

SENATE BILL REPORT

SB 5482

As of January 25, 2023

Title: An act relating to the margin tax.

Brief Description: Concerning the margin tax.

Sponsors: Senators Frame, Wagoner, Wellman, Nguyen, Dhingra, Fortunato, Hunt, Keiser, Kuderer, Lovelett, MacEwen, Saldaña and Stanford.

Brief History:

Committee Activity: Business, Financial Services, Gaming & Trade: 1/26/23.

Brief Summary of Bill

- Replaces Washington State's business and occupation tax with a margin tax.

SENATE COMMITTEE ON BUSINESS, FINANCIAL SERVICES, GAMING & TRADE

Staff: Jeffrey Mitchell (786-7438)

Background: Washington Business and Occupation Tax. Washington levies its primary business tax, the business and occupation (B&O) tax, on gross income from Washington-based business activity.

A business must report B&O tax if the business meets any of the following thresholds in the current or prior calendar year:

- has more than \$100,000 in combined gross receipts sourced or attributed to Washington;
- has physical presence nexus in Washington; and
- is organized or commercially domiciled in Washington.

Each legal entity must register and report taxes separately for affiliated entities.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not part of the legislation nor does it constitute a statement of legislative intent.

For B&O tax purposes, businesses engaging in apportionable activities may apportion their income to determine the amount subject to B&O tax. The formula for apportionment is Washington gross apportionable receipts divided by worldwide gross apportionable receipts for the taxing period.

The B&O tax includes a flat rate structure with different rates by activity. There are several surcharges on certain industries and activities, including surcharges on advanced computing and certain services for Workforce Education, timber or timber products manufacturing, specified financial institutions, and contests of chance. The B&O tax also includes approximately 200 tax preferences in the form of credits, deductions, exclusions, exemptions, and preferential rates.

Taxpayers engaging in business as a manufacturer or extractor are subject to state B&O tax regardless of whether the product manufactured or extracted is sold within or outside the state. If a taxpayer sells the manufactured or extracted product within the state, the taxpayer is subject to retailing or wholesaling B&O tax as well. State law provides a multiple activities tax credit to prevent the same product from being taxed twice.

While most businesses with activity in Washington are subject to the B&O tax, some businesses are instead subject to the public utility tax. The public utility tax is a tax on public service businesses, including businesses that engage in transportation, and the supply of energy, natural gas, and water. This tax is in lieu of the B&O tax, meaning that businesses would pay one or the other, but not both taxes on the same activity.

Approximately 49 cities impose local B&O taxes.

For the 2021-23 biennium, the state B&O tax is estimated to generate approximately \$12.5 billion and constitutes approximately 20 percent of near general fund revenue.

Texas Franchise Tax. The Texas franchise tax is a privilege tax imposed on each taxable entity formed or organized in Texas or doing business in Texas. Unless a taxable entity qualifies and chooses to file using the EZ Computation, the tax base is the taxable entity's margin, and is computed in one of the following ways:

- total revenue times 70 percent;
- total revenue minus cost of goods sold (COGS);
- total revenue minus compensation—capped at \$400,000 per employee; or
- total revenue minus \$1.23 million.

If a taxable entity's annual revenue is \$20 million or less, the business can use the EZ Computation method to file its tax return. This method applies a tax rate of 0.331 percent to all Texas-based earnings.

Total revenue is determined from revenue amounts reported for federal income tax minus

statutory exclusions. The COGS generally includes costs related to the acquisition and production of tangible personal property and real property. The compensation deduction includes the following: W-2 wages and cash compensation paid to officers, directors, owners, partners and employees, subject to an inflation-adjusted per person wage and cash compensation limitation; and benefits provided to all personnel to the extent deductible for federal income tax purposes, including workers' compensation, health care and retirement benefits.

Margin is apportioned to Texas using a single-factor apportionment formula based on gross receipts.

The tax rates are:

- 0.375 percent for retailing and wholesaling;
- 0.75 percent for activities other than retailing and wholesaling; and
- 0.331 percent for the EZ Computation.

The franchise tax constitutes a little over 5 percent of Texas' general fund revenue.

Summary of Bill: Beginning in calendar year 2027, Washington's B&O tax is replaced with a margin tax modeled after Texas's franchise tax. A margin tax is often considered a modified gross receipts tax.

Under this margin tax proposal, businesses are taxed on their margin, which is calculated as worldwide gross income minus the greater of four deductions:

- cost of inputs, for example cost of goods sold;
- compensation paid—capped at \$400,000 per employee;
- 30 percent of gross receipts; or
- a flat amount of \$1 million.

Unlike Texas's franchise tax, for this margin tax proposal the compensation and cost of goods sold deductions are based on federal reporting.

After the deduction amount is subtracted, a single-factor sales apportionment method is used to determine the amount of the business's worldwide margin attributable to Washington. For combined groups, each member of the group is included for purposes of attributing Washington income, if any member of the combined group has nexus in Washington. The amount attributable to Washington is multiplied by a 3.1966 percent tax rate to determine the tax due.

A taxpayer subject to the margin tax with gross income of not more than \$5,000,000 may elect to pay the tax based on an easy computation. The easy computation is a business's gross income attributable to Washington multiplied by a rate of 1.75 percent.

Under this proposal, the margin tax is imposed on the same entities subject to B&O tax,

including corporations, partnerships, limited liability companies, sole proprietorships, and nonprofits. Activities subject to public utility tax under current law remain subject to public utility tax, and are excluded from the margin tax. This proposal maintains Washington's surcharges which are imposed on certain industries and activities. It also maintains Washington's current registration and nexus thresholds. Local B&O taxes are maintained. Similar to state B&O taxes, manufacturers and extractors would potentially owe the margin tax regardless of whether products are sold within or outside the state.

Washington's definition of gross income is unchanged. Most of Texas's exclusions from total revenue are not qualified exclusions from gross income under this proposal, with the exception of bad debts, and cash and trade discounts.

This margin tax proposal also:

- changes the filing frequency for all entities to an annual return due of April 15th;
- requires entities with gross income over \$500,000 to file an annual return;
- requires quarterly estimated payments;
- requires combined reporting for corporations required to file consolidated federal returns;
- eliminates all preferential rates;
- eliminates most deductions, exclusions, and exemptions except those necessary for legal compliance or practical administration;
- allows businesses to carryover earned but unused B&O tax credits to be credited from margin tax due for a limited amount of time; and
- compensates retailers by creating a retail sales tax credit.

Appropriation: None.

Fiscal Note: Available.

Creates Committee/Commission/Task Force that includes Legislative members: No.

Effective Date: The bill takes effect on January 1, 2027.