



PB 10-9
March 10, 2010

UPDATE ON THE HOUSE AND SENATE TAX PACKAGES

BRIEFLY

This updates our March 8 brief on the House and Senate tax packages to reflect actions taken by the House on March 8.

With just two days left to go in this year's 60-day session, the supplemental budget remains the key "must do" for the Legislature. New revenue will be a part of legislative leaders' solution to the enormous gap in the enacted 2009–11 budget. There remains considerable disagreement, however, between the Senate and the House over precisely how to raise the additional funds.

Engrossed Substitute Senate Bill 6143 contains most of the Senate revenue package; Substitute Senate Bill 6874 contains the Senate proposal to hike the cigarette tax. The Senate passed both of these bills on March 7. ESSB 6143 came to the House floor on March 8. A striking amendment introduced by House Finance Committee chairman replaced most of the bill's text. After several additional amendments the House passed the bill.

The elements in the House version of 6143 are largely drawn from the House Finance Committee's revenue bill, SHB 3191, which we discussed in our previous brief (WRC 2010c). The bill the House passed, however, did omit four SHB 3191 elements: a limitation on the machinery and equipment sales and use tax exemption for wind farms, a limitation of the B&O tax exemption for investment earnings of nonfinancial firms, complete elimination of the sales tax exemption for janitorial services, and the addition of a sales and use tax exemption for data centers.

The House package would raise \$681 million over the remainder of the 2009–11 biennium; the Senate package would raise \$890 million.

The elements of the two packages are laid out on page 2. Eleven elements are substantially common to the two packages. These 11 elements would together raise \$375–\$378 million. Seven elements, which would raise \$513 million, are unique to the Senate package, while nine revenue raising elements, worth \$311 million, are unique to the House package. Also in the House package, adjustments to rural county tax incentive programs and the addition of six new tax incentives reduce revenue by \$5 million altogether.

COMMON ELEMENTS

The largest common element combines the prospective repeal of the direct sellers B&O tax exemption with the retroactive narrowing of the exemption to consumer goods. This element is a response to the Dot Foods case (for details see WRC 2010a and WRC 2010b) and is expected to provide \$155 million over the remainder of the 2009–11 biennium. The second largest common element is a \$1 hike in the tax on a pack of cigarettes, from \$2.025 to \$3.025. The third largest element involves the treatment of multistate service and royalty transactions under the B&O tax. Nexus for such activities

Comparison of the Senate and House Revenue Packages

| Senate Bill | House Striker | Proposal | Additional 2009-11 Revenue | |
|---------------|---------------|--|----------------------------|----------------|
| | | | Senate | House |
| 6143 | 6143 | Direct Sellers exemption repeal (Dot Foods) | \$154.7 | \$154.7 |
| 6874 | 6143 | Increase cigarette tax by \$1/pack | \$85.8 | \$85.8 |
| 6143 | 6143 | Nexus and apportionment of interstate services | \$72.8 | \$73.1 |
| 6143 | 6143 | Extend sales tax to bottle water | \$30.0 | \$30.0 |
| 6143 | 6143 | Addressing tax avoidance | \$13.6 | \$13.6 |
| 6143 | 6143 | Limiting the REET exemption for foreclosure sales | \$6.6 | \$6.6 |
| 6143 | 6143 | Limiting tax incentives for meat, fruit and vegetable processing (Agrilink) | \$4.8 | \$4.8 |
| 6143 | 6143 | Corporate officer liability for tax debts | \$4.5 | \$1.0 |
| 6143 | 6143 | Corporate board of director fees subject to B&O tax | \$2.1 | \$2.1 |
| 6143 | 6143 | Suspend livestock nutrient exemption | \$1.6 | \$1.6 |
| 6143 | 6143 | PUD privilege tax applies to all charges for electricity | \$1.2 | \$1.2 |
| | 6143 | Eliminate sales tax exemption for custom software | | \$76.5 |
| | 6143 | Cap first mortgage B&O deduction at \$100 million | | \$67.1 |
| | 6143 | Eliminate non-resident sales tax exemption | | \$41.5 |
| | 6143 | Eliminate sales tax exemption for candy and gum | | \$30.5 |
| | 6143 | Increase taxes on other tobacco products by amounts equivalent to \$1/pack on cigarettes | | \$25.8 |
| | 6143 | Temporary 0.5% increase in B&O for lawyers, accountants, and certain other professional services | | \$46.6 |
| | 6143 | Airplane excise tax 0.5% of market value | | \$8.4 |
| | 6143 | Narrow use tax exemption for vehicles used for interstate hauls | | \$7.7 |
| | 6143 | Extend sales tax to elective cosmetic surgery | | \$7.2 |
| | 6143 | Extend and adjust rural county tax incentives | | (\$4.5) |
| | 6143 | Various new tax incentives | | (\$0.3) |
| 6143 | | Temporary 0.3% sales tax increase/working families refundable tax credit | \$313.3 | |
| 6143 | | Temporary 0.25% increase in service B&O tax rate | \$170.8 | |
| 6143 | | Repealing coal exemption | \$10.0 | |
| 6143 | | Eliminate property management salary B&O exemption | \$8.3 | |
| 6143 | | Limiting the wind M&E exemption to projects serving instate users | \$7.8 | |
| 6143 | | Limiting bad debt deduction | \$1.5 | |
| 6143 | | Limiting initiation fees and dues B&O deduction to nonprofits | \$1.0 | |
| Totals | | | \$890.4 | \$681.0 |

Revenue estimates from House Finance Committee

would be based on economic rather than physical presence in the state and revenue would be apportioned based on sales (WRC 2010a and 2010b). The fourth largest element extends the sales tax to bottled water. This is expected to yield \$30 million over the remainder of this biennium.

Both packages contain the controversial element regarding “abusive” tax avoidance transactions, originally suggested by Governor Gregoire (WRC 2010a and 2010b). Under the House version, the broad powers granted to the Department of Revenue to disregard abusive transactions expire on July 1, 2011.

Other elements include: limiting the real estate excise tax exemption for foreclosure sales to transactions where the buyer is the mortgage holder; limiting tax incentives for meat, vegetable and fruit product manufacturing to products that are at least 50 percent meat, vegetable or fruit; holding chief executive officers and chief financial officers of insolvent limited liability entities personally liable for the entities’ unpaid taxes (the House limits this liability to sales taxes); making corporate directors’ fees subject to the B&O tax at the service rate; suspending the sales and use tax exemption for equipment and facilities used to handle nutrients at livestock feeding operations; applying the PUD privilege tax to all fees that PUDs receive from their customers related to supplying electricity.

HOUSE ELEMENTS

Among the House’s unique elements, the two projected to provide the most revenue are eliminating the sales tax exemption for custom and customized software (\$77 million) and capping the B&O deduction for interest received on loans secured by first mortgages on residential property located in Washington (\$67 million).

The House eliminates sales tax exemptions for sales to nonresidents, candy and gum, and cosmetic surgery. It limits the use tax exemption for motor vehicles employed in interstate commerce to those vehicles for which interstate commerce is no less than 50 percent of use. The House increases taxes on tobacco products other than cigarettes by amounts equivalent to the \$1/pack increase imposed on cigarettes; it increases, for three years, the B&O tax rate for lawyers, accountants and certain other professional services from 1.5 percent to 2.0 percent; and it increases the annual excise tax on aircraft to 0.5 percent of fair market value.

The House extends and adjusts rural county tax incentive programs, with a net reduction in revenue for the remainder of the biennium of \$4.5 million. Six new tax incentives reduce revenue by \$0.3 million.

SENATE ELEMENTS

The Senate element that provides the greatest amount of money is a temporary (three-year) increase in the state sales tax rate, from 6.5 percent to 6.8 percent. This temporary increase in the sales tax is paired with the permanent establishment of a “working families tax exemption.” This is not a true tax exemption but rather a grant from the state to eligible low-income individuals. For 2011, the grant will be the greater of \$25 or 7/240 times the earned income tax credit (EITC) that the individual received from the federal government for 2010; for 2012 the grant will be the greater of \$25 or 5 percent of the EITC for 2011; for subsequent years the grant will be the greater of \$50 or 10 percent of the EITC. After accounting for the cost of the grant, the sales tax hike will provide \$313 million over the remainder of the 2009–11 biennium.

The second largest unique Senate element is a temporary (three-year) increase in the B&O service rate from 1.5 percent to 1.75 percent. This is expected to provide \$171 million over the second year of the current biennium.

The remaining Senate elements are: elimination of the sales tax exemption on coal purchases made by the TransAlta power plant in Centralia; elimination of the B&O exemption for property management salaries; limiting the machinery and equipment sales tax exemption for electricity-generating windmills to projects whose customers are located in the state; limitation of the bad debt B&O deduction to the seller of the good (rather than to an assignee); and limitation of the B&O deduction for membership dues and initiation fees to nonprofit organizations exempt from the federal income tax.

REFERENCES

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- . 2010b. Governor Gregoire’s Tax Package. Policy Brief, PB 10–06. February 23. <http://www.researchcouncil.org>
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