

# Multiple Agency Fiscal Note Summary

<b>Bill Number:</b> 6143 E S SB AMH ENGR H5614.E	<b>Title:</b> Excise tax law modifications
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## Estimated Cash Receipts

Agency Name	2009-11		2011-13		2013-15	
	GF- State	Total	GF- State	Total	GF- State	Total
Department of Revenue	680,059,000	681,472,000	1,446,326,000	1,449,549,000	1,630,306,000	1,634,055,000
Department of Transportation	0	(26,000)	0	(54,000)	0	(54,000)
<b>Total \$</b>	<b>680,059,000</b>	<b>681,446,000</b>	<b>1,446,326,000</b>	<b>1,449,495,000</b>	<b>1,630,306,000</b>	<b>1,634,001,000</b>

Local Gov. Courts *						
Local Gov. Other **	Fiscal note not available					
Local Gov. Total						

## Estimated Expenditures

Agency Name	2009-11			2011-13			2013-15		
	FTEs	GF-State	Total	FTEs	GF-State	Total	FTEs	GF-State	Total
Office of Attorney General	.0	0	0	.0	0	0	.0	0	0
Department of Revenue	20.4	4,375,900	4,375,900	22.3	3,685,200	3,685,200	18.7	2,988,900	2,988,900
Department of Licensing	.0	0	0	.0	0	0	.0	0	0
Department of Transportation	.0	0	0	.0	0	0	.0	0	0
<b>Total</b>	<b>20.4</b>	<b>\$4,375,900</b>	<b>\$4,375,900</b>	<b>22.3</b>	<b>\$3,685,200</b>	<b>\$3,685,200</b>	<b>18.7</b>	<b>\$2,988,900</b>	<b>\$2,988,900</b>

Local Gov. Courts *									
Local Gov. Other **	Fiscal note not available								
Local Gov. Total									

## Estimated Capital Budget Impact

Agency Name	2009-11		2011-13		2013-15	
	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Office of Attorney General						
Acquisition	0	0	0	0	0	0
Construction	0	0	0	0	0	0
Other	0	0	0	0	0	0
<b>Total \$</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

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.

\* See Office of the Administrator for the Courts judicial fiscal note

\*\* See local government fiscal note

FNPID 27014

FNS029 Multi Agency rollup

<b>Prepared by:</b> Ryan Black, OFM	<b>Phone:</b> 360-902-0417	<b>Date Published:</b> Preliminary
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\* See Office of the Administrator for the Courts judicial fiscal note

\*\* See local government fiscal note

FNPID 27014

# Individual State Agency Fiscal Note

<b>Bill Number:</b> 6143 E S SB AMH ENGR H5614.E	<b>Title:</b> Excise tax law modifications	<b>Agency:</b> 100-Office of Attorney General
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## Part I: Estimates

☒ No Fiscal Impact

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, 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.

Legislative Contact:	Phone:	Date: 03/09/2010
Agency Preparation: Cam Comfort	Phone: (360) 664-9429	Date: 03/15/2010
Agency Approval: Sarian Scott	Phone: (360) 586-2104	Date: 03/15/2010
OFM Review: Matthew Bridges	Phone: (360) 902-0575	Date: 03/16/2010

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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.*

Section 1 of this bill states the intent to preserve funding, close obsolete tax preferences, clarify legislative intent regarding existing tax policy, and ensure balanced tax policy while bolstering emerging industries.

Part I (sections 101 through 108) would establish minimum nexus standards to be deemed to be engaging in business within this state. Businesses covered by RCW 82.04.460(1) and financial businesses would be required to apportion their income to Washington using the receipts factor. RCW 82.04.2907 would be amended to define “gross income from royalties.” Under section 2602, sections 101 through 108 would apply to gross income generated on or after July 1, 2010.

Part II (sections 201 through 212) would address tax avoidance transactions and would require the Department of Revenue (DOR) to adopt rules describing the circumstances in which it will disregard the form of a transaction. Various excise tax statutes would be amended to address the taxation of transactions between affiliated entities. The Secretary of State would be required to adopt rules with respect to any entity that is required to file an annual report regarding disclosing the granting of any option to acquire an interest in the entity if the exercise of the option would result in a sale as defined in RCW 82.45.010(2). Under section 2603, sections 201 through 212 must be construed liberally to effectuate the legislature’s intent to ensure that all business and individuals pay their fair share of taxes. Under section 2604, section 201 generally would apply to tax periods beginning January 1, 2006.

Part III (sections 301 and 302) would modify and place a cap on the first mortgage interest deduction provided by RCW 82.04.4292.

Part IV (section 401) would repeal the nonresident retail sales tax exemption provided by RCW 82.04.0273.

Part V (sections 501 and 502) would repeal the direct seller’s exemption effective April 1, 2010, and clarify the exemption for periods before that date.

Part VI (sections 601 through 619) would narrow the tax preference provided by RCW 82.04.260 to require that the end product be a nonperishable meat product to qualify for the lower tax rate. Various non-substantive grammatical changes are made and erroneous statutory references are corrected. Under sections 2618 and 2619, section 605 would expire on July 1, 2011, and section 606 would take effect on July 1, 2011.

Part VII (sections 701 and 702) would suspend the retail sales and use tax exemptions for livestock nutrient equipment and facilities during the period April 1, 2010, through June 30, 2013.

Part VIII (sections 801 through 803) would amend RCW 82.04.360 to impose the Business and Occupation (B&O) tax to amounts received by an individual from a corporation as compensation for serving as a member of the corporation’s board of director beginning April 1, 2010.

Part IX (sections 901 through 909) would make various changes to the airplane excise tax imposed under chapter 82.48

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RCW, including transferring responsibility for administering the tax to the Department of Licensing from the Department of Transportation.

Part X (section 1001) would amend RCW 82.12.0254 pertaining to the use tax on motor vehicles and trailers used in interstate commerce.

Part XI (sections 1101 and 1102) pertains to the foreclosure exemption and would amend RCW 82.04.010 and RCW 82.45.080. Under section 2608, sections 1101 and 1102 would apply to transfers or conveyances occurring on or after April 1, 2010.

Part XII (section 1201) would amend RCW 82.32.145 pertaining to the collection of unpaid retail sales taxes and the imposition of personal liability.

Part XIII (section 1301) would repeal the B&O tax credit provided by RCW 82.04.44525 related to new employment for international service activities.

Part XIV (sections 1401 through 1408) would repeal the retail sales and use tax exemptions for “candy” and “bottled water.” Certain exceptions would apply.

Part XV (sections 1501 through 1513) would extend the retail sales and use taxes to “cosmetic medical service” and “custom software.” Various non-substantive grammatical changes are made and erroneous statutory references are corrected.

Part XVI (sections 1601 through 1608) would increase tobacco taxes, amend the definition of “tobacco products,” and define “moist snuff” and “little cigar.” Under section 2609 through 2611, sections 1602 and 1605(1) would apply only with respect to tax liabilities incurred on or after April 1, 2010.

Part XVII (sections 1701 through 1715) would clarify the definitions of “manufacturing” and “research and development” for purposes of chapters 82.60 RCW and 82.62 RCW for periods prior to July 1, 2010, and amend the definitions for periods beginning July 1, 2010. The expiration date of the tax benefits provided by chapter 82.60 would be extended to July 1, 2020. Various non-substantive grammatical changes are made erroneous statutory references corrected. Under section 2615, sections 1701, 1702, 1704 through 1708, and 1712 through 1715 would take effect on July 1, 2010.

Part XVIII (section 1801) would clarify that the definition of “gross revenue” in RCW 54.28.011 includes regularly recurring charges billed to customers as a condition of receiving electric energy. Under section 2620, section 1801 would apply prospectively only.

Part XIX (sections 1901 and 1902) would impose an 0.5 percent B&O tax surcharge on certain “selected business services.”

Part XX (sections 2001 through 2003) would amend various excise tax statutes related to the taxation of “stirling converters.”

Part XXI (section 2101) adds new sections providing retail sales and uses tax exemptions for the sale and use of wax and ceramic materials used to create molds consumed during the process of creating ferrous and nonferrous investment castings used in industrial applications. These exemptions would expire July 1, 2020.

Part XXII (sections 2201 through 2206) would extend certain favorable excise tax treatment provided to aluminum smelters to January 1, 2017.

Part XXIII (section 2301) would add a July 1, 2023 expiration date to the preferential B&O tax rate provided by RCW 82.04.050(3) to persons classified by the Federal Aviation Administration as a federal aviation regulation part 145 certificated repair station, and require a person receiving the favorable rate to file an annual report with the DOR.

Part XXIV (sections 2401 and 2402) would provide a B&O tax deduction for certain manufacturing activities undertaken by specified nonprofit facilities and metropolitan park districts operating a zoological facility.

Part XXV (section 2501) would add a new section to chapter 82.32 RCW authorizing the governing board of a nonprofit organization, corporation, or association to apply for a tax deferral on a facility used primarily as a performing arts center.

Part XXVI contains various miscellaneous provisions. Several of the sections contained in Part XXVI are discussed above. In addition, under section 2605, sections 502, 802, 1701, and 1702 would apply both retroactively and prospectively. Under section 2606, refunds may not be granted under sections 802 and 2605 with respect to taxes collected before April 1, 2010. Under section 2613, except as otherwise provided, the act would take effect on April 1, 2010. Under section 2614, Parts I, II, and III would take effect on July 1, 2010.

Except as indicated above, this bill is assumed effective July 1, 2010.

## **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.*

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 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.*

None.

## **Part III: Expenditure Detail**

## **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.*

None.

# Department of Revenue Fiscal Note

<b>Bill Number:</b> 6143 E S SB AMH ENGR H5614.E	<b>Title:</b> Excise tax law modifications	<b>Agency:</b> 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 01 - Retail Sales Tax	33,597,000	211,656,000	245,253,000	471,464,000	571,505,000
GF-State-State 01 - Taxes 05 - Bus and Occup Tax	30,577,000	280,942,000	311,519,000	750,443,000	832,005,000
GF-State-State 01 - Taxes 25 - Cigarette Tax	14,737,000	88,423,000	103,160,000	172,853,000	171,970,000
GF-State-State 01 - Taxes 26 - Other Tobacco Tax	97,000	8,028,000	8,125,000	26,985,000	27,518,000
GF-State-State 01 - Taxes 36 - PUD Privilege Tax	182,000	1,091,000	1,273,000	2,248,000	2,339,000
GF-State-State 01 - Taxes 57 - Real Estate Excise	767,000	9,962,000	10,729,000	22,333,000	24,969,000
Publ Works Assist-State 01 - Taxes 57 - Real Estate Excise	51,000	659,000	710,000	1,477,000	1,653,000
Educ Legacy Trust-State 01 - Taxes 25 - Cigarette Tax	12,000	70,000	82,000	548,000	726,000
City County Asst-State 01 - Taxes 57 - Real Estate Excise	13,000	185,000	198,000	418,000	466,000
Performance Audit-State 01 - Taxes 01 - Retail Sales Tax	58,000	365,000	423,000	780,000	904,000
<b>Total \$</b>	80,091,000	601,381,000	681,472,000	1,449,549,000	1,634,055,000

### Estimated Expenditures from:

	FY 2010	FY 2011	2009-11	2011-13	2013-15
FTE Staff Years	6.8	34.0	20.4	22.3	18.7
<b>Account</b>					
GF-STATE-State 001-1	1,373,200	3,002,700	4,375,900	3,685,200	2,988,900
<b>Total \$</b>	1,373,200	3,002,700	4,375,900	3,685,200	2,988,900

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.

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*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.*

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- ☐ Capital budget impact, complete Part IV.
- ☒ Requires new rule making, complete Part V.

Legislative Contact:	Phone:	Date: 03/09/2010
Agency Preparation: Diana Tibbetts	Phone: 360-570-6085	Date: 03/16/2010
Agency Approval: Kim Davis	Phone: 360-570-6087	Date: 03/16/2010
OFM Review: Ryan Black	Phone: 360-902-0417	Date: 03/18/2010

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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 House amendment AMH ENGR H5614.E to ESSB 6143.

#### Part I - Minimum Nexus Standards

Part I of this bill would establish, for business and occupation (B&O) tax purposes, nexus standards in statute and a single sales factor apportionment method for many service businesses and businesses receiving royalty income from the use of intangible property in this state.

#### Background:

A tax on businesses engaging in interstate commerce is valid under the Commerce Clause of the United States Constitution as long as it:

- (1) Is applied to an activity with a substantial nexus with the taxing state;
- (2) Is fairly apportioned;
- (3) Does not discriminate against interstate commerce; and
- (4) Is fairly related to the services provided by the state.

This part relates to the nexus and apportionment requirements.

With respect to nexus, Washington does not at present impose B&O tax on businesses that conduct business in this state unless they have a physical presence in the state, such as tangible personal property or real property, or have either employees or non-employee representatives enter the state for business reasons. However, a number of states have successfully asserted that nexus is established by intentionally entering the state's marketplace to engage in business without physically entering the state. This is sometimes referred to as "economic nexus."

At least thirty states currently apply some form of economic nexus, and case law trends have shown a strong move toward judicial approval of economic nexus standards for the imposition of taxes on business income. It is important to note that the constitutionality of economic nexus is not definitively settled. Some tax practitioners argue that physical presence is required by the U.S. Constitution for all state taxes, but the vast majority of state case law upholds economic nexus for business activity taxes. The federal courts have not ruled directly on the issue, but the U.S. Supreme Court has refused on at least six occasions to review state court rulings sustaining economic nexus.

With respect to apportionment, most service businesses that engage in business both within and without Washington are eligible to use a cost apportionment method. The cost apportionment method assigns a portion of worldwide service income to Washington based on a ratio of the cost of doing business in Washington as compared to the total cost of doing business worldwide. Financial institutions use a three-factor apportionment formula, which is the average of three ratios: (1) property in Washington compared to property everywhere, (2) payroll in Washington compared to payroll everywhere, and (3) receipts sourced to Washington compared to worldwide receipts. Royalty income is not apportioned in this state. Rather, royalties are allocated to the domicile of the taxpayer. Businesses that are domiciled outside of Washington, but authorize the use of their intangible property in Washington, do not pay any B&O taxes in Washington on royalties received from the use of their intangible property in this state. This has led some Washington-domiciled taxpayers to transfer their intangible assets to wholly-owned subsidiaries whose sole place of business is outside of Washington. Sometimes these subsidiaries are domiciled in states, such as Nevada, that do not tax income from the use of intangibles.

Many states have been moving to a sales-only formula for apportioning income. In general, a sales-only apportionment

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formula would reduce taxes for in-state businesses that sell mostly to out-of-state customers.

#### Summary of Part I:

This proposal establishes nexus standards in statute for the B&O tax. Under the bill, a person has nexus if:

- The person is an individual who is a resident or domiciliary of this state,
- The person is a business entity that is organized or commercially domiciled in this state, or
- The person is a nonresident individual or a business entity that is organized or commercially domiciled outside of this state and in any tax year the business has:
  - More than \$50,000 dollars of property in this state,
  - More than \$50,000 of payroll in this state,
  - More than \$500,000 of receipts from this state, or
  - At least 25 percent of the business's total property, total payroll, or total receipts are in this state.

The dollar thresholds above will be adjusted by the consumer price index (CPI) whenever the cumulative change in the CPI reaches five percent. A person who has nexus with this state in any tax year will be deemed to have nexus with this state for the following four tax years.

Even though a business may have nexus by having more than \$500,000 of receipts from this state or at least 25 percent of its total receipts from this state, the business will not be required to pay B&O taxes on certain activities unless it has a physical presence. Those activities for which a physical presence is required for B&O tax purposes include: retail sales, wholesale sales, manufacturing, processing for hire, extracting, extracting for hire, printing, public road construction and other construction activities that are not considered retail or wholesale sales, certain warehousing activities, radio and television broadcasting, day care providers, and chemical dependency services.

This part also establishes a single factor apportionment method based on receipts. Under this apportionment method, a business determines the portion of its income taxable in this state by multiplying its taxable income by a fraction. The numerator of the fraction is gross income assigned to Washington, and the denominator is the business's total gross income. In general, gross income is assigned to Washington if the benefit of the service or, in the case of royalties, the intangible property is located in this state. If a business is unable to assign gross income using this method, the bill provides other methods for determining the location of gross income. The bill also provides very detailed provisions governing how financial institutions determine the location of their gross income.

The apportionment method provided in this bill is available primarily for businesses that report under the "service and other activities" B&O tax classification or the "royalties" B&O tax classification. It also applies to several other tax classifications including real estate brokers, insurance agents, travel agents and tour operators, and the printing and publishing classification-but only to the extent of income that would otherwise be apportionable if the printing and publishing classification did not exist (advertising income, for example).

This part also amends RCW 82.04.2907, the statute imposing B&O tax on royalties. The amendments: (1) make technical changes, and (2) extend royalty tax treatment to compensation received for the licensing of digital goods, digital codes, or digital automated services (digital products) to a person who is not the end user of the digital product.

If a court holds the nexus provisions relating to property, payroll, or receipts unconstitutional or otherwise invalid, Part I is

null and void in its entirety. Part I takes effect July 1, 2010, and applies to gross income generated on and after July 1, 2010. However, for purposes of determining nexus under the property, payroll, and receipts factors for the 2010 tax year, property, payroll, and receipts are based on the entire 2010 tax year

## Part II - Tax Avoidance Transactions

Part II addresses provisions or ambiguities in current law, which taxpayers use to avoid paying B&O tax, sales and use taxes, and real estate excise taxes (REET).

Sections 201 through 203 of this bill provide the Department of Revenue (Department) with tools to invalidate tax avoidance transactions and assess a 35 percent penalty when the taxpayer engages in a tax avoidance transaction. A tax avoidance transaction means a transaction or series of transactions adopted for the purpose of:

- Disguising income received, or otherwise avoiding tax on income, from a person that is not affiliated with the taxpayer;
- Disguising the purchase or sale of property or services from or to a person that is not affiliated with the taxpayer; or
- Avoiding use tax on the use of property in this state that is owned by an entity organized outside of Washington.

Affiliated means under common control. Control means the possession of more than 50 percent of the power to direct or cause the direction of the management of a person.

As resources allow, the Department must adopt rules to assist in determining when to disregard a tax avoidance transaction. In adopting rules, the Department may consider several judicial doctrines, including the sham transaction, economic substance, business purpose, and substance over form doctrines.

The bill also requires the Department to conduct a review of the state's tax policy with respect to the taxation of transactions between affiliated entities.

Section 205 of the bill imposes use tax on the use of tangible personal property acquired by the user in any manner, including through a step transaction. Under current law, use tax on tangible personal property applies only when tangible personal property is acquired through a purchase at retail, lease, gift, repossession, bailment, or is extracted or manufactured by the user, or is furnished to a person engaged in any business taxable under RCW 82.04.280(2) or (7) (certain public road and government construction activities). Use tax does not apply to the use of tangible personal property acquired in a step transaction. An example of a step transaction involves a business creating a subsidiary entity, transferring tangible assets to the subsidiary, transferring ownership of the subsidiary to another business (the acquiring business), followed by a merger of the acquired subsidiary into the acquiring business.

Part II of the bill also closes loopholes and clarifies ambiguities related to REET. Currently, payment of the REET may be avoided on the transfer of a controlling interest (at least a 50 percent interest) in an entity that owns real property where it takes longer than 12 months to transfer the controlling interest. This can be done by transferring a less than 50 percent ownership interest plus an option to acquire the remaining interest in the entity more than 12 months after the option was granted. Another way to avoid REET is to create a wholly-owned subsidiary, transfer real property to that subsidiary, and the subsidiary transfers real property followed by the dissolution of the subsidiary before the REET is paid. If the buyer has provided written notice of the sale within 30 days of the sale, the buyer is not liable for the tax. And the Department cannot pursue the seller for the tax, because the seller does not exist anymore.

In the case of the transfer or acquisition of publicly traded corporations, it could be argued that the "seller" liable for REET is the individual shareholders of the corporation in which a controlling interest was transferred.

The bill provides that, for the sole purpose of determining whether, pursuant to the exercise of an option, a controlling interest was transferred or acquired within a 12-month period, the date that the option agreement was executed is the date on which the transfer or acquisition of the controlling interest is deemed to occur. However, REET is due on the transfer or acquisition of a controlling interest pursuant to the exercise of an option on the date the option is exercised.

When there is a taxable sale resulting from the transfer or acquisition of a controlling interest in an entity, this bill allows the Department to enforce the obligation of the seller for payment of REET as follows:

- When the transfer or acquisition is of a corporation, the Department may collect the tax from either the corporation in which the controlling interest was transferred, the person or persons who acquired the controlling interest, or, except when the corporation is a publicly traded corporation, the person or persons who transferred the controlling interest.
- When the seller is a partnership, association, trust, or other entity, the Department may collect the tax from either the entity in which the controlling interest is transferred or acquired or the person or persons who transferred or acquired the controlling interest in the entity.

Part II of the bill establishes that the seller liable for REET is the parent of a wholly owned subsidiary when the subsidiary is the transferor to a third party transferee and the subsidiary dissolves before REET is paid on the transfer.

In addition, Part II clarifies that when there is a sale by reason of the transfer or acquisition of a controlling interest in an entity owning real property in this state, the REET is a lien on the real property in this state owned by the entity in which a controlling interest has been transferred or acquired from the date of sale until the tax is paid.

This part of the bill will take effect July 1, 2010. Section 201 of this bill applies to tax periods beginning January 1, 2006 through June 30, 2011.

#### Part III - Modifying and Placing a Cap on the First Mortgage Deduction

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 restores the Department's interpretation of the first mortgage interest deduction by providing a nonexclusive list of items that are not deductible. The bill also limits the amount that may be deducted by any business to no more than \$100 million per calendar year.

#### Part IV - Repealing the Nonresident Sales Tax Exemption

This part repeals the nonresident sales tax exemption in RCW 82.08.0273. This exemption currently applies to sales of tangible personal property and digital products for use outside the state to qualified nonresidents. The nonresident must be a resident of a state or possession or Province of Canada that does not impose a sales or use tax of three percent or more or,

if imposing a sales or use tax of three percent or more, exempts Washington residents from its tax.

#### Part V - Direct Seller Business and Occupation Tax Exemption

Current law (RCW 82.04.423) provides exemption from the B&O tax for sales by certain out-of-state-persons to or through seller's representatives. The Department's position had been that the "direct seller" exemption was limited to those businesses that only sold consumer products through a direct seller's representative in the home or otherwise in permanent retail establishments (stores). A recent Washington Supreme Court decision expands the exemption to businesses that sell nonconsumer products, some of which are sold in stores.

This bill:

- 1) Eliminates the exemption in its entirety effective April 1, 2010; and
- 2) Revises 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 April 1, 2010.

#### Part VI - Business and Occupation Tax Preferences for Manufacturers of Products Derived from Certain Agricultural Products

Part VI of the bill changes the application of the B&O tax to manufacturers and wholesalers of certain meat products, meat byproducts, or fruit and vegetable products by clarifying and narrowing the definitions of activities that are subject to the preferential tax treatment.

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 the activities eligible 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.

These changes take effect April 1, 2010.

#### Part VII - Suspending the Sales and Use Tax Exemption for Livestock Nutrient Equipment and Facilities

Current law provides a retail sales and use tax exemption for the purchase and use of certain equipment and services related to the management of livestock nutrients. Eligible operations include licensed dairies with a certified dairy nutrient plan, animal feeding operations that have a waste disposal permit issued under RCW 90.48, and animal feeding operations that have a nutrient management plan approved by a conservation district meeting certain requirements. This part of the bill temporarily suspends this exemption between April 1, 2010, and June 30, 2013.

#### Part VIII - Ending the Preferential Business and Occupational Tax Treatment Received by Directors of Corporations

Beginning April 1, 2010, compensation received by members of corporate boards of directors is taxed under the service and other activities B&O tax classification at a rate of 1.5 percent. An exemption is provided retroactively for director compensation received before April 1, 2010.

#### Part IX - Airplane Excise Tax

This part of the bill replaces the existing aircraft excise tax, which is a flat amount depending on the type of aircraft, with an excise tax of 0.5 percent of the taxable value of the non-commercial aircraft. The taxable value is the fair market value of the aircraft, which in most cases will be based on the most recent purchase price of the aircraft, less an allowance for depreciation based on a depreciation schedule that the Department is required to prepare. The tax imposed on aircraft with a date of manufacture before December 31, 1970 is capped. The maximum tax amounts vary with the type of aircraft and are established in this bill.

The administration of the airplane excise tax is moved from the Department of Transportation to the Department of Licensing.

#### Part X - Use Tax on Motor Vehicles and Trailers Used in Interstate Commerce

Currently, the use of motor vehicles or trailers used in "substantial part" for transportation of persons or property for hire across the boundaries of this state, which the Department interprets as at least 25 percent of the time for interstate transportation, is exempt from the state and local use tax. This bill restricts the use tax exemption to the use of motor vehicles or trailers and parts "primarily" (more than 50 percent) in interstate commerce.

#### Part XI - Foreclosure Exemption

Under current law, a judicial or nonjudicial foreclosure of a deed of trust is not considered a "sale" for REET purposes. This "foreclosure exemption" also applies to a transfer or conveyance of real estate pursuant to a deed in lieu of foreclosure or an order of sale by a court in any lien foreclosure proceeding or upon execution of a judgment. When REET is due, in most cases, it is the responsibility of the seller of the property.

Effective April 1, 2010, Part XI of this bill would limit the foreclosure exemption to the following transfers or conveyances: (1) to the beneficiary of a deed of trust in a nonjudicial foreclosure; (2) to the mortgagee, beneficiary of a deed of trust, or lien holder pursuant to an order of sale by the court in the judicial foreclosure of any mortgage, deed of trust, or lien; (3) to the mortgagee by the mortgagor or to the beneficiary of a deed of trust by the grantor pursuant to a deed in lieu of foreclosure; or (4) to the judgment creditor pursuant to a writ of execution.

In the taxable sale of a foreclosed property, the seller is the foreclosing creditor.

Thus, for example, the transfer of real property under a foreclosure sale to a third party, such as an investor who will resell the property or a person who will reside in the property, would become taxable under this proposal, and the payment of the REET would be the responsibility of the foreclosing creditor.

#### Part XII- Tax Debts

Currently, certain individuals can be held personally liable for collected but unremitted sales tax when a corporation or limited liability company goes out of business. This part of the bill imposes personal liability on the chief executive and chief financial officer regardless of fault or whether those individuals were aware of the unpaid sales tax liability.

#### Part XIII - Repealing the Business and Occupation Tax Credit for New Employment for International Service Activities

This part repeals the \$3,000 B&O tax credit provided for hiring new employees performing international service activities in eligible areas and is effective April 1, 2010.

#### Part XIV - Repealing the Sales and Use Tax Exemptions for Candy and Bottled Water

Currently candy and most other food is exempt from the state and local sales and use taxes. This bill extends the sales and use taxes to candy and bottled water.

"Candy" is defined as a preparation of sugar, honey, or other sweeteners in combination with chocolate, fruits, nuts, or other ingredients or flavorings in the form of bars, drops, or pieces. However, candy does not include any preparation containing flour, nor any products that require refrigeration.

"Bottled water" means water that is placed in a sealed container or package for human consumption or other consumer uses, including water that is delivered to the buyer in a reusable container that is not sold with the water. The sales or use of water sold pursuant to a prescription or to persons who do not otherwise have a readily available source of potable water are exempt from the sales and use tax.

#### Part XV - Imposing Sales and Use Tax on Cosmetic Surgery and Custom Software

Currently, cosmetic medical services and custom software are subject to the service and other activities classification of the B&O tax and not subject to the retail sales and use tax. This bill imposes the retail sales and use tax on the sale of these services. The B&O tax on these sales are reduced from the 1.5 percent service tax to 0.471 percent retail tax.

Cosmetic medical services include any medical procedures performed on an individual by a person licensed or regulated in a health profession as described in RCW 18.120.020. The services must improve the individual's appearance and must not be medically necessary. Cosmetic medical services includes, but is not limited to, cosmetic surgery, hair transplants, cosmetic injections, cosmetic soft tissue fillers, dermabrasion and chemical peel, laser hair removal, laser skin resurfacing, laser treatment of leg veins, sclerotherapy, and cosmetic dentistry.



Any medical procedure performed on abnormal structures caused by or related to congenital defects, developmental abnormalities, trauma, infection, tumors, or disease, including procedures to improve function or give a more normal appearance, is medically necessary. Services covered by the individual's medical or dental insurance or that are deductible by the individual as medical expenses for purposes of federal income tax are presumed to be medically necessary services.

Custom software is software created for a single person. The tax on custom software also includes the customization of prewritten computer software. The sale includes the charge for the software and the customization of the prewritten software regardless of the method of delivery to the customer. It also includes any charges for the right to access and use the software where possession of the software is maintained by the seller or a third party.

#### Part XVI - Increasing Tobacco Taxes

The current combined state cigarette tax is rate is \$0.10125 per cigarette or \$2.025 per pack of 20 cigarettes. This bill increases the tax on a pack of 20 cigarettes to \$3.025.

Three cents (per cigarette) of the cigarette tax is levied in RCW 82.24.026. The distribution of these revenues is revised with the state general fund dropping from 28.5 percent to 14 percent and the education legacy trust account share increasing from 71.5 percent to 86 percent.

Currently, tobacco products other than cigarettes are taxed at 75 percent of the taxable sales price, which is generally the price the taxpayer paid for the tobacco products. The tax on cigars is capped at 50 cents per cigar.

Under this bill the tax will be as follows:

1. For cigars except little cigars: 95 percent of the taxable sales price, not to exceed sixty-five cents per cigar.
2. For moist snuff (computed on the net weight listed by the manufacturer):
  - (a) On each single unit consumer-sized can or package whose net weight is 1.2 ounces or less, a rate per single unit that is equal to the cigarette tax under chapter 82.24 RCW multiplied by 20 (\$3.025 per can or package); or
  - (b) On each single unit consumer-sized can or package whose net weight is more than 1.2 ounces, a proportionate tax, on each ounce or fractional part of an ounce, at the rate established for moist snuff weighing 1.2 ounces or less.
3. For little cigars, an amount per cigar equal to the cigarette tax under chapter 82.24 RCW.
4. For all other tobacco products, 95 percent of the taxable sales price.

The moist snuff components of this bill are effective October 1, 2010, and the components affecting cigarettes, cigars, little cigars, and all other tobacco products are effective April 1, 2010.

#### Part XVII - Rural County Tax Incentive Programs

This legislative proposal establishes a tax deferral/waiver program for businesses locating in counties with high unemployment rates ("qualifying counties") or in designated community empowerment zones (CEZ) that would replace the current, expiring program.

The bill clarifies the definitions of "manufacturing" and "research and development" for both the current and new deferral programs.

Background:

The rural county sales/use tax deferral program provides a deferral of sales/use tax on qualified construction and equipment costs for manufacturing businesses locating or expanding in rural counties or in a CEZ or a county containing a CEZ when certain employment requirements are met (Chapter 82.60 RCW).

A person must maintain a qualified activity at the site of the investment project for the year in which the investment project is certified operationally complete plus seven additional years. If a business ceases operation, the amount of deferred taxes outstanding becomes immediately due based on the following schedule:

Year	Percent Tax Due
1	100
2	100
3	100
4	90
5	75
6	55
7	30
8	0

After all program requirements have been met and verified, the sales and/or use taxes are waived.

Eligibility for the program was originally based on qualified businesses locating in counties with high unemployment rates relative to the state as a whole.

This program expires on July 1, 2010.

Summary of Part XVII:

This part of the bill establishes a sales and use tax deferral/waiver program for certain businesses, mainly manufacturing businesses or businesses conducting research and development, located in distressed counties or a CEZ. The bill defines "distressed county" as a county that has an unemployment rate, as determined by the Employment Security Department, that is at least 20 percent above the state average for the three years immediately preceding the year in which the list of distressed areas is established or created.

The bill defines an "eligible area" as a "distressed county" or a designated CEZ.

The Department of Revenue must establish the list of qualifying counties by July 1, 2010. The list will be updated every two years based on Employment Security Department data.

Persons receiving a sales/use tax deferral/waiver under this program are required to electronically file any surveys, reports, returns, and other forms or information with the Department of Revenue.

The bill also makes changes to key definitions. The definitions of "manufacturing" and "research and development," for purposes of the existing rural county sales/use tax deferral program, are clarified. The definition of "manufacturing" currently includes computer programming, the production of computer software, and other computer -related services. This bill clarifies that these activities are manufacturing only when the computer programming, production of computer software, or other computer-related services are performed by a manufacturer as defined in RCW 82.04.110 and contribute to the production of a new, different, or useful substance or article of tangible personal property for sale. Similarly, the definition of "research and development" is clarified to include only specified activities that are intended to result in the production of a new, different, or useful substance or article of tangible personal property for sale. These clarifications apply retroactively.

The revised definition of research and development is carried forward to the new deferral program. However, the definition of "manufacturing" for the new deferral program is narrowed by eliminating the references to computer programming, the production of computer software, and other computer-related services. The result is that "manufacturing" will not include these activities, except that the production of computer software would be considered manufacturing where a tangible product is created for sale or commercial or industrial use. Thus, for example, the duplication of prewritten computer software on a tangible storage media to be sold would be considered manufacturing.

Similar definitional changes are made for the rural county new employee business and occupation tax credit program in chapter 82.62 RCW.

The new deferral program established in this bill takes effect July 1, 2010, and expires July 1, 2020.

#### Part XVIII - PUD Privilege Tax Clarification

The public utility district (PUD) privilege tax compensates for PUDs' exemption from property tax as public entities. The measure of the tax is "gross revenue," which is defined as "the amount received from the sale of electric energy excluding any tax levied by a municipal corporation upon the district pursuant to RCW 54.28.070."

This bill amends the definition of gross revenue to clarify that the term includes all amounts received from the sale of electric energy, including any regularly recurring charge to customers as a condition of receiving electric energy, and excluding any tax levied by cities under the authority of RCW 54.28.070. This is effective April 1, 2010.

#### Part XIX - Business and Occupation Surtax on Certain Services

This part imposes an additional B&O tax on selected business services. The additional tax rate is 0.5 percent, for a total service B&O tax rate of 2.0 percent. The additional tax rate is imposed on the following services:

- Accounting, tax preparation, bookkeeping, payroll, services.
- Agent and management services for artists, athletes, entertainers, and other public figures.
- Attorney services, paralegal services, arbitration and conciliation services, mediation product services, legal research services, and court reporting services.
- Business support services.

- Computer systems design and related services including but not limited to: computer systems design services, computer facilities management services, other computer facilities management services, and other computer related services (such as computer disaster recovery services and software installation services). Computer systems design and related services does not include custom computer programming services.
- Data processing, hosting, and related services including but not limited to: application hosting services, application service provider services, automated data processing services, computer input preparation services, computer time rental services, data entry services, media streaming services, optical scanning services, and web hosting services.
- Facilities support services.
- Investment advice services .
- Management, scientific, and technical consulting services.
- Marketing research and public opinion polling services.
- Office administrative services.
- Parking lot management services.
- Promoting services for performing arts, sporting, and similar events.
- Public relations services.
- Scientific research and development services.
- Software publishing support services.
- The following professional, scientific, and technical services not otherwise included within the definition of selected business service: business brokers except real estate brokers, commodity inspection services, consumer credit counseling services, consumer credit repair services, estate assessment services, handwriting analysis services, handwriting expert services, marine surveyor services, meteorological services, outplacement services, patent broker services, electric transmission or gas line visual inspection services, pipeline inspection services, power line visual inspection services, quantity surveyor services, and weather forecasting services.

This tax will be levied and collected from July 1, 2010, through June 30, 2013.

#### Part XX - Solar Energy Tax Incentives

Currently, the B&O tax rate on manufacturing solar energy systems or the production of silicon components of these systems is 0.275 percent. This bill extends the 0.275 percent B&O tax to the manufacturing of "stirling converters," which are a device that produces electricity by converting heat from a solar source utilizing a stirling engine. This reduced B&O tax rate expires June 30, 2014.

This part also allows a light and power business with greater than one thousand megawatt hours of annual sales to participate in utility-owned community solar projects for purposes of the investment cost recover incentive program.

This part also expands the investment cost recovery incentive program to renewable energy systems that produce electricity with a stirling converter.

#### Part XXI - Sales and Use Tax Exemption for Investment Castings

This part provides a sales and use tax exemption for the purchase or use of wax and ceramic materials used to create molds consumed during the process of creating investment castings for industrial applications. The sales tax exemption also applies to labor and services used to create wax patterns and ceramic shells used as molds and consumed during the

process of creating such investment castings.

The sales and use tax exemptions expire July 1, 2020.

#### Part XXII - Tax Relief for Aluminum Smelters

Current law provides the following tax incentives to the aluminum industry:

- A preferential B&O tax rate of 0.2904 percent (the general manufacturing and wholesaling rate is 0.484 percent).
- A credit against B&O tax liability for property taxes paid.
- A credit against retail sales and use tax liability for the amount of the state portion of sales and use taxes paid on certain property and services associated with an aluminum smelter.
- An exemption from the brokered natural gas use tax.

These incentives are scheduled to expire January 1, 2012. This bill extends the expiration date to January 1, 2017.

#### Part XXIII - Preferential Business and Occupation Tax Rate for Certain Aviation Repair Businesses

Under current law, repair services performed by aircraft repair facilities classified as federal aviation regulation Part 145 certificated repair stations are subject to a B&O tax of 0.2904. Repair activities are generally subject to the 0.471 percent retail B&O tax. This reduced tax rate currently expires on July 1, 2011. This bill extends the expiration date to July 1, 2024.

#### Part XXIV - Excise Taxation of Publicly Owned Facilities Accredited by the Association of Zoos and Aquariums

This bill provides that nonprofit organizations or a metropolitan park district operating a zoological facility when computing their B&O tax liability may deduct from the measure of the tax:

- The value of articles manufactured for use in displaying, or presenting exhibitions, presentations, performanc-Income from business activities; and
- Amounts received from the federal government, the state, and municipal corporations or subdivisions of municipal corporations.

To be eligible a zoo or aquarium must be a publicly owned facility that is accredited by the association of zoos and aquariums.

This part would take effect April 1, 2010, and expires July 1, 2020.

#### Part XXV - Sales and Use Tax Deferral for Performing Arts Centers

This bill provides a retail sales/use tax deferral for the construction of a performing arts center operated by a 501 (c)(3) nonprofit organization. The performing arts center must be located in a city with a population of between 115,000 and 150,000 at the time construction of the facility is initiated. The application must be submitted before initiation of construction and no later than December 31, 2012. The tax deferred applies to activity that occurs on or after July 1, 2011. The tax deferred is to be repaid over a ten-year period beginning in the fifth calendar year after an occupancy permit is issued.

#### 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

#### Part I: Minimum Nexus Standards

#### Data Sources:

Department of Revenue excise tax data; Department of Financial Institutions; U.S. Census Bureau; U.S. Bureau of Economic Analysis; The Federal Reserve Board; Securities and Exchange Commission; Price, Waterhouse, Coopers; the Nielson Company; the Washington Implan Model, the Washington Input-Output Model, and other sources.

#### Assumptions:

A compliance rate of about 100 percent is assumed in the first year for businesses currently registered with the Department. For businesses not registered with the Department, it's assumed that compliance rates for large, nationwide franchise businesses will be 90 percent. Compliance rates for credit card issuers are assumed to be 50 percent the first year, 75 percent the second, 90 percent the third, and about 100 percent in the fourth year. Compliance rates for other financial institutions are assumed to be 25 percent the first year, 50 percent the second, 75 percent the third, and about 100 percent in the fourth year. Compliance rates for small, out of state businesses are assumed to be 13 percent the first year, 26 percent the second, 39 percent the third, and 52 percent in the fourth year and thereafter. It is assumed that 90 percent of the non-franchise, royalty receipts from the out of state affiliates of Washington domiciled businesses will be apportioned outside of Washington.

It is assumed the effective date for this section is July 1, 2010, so the Fiscal Year 2011 impact is based on 11 months of collections.

#### Revenue Impact:

General fund revenues are estimated to rise by \$73.1 million in Fiscal Year 2011 and \$163 million in Fiscal Year 2012. There is no local impact.

## Part II - Tax Avoidance Transactions

#### Data Sources:

Department of Revenue  
Employment Security Department  
Statistics of Income for corporations

#### Assumptions:

For abusive tax avoidance transactions, the types of transactions that are provided as examples are not easily estimated with available data because many transactions involve businesses that aren't registered with the Employment Security Department or the Secretary of State's Office and an affiliate relationship with a registered business is not known. Businesses that appear to be underreporting revenue based on wages paid in the state and those not reporting any revenue to the Department were selected.

For the abusive tax avoidance transaction provisions, this estimate uses a compliance adjustment of 13 percent for 2011, 26 percent for 2012, 39 percent for 2013, and 52 percent for 2014.

The abusive tax avoidance transaction provisions impact about 600 firms in Fiscal Year 2011.

For the provision extending use tax to tangible personal property acquired through a step transaction, multiple successorship

information from the Employment Security Department was used to determine the level of assets transferred from businesses with no assets in their final year of liquidation. This estimate also uses a compliance adjustment of 13 percent for 2011, 26 percent for 2012, 39 percent for 2013, and 52 percent for 2014.

This estimate assumes three taxpayers avoided REET in Fiscal Year 2009 through the means noted above in the bill description, increasing to between 5 to 12 taxpayers by Fiscal Year 2015.

This estimate assumes taxpayers avoiding REET by transferring an ownership interest of less than 50 percent, but including a binding option to purchase an additional ownership interest that would result in a transfer of more than a 50 percent interest, to be exercised more than 12 months after the option was granted, would be avoiding the average amount of REET paid on controlling interest transfers from Fiscal Years 2005, 2006, 2008, and 2009.

This estimate assumes taxpayers avoiding REET through the use of a subsidiary in the manner described above in the bill description would owe REET of over \$1 million.

This estimate assumes that each year, the amount of REET avoided through the use of a subsidiary must increase by about four percent in order for it to be worth the taxpayer's time and effort to transfer the property in the manner described.

#### Revenue Impact:

This proposal will result in a state revenue increase of an estimated \$11.6 million for Fiscal Year 2011. Local governments will see an estimated \$1.5 million in Fiscal Year 2011.

### Part III - Modifying and Placing a Cap on the First Mortgage Deduction

#### Data Sources and assumptions:

Estimates are based on Department of Revenue 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 Economic and Revenue Forecast Council.

#### Revenue Impact:

This part will result in a state general fund revenue increase of an estimated \$52.7 million for Fiscal Year 2011. There is no local impact.

### Part IV - Repealing the Nonresident Sales Tax Exemption

#### Data Sources:

Department of Revenue deduction data for qualified nonresident sales and the 1990 Border Study. Growth rates were based on Washington State Economic and Revenue Forecast Council data.

#### Assumptions:

This fiscal note assumes that there will be fewer retail sales made in this state to nonresidents after the nonresident sales tax exemption is repealed. The percent of lost sales to nonresidents was calculated by dividing counties into border counties (along Canada, Oregon and Idaho borders) and non-border counties. Boats and automobiles were excluded since this proposal does not eliminate the specific sales tax exemptions available to nonresidents for these items.

Revenue Impact:

In Fiscal Year 2011, state general fund revenue will gain \$36.0 million and local governments will gain approximately \$13.3 million.

Part V - Direct Seller Business and Occupation Tax Exemption

Data Sources:

Department of Revenue.

Assumptions:

The Washington Supreme Court decision regarding sales by certain out-of-state-persons to or through direct seller's representatives is final, and the state general fund revenue forecast has been adjusted downward for the effect of this court decision. For periods beginning April 1, 2010, the exemption is eliminated. The revenue gain from the elimination of this exemption is included in the amounts shown on the front page of this fiscal note.

Revenue Impact:

State general fund revenue would increase by \$122.1 million in Fiscal Year 2011. There is no local impact.

Part VI - Business and Occupation Tax Preferences for Manufacturers of Products Derived from Certain Agricultural Products

Assumptions:

It is assumed that the changes to the tax preferences for processors of fresh fruits or vegetables would cause about ten percent of the amount currently exempted to become taxable.

Revenue Impact:

State revenues will increase by over \$4 million per fiscal year due to this legislation. Approximately \$4.1 million will be realized during Fiscal Year 2011, the first full fiscal year of impact.

Part VII - Suspending the Sales and Use Tax Exemption for Livestock Nutrient Equipment and Facilities

Revenue Impact:

Suspending this exemption will generate \$1.4 million per fiscal year for the state general fund. Local governments will gain approximately \$431,000 per fiscal year.

Part VIII - Ending the Preferential Business and Occupational Tax Treatment Received by Directors of Corporations

Data Sources:

Department of Revenue

Secretary of State's Office

Assumptions:

The tax will be on directors' fees of corporations based or headquartered in Washington. It is assumed that 200



Washington-based firms are publicly traded.

It is assumed that the 100 highest grossing firms that are not publicly traded have directors who are compensated. Based on a sampling of the top 30 of these firms, it is assumed that 50 firms that are not publicly traded have directors in Washington.

The average annual compensation for a director is estimated to be \$61,000 per year. It is assumed that all the director activities will be in Washington, therefore, no apportionment will apply. The average number of directors is assumed to be 10 members per firm.

The amount of directors' fees paid is assumed to be constant through Fiscal Year 2015. A large portion of director compensation is based upon stock options and cannot be estimated due to market volatility.

Revenue Impact:

State government will gain an estimated \$2.3 million in Fiscal Year 2011.

Part IX - Airplane Excise Tax

The estimated fiscal impact of the revised airplane excise tax will be included in the fiscal note prepared by the Department of Licensing.

Part X - Use Tax on Motor Vehicles and Trailers Used in Interstate Commerce

Data Sources:

Department of Licensing

Revenue Impact:

In Fiscal Year 2011, this part would generate \$7.7 million for the state general fund and \$2.4 million for local governments.

Part XI - Foreclosure Exemption

Data Sources:

Real estate excise tax affidavits in which the foreclosure exemption was claimed in King, Franklin, and Mason counties

Assumptions:

It is assumed that real estate excise tax collections on the sale of foreclosed properties to third parties relative to total collections will remain constant

Revenue Impact:

In Fiscal Year 2011, the state general fund will gain \$6.0 million and local governments will gain \$2.4 million.

Part XII - Tax Debts

Data Sources:

## Department of Revenue

### Revenue Impact:

State general fund revenue will gain an estimated \$1.0 million in Fiscal Year 2011. There is no local impact.

## Part XIII - Repealing the Business and Occupation Tax Credit for New Employment for International Service Activities

### Data Sources:

Department of Revenue

### Revenue Impact:

Fewer than three firms have claimed this credit. Due to confidentiality requirements, the impact of this part cannot be shown on this fiscal note.

## Part XIV - Repealing the Sales and Use Tax Exemptions for Candy and Bottled Water

### Data sources:

2008 Beverage Digest Fact Book, the National Confectioners Association, the Office of Financial Management, the U.S. Department of Commerce, and the Department of Revenue

### Assumptions:

The per capita consumption of candy is relatively consistent over time, so this estimate assumes candy consumption growth follows population growth.

The overall price elasticity of demand for bottled water and candy is assumed to equal 0.9.

This part of the bill is effective April 1, 2010.

### Revenue Impact:

In Fiscal Year 2011, state general fund revenue will increase by \$63.4 million and local governments will gain \$24.0 million.

## Part XV - Imposing Sales and Use Tax on Cosmetic Surgery and Custom Software

### Data Sources:

The estimate for cosmetic surgery was based on data collected from New Jersey's Department of the Treasury, Division of Taxation's 2007 Annual Report. Washington State's estimated sales tax revenue from cosmetic surgery was based on New Jersey's sales tax revenue but was adjusted for the differences in population and median household income. Population and household income data was collected from the U.S. Census Bureau. Growth rates were based on data collected from the American Society of Plastic Surgeons report, Plastic Surgery Procedural Statistics.

The estimate for custom software is based on data collected from Department of Revenue's tax returns and the Washington Implan Model, because approximately one-third of the businesses customizing computer software are not in the specific business classification of custom computer programming services.

#### Revenue Impact:

There is a loss in revenue to the B&O tax, as the income previously taxed at the 1.5 percent service rate will be taxed at the retail rate of 0.471 percent.

In Fiscal Year 2011, state general fund revenue will increase by \$83.6 million and local governments will gain about \$38.5 million.

#### Part XVI - Increasing Tobacco Taxes

##### Data Sources:

The cigarette tax impact of this bill was estimated using the Washington Economic and Revenue Forecast Council's data on cigarette consumption and other Department of Revenue sources. Under this bill, taxable consumption is expected to decline by about 17 percent.

##### Assumptions:

It is assumed that the sale of taxed moist snuff will decline by more than 40 percent and the sale of taxed little cigars by more than 35 percent as a result of this bill. The number of cigars taxed under the new sixty-five cent cap will be about the same as the number taxed under the existing fifty cent cap. It is also assumed that the remainder of the other tobacco products market represents about six percent of the taxable value under the current rate of 75 percent.

#### Revenue Impact:

In Fiscal Year 2011, state general fund revenue will increase by \$94.2 million and local governments will lose \$538,000.

#### Part XVII - Rural County Tax Incentives

##### Data Sources:

Distressed Areas list for 2009 from the Washington State Employment Security Department.  
Employment data for 2005 through 2007 from the Employment Security Department  
Department of Revenue

##### Assumptions:

To develop an estimate of the level of activity that would qualify for this proposal, structure-to-equipment ratios were used. These assumptions result in an estimated statewide spending level of \$424 million for manufacturing structures for Fiscal Year 2011. County-to-state manufacturing employment ratios were then used to estimate the structure costs located in distressed counties. These assumptions result in an estimated \$74 million in structure costs that qualify for the distressed counties deferral in Fiscal Year 2011. There is an additional estimated \$2.2 million in structure costs that qualify for the deferral in a CEZ in Fiscal Year 2011.

The new deferral program established in this bill takes effect July 1, 2010.

#### Revenue Impact:

This proposal has an eleven month impact in Fiscal Year 2011 of \$4.4 million. This is based on the assumption that 19 counties would qualify as distressed counties under this proposal. Those counties are: Adams, Clallam, Clark, Columbia, Cowlitz, Ferry, Franklin, Grant, Grays Harbor, Klickitat, Lewis, Mason, Okanogan, Pacific, Pend Oreille, Skamania,

Stevens, Wahkiakum, and Yakima. This is based on the Employment Security Department's list of distressed areas in 2009.

The estimated state impact for projects locating in a CEZ has an eleven month impact in Fiscal Year 2011 of \$133,000 and \$167,000 in Fiscal Year 2012, the first full year of impact.

The revisions to the definitions of manufacturing and research and development, for purposes of the rural county new employee B&O tax credit, is estimated to reduce revenues by \$5,000 in Fiscal Year 2011.

#### Part XVIII - PUD Privilege Tax Clarification

This fiscal note assumes that all PUDs will separate their kilowatt-hour charges from other charges and pay the privilege tax on only the kilowatt-hour charges. A recent Washington State Court of Appeals decision held that gross revenue for purposes of PUD privilege tax only applies to charges for electricity and not other separately stated charges.

##### Revenue Impact:

This bill modifies the definition of gross revenue for the PUD privilege tax and results in a gain in general fund revenue of \$1.1 million in Fiscal Year 2011 and local governments will gain approximately \$1.3 million.

#### Part XIX - Business and Occupation Surtax on Certain Services

##### Data Sources:

Department of Revenue.

Growth rates were based on the Economic and Revenue Forecast Council's February 2010 forecast.

##### Revenue Impact:

This legislation results in a gain in general fund revenue of \$44.7 million in Fiscal Year 2011.

#### Part XX - Solar Energy Tax Incentives

##### Data Sources:

Washington State Energy Marketplace Directory, Dept. of Commerce, Dec. 2009.

Department of Revenue

There are currently no developers of stirling converters paying B&O tax at the manufacturing rate. No solar thermal powered stirling converters are known to be operating in Washington, although some Washington businesses are developing this technology. Adding stirling engines to the investment cost recovery program for solar power will have no revenue impact at this time but may result in a revenue loss if such systems are placed into production.

##### Revenue Impact:

There is no revenue impact for this part.

#### Part XXI - Sales and Use Tax Exemption for Investment Castings

Data Source:  
Department of Revenue  
Business websites

Assumptions:

Based on U.S. industry (NAICS) coding and census information, there are at least seven industry codes that do some amount of investment casting. The proportions range from 0.7 percent of revenue to 100 percent based on this information. These proportions are used to determine the level of activity where wax or ceramic molding material would be used.

The websites of the largest firms selected in the NAICS codes above were reviewed, and it was determined that some firms did not claim expertise in investment castings or use of wax or ceramic molds and were not included in this analysis. Based on business activity reported to the Department of Revenue for these industries, 21 firms could potentially take advantage of this exemption.

Revenue Impact:

In Fiscal Year 2011, state government will lose an estimated \$189,000 and local governments will lose \$68,000.

Part XXII - Tax Relief for Aluminum Smelters

Data sources:  
Department of Revenue records  
Industry-provided data

Note: The aluminum smelters provided waivers authorizing the release of their confidential tax information.

Revenue Impact:

Extending the expiration date of tax incentives for aluminum smelters from January 1, 2012, to January 1, 2017, results in a loss in general fund revenue of \$1.3 million in Fiscal Year 2012 and \$3.4 million in Fiscal Year 2013.

The following table shows the detailed impact:

	FY 2012	FY 2013
B&O Rate Reduction	\$408,000	\$1,029,000
Property Tax Credit	\$716,000	\$1,804,000
Sales/Use Credit	\$48,000	\$120,000
Use Tax on Nat Gas	\$182,000	\$458,000
Total	\$1,354,000	\$3,411,000

Part XXIII - Preferential Business and Occupation Tax Rate for Certain Aviation Repair Businesses

Data Sources:  
Department of Revenue  
Economic and Revenue Forecast Council

In Fiscal Year 2009, 21 firms benefitted from the reduced B&O tax rate for aircraft repair firms. This estimate assumes aircraft repair trends are based on previous sales of aircraft.

Revenue Impact:

This legislation results in a loss to general fund revenue of \$577,000 in Fiscal Year 2012.

Part XXIV - Excise Taxation of Publicly Owned Facilities Accredited by the Association of Zoos and Aquariums

Data Sources:

Department of Revenue

A list of facilities accredited by the Association of Zoos and Aquariums was downloaded from <http://www.aza.org/findzooaquarium>.

Assumptions:

This estimate assumes no additional publicly-owned zoological facilities will be accredited by the Association of Zoos and Aquariums during the forecast period.

Revenue Impact:

This bill results in a loss to general fund revenue of \$76,000 in Fiscal Year 2011.

Part XXV - Sales and Use Tax Deferral for Performing Arts Centers

Assumptions:

It is assumed that during the forecast period one performing arts center in Bellevue will be constructed.

Revenue Impact:

This legislation results in a loss to general fund revenue of \$2.9 million in Fiscal Year 2012.

REVENUE ESTIMATES

The estimated state revenue gain resulting from this bill is \$600.2 million in Fiscal Year 2011. Local governments will gain over \$81.4 million in Fiscal Year 2011.

TOTAL REVENUE IMPACT:

State Government (cash basis, \$000):

FY 2010 -	\$ 80,091
FY 2011 -	\$ 601,381
FY 2012 -	\$ 685,230
FY 2013 -	\$ 764,319
FY 2014 -	\$ 793,438
FY 2015 -	\$ 840,617

Local Government, if applicable (cash basis, \$000):

FY 2010 -	\$ 10,829
FY 2011 -	\$ 81,448
FY 2012 -	\$ 86,463
FY 2013 -	\$ 94,633
FY 2014 -	\$104,269
FY 2015 -	\$114,827

## 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*

This expenditure estimate assumes that the Department will not incur any cost in the implementation of airplane excise tax (Part IX), tax debts (Part XII), repealing the business and occupation tax credit for new employment for international service activities (Part XIII), PUD privilege tax classification (Part XVIII), tax relief for aluminum smelters (Part XXII), preferential business and occupation tax rate for certain aviation repair businesses (Part XXIII), excise taxation of publicly owned facilities accredited by the Association of Zoos and Aquariums (Part XIV), and sales and used tax deferral for performing arts centers (Part XV).

To implement this legislation the Department will incur costs of \$1,373,200 in Fiscal Year 2010. Time and effort equates to 6.8 FTEs.

The Department will incur costs of \$3,002,700 in Fiscal Year 2011. Time and effort equates to 33.9 FTEs.

The Department will incur ongoing costs of \$3,685,200 in the 2011-2013 Biennium and \$2,988,900 in the 2013-2015 Biennium. Time and effort equates to 22.4 FTEs in Fiscal Year 2012, 22.2 FTEs in Fiscal Year 2013, 19.1 FTEs in Fiscal Year 2014, and 18.3 FTEs in Fiscal Year 2015.

Individual parts are grouped where similar activities occur. Parts with larger costs are described separately. Costs and FTEs shown for these are included in the yearly or biennial totals above.

### Minimum nexus standards (Part I)

To implement this part of the legislation, the Department will incur costs of \$507,900 in Fiscal Year 2010. The Department will identify impacted businesses, including those located out of state, to provide them with information on the change in how the state determines nexus for out-of-state based businesses conducting operations in Washington. This will include creating and mailing a special notice to impacted businesses and tax practitioners, both within Washington and out of state, and updating online and printed information. Additional staff will be needed to handle an expected increase in telephone inquiries. The cost of printing and mailing special notices to taxpayers and practitioners is \$321,000. Time and effort equates to 2.3 FTEs.

The Department will incur costs of \$1,834,200 in Fiscal Year 2011. The Department will create and conduct workshops to assist taxpayers with reporting questions in several places around the state. Additional calls from taxpayers to the Telephone Information Center are also expected, as well as additional email questions and requests for letter rulings. Adopting a new nexus standard for service income will increase the number of taxpayers filing returns, creating additional error and out of balance returns, amended returns, requests for penalty waivers, and telephone questions. Additional staff time will be needed to perform these tasks and to assist taxpayers.

Additional new taxpayers will require an increase in the staff to locate, explain, examine, assess taxes due, and verify compliance. A change in the nexus standard is also expected to increase the number of appeals. The Department will amend two administrative rules and create one new administrative rule.

Time and effort in Fiscal Year 2011 equates to 20.3 FTEs. The non-labor cost of informational workshops is \$12,000, printing and mailing additional tax returns is \$29,000, and the non-labor cost of setting up new taxpayers with electronic payment is \$12,000.

The Department will incur ongoing costs of \$2,971,000 in the 2011-2013 Biennium, and \$2,343,200 in the 2013-2015 Biennium. Time and effort equates to 17.6 FTEs in Fiscal Year 2012, 17.4 FTEs in Fiscal Year 2013, and 14.4 FTEs in the 2013-2015 Biennium. The cost of printing and mailing additional tax returns is \$29,000 each fiscal year.

Tax avoidance transactions (Part II) and modifying and placing a cap on the first mortgage deduction (Part III)

To implement these parts of the legislation, in Fiscal Year 2010 the Department will make modifications to the excise tax and e-file systems to accommodate the new penalty found in Part II and the deduction cap found in Part III. This includes a new deduction code to track the cap on first mortgage deductions, new system logic and balance due reason codes, and programming to setup, test, and verify the computer systems. A special notice will be prepared and mailed to impacted taxpayers for each part. The non-labor cost of the notices is \$14,700.

In Fiscal Year 2011 the Department will continue updating the computer systems as noted for Fiscal Year 2010. The Department will amend three administrative rules and adopt one new rule related to abusive tax transactions and amend one administrative rule related to modifying and placing a cap on the first mortgage deduction.

Repealing the nonresident sales tax exemption (Part IV), direct seller business and occupation tax exemption (Part V), suspending the sales and use tax exemption for livestock nutrient equipment and facilities (Part VII), ending the preferential business and occupations tax treatment received by directors of corporations (Part VIII), and sales and use tax exemption for investment castings (Part XXI)

To implement these parts of the legislation, in Fiscal Year 2010 the Department will prepare and mail a special notice to taxpayers impacted by each part. The non-labor cost of the notices is \$179,600. Taxpayers who are now using the exemption for livestock nutrient equipment and facilities will be mailed letters informing them of the suspension. The non-labor cost of this correspondence is \$600.

In Fiscal Year 2011 the Department will amend five administrative rules to administer these parts of the legislation. Two of these rules are related to repealing the nonresident sales tax exemption; there were no rule amendments required for the sales and use tax exemption for investment castings. The Department also expects that there will be an increase in telephone calls and error and out of balance returns related to ending the preferential business and occupation tax treatment received by directors of corporations.

Ongoing costs are for handling telephone calls and error and out of balance returns related to ending the preferential business and occupation tax treatment received by directors of corporations. These costs continue from Fiscal Year 2012 through



2015, reduced after Fiscal Year 2012.

Business and occupation tax preferences for manufacturers of products derived from certain agricultural products (Part VI), use tax on motor vehicles and trailers used in interstate commerce (Part X), foreclosure exemption (Part XI), rural county tax incentive programs (Part XVII), ), solar energy tax incentives (Part XX)

To implement these parts of the legislation, the Department will amend six administrative rules in Fiscal Year 2011, including two rule amendments to be made for the rural county tax incentive programs.

Repealing the sale and use tax exemptions for candy and bottled water (Part XIV) and imposing sales and use tax on cosmetic surgery and custom software (Part XV)

To implement Parts XIV and XV of the legislation, the Department will incur costs of \$221,600 and \$109,000 respectively in Fiscal Year 2010. The Department will create and mail a special notice to businesses identified as selling these types of products or services, informing them of the reporting changes. Online web information, printed guides, and other information for taxpayers will be updated. Additional staff will be needed to handle an expected increase in inquiries concerning the change in application of sales tax. This change is also expected to increase the number of error and out of balance returns, resulting in additional amended returns, credits, tax assessments, refunds, and telephone calls concerning returns filed. The non-labor cost to print and mail special notices is \$180,800 for Part XIV and \$29,300 for Part XV. Time and effort equates to 0.5 FTE for Part XIV and 1.0 FTE for Part XV

The Department will incur costs of \$149,900 for Part XIV and 126,100 for Part XV in Fiscal Year 2011. These costs are for handling phone, email, and written inquiries, as well as working with taxpayers on error and out of balance returns as described for Fiscal Year 2010. The Department will amend one administrative rule related to repealing the sales and use tax exemptions for candy and bottled water, two administrative rules related to imposing sales and use tax on the sale of custom software, and two administrative rule related to imposing the sales tax on cosmetic medical services. Time and effort equates to 2.0 FTEs for Part XIV and 1.4 FTEs for Part XV.

The Department will incur ongoing costs for Part XIV of \$87,500 in the 2011-2013 Biennium and \$33,700 in the 2013-2015 Biennium. Ongoing costs for Part XV will be \$6,900 in Fiscal Year 2012 only. Costs include working at a reduced level with taxpayers on error and out of balance returns as described for Fiscal Year 2010. Time and effort for Part XIV equates to 0.7 FTE in Fiscal Year 2012, 0.6 FTE in Fiscal Year 2013, 0.3 in Fiscal Year 2014, and 0.2 FTE in Fiscal Year 2015. Time and effort for Part XV equates to 0.1 FTE in Fiscal Year 2012.

Increasing tobacco taxes (Part XVI)

To implement this part of the legislation the Department will incur costs of \$134,900 in Fiscal Year 2010. These costs are for modifications to the combined excise tax return and the E-file system for three new classifications for reporting of Other Tobacco Products (OTP) tax. This includes new reporting line codes, new forms and reports, new error and out of balance logic and issuance codes, and programming to set up, test, and verify the computer systems. A new tax calculating worksheet will be created in E-file to automatically determine tax rates, and a second new worksheet will be created to

capture tobacco product codes and product description information. Similar addendums will be created for paper filing of OTP tax and product information. Additional new reports will be created from the product information collected from worksheets and addendums. A special notice will be created and mailed to affected taxpayers prior to the effective date for the rate changes. The Department will administer a one-time floor stock return for the cigarette tax rate increase. The non-labor cost to print and mail the special notice and floor stock return is \$28,000. Time and effort equates to 1.2 FTEs.

The Department will incur costs of \$356,300 in Fiscal Year 2011. These are costs for continued computer system programming development and testing of system logic, new codes, forms, and reports. Modifications will be made within the computer systems for reporting of federal information. The Department will find an increase in error and out of balance returns, resulting in additional amended returns, assessments, credit issuances, and telephone calls. Additional time will also be required to process reporting and product information addendums. The Department will need to amend one administrative rule. The cost of printing addendums is \$400. Time and effort equates to 3.8 FTEs.

The Department will incur ongoing costs of \$314,400 during the 2011-2013 Biennium and \$388,400 during the 2013-2015 Biennium. The Department will continue to experience additional error and out of balance returns as described for Fiscal Year 2011 but at a reduced level. Beginning in Fiscal Year 2013 additional time will be needed for audit review of taxpayers reporting OTP tax. The cost of printing addendums is \$400 each fiscal year. Time and effort equates to 1.5 FTEs in Fiscal Year 2012 and 2.5 FTEs in Fiscal Years 2013 through 2015.

#### Business and occupation surtax on certain services (Part XX)

To implement this part of the legislation the Department will incur costs of \$61,800 in Fiscal Year 2010. These costs are for programming to set up, test, and verify the computer systems for changes in the combined excise tax return and the E-file system. The Department will create and mail a special notice to businesses identified as reporting services subject to the surtax, informing them of the reporting changes. This change is expected to increase the number of error and out of balance returns, resulting in additional amended returns, credits, tax assessments, refunds, and telephone calls concerning returns filed. The non-labor cost to print and mail the special notice is \$24,300. Time and effort equates to 0.4 FTE.

The Department will incur costs of \$364,500 in Fiscal Year 2011. These costs are for handling phone, email, and written inquiries, as well as working with taxpayers on error and out of balance returns as described for Fiscal Year 2010. An increase in error and out of balance returns will require additional effort for collection of unpaid assessments. The Department also expects that the surtax will require additional time for audits of taxpayers subject to the surtax. The Department will need to amend seven administrative rules and create one new administrative rule. Costs for two of the amended rules are included in Part XV and are not duplicated here. Time and effort equates to 4.4 FTE's.

The Department will incur ongoing costs of \$285,800 in the 2011-2013 Biennium and \$210,100 in the 2013-2015 Biennium. Costs include working at a reduced level with taxpayers on error and out of balance returns, collection of assessments, and audits as described for Fiscal Year 2011. There is an expected increase in error and out of balance returns as the surtax is removed, beginning in Fiscal Year 2014, decreasing again in Fiscal Year 2015. Time and effort equates to 2.3 FTEs in Fiscal Year 2012, 1.6 FTEs in Fiscal Year 2013, 1.8 FTEs in Fiscal Year 2014, and 1.1 FTEs in Fiscal Year 2015.

## Part III: Expenditure Detail

### III. A - Expenditures by Object Or Purpose

	FY 2010	FY 2011	2009-11	2011-13	2013-15
FTE Staff Years	6.8	34.0	20.4	22.3	18.7
A-Salaries and Wages	349,300	1,748,300	2,097,600	2,332,300	1,863,900
B-Employee Benefits	87,300	437,000	524,300	583,100	465,900
E-Goods and Services	884,700	555,200	1,439,900	646,200	549,700
G-Travel	5,300	37,900	43,200	73,400	72,000
J-Capital Outlays	46,600	224,300	270,900	50,200	37,400
<b>Total S</b>	<b>\$1,373,200</b>	<b>\$3,002,700</b>	<b>\$4,375,900</b>	<b>\$3,685,200</b>	<b>\$2,988,900</b>

**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
COMMUNICATIONS CNSLT 4	53,146	0.1		0.1		
EXCISE TAX EX 2	42,583	1.6	8.5	5.1	6.4	5.9
EXCISE TAX EX 3	50,563	0.7	2.0	1.3	1.5	1.5
EXCISE TAX EX 4	55,839	0.5	0.2	0.4	0.1	
HEARINGS SCHEDULER	32,688		0.1	0.1		
INFO TECH S/A S 6	76,990		0.3	0.1		
IT SPEC 4	63,195	1.0	0.9	1.0		
IT SPEC 5	69,756	0.4	1.1	0.7	0.1	0.1
OFF ASST 3	29,780		2.6	1.3	0.4	0.4
REVENUE AGENT 2	47,014		3.1	1.5	2.3	1.8
REVENUE AGENT 3	51,861	0.1		0.1		
REVENUE AUDITOR 2	48,164		0.5	0.3	0.5	0.5
REVENUE AUDITOR 3	54,505		6.0	3.0	6.5	7.0
TAX INFO SPEC 1	36,757	0.9	1.2	1.0		
TAX INFO SPEC 4	54,505	1.5	1.9	1.7	0.6	0.5
TAX POLICY SP 2	61,628		0.1	0.1		
TAX POLICY SP 3	69,756		5.5	2.7	4.0	1.0
WMS BAND 3	88,546		0.2	0.1		
<b>Total FTE's</b>	<b>987,276</b>	<b>6.8</b>	<b>34.0</b>	<b>20.5</b>	<b>22.3</b>	<b>18.7</b>

## 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 take the following rule actions:

(Part I)

The Department will use the standard process to amend WAC 458-20-14601, titled: "Financial institutions - Income apportionment" and WAC 458-20-194, titled: "Doing business inside and outside the state". The standard process will also be used to adopt one new rule under chapter 458-20 WAC. Persons affected by this rule-making would include financial and other service businesses and businesses earning royalty income.

(Part II)

The Department will use the significant legislative process to adopt one new administrative rule under 458-20 WAC. The expedited process will be used to amend WAC 458-20-228, titled: "Returns, payments, penalties, extensions, interest, stay of

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collection". Persons affected by this rule-making would include tax practitioners and businesses that utilize state tax avoidance strategies.

The Department will use the standard process to amend WAC 458-20-106, titled: "Casual or isolated sales - Business reorganizations". Persons affected by this rule-making would include businesses selling capital assets using step transactions to avoid retail sales and use taxes.

The Department will use the standard process to amend WAC 458-61A-101, titled: "Taxability of the transfer or acquisition of the controlling interest of an entity with an interest in real property located in this state". Persons affected by this rule-making would include those making transfers of real estate.

(Part III)

The Department will use the expedited process to amend WAC 458-20-146, titled: "National and state banks, mutual savings banks, savings and loan associations and other financial institutions". Persons affected by this rule-making include those businesses that receive interest from investments or loans primarily secured by first mortgages or trust deeds on nontransient residential properties.

(Part IV)

The Department will use the expedited process to amend WAC 458-20-193, titled: "Inbound and outbound interstate sales of tangible personal property". The expedited process will also be used to amend WAC 458-20-178, titled: "Use tax". The Department will not incur an additional cost because it is currently amending this rule and will incorporate this legislation as necessary. Persons affected by this rule-making include businesses making sales to nonresidents.

(Part V)

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.

(Part VI)

The Department will 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.

(Part VII)

The Department will use the expedited process to amend WAC 458-20-210, titled: "Sales of tangible personal property for farming - Sales of agricultural products by farmers". Persons affected by this rule-making would include those operating livestock nutrient management facilities.

(Part VIII)

The Department will use the expedited process to amend WAC 458-20-105, titled: "Employees distinguished from persons engaging in business". Persons affected by this rule-making would include those individuals who are receiving compensation as a corporate director.

(Part X)

The Department will use the expedited process to amend WAC 458-20-17401, titled: "Use tax liability for motor vehicles, trailers, and parts used by motor carriers operating in interstate or foreign commerce". Persons affected by this rule-making

would include those business transporting persons or property for hire.

(Part XI)

The Department will use the expedited process to amend WAC 458-61A-208, titled: "Foreclosure - Deeds in lieu of foreclosure - Sales pursuant to court order". Persons affected by this rule-making would include those who sell real property, acquired through foreclosure, to third parties.

(Part XIV)

The Department will use the standard process to amend WAC 458-20-244, titled: "Food and food ingredients". Persons affected by this rule-making would include businesses that sell candy or bottled water and persons who purchase these products at retail.

(Part XV and Part XIX as noted)

The Department will use the standard process to amend WAC 458-20-155, titled: "Information and computer services" and WAC 458-20-15501, titled: "Computer hardware, computer software, information service, and computer services". Persons affected by this rule-making would include those who purchase and those who sell custom software and those providing other computer services subject to the surtax in Part XIX.

The Department will use the standard process to amend WAC 458-20-168, titled: "Hospitals, nursing homes, boarding homes, adult family homes and similar health care facilities" and the expedited process to amend WAC 458-20-151, titled: "Dentists and other health care providers, dental laboratories, and dental technicians". Persons affected by this rule-making would include persons who purchase cosmetic medical services and businesses that perform such services.

(Part XVI)

The Department will use the standard process to amend WAC 458-20-185, titled: "Tax on tobacco products." Persons affected by this rule-making would include those who purchase or sell cigarettes or other tobacco products.

(Part XVII)

The Department will use the standard process to amend WAC 458-20-240, titled: "Manufacturer's new employee tax credits" and WAC 458-20-24001, titled: "Sales and use tax deferral - Manufacturing and research / development activities in rural counties - Applications filed after March 31, 2004". Persons affected by this rule-making would include businesses that have an eligible investment project in a rural county.

Part (XIX)

The Department will use the standard process to adopt one new rule under chapter 458-20 WAC. The Department will use the expedited process to amend WAC 458-20-138, titled: "Personal services rendered to others", WAC 458-20-162, titled: "Stockbrokers and security houses", WAC 458-20-207, titled: "Legal, arbitration, and mediation services", WAC 458-20-218, titled: "Advertising agencies", and WAC 458-20-224, titled: "Service and other business activities". Persons affected by this rule-making would include businesses performing services subject to the surtax.

(Part XX)

The Department will use the expedited process to amend WAC 458-20-273, titled: "Renewable energy system cost recovery". Persons affected by this rule-making would include electric utilities and those individuals or non-utility businesses that make investment in solar energy systems.

# Individual State Agency Fiscal Note

<b>Bill Number:</b> 6143 E S SB AMH ENGR H5614.E	<b>Title:</b> Excise tax law modifications	<b>Agency:</b> 240-Department of Licensing
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## Part I: Estimates

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No Fiscal Impact

### Estimated Cash Receipts to:

<b>ACCOUNT</b>					
<b>Total \$</b>					

### Estimated Expenditures from:

	<b>FY 2010</b>	<b>FY 2011</b>	<b>2009-11</b>	<b>2011-13</b>	<b>2013-15</b>
<b>Account</b>					
<b>Total \$</b>					

### Estimated Capital Budget Impact:

<b>Total \$</b>					

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, 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.

<b>Legislative Contact:</b>	<b>Phone:</b>	<b>Date:</b> 03/09/2010
<b>Agency Preparation:</b> Sally McVaugh	<b>Phone:</b> (360) 902-3642	<b>Date:</b> 03/12/2010
<b>Agency Approval:</b> Sam Knutson	<b>Phone:</b> (360) 902-3644	<b>Date:</b> 03/12/2010
<b>OFM Review:</b> Alyson Cummings	<b>Phone:</b> 360-902-0576	<b>Date:</b> 03/15/2010

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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.

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.

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.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2010	FY 2011	2009-11	2011-13	2013-15
FTE Staff Years					
Total:					

Part IV: Capital Budget Impact

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.

## **Part II: Explanation**

This bill revises RCW 84.48 and directs the Department of Licensing (DOL) to collect an excise tax in the amount of five-tenths of one percent of the taxable value of the aircraft used in the state. It revises RCW 82.12.020 to make vehicle and vessel transactions obtained by lease, gift, repossession, and homemade vehicles/vessels subject to use tax. RCW 43.07.390 is revised to require legal entities regulated by the Secretary of State to disclose information regarding their holdings and transfers of real property located in Washington State.

### **II. A – Brief Description of What the Measure Does that Has Fiscal Impact**

Section 205 revises RCW 82.12.020 and would make vehicle and vessel transactions obtained by lease, gift, repossession, and homemade vehicles and vessels subject to use tax.

Section 212 revises RCW 43.07.390 and requires entities to disclose any transfer of controlling interest in the entity and the granting of any option to acquire an interest in the entity if the exercise of the option would result in a sale as defined in RCW 82.45.010. The disclosure requirement applies to entities owning an interest in real property located in this state.

Section 901 amends RCW 82.48.010 by defining “department” as the Department of Licensing for purposes of excise tax assessment and collection required later in the bill and removes the Department of Transportation from this function.

Section 902 establishes a five-tenths of one percent aircraft excise tax on the taxable value of aircraft manufactured after December 31, 1970 and establishes excise amounts that cannot be exceeded for aircraft manufactured before December 31, 1970. It permits the Department of Licensing to establish by rule a staggered collection system for the excise tax and permits the Department of Revenue to collect unpaid aircraft excise tax including penalties and interest.

Section 903 creates a new section in chapter 82.48 RCW which requires the Department of Revenue to create a depreciation schedule for aircraft excise tax which will be considered the taxable value of an aircraft.

Section 904 amends RCW 82.48.030 by removing the flat-rate aircraft excise tax currently imposed.

Section 905 requires DOL to give a receipt to each person paying the aircraft excise tax.

Section 906 requires DOL to regularly pay aircraft excise taxes to the state treasurer and to deposit them in the general fund.

Section 907 exempts aircraft from personal property taxes if an aircraft excise tax has been assessed and requires assessment of personal property tax if the aircraft excise tax has not been assessed.

Section 908 amends RCW 47.68.230 by making it unlawful to operate an aircraft without a current registration certificate issued by the Department of Licensing.

Section 909 amends RCW 82.48.090 by moving responsibility for refunds of aircraft excise tax from the Washington State Department of Transportation to the Department of Licensing.

Section 2614 makes July 1, 2010, the effective date for Sections 205, 212, and 903-909.

Section 2615 makes January 1, 2011, the effective date for Section 902.



## **II. B – Cash Receipt Impact**

The cash receipt impact is indeterminate. Section 902 imposes an excise tax on aircraft based on valuation except for aircraft manufactured before December 31, 1970. There is no information on the fair market value of aircraft currently registered in Washington as the Washington State Department of Transportation registration data does not contain fair market value of aircraft.

Section 903 stipulates that the Department of Revenue (DOR) must develop a depreciation schedule for use in determining fair market value. DOR will develop a depreciation schedule if this legislation passes.

Thus, until the fair market value of each aircraft is established and a depreciation schedule is established by DOR to estimate future values, the Department of Licensing cannot determine how much excise tax to impose.

## **II. C – Expenditures**

The expenditures for sections 901-907 are indeterminate. The department cannot implement this bill as it is currently written. Section 902 of this bill has an effective date of January 1, 2011. The proposed excise tax will be based on the fair market value of the aircraft except for aircraft manufactured before December 31, 1970, which will have a fixed schedule based on aircraft type. The system currently used by the Washington State Department of Transportation does not include the manufactured date of the aircraft. The Department of Licensing will not have sufficient time to develop an excise tax system, gather information from aircraft owners about the manufactured date of their aircraft, populate the system with this new information, and send out the excise tax billings.

The tax in Section 205 is reported by the Department of Revenue. The Department of Licensing would have to make modifications to the Vehicle Field System to correctly collect the tax and to submit correct information to the Department of Revenue. The costs for this are minimal.

Some of the information required by the Secretary of State to implement Section 212 is provided by the Department of Licensing's Master License Service (MLS). MLS currently maintains two questions on the corporation and limited liability renewals processed on behalf of the Secretary of State regarding the legal entity's real estate holdings and transfers. It is assumed that Section 212 will require removing one of those questions and therefore the renewal forms will need to be reprinted. The online renewal process will need to be changed to capture the question changes and also to collect the information from both the paper and internet renewal transactions. The costs for reprinting renewal forms will be minimal. The programming changes will require a temporary employee during fiscal year 2010 for three months at \$9,284 per month for a total cost of \$27,852. This employee will do the analysis, coding, testing, and implementation needed for the changes to the internet renewal process.

## **Part IV: Capital Budget Impact**

None

## **Part V: New Rule Making Required**

Section 902 requires DOL to establish by rule a staggered aircraft excise tax collection schedule.

# Individual State Agency Fiscal Note

<b>Bill Number:</b> 6143 E S SB AMH ENGR H5614.E	<b>Title:</b> Excise tax law modifications	<b>Agency:</b> 405-Department of Transportation
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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
Aeronautics Account-State	039-1		(26,000)	(26,000)	(54,000)	(54,000)
<b>Total \$</b>			(26,000)	(26,000)	(54,000)	(54,000)

### Estimated Expenditures from:

	FY 2010	FY 2011	2009-11	2011-13	2013-15
<b>Account</b>					
<b>Total \$</b>					

### Estimated Capital Budget Impact:

<b>Total \$</b>					

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, 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.

Legislative Contact:	Phone:	Date: 03/09/2010
Agency Preparation: Joe Patterson	Phone: 360-705-7545	Date: 03/12/2010
Agency Approval: Doug Vaughn	Phone: 306-705-7500	Date: 03/12/2010
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Request # 10-107-1

## 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.*

Section 902 amends RCW 82.48.020 imposing an annual excise tax for the privilege of using any aircraft in the state and transfers the responsibility of collecting the excise tax to the Department of Licensing (DOL). The amount of the tax is five-tenths of one percent of the taxable value of the aircraft. A new subsection (2) in section 902 sets a maximum tax amount that may be imposed for each type of aircraft.

Section 906 amends RCW 82.48.080 and removes the provision that ten percent of the tax collections be deposited into the aeronautics account for administrative expense.

### 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.*

The cash receipts reflect the reduction to the aeronautics account directed in section 906. Instead, all aircraft excise tax collections will be deposited into the general fund. Those amounts will be reflected in the DOL fiscal note.

### 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.*

WSDOT currently collects both the airplane excise tax and registration fees. As noted above, section 902 transfers the responsibility for the excise tax to the Department of Licensing. In addition, section 908 amends airplane registration language in RCW 47.68.230, transferring responsibilities from Department of Transportation to Department of Licensing. However, this legislation does not amend RCW 47.68.250, which requires the Department of Transportation to collect a \$15 registration fee for aircraft operated or based within the state. Because that requirement remains unchanged, no savings are assumed in this fiscal note. Some administrative savings could be assumed if it is the intent that aircraft registration be administered by the Department of Licensing.

### Part III: Expenditure Detail

#### III. A - Expenditures by Object Or Purpose

	FY 2010	FY 2011	2009-11	2011-13	2013-15
FTE Staff Years					
A-Salaries and Wages					
B-Employee Benefits					
C-Personal Service Contracts					
E-Goods and Services					
G-Travel					
J-Capital Outlays					
M-Inter Agency/Fund Transfers					
N-Grants, Benefits & Client Services					
P-Debt Service					
S-Interagency Reimbursements					
T-Intra-Agency Reimbursements					
9-					
<b>Total:</b>	\$0	\$0	\$0	\$0	\$0

### Part IV: Capital Budget Impact

### 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.*