

# Details of House Revenue Package March 1, 2010

(Numbers in Millions)

## **PART I: CLOSING TAX LOOPHOLES (HOUSE BILL 3176) \$385.31 2009-11/ \$884.10 2011-13**

### **Minimum Nexus Standards \$73.1 / \$374.6**

Extending the B&O tax to certain out-of-state businesses levels the playing field for Washington-based companies to compete for business in Washington, and eliminates the incentive for companies to move jobs out of Washington. This will also help protect community banks. Some Washington-based businesses will see a decrease in taxes while out-of-state business will be taxed for business they conduct in Washington.

- Extends business and occupation tax to out-of-state businesses that have a certain level of economic activity within state (\$500K of receipts derived from in-state activity or 25% of total receipts derived from in state activity), regardless of whether the business has a physical presence in the state.
- Apportions service income based on in-state income as a proportion of all receipts.
- Apportions royalty income based on income derived from royalties within the state.

### **Tax Avoidance \$13.6 / \$54.4**

This would end the most recent iteration of schemes and shell games used by clever tax attorneys to avoid taxes. One example is contractors and builders who jointly create an LLC when beginning a project to avoid paying taxes, and then dissolve the LLC once the project is complete.

Addressing such issues is a part of the routine scrubbing of the tax code necessary to keep up with tax avoidance schemes.

- Allows the Department to re-characterize abusive tax avoidance transactions and authorizes a 35 percent penalty for abusive tax avoidance transactions.
- Streamlines use tax language to eliminate potential abuse.

### **Repeal of First Mortgage Deduction \$67.1 / \$112.0**

This exemption was originally intended to help a major bank headquartered in Washington compete with other national banks. The vast majority of mortgages are originated by out-of-state banks or sold to out-of-state banks. The exemption no longer makes sense.

Modifications to this exemption protect community banks and allow them to compete with national banks that received federal bailout funds.

- Repeals the business and occupation tax deduction for interest derived from loans secured by first mortgages.
- Exempts the first \$100 million of interest income.

### **Nutrient Management (Five-Year Suspension, 10-Year Sunset) \$1.6 / \$2.8**

Suspend sales/use tax exemption for all operations in livestock nutrient management.

### **Repeal of Out-of-State Sales Tax Exemption**

**\$41.5 / \$76.1**

Washington is a sales tax dependent state. Sales taxes support public safety, transit and a variety of other public services that out-of-state residents utilize when they visit Washington.

- Eliminates the general sales tax exemption for nonresidents. (Several other property specific nonresident sales tax exemptions, such as cars and boats, are not impacted.)

### **Corporate Board of Directors**

**\$2.1 / \$4.6**

State law exempts employee wages from B&O tax, but not income earned as an independent contractor. This proposal makes it clear that members of corporate boards are not employees (as they do not pay payroll taxes), hence their compensation does not receive the same tax treatment as employee wages.

The B&O tax does exempt the first \$28,000 of gross receipts so those who receive reimbursements for duties on non-profit boards would be exempt.

### **Airplanes like Boats (JLARC recommendation - 0.5% excise tax)**

**\$6.3 / \$10.8**

Boat owners currently pay 0.5% excise tax based on the value of the boat to license their boats in Washington. Private aircraft owners pay a flat fee based on engine type or size ranging from \$20 for small aircraft and gliders to \$125 for multi-engine jets.

These rates were set in statute in 1949 when the taxes on boats and planes were roughly the same. That's no longer the case. Using the above example, a yacht owner would pay \$50,000 to license a \$1 million yacht, while a private jet owner would only pay \$125 to license a \$1 million jet. This proposal would treat airplanes like boats, and is only geared at privately-owned aircraft. It would not apply to commercial airlines.

### **Use Tax on Vehicles Used for Interstate Hauls**

**\$7.7 / \$16.0**

Ensures that use tax is paid on trucks and equipment that is primarily (more the 50% of the time) used in Washington.

### **Foreclosure Exemption**

**\$6.6 / \$12.9**

Banks are currently exempt from paying real estate excise taxes on foreclosure sales. Every homeowner pays REET and so should banks. There should not be an incentive for banks to foreclose to avoid paying taxes.

- Specifies that the REET is the legal obligation of a financial institution where property is sold to a 3rd party as part of a judicial or non-judicial foreclosure sale.

### **Corporate Officer Liability for Tax Debts**

**\$6.2 / \$11.6**

Presently, business owners can be held personally liable for delinquent sales tax when a company goes out of business. This provision would extend the same liability treatment to B&O tax.

- Allows the department to pursue any officer, manager, member, partner, or trustee of a business that has been dissolved, terminated, or abandoned if there are unpaid taxes.

### **COURT CASE: Dot Foods Repeal**

**\$154.7 / \$199.5**

Washington law provides an exemption for wholesale or retail sales of consumer goods for businesses that exclusively use an independent party – referred to as a direct seller's representative – to make sales in the state. The direct seller's representative is subject to B&O tax only on the commission.

The exemption was originally intended for sales of consumer products through home-based businesses such as a person selling products from Avon, Longaberger, Mary Kay, etc, out of his/her home. The size of this exemption is about \$5 million per year.

Because of ambiguities in the statutory language and a recent State Supreme Court decision, out-of-state businesses could create a wholly owned subsidiary that acts as a direct seller’s representative. That subsidiary might amount to one employee. Out-of-state businesses would then owe no B&O tax on wholesale or retail sales in the state. One business would get a \$95 million tax cut and we expect that many Washington businesses would restructure to take advantage of this bizarre interpretation, shifting Washington jobs out-of-state and giving out-of-state businesses an advantage over home-grown ones.

- Repeals the exemption for out-of-state businesses that exclusively sell their products through in-state direct seller's representatives.

**COURT CASE: Agrilink Fix \$4.8 / \$8.8**

Current law provides a preferential tax rate for processing or wholesaling perishable meat products. In *Agrilink Foods, Inc. v. Dep't of Revenue* the Supreme Court expanded the exemption to nonperishable finished products, such as chili and soup.

This ruling expanded the existing preference well beyond the legislature’s original intent and could potentially expand the original legislative intent for a similar exemption for processing perishable fruits and vegetables.

**Changes to House Bill 3176 since public hearing**

- *B&O exemption on precious metal bullion*: The original bill eliminated the B&O tax exemption, this current proposal removes that provision so the exemption remains in place.
- *First Mortgage Deduction*: The original bill exempted up to \$35 million of the first mortgage deduction. To help more community banks, this current proposal exempts up to \$100 million.
- *Use Tax on Vehicles Used for Interstate Hauls*: The original bill addressed both a PUT and a use tax. In response to concerns from the trucking and port industries, the PUT provision is withdrawn and the use tax remains.
- *Tax avoidance language*: In response to concerns, additional changes were made to language regarding tax avoidance.

**PART II: TOBACCO PRODUCTS \$111.6 2009-11 / \$195.0 2011-13**

Cigarette tax increase of \$1 per pack, plus taxes on other tobacco products are equalized.

**PART III: REMOVING SALES TAX EXEMPTIONS \$163.2 2009-11 / \$367.2 2011-13**

<b>Bottled water</b>	<b>\$30.0 / \$69.2</b>
<b>Elective cosmetic surgery</b> (exemption remains for medically-needed reconstructive surgery)	<b>\$7.2 / \$15.1</b>
<b>Candy and gum</b>	<b>\$30.5 / \$62.4</b>
<b>Custom software</b> (sales tax is already paid for off-the-shelf software)	<b>\$76.5 / \$181.1</b>
<b>Janitorial services</b>	<b>\$19.0 / \$39.4</b>

**PART IV: TAX FAIRNESS****\$98.8 2009-11 / \$212.1 2011-13****0.5% increase on certain services****\$21.7 / \$47.0**

A 0.5% increase in B&O tax rate for lawyers, accountants, agents (not real estate), marketing and management consultants.

**Repealing exemption on investment earnings for nonfinancial firms****\$58.0 / \$126.0**

To protect smaller businesses and non-profits, the first \$250,000 in investments earning are exempt. After that, a 1.5% B&O tax applies.

**Convention Center Tax Recovery (HB 3027)****\$10.1 / \$24.7**

The State Convention Center is partially funded with 2% credit against the state's share of the sales tax collected on hotel stays in King County. Part HB 3027 would eliminate this credit.

**Limiting the wind M&E exemption****\$7.8 / \$12.2**

Sales tax is not collected on maintenance and equipment for renewable energy generation (wind mills, solar panels, etc.). This proposal would limit the exemption to renewable projects that generate electricity for Washington customers.

**PUD privilege tax****\$1.2 / \$2.2**

The Public Utility District Privilege tax applies to all charges for sale of electricity including any recurring charges that are billed to consumers as a condition for receiving electricity.

**PART V: OTHER ANTICIPATED BUDGET ACTIONS****\$230.7 2009-11 / \$298.1 2011-13**

Lottery (Senate Bill 6409)

\$30.0 / \$64.0

Additional capital budget transfers

\$70.0 / \$0