

HOUSE BILL REPORT

HB 2257

As Reported by House Committee On:

Finance

Title: An act relating to improving the tax law administered by the department of revenue by making technical corrections, clarifying ambiguities, and providing administrative efficiencies in a manner that is not estimated to affect state or local tax.

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.

Brief History:

Committee Activity:

Finance: 1/27/26, 2/4/26 [DPS].

Brief Summary of Substitute Bill

- Makes technical and administrative changes to the tax code.
- Removes alternative nicotine products from the definition of tobacco products prohibited to be ordered or purchased by mail or through the internet.
- Makes changes related to the implementation of Chapter 422, Laws of 2025—Engrossed Substitute Senate Bill 5814.
- Makes changes related to Chapter 420, Laws of 2025—Engrossed Substitute House Bill 2081.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 15 members: Representatives Berg, Chair; Street, Vice Chair; Orcutt, Ranking

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.

Minority Member; Jacobsen, Assistant Ranking Minority Member; Abell, Chase, Mena, Penner, Ramel, Santos, Scott, Springer, Walen, Wylie and Zahn.

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 Sections of the RCW may be repealed, recodified, or amended in a way that changes their internal or statutory numbering or terminology.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.

Shipping or Transporting Tobacco Products.

A person may not ship or transport, cause to be shipped or transported, or provide substantial assistance to a person shipping or transporting any tobacco product ordered or purchased by mail or through the internet to anyone in Washington other than a licensed wholesaler or retailer. Any person found in violation of shipping or transporting any tobacco product ordered or purchased by mail or through the internet is guilty of a Class C felony and a maximum fine up to \$5,000.

Tobacco product means a product that contains tobacco and is intended for human use, including cigarettes, cigars, chewing tobacco, and any other product, regardless of form, that:

- contains tobacco or nicotine, whether derived from tobacco or created synthetically; and
- is intended for human consumption or placement in the oral or nasal cavity or for absorption into the human body by any other means.

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.

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

Business and Occupation Surcharge on High Grossing Businesses.

An additional B&O tax is imposed on businesses 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.

The following income is exempt from the additional B&O tax:

- income related to manufacturing activities, which includes the income from the wholesale or retail sale of products manufactured by a person subject to the manufacturing tax rates;
- income related to the sale of food, food stamp purchases, and prescription drugs;
- income attributable to the wholesale or retail sale of petroleum products by a person who is located in another state and the owner of such materials processed it in Washington by an affiliated processor for hire;
- income from the retail and wholesale transactions of fuel; and
- income subject to preferential rates for timber and timber products, including manufacturing, processing for hire, extracting, and wholesaling activities.

In addition, a person primarily engaged as a farmer or eligible apiarist, as well as financial institutions, are exempt from the additional B&O tax. Taxpayers who pay the advanced computing surcharge are also exempt from this additional B&O tax.

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 nonitemized 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. 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 Engrossed Substitute Senate Bill (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 digital automated services 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 Legislative 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.

Estate Tax.

The estate tax is a tax on the right to transfer property at the time of death. A decedent or a nonresident 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 Substitute Bill:

Shipping or Transporting Tobacco Products.

Alternative nicotine products are removed from the definition of tobacco products prohibited to be ordered or purchased by mail or through the internet. "Alternative nicotine product" means any noncombustible product containing nicotine from any source that is intended for human consumption, whether chewed, absorbed, dissolved, or ingested by any other means.

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;
 - before and after school care provided in-person and on-site by elementary

- schools;
- presentations given by nonprofit organizations;
- musical, dramatic, comedic, or similar performances, including any incidental instruction;
- one-on-one instructional activities including tutoring, consulting, music lessons, and any ensemble or large group instruction;
- 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 statewide 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.

Exemption.

Kindergarten through grade 12 (K-12) schools, school districts, and educational service districts are exempt from sales and use tax on all services recently enacted by ESSB 5814.

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.

Business and Occupation Surcharge on High Grossing Businesses.

Washington taxable income attributable to wholesale sales of food and food ingredients sold by wholesalers to retailers not under common ownership is exempted from the B&O 0.5 percent surcharge on high grossing businesses.

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.

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:

- explicitly excludes the use of self-created services from use tax;
- explicitly excludes from the definition of retail sale all services provided by one public agency to another pursuant to an interlocal agreement;
- 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.

Substitute Bill Compared to Original Bill:

The substitute bill:

- removes Section 1, which corrects outdated language related to the tire fee that sellers must retain and pay to the DOR;
- removes alternative nicotine products from the definition of tobacco products prohibited to be ordered or purchased by mail or through the internet;
- removes Section 9, which clarifies that peer-to-peer car sharing transactions are not

- subject to the additional motor vehicle sales tax;
- removes Section 11, which expires the requirement that the DOR produce a biannual report on the number of vehicles that qualify for the clean alternative fuels and electric vehicles sales tax exemption;
- removes Section 19, which clarifies that the additional luxury aircraft tax is only due once;
- excludes before and after school care provided in-person and on-site by elementary schools from the definition of live presentations;
- excludes presentations given by nonprofits from the definition of live presentations;
- excludes incidental, ensemble, and large group instruction from the definition of live presentations;
- creates retail sales and use tax exemptions for all new service taxes created in Chapter 422, Laws of 2025—ESSB 5814 for K-12 schools, school districts, and educational service districts;
- exempts any Washington taxable income attributable to wholesale sales of food and food ingredients sold by wholesalers to retailers not under common ownership from the B&O 0.5 percent surcharge implemented in Chapter 420, Laws of 2025—Engrossed Substitute House Bill 2081;
- removes Section 26, which states if any provision excluding activities from the definition of advertising services is held invalid, then the entire exclusion is invalid; and
- makes administrative, clarifying, and technical changes.

Appropriation: None.

Fiscal Note: Available. New fiscal note requested on February 7, 2026.

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

Staff Summary of Public Testimony:

(In support) This is a DOR-requested bill that is a follow up to several bills passed last session that needed technical and administrative changes. Many taxpayers express the desire for the DOR's legislative guidance to be codified, and this bill accomplishes that. This bill is revenue neutral.

(Opposed) Section 26 of the bill will rescind the newspaper exemption if the state loses a current lawsuit. If this happens, it will put many newspapers in precarious monetary situations, since many papers lost money last year and things are not looking better this year. Washington should do all it can to save local and community papers. Section 26 of the bill should be stricken. If the state loses the current lawsuit, this will also result in a considerable expansion of the tax on advertising services and will tax entities that were

never intended to be taxed.

(Other) There were unintended consequences from Senate Bill (SB) 5814, especially on schools because they rely on contracts. Schools with greater needs are especially affected. Schools are asking for a full exemption from these taxes. Schools requested the Governor veto the bill. Senate Bill 5814 forced arts organizations to charge sales tax on orchestra rehearsals. Section 26 of the bill should be removed. The legislature should allow the lawsuit to conclude and then the legislature should make policy changes, once it knows the outcome of the lawsuit.

Last session's passage of SB 5814 negatively affected counties since they are required to charge sales tax on live presentations, including conferences. This bill takes money away from counties and gives it to the state. Local governments should be exempted from the sales tax on live presentations.

This bill is a first step towards fixing the taxation of education. However, it does not address the taxation of certificate programs. Students enrolled in workforce training are still paying sales tax on their tuition.

Persons Testifying: (In support) Representative April Berg, prime sponsor; Steve Ewing, Department of Revenue; and Kate Armstrong, Department of Revenue.

(Opposed) Rowland Thompson, Allied Daily Newspapers of WA, WA State Assn. of Broadcasters, and WA Newspaper Publishers Assn; Ryan Blethen, Seattle Times; Paul Archipley, Owner, Beacon Publishing; Scott Hazlegrove, WA Beer and Wine Distributors Association; and Connor Haggerty, Washington State University.

(Other) Milt Harper, Student Orchestras of Greater Olympia; Marissa Rathbone, WA Assoc. of School Administrators (WASA) and WA Assoc of School Business Officials (WASBO); Cliff Traisman, Highline, Seattle, Northshore, Bellevue; Charlie Brown, South Sound Superintendents; Paul Jewell, Washington State Association of Counties; and Devin Gombosky, Northwest Career College Federation.

Persons Signed In To Testify But Not Testifying: Carrie Radcliff; Lloyd Mullen, The Port Townsend and Jefferson County Leader; Keith Shipman, Washington State Association of Broadcasters; Mike Nelson, Washington Society of CPA's; and Jessi Wasson, Inspire Washington.