculating federal net long-term capital gain.

Long-term assets can include real estate and intangible or tangible personal property. For real estate, the capital gains tax applies if the real property sold or exchanged is in Washington, or the majority of the fair market value of the property is in this state. For intangible personal property, capital gains will apply if the taxpayer was domiciled in Washington at the time of sale or exchange. For tangible personal property, capital gains tax will apply if property was located in Washington at the time of the sale or exchange. The sale of tangible personal property will also be subject to the states capital gains tax if: (1) the property was located in Washington at any time during the current or immediately preceding taxable year; (2) the taxpayer was a Washington resident at the time of the sale or exchange; and (3) the sale was not subject to income or excise tax on the adjusted capital gain by another taxing jurisdiction.

The following assets are exempt from the capital gains tax:

- any residential dwelling, which means property that consists solely of a single-family residence, a residential condominium unit, or a residential cooperative unit, including an accessory dwelling unit, a multifamily residential building consisting of common walls and fewer than four units, or a floating home;
- retirement assets, including 401(k), a tax-sheltered annuity and custodial account, deferred compensation plans, individual retirement accounts (IRAs), Roth IRAs, employee defined contribution programs, employee defined benefit programs or similar retirement saving vehicles;
- assets condemned by the government;
- cattle, horses, or breeding livestock held for more than 12 months if 50 percent of the taxpayer's gross income for the year is from farming or ranching;
- agricultural or timber lands that the taxpayer has regular, continuous, and substantial involvement in the operation of the land, and meets the federal criteria for "material participation" for 10 years previous to a sale;
- property used in a trade or business if it qualifies for depreciation under federal law; and
- timber or receipts from a Real Estate Investment Trust.

A "resident" is an individual domiciled in Washington during the entire taxable year. A resident also includes a person who is not domiciled in Washington during the taxable year, but maintained a place of abode, and was physically present in Washington for more than 183 days during the taxable year. Such person will be a resident for that portion of the year in which domiciled or maintained a place of abode. If an individual maintained no permanent place of abode in this state during the entire taxable year, maintained a permanent place of abode outside of Washington for an entire taxable year, and spent an aggregate of no more than 30 days in Washington, the person is considered a nonresident.

Deductions are allowed for taxes prohibited by the United States or Washington constitutions or laws. In addition, a deduction for Washington capital gains tax paid is available for the B&O tax. Credits are allowed equal to the amount of any legally imposed income or excise tax paid by the taxpayer to another jurisdiction.

The administrative provisions for the DOR apply to this new tax, and additional provisions for the filing, payment, and applicable penalties are included. The DOR may enter into reciprocal agreements with other states to offset delinquent taxes.

It is a class C felony for knowingly attempting to evade payment of the capital gains tax. It is a gross misdemeanor for knowingly failing to pay tax, make returns, keep records, or supply information required.

All revenues from the capital gains tax will be deposited into the Education Legacy Trust Account.

Part II – Business and Occupation Rate Changes and Deduction.

The filing threshold for B&O taxes is increased to \$150,000. A deduction of \$250,000 is authorized for businesses with a taxable amount of less than or equal to \$250,000. If a business' taxable amount is greater than \$250,000, but less than \$500,000, there is a deduction of \$100,000.

If a taxpayer claims a Multiple Activities Tax Credit, they can claim a credit instead of a deduction. The credit for a calendar year will be equal to or lesser of tax due or the amount:

- for a person with a taxable amount of less than or equal to \$250,000 — \$250,000 multiplied by the highest applicable B&O rate to the taxpayer; or
- for a person with a taxable amount of greater than \$250,000, but less than \$500,000 — \$100,000 multiplied by the highest applicable B&O rate to the taxpayer.

A 20 percent surcharge on the B&O tax is imposed for selected business activities:

- Beginning July 1, 2017: extractors, manufacturers, most retailers, real estate brokers, digital products or services, nonprofit research and development, insurance producers, hospitals, salmon canning, radioactive waste clean-up, wholesalers, insurance agents, radio and television broadcasters, government contractors, printers, publishers highway contractors, extracting or processing for hire, warehousing, contest of chance, international investment management, custom software, loan interest, royalties, professional employer organizations, day care, chemical dependency services, and grocery distribution co-ops.
- Beginning July 1, 2024: meat slaughter and processing for wholesale.

The small business B&O credit is repealed.

A tax preference performance statement is provided for the B&O deduction. The legislative public purposes of the tax preference is to provide tax relief for certain businesses or individuals. If a Joint Legislative Audit and Review Committee (JLARC) review finds that more than 100,000 businesses in the state per year experience tax relief, it is the intent of the Legislature to extend the preference beyond the expiration date of January 1, 2033.

Part III – Eliminating or Narrowing Tax Preferences.

The sales tax exemption for bottled water is eliminated; however, there are exceptions for medically prescribed water, or if a person's primary source of drinking water is considered unsafe.

The preferential B&O rate for warehousing and reselling prescription drugs is repealed.

The use tax exemption for self-produced fuel is narrowed to include only biomass fuels. The use tax for refinery fuel gas is 3.852 percent. The value of refinery fuel gas is set to the United States natural gas wellhead price.

The preferential B&O tax rate on international investment management services of 0.275 percent is repealed, thereby imposing the general service rate of 1.5 percent on this class of services.

The nonresident sales tax exemption is converted to a remittance program. Refunds may only be requested by nonresidents for the immediately preceding CY, and must be for at least \$25. In addition, a nonresident may only make one refund request per CY. The request must include proof of nonresident status as prescribed by DOR. Penalties are created for making fraudulent statements or submitting fraudulent documents.

Part IV – Real Estate Excise Tax.

New graduated REET rates based on the value of real property sold are imposed. The rates are as follows:

- 0.75 percent if the selling price is less than \$250,000;
- 1.028 percent if the selling price is equal to or greater than \$250,000, and less than \$1 million;
- 2 percent if the selling price is equal to or greater than \$1 million, but less than \$5 million; or
- 2.5 percent if the selling price is equal to or greater than \$5 million.

In addition, the REET will be paid when a lender or creditor receives property through a foreclosure proceeding, or by enforcing a judgment. It will also be imposed when property is sold at a foreclosure or sheriff's auction, or if the property is transferred by order of the court in a foreclosure, or judgment enforcement proceeding.

A tax preference performance statement is provided for the preferential rate for the sale of real property for less than \$250,000. The JLARC is directed to review the tax preference and it is the intent of the Legislature to extend the expiration date of the preferential rate if more than 1,000 transactions per year in this state are experiencing tax relief from the preference. The expiration date of the graduated REET rates is January 1, 2033.

Part V – Local Governments/Building Permits.

Upon final inspection of a residential dwelling, the local jurisdiction that issued the building permit is required to obtain general information of any subcontractors that worked under the building permit. Local jurisdictions must provide all collected information to the DOR on a monthly basis. The DOR may share the information with the Department of Labor and Industries and the Employment Security Department. The local jurisdictions are permitted to charge the contractor a fee to defray the costs of information collection.

Part VI – Remote Sellers, Referrers & Marketplace Facilitators.

Beginning January 1, 2018, remote sellers, referrers, and marketplace facilitators that meet the statutory criteria must remit sales or use tax, or comply with the notice and reporting requirements in this act. An election by a marketplace facilitator, referrer, or remote seller to collect and remit sales or use tax can only be changed upon written notice to the DOR, will not take effect until January 1 of the calendar year at least 12 months past the date of election to collect and remit, and the written notice must occur at least 30 days prior to the election being changed.

This act applies to marketplace facilitators or remote sellers that have gross receipts sourced to Washington of at least \$10,000. A referrer must comply with this act if during the current or previous calendar year, the gross business income received from its referral services sourced to Washington, whether or not they are subject to sales or use tax, is at least \$10,000.

Notice and Reporting Requirements

A seller that meets the nexus criteria in this act, but not the physical presence nexus, and who does not collect and remit sales or use tax on all taxable retail sales into Washington, must comply with the reporting and notice requirements.

A seller, other than a referrer, must post a conspicuous notice on its website or catalog, as well as on its invoices or sales receipts, that include a statement for Washington consumers that sales or use tax is due on certain purchases, and that Washington requires the purchaser to file a use tax return. In addition, this seller must also provide an annual report to each Washington purchaser that the seller did not collect sales or use tax on any sales, and must include the details on the purchaser's transactions in the previous year. Finally, a seller, other than a referrer, must file an annual report with the DOR that includes Washington purchasers' information, and an affidavit signed under penalty of perjury from a seller's officer affirming that the seller has made reasonable efforts to comply with consumer notice and reporting requirements. These reporting requirements do not apply to sellers registered with the DOR to collect and remit sales and use tax, and who make a reasonable effort to comply with current requirements.

A referrer must post conspicuous notice on its platform that informs Washington purchasers that sales or use tax is due on certain purchases, and a purchaser may have to file a use tax return with the DOR. Annually, a referrer must send a report to its marketplace sellers to whom the referrer transferred a potential purchaser located in Washington during the previous year. The report to a referrer's seller must state that Washington imposes a sales or use tax on retail sales, and a seller meeting the acts requirements must either collect and remit sales or use tax, or comply with the states notice and reporting requirements for sellers. The referrer must also send a report to the DOR that includes a list of sellers who received notice, and an affidavit signed under the penalty of perjury from a referrer's officer stating that the referrer has made reasonable efforts to comply with the notice and reporting requirements under this act.

Penalties

A penalty is imposed on a seller, other than a referrer, who fails to provide notice or post a conspicuous notice to consumers at the time of purchase, in the amount of \$20,000. A penalty is imposed on a seller, other than a referrer, who fails to provide a report to its

purchasers of all sales in the previous CY in the amount of 8.5 percent of gross taxable sales in Washington for the CY.

A penalty is imposed on a referrer that fails to post a notice to consumers on its platform in the amount of \$20,000. A penalty in the amount of 8.5 percent of gross taxable sales in Washington is imposed on a referrer who fails to provide the required report to its sellers.

A penalty of \$25 per failure, but not less than \$20,000, is imposed on any seller who fails to file required reports with the the DOR.

A seller is entitled to a conditional waiver if the seller enters into a written agreement to fully comply with all notice and reporting requirements beginning on a date acceptable to the DOR. The DOR may grant a waiver for one or more violations; however, the DOR may not grant more than one request by a seller for a waiver. The conditional waiver can be invalidated if the seller fails to comply.

Definitions

A "marketplace facilitator" is a person that contracts with sellers to facilitate, for consideration, regardless of whether its deducted as fees from a transaction, the sale of the seller's products through a catalog, or a physical or electronic marketplace, and engages:

- directly or indirectly, through one or more affiliated persons in: communicating an offer and acceptance between the buyer and seller; owning or operating the infrastructure (electronic or physical) that brings buyers and sellers together; providing virtual currency; or software development or research and development related to the marketplace operated; and
- payment processing services; fulfillment or storage services; listing for sale for consideration; setting prices; branding sales as those of the marketplace facilitator; order taking; advertising or promotion; or providing customer service and assistance with returns and exchanges.

A "marketplace seller" is a seller that makes retail sales through a physical or electronic marketplace operated by a marketplace facilitator, regardless of whether the seller is required to be registered with the DOR.

A "referrer" is defined as a person who contracts or otherwise agrees with a seller to list or advertise for sale items in any medium, receives a commission, fee, or other consideration from a seller for listing or advertising, transfers a potential purchaser to a seller or an affiliated person to complete the sale, and does not collect receipts from the purchasers for the transaction.

A "remote seller" refers to any seller who does not have a physical presence in this state, and makes sales to purchasers.

Liability for Unpaid Taxes

A marketplace facilitator or referrer is relieved of liability for failure to collect the correct sales or use tax if it can show that the error was due to incorrect information from an unaffiliated seller. The seller would be solely liable for unpaid tax. A marketplace facilitator or referrer is also relieved of liability, if: (1) the sale was made in a marketplace facilitator's

marketplace or directly resulting from referral by the referrer; (2) the seller is unaffiliated; and (3) the seller fails to pay the tax, not due to sourcing the sale. The maximum amount of relief is phased in, and represents a percentage of a marketplace facilitator's total tax due, or a percentage of a referrer's taxable retail sales in Washington.

The marketplace seller is relieved of liability for failure to collect and remit the correct sales or use tax if: there is documentation that the marketplace facilitator is registered with the DOR, and it will collect all applicable taxes on behalf of the marketplace seller made through the facilitator's marketplace. In addition, a marketplace seller is relieved of liability for all taxes on sales made through a marketplace facilitator if the marketplace seller is also a remote seller, and the marketplace facilitator provides the seller with written confirmation that the facilitator has elected to comply with notice and reporting requirements in lieu of collecting sales or use tax.

The relief of liability does not affect the obligation of any purchaser to remit sales or use tax concerning any applicable taxable transaction in which the seller or seller's agent does not collect and remit sales tax.

Class action lawsuits are prohibited against a marketplace facilitator on behalf of buyers arising from overpayment of sales or use tax. In addition, this act is subject to compliance with the streamlined sales and use tax agreement and federal law.

Nothing in this act relieves sellers or consumers currently subject to sales or use tax from their responsibilities under chapters 82.08 and 82.12 of the RCW, nor prevents the DOR from administering or enforcing those taxes.

Part VII – Expanding Individual Liability for an Entity's Unpaid Tax Obligations.

Officers and other persons with the responsibility to remit taxes are liable for the recoverable tax liability. This recoverable tax liability includes B&O taxes, sales or use taxes, cigarette taxes, and other tobacco product taxes.

Part VIII – Interest Rate on Tax Refunds.

Beginning January 1, 2018, the interest rate on tax refunds will be the federal short-term rate.

Part IX – Transfers to the Education Legacy Trust Account.

The DOR must estimate the increase in general fund revenue from the B&O tax changes, the narrowing of tax preferences, and the sales and use tax changes (parts II, III and VI of the act) by June 15, and December 15, of each year. The State Treasurer must transfer an amount equal to the DOR's estimate from the General Fund to the ELTA by the last workday of the second and fourth quarters.

The DOR must estimate the increase in General Fund revenue from the changes in the REET (part IV of the act) by September 15, April 15, June 15, and December 15 of each year. The State Treasurer must transfer an amount equal to the DOR's estimate from the General Fund to the ELTA by the last workday of each quarter.

The transfers from the State General Fund to the ELTA are exempted from the requirement to lower the state expenditure limit. The transfers to the ELTA under this act are also excluded from calculations of constitutional and statutory debt limits.

Part X – Conforming Amendments.

Technical changes are made to existing law to reflect the changes made in the rest of the bill.

Part XI – Miscellaneous.

This act applies prospectively and includes a savings clause, and a severability clause.

Substitute Bill Compared to Original Bill:

The substitute bill provides that single-family residences include duplexes and triplexes. The substitute bill provides a tax preference performance statement for both the B&O deductions for businesses with taxable income under \$250,000 and under \$500,000, and the preferential REET rate for sales of real property under \$250,000.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill contains an emergency clause and takes effect on July 1, 2017, except section 801, relating to interest rates, and part IV, relating to remote sellers, referrers, and marketplace facilitators, which take effect January 1, 2018.

Staff Summary of Public Testimony:

(In support) In general, the paramount duty of this state is to educate its students, not keep taxes low on big business and wealthy individuals. Our tax system is so upside down that it burdens the lower income families while providing less to the schools in their community. Class sizes are still too big. Many of us here today owe a great deal to the educational system in Washington. This is a progressive bill and is a good first step to address *McCleary* and fully fund K-12 education. Taxes are choices that reflect our values as a civil society.

In addition to providing stable and equitable funding to K-12, the revenue generated from these taxes will allow social services and public safety to receive the funding they need to perform their important roles.

Part I – Capital Gains Tax.

Washington is one of nine states that does not have a tax on capital gains. Yet some of our residents are among the wealthiest individuals in the world. Imposing a capital gains tax on the sale of assets by these individuals will have the wealthier among us begin to pay a more comparable share of their personal income in tax. Many of us here today will be subject to the capital gains tax, and welcome the opportunity to pay our fair share to fully fund education without making cuts to social service programs that are imperative for educating

our youth and providing stability to our families. This bill avoids increasing property taxes, which would impact the poor by pricing them out of good school districts.

A diversified and modest capital gains tax will not affect behavior. "Buy low, sell high" will still guide the sale of capital assets. As an investor, a capital gains tax would become part of ones investment planning, but would not decrease investments.

By allowing municipalities to move away from reliance on property tax, it will indirectly open up capacity for local communities to address their own needs.

Part II – Business and Occupation Tax.

The changes in this bill to the B&O tax system will help boost small businesses, which will positively impact local communities. The increased threshold for filing will also remove the burden from small businesses that do not have in-house tax experts. A business must pay its fair share if it wants a well-educated workforce and a dynamic economy.

There are over 260,000 businesses that will be exempt under this bill, and that equates to 490,000 jobs in Washington. Big business already benefits from the "Swiss cheese" of B&O tax exemptions; this bill adjusts the tax burden on business.

Part IV – Real Estate Excise Tax.

The REET reforms will actually promote homeownership and offer the American dream to a greater number of our residents.

Part VI – Remote Sellers, Referrers, and Marketplace Facilitators.

This bill finally addresses the systemic imbalance between online retailers and the brick-and-mortar stores. Both retailers will now have obligations regarding tax administration relating to sales to their Washington purchasers.

(Opposed) Taxpayers are under assault in Washington. The voters have repeatedly rejected new taxes at the ballot box. This is a horrible time to hit citizens with additional taxes, as the newly imposed Sound Transit taxes have hit many of them hard.

Many of the provisions of this bill negatively impact our family businesses and family farms. This also makes it more difficult to own and manage timberlands.

Part I – Capital Gains.

In order to fund their retirement, an estimated 80 percent of small business owners count on the sale of their business to fund some portion of that retirement. Unlike other retirement income, such a sale is not exempted from the capital gains tax. This is a horrible burden on small business owners.

This tax acts as an income tax, which is volatile in nature and not the reliable source of funding needed under *McCleary*. This is also constitutionally questionable.

Part II – Business and Occupation Tax.

Although the deduction and filing requirements are an improvement, the B&O surcharge will cause a large tax shift as it applies to many service-related industries. In many cases, it is very difficult to pass on the increased cost to customers. This would also hurt smaller firms, as well as women, and minority owned firms.

Because of the constraints of a highly regulated market, insurance agents cannot pass on overhead, including an increased B&O rate due to the proposed surcharge. In addition, the dynamics of the insurance industry has changed with many companies selling insurance directly to the consumer without the assistance of an agent. Those direct sales would not be subject to the surcharge, further advantaging them.

The surcharge application to many of the businesses may have unintended consequences on consumers, such as in the case of daycares, in home care providers and hospitals. Our families and the elderly will feel the impact of this change in higher charges for care. It also impacts retailers and other businesses that have low profit margins, especially in border areas.

The construction industry would be hit especially hard by the proposed B&O changes. There are multiple classes of businesses involved and it will result in a layering effect. This is another industry that is highly competitive with low profit margins, especially in the case of public construction contracts.

Part III – Elimination and Narrowing of Tax Exemptions.

The narrowing of the extracted fuel exemption is bad environmental policy, and goes against the state's focus on sustainable energy sources. Instead of reducing the use of natural gas by burning extracted fuels, this bill would cause the increased use of natural gas by removing the incentive to use extracted fuels. Refineries would likely burn off the extracted fuels, further impacting the environment. In addition, most states do not tax recycled fuels, and this could put Washington jobs at risk.

While there are challenges in funding K-12 and economic development, the impact of repealing the international investment management exemption, and the imposition of the 20 percent surcharge, would increase a business's corporate tax liability significantly. Moreover, this bill seeks to tax transactions not subject to tax elsewhere. The current tax exemption helps mitigate an already burdensome tax obligation, and allows international investment management service businesses in Washington to stay competitive.

The conversion of the nonresident sales tax exemption to a remittance program will have significant impact on businesses in border communities. In low-margin industries it will be difficult to attract out-of-state buyers if they have to do additional paperwork to recover a tax that they do not owe.

The changes in the rate for prescription drug wholesaling would result in a 250 percent increase in taxes. This is a high-volume, low-profit margin industry. An increase in the

B&O tax would be passed onto hospitals and pharmacies, and ultimately Washington citizens will bear the cost. This is a tax preference that JLARC recommended be maintained.

Washington voters already rejected eliminating the sales tax exemption on bottled water. The bottled water industry is an important economic force in Washington, and provides a healthy substance that should not be taxed.

Part IV – Real Estate Excise Tax.

The new REET rates will punish businesses that are trying to achieve stability by purchasing their own property. Higher REET means higher home prices, as the seller passes on the REET increase to the buyer in the form of a higher sales price. It is also improper to impose REET on foreclosures, as there is not revenue to apply it to.

Financial institutions already pay REET and face a significant tax burden in this state. In addition, Washington's current REET is already one of the highest in the nation.

Part V – Requiring Permits.

It is unclear what happens for a failure to submit a report or an inaccuracy in the report. The report must be filed after the dwelling is complete. What happens to the house? There are better ways to fight the underground economy than onerous regulations and unlimited fees.

Part VI – Marketplace Facilitators, Referrers, and Remote Sellers.

This proposal represents a fundamental change in the relationship between third parties. Many of these entities are unequipped to collect and remit sales or use tax. The proposal is legally aggressive and burdensome. The complexity of the definitions make it difficult to determine who is ultimately responsible for compliance.

This is an unprecedented attempt to circumvent the Dormant Commerce Clause and will likely be the subject of a protracted legal challenge. The estimate revenue impacts are speculative at best.

Part VII – Liability for Unpaid Taxes.

Corporate entities already have liability for trust account moneys. It is not appropriate to apply that same liability to other taxes.

(Other) In constructing a new tax policy, one must examine the fairness of the tax, the efficiencies in collection, and if it promotes trust in government. This is a good start. The Legislature may need to look at an income tax.

Persons Testifying: (In support) Representative Lytton, prime sponsor; Summer Stinson, Washington's Paramount Duty; Asher Ravona; Samantha and Ian Fogg; Amy Egizii; Stephanie Scott; Emily Carmichael; Vanessa Stedman; Vanessa Goldberg; Kelly McAffrey; Shaula Massena; Pete Miller; Becky Liebman; Marvin Rosete; Chavi Hohm, Caldwell Banker Bain; Brittney McVicar, Britt McVicar Fitness; Heidi Bennet; Madeline Bishop;

Natalya Yukovsky; Hillary Shaw; Melissa Taylor; Alfred Frates; Arne Nelson; Jim Dawson, Spokane Alliance; Ben Wislogle; Paul Benz, Faith Action Network; Andy Nicholas, Washington Budget and Policy Center; Edward Messerly; Mitch Denning, Alliance of Educational Associations; Lynn MacDonald; Patrick Kelly; Jo Tono; Colin Cole; Nora Leech, League of Women Voters of Washington; Steven Kelley, Fuse Washington; Bob Hodges; Becca Kenna-Schenk, Western Washington University; Amy Goings, Lake Washington Institute of Technology; Gary Oertli, South Seattle College; Amanda Deshazo, Pierce County Human Services; Ryan Tully, Teamsters Joint Council 28; Karen Strickland, American Federation of Teachers; Joe Kendo, Washington State Labor Council; Emily Murphy, Children's Alliance; Elyette Weinstein; Dan Steele, Washington Association of School Administrators; Merritt Mount, Washington State Community Action Partnership; Grace Huerta, United Faculty of Washington State and The Evergreen State College; Julie Salvi, Washington Education Association; Antonio Ginatti, Columbia Legal Services; Dennis Eagle, Washington Federation of State Employees; Bob Cooper, National Association of Social Workers; Marcie Taylor, Community Employment Alliance; Melanie Smith, Wellspring Family Services; Steve Breaux, Planned Parenthood Votes Northwest and Hawaii; Seth Dawson, National Alliance on Mental Illness; Jerry Bender, Association of Washington School Principals; Demas Nesterenko, Service Employees International Union 775; and Charles Adkins and Collin Thrower, Legislative Affairs for the Geoduck Student Union of The Evergreen State College.

(Opposed) Dale Kelley, Professional Insurance Agents of Washington and Alaska; Richard Ek, National Association of Insurance and Financial Advisors of Washington; Keith Wallace, Washington Association of Health Underwriters; Ross Wilson, Shell Puget Sound Refinery; Tim Eyman; Erik Strom and Leanne Webber, Russell Investments; Gary Smith, Independent Business Association; Scott Hazelgrove, Washington Auto Dealers Association; Bill Stauffacher, Independent Insurance Agents and Brokers of Washington; Brad Tower, Community Bankers of Washington; Tom McBride, CompTIA; Leslie Emerick, Washington Home Care Association; Jerry Vanderwood, Associated General Contractors; Tom Kwieciak, Building Industry Association of Washington; Van Collins, American Council of Engineering Companies of Washington; Cliff Webster, Washington Construction Industry Council; Joanie Deutsch, TechNet; Greg Hanon, Washington State Petroleum Association; Bill Clarke, Washington Realtors; Eric Lohnes, Association of Washington Business; Patrick Connor, National Federation of Independent Business; Mark Johnson, Washington Retail Association; Don Arsenault, Washington Self Storage Association; Tom Davis, Washington Farm Bureau; Holli Johnson, Washington Food Industry; Denny Eliason, Washington Bankers Association and United Financial Lobby; John Ehrenrieck, Washington Forest Protection Association; Heather Hansen, Washington Farm Forestry Association; Roman Daniels-Brown, Washington State Medical Association; Amber Carter, Identity Clark County; Bob Mitchell, Washington Commercial Association of Realtors; Brad Boswell, American Institute of Architects; Rob Makin, Washington Wholesale Druggists' Association; Jim King, Washington State Heating, Ventilation, and Air Conditioning Industry Association; and Denny Eliason, Hospitality Association.

(Other) Suzette Cooke, City of Kent; Peter King, Association of Washington Cities; Ken Smith, Northshore School Board; and Barb Billingham.

Persons Signed In To Testify But Not Testifying: Deborah Kilgore; Alan Charnley; Karen Strickland; Ross Cohen; Sheila Babb Anderson; Peter Miller; Gene Hart; Steve Nesich; Anastasia Taylor; Phyllis Farrell; Bob Cooper; Molly Gibbs; Kelly McCaffrey; and Colin Cole.