

# HOUSE BILL REPORT

## HB 1834

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**As Reported by House Committee On:**  
Finance

**Title:** An act relating to reconciliation returns for apportionable income.

**Brief Description:** Concerning reconciliation returns for apportionable income.

**Sponsors:** Representatives Walen, Springer, Orcutt, Stokesbary, Wylie and Barnard.

**Brief History:**

**Committee Activity:**

Finance: 3/9/23, 3/21/23 [DP].

**Brief Summary of Bill**

- Modifies the penalties and penalty waivers for the reconciliation of apportionable income forms for the purposes of determining business and occupation tax liability.

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### HOUSE COMMITTEE ON FINANCE

**Majority Report:** Do pass. Signed by 12 members: Representatives Berg, Chair; Street, Vice Chair; Orcutt, Ranking Minority Member; Jacobsen, Assistant Ranking Minority Member; Barnard, Chopp, Ramel, Santos, Springer, Thai, Walen and Wylie.

**Staff:** Kristina King (786-7190).

**Background:**

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

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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 (businesses with taxable income of less than \$1 million) or 1.75 percent (businesses with taxable income of \$1 million or more) for services and for activities not classified elsewhere. Several preferential rates also apply to specific business activities.

#### Business and Occupation Income Apportionment.

Depending on the type of business activity, businesses generating gross income from sources in this state and sources in other states, allocate/source their income to the state where the business activity occurred or use an apportionment formula to determine how much of their apportionable gross income is subject to B&O tax in Washington. Businesses engaged in multiple types of business activities may need to both allocate/source and apportion income to Washington to calculate their B&O tax liability.

To apportion income for B&O tax purposes, Washington uses a single factor apportionment formula based on the taxpayer's gross receipts. A taxpayer may calculate the receipts factor for the current tax year based on the most recent calendar year for which a full calendar year of information is available or based on the current tax year. Once a taxpayer determines the receipts factor for an entire calendar year, they are required to file an annual reconciliation of apportionable income (ARAI) form with the Department of Revenue (DOR) to correct their reporting by October 31 of the following calendar year. Once this is filed, the taxpayer will receive a refund or pay any additional tax due. If there is additional tax due, interest applies, and late payment penalties apply if not paid by the due date. The late payment penalty is a percentage of the additional tax due and is graduated based on the length of delinquency. The penalty rates are:

- 9 percent when not paid by the October 31 due date;
- 19 percent when not paid by November 30; and
- 29 percent when not paid by December 31.

A general waiver, applicable for most taxes, from the late payment penalty is available, if:

- the failure to pay timely is a result of circumstances beyond the taxpayer's control; or
- the taxpayer has timely filed and paid taxes due for the 24-months immediately preceding the period for which a waiver is requested.

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#### **Summary of Bill:**

The bill modifies the penalty and penalty waivers applicable to the ARAI. If a taxpayer does not pay the additional tax due by October 31, replacing the graduated penalty schedule is a penalty equal to the greater of 9 percent of the unpaid tax due or \$25.

The bill creates two new penalty waivers, in addition to existing waivers, for delinquent taxes due specifically for an ARAI return for circumstances in which:

- the taxpayer has timely filed and paid taxes due for the 24-months immediately preceding the period for which a waiver is requested; or
- the tax deficiency occurs due to the DOR's reclassification of the taxpayer's income to an apportionable tax classification from a non-apportionable tax classification resulting from a DOR audit or examination of the taxpayer's returns or records.

Additionally, the waiver can only be granted once and applies to all tax years included in the DOR's audit or examination. The waiver will not be granted if the tax deficiency is due to the taxpayer's failure to follow specific written instructions provided to the taxpayer by the DOR or if the taxpayer previously reported the apportionable income incorrectly.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.

**Staff Summary of Public Testimony:**

(In support) Businesses have taxable periods that are based on an annual basis. The businesses make estimated payments each quarter, but they do not know what their total liability is until the end of the year. Typically, businesses file a reconciliation return at the close of the year and make any corrections that are needed. If there is a failure to file immediately or a mistake is made, the penalties are very severe. Currently the penalty percentages are 9 percent for one month, 19 percent for the second, and 29 percent for the third. This bill allows for enforcement but gives a little bit of grace for those who do make a mistake.

Washington businesses support this bill due to the undue administrative compliance burdens it eliminates. This year 40 percent of businesses, according to a study, were unaware or unable to file reconciliations on time, which created additional penalties for them. This bill would not only fix an undue administrative burden for taxpayers and businesses, it begins the process of further examination of the B&O tax system as a whole.

There is ambiguity in our state code as to when the annual reconciliation penalty applies, and this is harmful to taxpayers and creates substantial conflict between well-intentioned taxpayers and the DOR when the DOR conducts audits. This occurs in situations when a taxpayer that has filed timely returns for all the periods at issue, reclassifies income from a non-apportionable classification to an apportionable classification. The DOR then imposes a 29 percent late filing penalty for not filing annual reconciliations that the taxpayer would

not otherwise have been required to file. It is unfair and creates needless animosity. This bill is a reasonable, well-crafted solution to this problem. It eliminates uncertainty as to when the annual reconciliation penalty applies. It would continue to penalize taxpayers who ignore or disregard their filing obligations and provides narrowly tailored exceptions for reclassification situations. For taxpayers, who have shown a track record of compliance, it would prevent future controversy between taxpayers and the DOR.

(Opposed) None.

(Other) The DOR has found that some taxpayers who should file a reconciliation either are not aware of it at all or think they do not have to file, which results in a late penalty when a taxpayer might have paid under an incorrect classification. The DOR administers the tax code and strives for voluntary compliance and not necessarily higher penalties. As was stated before, sometimes grace is a good method. This bill gives businesses grace when they fail to file their enforcement reconciliation timely or correctly, while still maintaining needed guardrails.

**Persons Testifying:** (In support) Representative Amy Walen, prime sponsor; Emily Shay, Association of Washington Business; and Joseph Habertzette.

(Other) Steve Ewing, Department of Revenue.

**Persons Signed In To Testify But Not Testifying:** None.