Department of Revenue Fiscal Note

Bill Number: 3159 HB PL	Title: Excise tax on food products	Agency: 140-Department of Revenue

Part I: Estimates

☐ **No Fiscal Impact**

Estimated Cash Receipts to:

FUND	FY 2006	FY 2007	2005-07	2007-09	2009-11
GF-STATE-State 01 - Taxes 01 - Retail Sales Tax		(56,000)	(56,000)	(128,000)	(136,000)
GF-STATE-State 01 - Taxes 05 - Bus and Occup Tax		(2,810,000)	(2,810,000)	(6,474,000)	(6,983,000)
Total $		(2,866,000)	(2,866,000)	(6,602,000)	(7,119,000)

Estimated Expenditures from:

	FY 2006	FY 2007	2005-07	2007-09	2009-11
FTE Staff Years		0.2	0.1		
Fund					
GF-STATE-State 001-1		26,100	26,100		
Total $		26,100	26,100		

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

☒ If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.

☐ If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).

☐ Capital budget impact, complete Part IV.

☒ Requires new rule making, complete Part V.

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Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe, by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

Note: This fiscal note reflects the bill as adopted by the Legislature.

In the 2005 legislative session, HB 2221 was enacted to provide a new business and occupation tax exemption for canning, preserving, freezing, processing, or dehydrating fresh fruit and vegetables. The sale of fruits and vegetables canned, preserved, frozen, processed, or dehydrated by the seller are also exempt when the purchaser transports such fruits and vegetables outside the state in the ordinary course of business. The exemption took effect July 1, 2005.

HB 2221 established a deferral of state and local retail sales/use tax for eligible investments in facilities used for processing fresh fruit and vegetables, cold storage of fruits and vegetables, or for related research and development purposes. If the taxpayer claiming the deferral continues to use the facility for eligible purposes, the deferred tax becomes an exemption and does not need to be repaid. The deferral/exemption program takes effect July 1, 2007, and expires July 1, 2012.

HB 2221 established accountability provisions for firms claiming these exemptions or deferrals. Annually, firms are now required to submit a report to the Department of Revenue (Department) by March 31 of the following year. The survey must contain information on the firm's employment, wages, and benefits provided to these employees. The Department is required to submit a report to the Legislature by December 1, 2011, detailing the impact of the exemptions on job creation and retention, company growth, and other related factors. HB 2221 also extended the sales/use tax remittance program for warehouses to large "cold storage" warehouses that meet certain conditions. This will take effect July 1, 2007.

Under current law, the inspection, testing, and labeling of canned salmon is subject to the business and occupation tax at the service rate of 1.5 percent.

This 2006 legislation, HB 3159, makes changes to the law enacted last session and extends the fruit and vegetable processing tax exemption to gross receipts derived from the manufacturing of dairy or seafood products that remain in a raw, raw frozen, or raw salted state after manufacturing or the selling of manufactured dairy products to purchasers who transport the goods out of state. This measure also reduces the business and occupation tax rate for canned salmon activities to 0.484 percent and allows a sales and use tax exemption for materials used to package salmon.

Section 1 establishes a new business and occupation tax exemption for the manufacturing of dairy products or selling of dairy products to purchasers who transport the goods out of state. This measure requires a taxpayer to maintain records that indicate that the goods were transported out of state. This takes effect July 1, 2006, and expires July 1, 2012.

Section 2 establishes a new business and occupation tax exemption for the manufacturing of seafood products that remain in a raw, raw frozen, or raw salted state at the completion of manufacturing or selling the manufactured seafood products that remain in a raw, raw frozen, or raw salted state at the completion of manufacturing to purchasers who transport the goods out of state. This proposal requires a taxpayer to maintain records that indicate that the goods were transported out of state. This takes effect July 1, 2006, and expires July 1, 2012.

Section 3 replaces a requirement for persons claiming the fruit and vegetable processing tax exemption to submit an annual statement to the Department verifying that the buyer transported the products outside of Washington with the requirement to keep records verifying that the products were transported outside of the state. This change takes effect July 1, 2006, and the entire tax exemption expires July 1, 2012.

Section 4 reimposes the business and occupation tax at the rate of 0.138 percent on the processing of fresh fruits and vegetables and on wholesale manufactured fruits and vegetables which are sold to purchasers who transport the goods out of state. This section also reimposes the business and occupation tax at the rate of 0.138 percent on the manufacturing of dairy products or the sale of such products to a purchaser who transports the products outside the state. This section reimposes the business and occupation tax at the rate of 0.138 percent on seafood products which remain in the raw, raw frozen, or raw salted state at the completion of the manufacturing. The 0.138 percent business and occupation tax rate for the manufacturing of fruits and vegetables and dairy products and seafood products becomes effective beginning July 1, 2012. A taxpayer who claims the exemption for sales of dairy products or fruit and vegetable products must keep records verifying that the goods have been transported out of state. This bill also provides a lower business and occupation tax rate of 0.484 percent for activities in inspecting, testing , labeling, and storing canned salmon owned by another person.

Section 5 expands the requirement to file an annual survey to include those persons claiming the business and occupation tax exemptions provided in sections 1 and 2 of this proposal. Section 5 also allows the Department to extend the due date for filing the survey when delay is the result of circumstances beyond the taxpayer's control.

Sections 6 through 9 expand the sales and use tax deferral/exemption program for eligible investments in facilities used for fruit and vegetable processing, warehouses, and cold storage warehousing to include investments in facilities and qualified machinery and equipment that store or manufacture dairy or seafood products, perform research and development activities with respect to manufacturing dairy or seafood products. This bill defines seafood and dairy product and seafood product manufacturing and dairy product manufacturing. Sections 6 through 9 take effect July 1, 2007.

Section 8 allows the Department to extend the due date for filing an accountability report for the tax deferral/exemption when the delay for filing is due to circumstances beyond the taxpayer's control. This section also eliminates the requirement that the report identify the number of jobs created for residents of eligible areas.

Section 11 amends the definition of cold storage warehouse to be consistent with the definition in RCW 82.74.010, as amended in Section 6, for purposes of the sales tax exemption in the form of a remittance program for distribution centers and warehouses. This section becomes effective July 1, 2007, and expires July 1, 2012.

Sections 12 and 13 eliminate cold storage warehouses as being eligible for the sales and use tax exemptions in the form of a remittance program for distribution centers and warehouses. Sections 12 and 13 take effect July 1, 2012.

Sections 14 and 15 add a new sales and use tax exemption on the purchases of materials used in the packing of canned salmon. The exemption is available only if the buyer provides the seller with an exemption certificate in a form prescribed by the Department. The seller is required to retain a copy of the certificate.

Section 16 expands the requirement to file surveys and returns electronically to include manufacturers of dairy and seafood products and those businesses involved in the warehouse remittance program. This section also replaces the Department's authority to relieve a taxpayer of the requirement to file electronically if the taxpayer has a total tax reduction amount of less than $1,000 from all tax exemptions with the authority to waive the requirement for good cause. Section 16 takes effect July 1, 2006.

Section 17 expands the Department's authority to extend the due date for filing of annual surveys if the delay is caused by circumstances beyond the taxpayer's control to include reports and surveys required from manufacturers and sellers of dairy and seafood products and fresh fruits and vegetables. This section takes effect July 1, 2006.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

ASSUMPTIONS/DATA SOURCES

The provision in this measure that has the largest revenue impact is the business and occupation tax exemption for gross receipts from dairy and seafood product manufacturing or the selling of manufactured dairy or seafood products to buyers who transport the products outside the state. This proposal would provide business activities of dairy or certain seafood products manufacturing with a business and occupation tax exemption instead of the lower tax rate of 0.138 percent currently imposed. In addition, this proposal will allow the sales of manufactured dairy or certain manufactured seafood products to be exempt from the business and occupation tax if they are sold to a purchaser who transports the products outside of Washington. This bill provides a lower business and occupation tax rate for canned salmon labeling activities and a retail sales tax exemption for materials used in packing salmon. These revenue estimates assume the following:

1) If dairy or seafood products are being manufactured and the taxpayer qualifies for the lower tax rate on those manufacturing activities, then under this proposal, those same business activities would now be tax exempt. These estimates focus on businesses in the dairy and seafood processing, production, and wholesale industry sectors. Under current law, in Fiscal Year 2005 there were 12 dairies and 75 seafood companies qualifying for the special lower business and occupation tax rate.

2) The Department assumed that a portion of the seafood industries' wholesale activities would now qualify under this proposal as sales of manufactured seafood products that remain in raw, raw frozen, or raw salted state and are sold to purchasers who transport the goods out of state. In Fiscal Year 2005 there were 530 seafood industry businesses in Washington reporting sales for wholesale on their excise tax returns. These are the businesses which could potentially qualify for a tax exemption if they sold manufactured seafood products in a raw, raw frozen, or raw salted state to a buyer who transported them out of state.

3) The Department assumed that 45 percent of the seafood processing and wholesale sectors' wholesale business activities would be to buyers who would export the product outside the state of Washington. This was based on examining the portion of manufacturing activities that are already currently receiving a special assessment rate for the past three fiscal years. In Fiscal Year 2005, $3.72 million in business and occupation tax was assessed for wholesale activities from these seafood industry sectors.

4) The Department assumed that 60 percent of the fishing production sector's wholesale business activities would be to buyers who would export the product outside the state of Washington. This was based on examining Washington IMPLAN data for 2003 on the fishing production industries' consumption demand in Washington, out-of-state demand, and the total industry production. This data revealed that 8 percent of the fishing production is consumed locally in Washington State and 92 percent is exported outside the state. In addition, this data revealed that 34 percent of the industry production was demanded by the seafood product preparation and processing sectors. It is assumed that half of these sales to the processing sectors would further process the seafood product and then it would no longer qualify for this tax exemption. Of the manufactured seafood product that was still in the raw, raw frozen, or raw salted state and would qualify for the tax exemption, it was assumed that 80 percent would be exported outside the state. In Fiscal Year 2005, $0.22 million in business and occupation tax was assessed for wholesale activities from the fishing industry sector.

Salmon Labeling Activities Business and Occupation Tax Exemption
5) Washington business and occupation tax service activities were examined for the three seafood labeling firms impacted by this proposal.

Materials for Packaging Salmon Sales Tax Exemption
6) The Department used retail purchases of packing materials obtained from one of the three firms impacted by the sales tax exemption as the basis for the sales tax revenue loss estimate. It is assumed that this firm's purchases were similar to purchases by the other two firms and that each firm would make up one-third of the total statewide sales tax exemption.

7) The Department assumed a combined state and local sales tax rate of 8.5 percent.

8) The Department assumed a 3 percent annual growth rate in the sales tax exemption for packing materials and business and occupation tax exemption for the service activities of the canned salmon labeling firms. This was the annual growth rate of the impacted firms' growth rate in service activities between 2004 and 2005.

9) The Department assumed only 11 months of reduced business and occupation and retail sales tax collections for Fiscal Year 2007 due to the effective date of the tax exemptions being July 1, 2006.

REVENUE ESTIMATES

The estimated loss in general fund revenue is $2.9 million beginning Fiscal Year 2007 and increasing to $3.6 million by Fiscal Year 2011. The business and occupation tax exemption for the dairy industry is smaller than the tax revenue loss for the seafood industry. In Fiscal Year 2007, the dairy industry business and occupation tax exemption would result in an estimated loss of $0.8 million and the seafood industry tax exemption would be $2 million. These estimates are based on the Washington combined excise tax return information for the dairy and seafood processing, production, and wholesale sectors for the business and occupation tax paid in the most recent fiscal year, Fiscal Year 2005. In addition, prior years' business and occupation taxes paid by these industry sectors were also examined to determine tax revenue growth trends for these sectors.

Another provision in this measure is to include manufacturing of dairy and seafood products into the list of qualified eligible investments for the sales/use tax deferral/exemption. The Department assumed that new eligible investments would be in rural areas or empowerment zones which would allow the new investment projects to already qualify for a sales/use tax exemption for the new manufacturing structures and machinery and equipment. This assumption was based on information from these industries.

A third tax provision in this proposal is an amendment to the existing state sales/use tax remittance program for warehouses and certain cold storage warehouses. It allows the cold storage warehouses to also store dairy and seafood products. Given the fact that the estimates on the revenue loss from adding cold storage warehouses from the 2005 legislation included all cold storage warehouses, regardless of what type of food was stored in them, expanding the list of foods that can be stored in the warehouses will not have any additional negative revenue impact.

A fourth tax provision in this proposal is the retail sales tax exemption for packing materials of salmon. This provision produces a state revenue loss of $56,000 in Fiscal Year 2007 and it grows to $69,000 by Fiscal Year 2011. The local sales tax revenue loss is minimal each year, less than $25,000.

TOTAL REVENUE IMPACT:

State Government (cash basis, $000):

FY 2007 - ($2,866)
FY 2008 - ($3,241)
FY 2009 - ($3,361)
FY 2010 - ($3,490)
FY 2011 - ($3,629)

Local Government (cash basis, $000):

FY 2007 - ($17)
FY 2008 - ($19)
FY 2009 - ($20)
FY 2010 - ($21)
FY 2011 - ($21)

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing functions.

To implement this legislation, the Department will incur costs of approximately $26,100 during Fiscal Year 2007. These are costs to adopt one new administrative rule and amend two current rules.

The Department will absorb these costs. However, should this bill and other similar bills pass, the net impact may result in costs above the level the Department can reasonably absorb. In that event, the Department will need additional resources to implement the legislation.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2006	FY 2007	2005-07	2007-09	2009-11
FTE Staff Years		0.2	0.1		
A-		11,400	11,400		
B-		2,800	2,800		
E-		10,600	10,600		
J-		1,300	1,300		
Total $		$26,100	$26,100		

III. B - Detail: *List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA*

Job Classification	**Salary**	FY 2006	FY 2007	2005-07	2007-09	2009-11
HEARINGS SCHEDULER	31,056		0.0	0.0		
RULES MANAGER	78,194		0.0	0.0		
RULES POLICY SPECIALIST	64,587		0.0	0.0		
TAX POLICY SPECIALIST 2	54,372		0.0	0.0		
TAX POLICY SPECIALIST 3	61,500		0.1	0.1		
Total FTE's			0.2	0.1		

Part IV: Capital Budget Impact

NONE.

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

Should this legislation become law, the Department will use the standard and expedited processes to amend WAC 458-20-115 -- Sales of packing materials and containers, and WAC 458-20-267 -- Annual reports for certain tax adjustments. The Department will also adopt a new rule in chapter 458-20 WAC.

Persons affected by this rule-making would include firms manufacturing dairy and seafood products and persons inspecting, testing, labeling, and storing canned salmon owned by another person.