

Department of Revenue Fiscal Note

Bill Number: 2971 HB	Title: Limiting tax preferences	Agency: 140-Department of Revenue
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Part I: Estimates

☐ No Fiscal Impact

Estimated Cash Receipts to:

Account	FY 2010	FY 2011	2009-11	2011-13	2013-15
GF-State-State 01 - Taxes 05 - Bus and Occup Tax	32,900,000	134,500,000	167,400,000	230,100,000	255,400,000
Total \$	32,900,000	134,500,000	167,400,000	230,100,000	255,400,000

Estimated Expenditures from:

	FY 2010	FY 2011	2009-11	2011-13	2013-15
FTE Staff Years		0.1	0.1		
Account					
GF-STATE-State 001-1	11,300	10,500	21,800		
Total \$	11,300	10,500	21,800		

This bill was identified as a proposal governed by the requirements of RCW 43.135.031 (Initiative 960). Therefore, this fiscal analysis includes a projection showing the ten-year cost to tax or fee payers of the proposed taxes or fees.

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates,

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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Agency Approval:	Don Gutmann	Phone: 360-570-6073	Date: 02/10/2010
OFM Review:	Ryan Black	Phone: 360-902-0417	Date: 02/10/2010

Request # 2971-2-2

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

This revised fiscal note reflects a final decision in the court case concerning the business and occupation (B&O) tax for sales by certain out-of-state-persons to or through seller's representatives (Dot Foods vs. Department of Revenue) described in Part I below.

There have been several recent court decisions that have expanded certain tax preferences to activities that were not originally allowed under the Department of Revenue's (Department) interpretation of the law. This bill would clarify which activities qualify for the various tax preferences and effectively return the application to that originally adopted by the Department.

Part I

Current law (RCW 82.04.423) provides an exemption from the B&O tax for sales by certain out-of-state-persons to or through direct seller's representatives. The Department's position had been that the "direct seller" exemption was limited to those businesses who sell their products exclusively through "door to door" type sellers, and not in permanent retail establishments (stores). A recent Washington Supreme Court decision expands the exemption to businesses whose products are sold in stores.

This bill proposes to:

- 1) Eliminate the exemption in its entirety effective July 1, 2010; and
- 2) Revise the definition of "direct seller's representative" to conform to the Department's interpretation of the exemption as noted above. This change applies retroactively to tax periods before July 1, 2010.

Part II

Currently, financial businesses are allowed to deduct from their B&O tax, amounts derived from interest received on investments or loans primarily secured by first mortgages or trust deeds on nontransient residential properties (RCW 82.04.4292). Recently the Washington Supreme Court held that the deduction includes amounts retained as servicing fees by lenders after the loan is sold on the secondary market.

This bill would prospectively restore the Department's interpretation of the first mortgage interest deduction.

The bill specifies that income from the following activities is taxable:

- 1) Fees for specific services. This includes servicing fees, including servicing fees received by lenders when they sell loans or mortgage-backed or mortgage-related securities in the secondary market while retaining the right to service the loans or securities and receive a portion of the interest payments as the servicing fee.
- 2) Commitment fees.
- 3) Any other fees, or portion of a fee, that is not recognized over the life of the loan as an adjustment to yield in the taxpayer's books and records according to generally accepted accounting principles.
- 4) Gains on the sale of valuable rights. This includes service release premiums and gains on the sale of loans.

Part III

Currently, processors of perishable meat products receive a reduced B&O tax rate of 0.138 percent. A 2005 decision by the Washington Supreme Court held that this reduced B&O tax rate applied to the processing of perishable meat into a nonperishable finished product.

Current law also provides a B&O tax exemption for canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables. Beginning July 1, 2012, this exemption is replaced with a reduced B&O tax rate for these activities.

This legislation modifies qualifying activities for the reduced B&O tax rate for processing perishable meat products by requiring that the end product be: a perishable meat product; a nonperishable meat product that is comprised primarily of animal carcass by weight or volume, other than a canned meat product; or a meat by-product manufactured in a rendering plant.

This legislation also modifies the B&O tax preferences for canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables by requiring the end product to be:

- Comprised exclusively of fruits, vegetables, or both fruits and vegetables, or
- Comprised of fruits, vegetables, or both fruits and vegetables, where the amount of all ingredients contained in the product, other than fruits, vegetables, and water, does not exceed the amount of fruits and vegetables contained in the product measured by weight or volume.

The proposal is effective July 1, 2010, except those provisions which are retroactive clarifications.

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

ASSUMPTIONS/DATA SOURCES

Sections 101-102

The effect of the Washington Supreme Court's decision regarding sales by certain out-of-state-persons to or through direct seller's representatives is reflected in the Forecast Council's revenue forecast.

The estimated revenue increase reflects the retroactive revision to the definition of "direct seller's representative" to conform to the Department's interpretation, thereby eliminating any refund claims resulting from the recent court decision, other than for Dot Foods, and the elimination of this exemption in its entirety as of July 1, 2010.

Sections 201-203

The effect of the Washington Supreme Court's decision regarding the first mortgage interest deduction is reflected in the Forecast Council's revenue forecast.

Estimates are based on the Department's tax reporting information, information from financial institutions as reported in their Report of Condition and Income (Call Report) to federal agencies, and forecasts of mortgage activity derived from data provided by the Forecast Council for the November 2009 forecast.

Since the proposal would be effective July 1, 2010, and would apply prospectively only, there would be a cash impact for eleven months in Fiscal Year 2011.

Sections 301-304

The effect of the perishable meat processing court case is reversed effective July 1, 2010. The changes to the tax preferences for processors of fresh fruits or vegetables would cause about ten percent of the amount currently exempt to become taxable.

The striking of language in section 314 removes obsolete language and has no substantive effect on the bill.

REVENUE ESTIMATES

Based on the above assumptions there would be revenue increases for Fiscal Year 2010 of \$32.9 million and a Fiscal Year 2011 eleven month impact of \$134.5. Of these amounts avoided refunds are estimated at \$56.2 million.

TOTAL REVENUE IMPACT:

State Government (cash basis, \$000):

FY 2010 - \$ 32,900
FY 2011 - \$ 134,500
FY 2012 - \$ 112,200
FY 2013 - \$ 117,900
FY 2014 - \$ 124,400
FY 2015 - \$ 131,000

Local Government, if applicable (cash basis, \$000): None

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

To implement this legislation, the Department will incur costs of \$11,300 in Fiscal Year 2010. These costs are to print and mail a special notice to those businesses identified as direct sellers, informing them of the exemption change.

The Department will incur costs of \$10,500 in Fiscal Year 2011. These costs are for the amendment of two administrative rules.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2010	FY 2011	2009-11	2011-13	2013-15
FTE Staff Years		0.1	0.1		
A-Salaries and Wages		6,500	6,500		
B-Employee Benefits		1,600	1,600		
E-Goods and Services	11,300	1,800	13,100		
J-Capital Outlays		600	600		
Total \$	\$11,300	\$10,500	\$21,800		

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 2010	FY 2011	2009-11	2011-13	2013-15
HEARINGS SCHEDULER	32,688		0.0	0.0		
TAX POLICY SP 3	69,756		0.1	0.0		
WMS BAND 3	88,546		0.0	0.0		
Total FTE's	190,990		0.1	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 expedited process to amend WAC 458-20-246, titled: "Sales to or through a direct seller's representative". Persons affected by this rule-making would include businesses making sales to or through direct seller's representatives. The Department will also use the expedited process to amend WAC 458-20-136, titled: "Manufacturing, processing for hire, fabricating". Persons affected by this rule-making include those businesses that use meat, vegetables, or fruit in manufactured products.



Ten-Year Analysis

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This ten-year analysis is limited to agency estimated cash receipts associated with the proposed tax or fee increases. The Office of Financial Management ten-year projection can be found at <http://www.ofm.wa.gov/tax/default.asp>.

Estimates

☐ **No Cash Receipts**
☐ **Indeterminate Cash Receipts**

Estimated Cash Receipts

Name of Tax or Fee	Acct Code	Fiscal Year 2010	Fiscal Year 2011	Fiscal Year 2012	Fiscal Year 2013	Fiscal Year 2014	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2017	Fiscal Year 2018	Fiscal Year 2019	2010-19 TOTAL
B&O Tax	001	32,900,000	134,500,000	112,200,000	117,900,000	124,400,000	131,000,000	137,800,000	144,900,000	152,500,000	160,400,000	1,248,500,000
Total		32,900,000	134,500,000	112,200,000	117,900,000	124,400,000	131,000,000	137,800,000	144,900,000	152,500,000	160,400,000	1,248,500,000
Biennial Totals		167,400,000		230,100,000		255,400,000		282,700,000		312,900,000		1,248,500,000

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OFM Review: Ryan Black	Phone: 360-902-0417	Date: 1/22/2010 4:51:12 pm