

FINAL BILL REPORT

ESSB 6138

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Synopsis as Enacted

Brief Description: Increasing state revenue through improved compliance methods and eliminating tax preferences for royalties and certain manufacturing equipment.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senator Hill).

Senate Committee on Ways & Means

Background: PART 1 - Preferential Business & Occupation (B&O) Tax Rate for Royalty Income: Currently, royalty receipts are apportioned using a single factor receipts method and taxed at a rate of 0.484 percent. The 0.484 percent rate was adopted in 1998 (lowered from 1.5 percent) to align software royalty receipts with the rates for software manufacturing. Royalty income is compensation for the use of intangible personal property such as copyrights, patents, licenses, franchises, trademarks, and similar items.

PART 2 - Nexus: As currently interpreted by the United States Supreme Court, the commerce clause of the United States Constitution prohibits states from imposing sales or use tax collection obligations on out-of-state businesses unless the business has a substantial nexus with the taxing state. Under the Court's decision in *Quill Corp. v. North Dakota* (1992), a substantial nexus for sales and use tax collection purposes requires that the taxpayer have a physical presence in the taxing state. Physical presence can be established through a taxpayer's own activities in the taxing state, or indirectly, through independent contractors, agents, or other representatives that act on behalf of the taxpayer in the taxing state.

Currently, Washington cannot impose wholesaling B&O tax on sales of goods that originate outside the state unless the goods are:

- received by the purchaser in this state; and
- the out-of-state seller has physical presence nexus (i.e., the same physical nexus requirement that is used for sales tax purposes).

Both the criteria must be met for the seller to be subject to Washington B&O taxation.

In 2010 Washington adopted an economic presence test for nexus with respect to service-related activities but not wholesaling or retailing activities. For these classifications, a business does not need to have a physical presence to have nexus and be subject to Washington tax. Economic nexus is established by having sales in excess of \$267,000 to Washington customers. (The threshold is adjusted from year-to-year based on inflation.)

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.

PART 3 - Manufacturing Machinery Equipment Exemption for Software Manufacturers: In 1995, the legislature enacted legislation that exempted machinery and equipment used by a manufacturer in a manufacturing operation from the retail sales tax. This exemption applies to firms that manufacture software.

Summary: PART 1 - Preferential B&O Tax Rate for Royalty Income: The preferential B&O tax rate for royalty income is eliminated. This income is subject to the 1.5 percent B&O tax rate and would qualify for the increased small business credit.

PART 2 - Nexus: The "physical presence" standard is eliminated and replaced with an "economic nexus" standard for wholesaling activities. Wholesale businesses that lack physical nexus but gross \$267,000 or more in sales to Washington customers, \$50,000 in payroll, or \$50,000 in property in any calendar year are subject to B&O tax.

For purposes of collecting sales tax and paying the B&O tax, remote sellers are deemed to have nexus in this state if the remote seller enters into an agreement with a Washington resident for a commission or other consideration to directly or indirectly refer potential customers, by a link on an Internet website or other method, to the remote seller. The remote seller must also have at least \$10,000 in sales to this state in the preceding year.

PART 3 - Manufacturing Machinery Equipment Exemption for Software Manufacturers: The manufacturing machinery and equipment exemption does not apply to:

- an affiliated group or member of an affiliated group that was registered to do business in Washington prior to 1981;
- the affiliated group has a combined employment exceeding forty thousand full and part time employees in the state; and
- the business activities of the affiliated group primarily include the development, sales, and licensing of computer software and services.

PART 4 - Late Payment Penalties: The penalties for late payment of excise taxes are increased 4 percent at each level of delinquency. The penalty rates will go from 5 percent, 15 percent, and 25 percent to 9 percent, 19 percent, and 29 percent.

Votes on Final Passage:

Third Special Session

Senate	35	10
House	60	38

Effective: August 1, 2015
September 1, 2015 (Part II)