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## Finance Committee

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### HB 2257

**Brief Description:** Concerning taxes administered by the department of revenue.

**Sponsors:** Representatives Berg, Ramel, Reeves, Parshley, Ryu, Peterson, Wylie, Thai, Leavitt, Scott, Santos, Mena, Zahn, Thomas, Doglio, Ormsby, Macri, Hill, Pollet and Salahuddin; by request of Department of Revenue.

<p style="text-align: center;"><b>Brief Summary of Bill</b></p> <ul style="list-style-type: none"><li>• Makes technical and administrative changes to the tax code.</li><li>• Codifies Department of Revenue guidance related to the implementation of Chapter 422, Laws of 2025—ESSB 5814.</li></ul>
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**Hearing Date:** 1/27/26

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

**Background:**

Each year the Department of Revenue (DOR) identifies technical and administrative changes to the tax and licensing sections of the Revised Code of Washington (RCW) for consideration by the Legislature. Technical revisions to state law may be required for multiple reasons. Sections of the RCW may be repealed, recodified, or amended in a way that changes their internal or statutory numbering or terminology. The language in these sections, as well as references to these sections in other provisions of the RCW, then become incorrect. Statutes may become obsolete with the passage of time, evolution of technology, improvement of administrative processes, or adoption of state or federal legislation. Administrative agencies occasionally suggest statutory revisions to increase clarity or improve administration, including codifying department guidance. This bill addresses the DOR's recommendations.

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*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.*

### 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 and wholesaling; and 1.5 percent (businesses with taxable income of less than \$1 million), 1.75 percent (businesses with taxable income of \$1 million to \$5 million), and 2.1 percent (businesses with taxable income over \$5 million) for services and for activities not classified elsewhere. There are many specialized B&O tax rates and preferential rates that apply to specific business activities.

Small businesses may take a credit against their B&O tax due. The maximum credit equals \$55 per month—or \$160 per month—depending on whether at least 50 percent of the business's taxable amount is in certain classifications. When tax due is less than or equal to the maximum credit, the credit equals the tax due; otherwise, a reduced credit formula applies.

An additional B&O tax is imposed on businesses in Washington with at least \$250 million in Washington taxable income. The tax is 0.5 percent of the business's annual Washington taxable income in excess of \$250 million and is in addition to the other B&O taxes imposed on the income. This surcharge expires December 31, 2029.

Beginning January 1, 2027, the rate for certain business activities increases to 0.5 percent, including standard manufacturing, extracting, wholesaling, and retailing.

### Retail 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 are not collected when the user acquires the property, digital product, or service, then use tax applies to the value of property, digital product, or service when used in this state. The state, all counties, and all cities levy retail sales and use taxes. The state sales and use tax rate is 6.5 percent; local sales and use tax rates vary, depending on the location.

#### *Retail Services.*

Businesses that sell intangible products to customers are generally subject to the B&O tax under the services and other classification. Customers do not pay retail sales and use tax on most services. A select number of services are subject to retail sales and use tax, including construction services, personal training at athletic and fitness facilities, extended warranties and maintenance agreements, alarm monitoring services, and vehicle towing. If the service is taxable as a retail sale, then the business activity is subject to the retailing B&O tax.

Information technology products and services sold as a non-itemized package are generally subject to retail sales and use tax. When the products and services are separately stated on a sales invoice or contract, charges for computer hardware and prewritten computer software are subject to retail sales and use tax. Separately stated charges for custom software and customization of prewritten software are not subject to retail sales and use tax.

#### *Digital Products.*

Retail sales and use taxes apply to all digital products, regardless of how they are accessed. Digital products are digital goods and digital automated services (DAS). A digital automated service is any service transferred electronically that uses one or more software applications. A digital good is a sound, image, data, fact, or information, or any combination thereof, transferred or accessed electronically.

#### Newly Enacted Retail Services.

Pursuant to ESSB 5814 beginning October 1, 2025, the following select services are classified as retail services and subject to retail sales tax and retailing B&O tax:

- custom software and customization of prewritten software;
- custom website design, support, and development services;
- information technology related training services, technical support, and other services;
- investigation, security services, security monitoring, armored car services, but excluding locksmith services;
- temporary staffing, except for temporary staff provided at hospitals;
- advertising services, but excluding web hosting services, domain name registration, and services rendered in respect to newspapers, printing or publishing, certain radio and television broadcasting, out-of-home advertising, including billboards, street furniture advertising, transit advertising, place-based advertising, such as in-store displays or point-of-sale advertising, dynamic or static signage at live events, naming rights, and fixed signage advertising; and
- live presentations.

The following DAS are also classified as retail services and subject to retail sales tax and retailing B&O tax:

- any service that primarily involves the application of human effort by the seller;
- live presentations;
- advertising services; and
- digital processing services.

The sale of services between members of an affiliated group are not considered a retail service for purposes of retail sales tax and retailing B&O tax.

#### Multiple Points of Use.

A buyer may claim an exemption from sales tax when purchasing digital goods, digital codes, or digital automated services that are available for multiple points of use inside and outside Washington. Taxpayers claiming the multiple points of use exemption must apportion and report

use tax directly to the DOR.

#### Payment Card Processing.

Beginning January 1, 2026, businesses must report income from payment card processing activities under the payment card processing B&O tax classification. The tax rate for this classification is 3.1 percent.

#### Workforce Education Investment Surcharge.

A workforce education investment surcharge applies to select advanced computing businesses in addition to the B&O tax on service and other activities and certain royalty income. Beginning January 1, 2026, the workforce education investment surcharge rate is increased for select advanced computing businesses from 1.22 percent to 7.5 percent. The surcharge applies only to income from advanced computing activities and is capped at \$75 million annually per affiliated group. The B&O tax surcharge is in addition to all other taxes.

#### Specified Financial Institution Surcharge.

A specified financial institution is a financial institution that is a member of a consolidated financial institution group that reports an annual net income of at least \$1 billion on its consolidated financial statement for the previous calendar year, not including net income attributable to noncontrolling interests. From January 1, 2020, through September 30, 2025, an additional 1.2 percent tax applied to the income of specified financial institutions subject to the service and other activities B&O tax. Beginning October 1, 2025, the additional B&O tax rate on specified institutions is increased from 1.2 percent to 1.5 percent. The B&O tax surcharge is in addition to all other taxes.

#### State-Chartered Credit Unions.

Federal and state-chartered credit unions are generally exempt from the B&O tax. Legislation passed during the 2025 session modified the chartered credit union B&O tax exemption. Beginning October 1, 2025, if a state-chartered credit union merges with or acquires a bank regulated by the Department of Financial Institutions (DFI), the credit union is no longer exempt from the B&O tax. The B&O tax will be 1.2 percent of the gross income of the state-chartered credit union.

#### Motor Vehicle Sales Tax.

An additional tax of 0.5 percent of the selling price applies to retail sales of motor vehicles. The tax is in addition to general retail sales and use taxes. The additional tax does not apply to retail car rentals.

#### Clean Alternative Fuel Vehicle Report.

The DOR must biannually provide to the transportation committees of the Legislature a report on the clean alternative fuel vehicle sales and use tax exemption. The report must include information on the number of vehicles that qualified for the exemption, the make and model of such vehicles, the dollar amount of exempted state retail sales and use taxes, and the estimated future costs of leased vehicles that qualified for the exemption. The exemption qualification

period expired August 1, 2025. The DOR provided its final report on October 31, 2025.

#### Luxury Aircraft Tax.

Retail sales and use taxes apply to non-commercial aircraft used in Washington unless a specific exemption applies. A separate aircraft excise tax also applies. The Washington Department of Transportation Aviation Division registers aircrafts and collects the aircraft excise tax. An additional 10 percent luxury tax also applies to non-commercial aircraft if the purchase price, including the value of any trade-in of a similar kind, is over \$500,000. For leased aircraft, the tax applies if the fair market value is over \$500,000 at the time the lease begins. The sustainable aviation fuel account receives the aircraft luxury taxes.

#### Estate Tax.

The estate tax is a tax on the right to transfer property at the time of death. A decedent or a non-resident decedent who owns property in Washington may owe estate tax depending on the value of their estate. An estate tax return is not required to be filed unless the gross estate is equal to or greater than the applicable exclusion amount. The value of a qualified family-owned business interest (QFOBI) may be deducted from the taxable value of an estate as long as certain conditions are met. The applicable deduction amount means:

- \$2.5 million for estates of decedents dying on or after July 1, 2014, but before July 1, 2025;
- \$3 million for estates of decedents dying on or after July 1, 2025, but before July 1, 2026; and
- an amount determined by multiplying \$3 million by one plus the percentage by which the most recent October consumer price index (CPI) exceeds the CPI for October 2024 for estates of decedents dying in calendar year 2026 and each year after.

#### Incidental Use of Land Classified as Farm and Agricultural Land or Timberland.

Land classified as farm and agricultural or timberland may allow for incidental uses not directly related to farming or timber production. For property classified as timberland, incidental use may not exceed 10 percent of the total classified land. For property classified as farm and agricultural land, incidental use may not exceed 20 percent of the total classified land.

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

#### Technical and Administrative Changes to Newly Enacted Retail Services.

The following technical and administrative changes are made to the retail services recently enacted under ESSB 5814:

- clarifies the types of activities that meet the definition of information technology services and investigation services for purposes of the retail sales tax;
- clarifies that temporary staffing services do not include direct hires or paymasters;
- clarifies that the following activities do not meet the definition of live presentation subject to the retail sales tax:
  - classes provided by preschools;
  - classes provided by elementary schools, secondary schools, and institutions of

- higher education as part of their accreditation;
- musical, dramatic, comedic, or similar performances;
- one-on-one instructional activities including tutoring, consulting, and music lessons;
- presentations given at the physical location of a religious organization;
- presentations where participants may join via internet or telecommunications equipment and are given at the physical location of the presenter during the real-time presentation; and
- youth camps.
- provides that if a person is unable to source advertising services to the local level due to a lack of information, the person must source the services state-wide in a manner prescribed by the DOR;
- authorizes the application of the affiliate exclusion for customized software and customization of prewritten computer software;
- clarifies that the use of a digital automated service that is incidental to the underlying service provided by a business is not subject to retail sales tax if the underlying service is subject to any B&O tax classification other than retailing;
- imposes the use tax on all the newly enacted retail services except live presentations; and
- corrects statutory references, updates definitions, repeals obsolete language, and makes other changes to conform the newly enacted retail services with existing law.

*Transition Grace Period.*

A transition period is established for taxpayers with qualifying existing contracts for service activities that have been reclassified to retailing activities. The transition period begins October 1, 2025, and ends March 31, 2026. Taxpayers with a qualifying existing contract may elect to treat the amounts received during the transition period as gross income subject to the retailing B&O tax and retail sales tax or the service and other activities B&O tax. If a taxpayer with a qualifying, existing contract makes no election during the transition period, the amounts received will be subject to the retailing B&O tax and retail sales tax.

*Multiple Points of Use for Advertising Services.*

Advertising services are added to the list of items eligible for the multiple points of use exemption. Businesses that purchase advertising services for both inside and outside Washington may claim the exemption by providing the seller with an exemption certificate.

*Effective Date.*

The technical and administrative changes related to ESSB 5814, including the transition grace period, apply both prospectively and retroactively to October 1, 2025.

*Legislative Intent for Advertising Services.*

It is the intent of the Legislature to broadly define advertising services as a retail service subject to retail sales tax. If any provision excluding activities from the definition of advertising services is held invalid, then the entire exclusion is invalid.

Payment Card Processing.

Clarifies that the gross income subject to the B&O tax under the payment card processing classification may be subject to the surcharge on specified financial institutions and the workforce education investment surcharge on advanced computing businesses. The clarification to the payment card processing classification applies both prospectively and retroactively to January 1, 2026.

Clarifying the Applicability of the Small Business Credit to Credit Unions.

It is clarified that the small business credit applies to the tax imposed on credit unions merging with a bank regulated by the DFI.

Motor Vehicle Sales Tax.

Clarifies that peer-to-peer car sharing transactions are not subject to the additional motor vehicle sales tax. Vehicle owners must retain and provide certain information to the DOR for the purpose of demonstrating that the vehicle owner paid state sales or use tax on the shared vehicle at the time the vehicle was obtained.

Incidental Use of Land Classified as Farm and Agricultural Land or Timberland.

Incidental use with respect to land classified as farm and agricultural must be compatible with commercial agricultural purposes. Incidental use with respect to land classified as timberland must be compatible with the commercial growing and harvesting of timber. Such incidental use for farm and agricultural land or timberland may include, but is not limited to, wetland preservation, a gravel pit, a farm woodlot, a produce stand, or an unpaved parking area necessary for the safe visiting or viewing of classified land.

Miscellaneous.

The following additional technical and administrative changes are made:

- repeals obsolete language related to the tire fee that sellers must retain and pay to the DOR;
- expires the requirement that the DOR produce a biannual report on the clean alternative fuels and electric vehicles sales and use tax exemption;
- clarifies that the additional luxury aircraft tax is only due once;
- corrects dates for the applicable QFOBI deduction to ensure the dates align with the calendar year, rather than the fiscal year; and
- makes other technical and administrative changes, such as updating definitions and correcting statutory references.

**Appropriation:** None.

**Fiscal Note:** Requested on January 15, 2026.

**Effective Date:** The bill contains multiple effective dates. Please see the bill.