

TAX EXEMPTION FACT SHEETS

Office of Financial Management

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Limit trade-in exemption to first \$10,000 of value

Repeal sales tax exemption for local residential telephone service (HB 1971)

Repeal sales tax exemption for custom computer software

Trim preferential B&O rates for most industries by 25%

Repeal sales tax exemption for non-residents

Repeal sales tax exemption on bottled water

Repeal use tax exemption for extracted fuel, except hog fuel

Eliminate preferential tax rate for resellers of prescription drugs

Repeal B&O tax exemption for long-term rental of commercial real estate

Narrow tax exemption for import commerce

Repeal sales and use tax exemption for farm auction purchases

Limit trade-in exemption to first \$10,000 of value

Description This proposal would limit the exclusion of trade-in value from retail sales and use tax to \$10,000 for motor vehicles, recreational vehicles, boats and other items.

Current Law When a consumer purchases tangible personal property, the measure of sales or use tax excludes the value of like-kind property traded in at the time of sale. Consequently, the trade-in value is deducted from the selling price that is subject to sales tax. (RCW 82.08.010(1) and 82.12.010(1))

Original Purpose and Current Analysis The trade-in exclusion was approved by voter initiative in 1984 to encourage purchases of new items, especially motor vehicles.

Trade-ins of motor vehicles average \$7,500, so limiting deductible trade-in values to \$10,000 benefits most households. The current unlimited deduction primarily benefits high-income purchasers with the lowest tax burdens in Washington. Setting a limit would reduce the regressivity of the current tax system.

Citizen Commission Recommendation The Citizen Commission has not reviewed the trade-in exclusion.

Revenue Impact General Fund Impacts (\$ millions)

| Fiscal Year 2014 | Fiscal Year 2015 | 2013-15 Biennium | Fiscal Year 2016 | Fiscal Year 2017 | 2015-17 Biennium |
|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| \$44.6 | \$50.2 | \$94.8 | \$52.6 | \$54.3 | \$106.9 |

Notes:

- This proposal impacts an estimated 85,000 taxpayers.
 - Estimates assume a July 1, 2013, effective date, representing 11 months of collections for FY 2014.
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Repeal the sales tax exemption for local residential telephone service (HB1971)

Description Repeals the sales tax exemption for local residential telephone service.

Current Law

- Telecommunications services (e.g., wireless, VoIP and landline voice services) are generally subject to state and local retail sales taxes.
- RCW 82.08.0289 exempts local residential telephone service from retail sales tax, but long-distance service is subject to retail sales tax.

Original Purpose and Current Analysis

To relieve the tax burden for the “necessary” portion of telephone service (i.e., local calls by individuals). Enacted in 1983.

The advent of cellular and VoIP phone service has blurred the distinction between local residential telephone service and long-distance service subject to the sales tax. The Department of Revenue has held that only traditional landline local service qualifies for the exemption because neither cellular nor VoIP phone service operates under tariffs regulated by the Utilities and Transportation Commission. The department’s interpretation is currently subject to court challenge, and a court win could have a large negative financial impact on the state if a court decision extends the exemption to wireless and cable providers. The simplest solution would be to eliminate the deduction as outmoded, given the technological changes over the past 30 years.

Citizen Commission Recommendation

The Citizen Commission has not reviewed this item.

Revenue Impact General Fund impacts (\$ millions)

| Fiscal Year 2014 | Fiscal Year 2015 | 2013-15 Biennium | Fiscal Year 2016 | Fiscal Year 2017 | 2015-17 Biennium |
|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| \$39.8 | \$43.4 | \$83.2 | \$43.4 | \$43.4 | \$86.8 |

- *This proposal impacts an estimated 100 taxpayers.*
- *Estimates assume a July 1, 2013 effective date, resulting in 11 months of collections for FY 2014.*

Repeal sales tax exemption for custom computer software

Description

Tax and exemption

This proposal would repeal the sales tax exemption on the service of creating custom software. The following would continue to be exempt:

- Custom software services purchased for resale,
- Custom software services consumed as a component of a new product produced for sale. “Product” means tangible personal property, digital products, remote access software or both pre-written and custom software.

Use tax

Custom software used by the purchaser, except as a component of a new product for resale, would be subject to use tax.

Royalties

Treatment of software licenses taxed under the royalties classification would be the same for custom software as for prewritten software.

Current Law

Custom computer software services are not subject to sales or use tax. Providers of these services are taxable under the service classification of the business and occupation tax, currently 1.8% of gross income.

Original Purpose and Current Analysis

To reflect the fact that producing customized software was considered to be a service.

In today’s economy, the distinction between custom software and standard prewritten software has become much more indistinct. Repealing the sales tax exemption would reduce the B&O tax rate to the retailing rate of 0.471%.

Citizen Commission Recommendation

The Citizen Commission has not reviewed this tax preference.

Revenue Impact

General Fund Impacts (\$ millions)

| Fiscal Year 2014 | Fiscal Year 2015 | 2013-15 Biennium | Fiscal Year 2016 | Fiscal Year 2017 | 2015-17 Biennium |
|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| \$36.8 | \$41.7 | \$78.5 | \$46.1 | \$51.0 | \$97.1 |

- *This proposal will impact an estimated 3,300 taxpayers.*
 - *Estimates assume a July 1, 2013, effective date, representing 11 months of collections for FY 2014.*
-

Trim preferential B&O tax rates for most industries by 25%

Description This proposal would reduce the value of preferential B&O tax rates for all industries except aerospace and radioactive waste cleanup by the federal government.

Current Law The state’s B&O tax code now includes preferential tax rates that benefit about 40 industries, from the manufacturers of certain agricultural products to travel agencies and international investment management. Industries with a preferential rate do not pay the standard B&O tax rate for their specific classification.

Many of these preferential rates have been enacted in the past 15 years, often without any specific, measurable public policy objectives. For example, income from royalties, which is classified as a service, would normally require payment of the standard service B&O tax rate of 1.5 percent, but instead requires payment of a much lower rate of 0.484 percent.

Citizen Commission Recommendations The Citizen Commission for Performance Measurement of Tax Preferences recently recommended terminating the preferential B&O tax rate for several industries due to a lack of evidence that the tax preference is achieving any specific public policy objective.

Revenue Impact General Fund impacts (*\$ millions*):

| Fiscal Year 2014 | Fiscal Year 2015 | 2013-15 Biennium | Fiscal Year 2016 | Fiscal Year 2017 | 2015-17 Biennium |
|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| \$30.9 | \$35.3 | \$66.2 | \$43.9 | \$46.4 | \$90.3 |

- *This proposal impacts an estimated 7,524 taxpayers.*
 - *Estimate assumes a July 1, 2013 effective date, representing 11 months of collections for FY 2014.*
-

Repeal sales tax exemption for non-residents

Description This proposal would repeal the nonresident sales tax exemption.

Current Law Under RCW 82.08.0273, bona fide residents of a state, U.S. possession or territory, or province of Canada that does not impose a sales tax or similar consumer tax of 3% or more, may purchase tangible personal property for use outside this state without paying Washington's sales tax.

The seller is not required to make a tax-free sale to a nonresident, but if the seller does:

- The purchaser must provide proof of exemption to the seller, and
 - The seller must retain a record of the proof.
-

Original Purpose and Current Analysis To enable Washington sellers, especially those along the Oregon border, to compete with merchants in other states that either do not levy a retail sales tax or levy a sales tax with a low rate. Enacted in 1965.

No other state has seen the need to provide similar preferential treatment to nonresidents.

Citizen Commission Recommendation The Citizen Commission recommended that the Legislature review and clarify the exemption.

Revenue Impact General Fund impacts (\$ millions)

| Fiscal Year 2014 | Fiscal Year 2015 | 2013-15 Biennium | Fiscal Year 2016 | Fiscal Year 2017 | 2015-17 Biennium |
|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| \$29.8 | \$33.9 | \$63.7 | \$35.3 | \$36.7 | \$72.0 |

- *This proposal impacts an estimated 4,436 taxpayers.*
 - *Estimates assume a July 1, 2013, effective date, resulting in 11 months of collections for FY 2014.*
-

Repeal sales tax exemption on bottled water

Description This proposal would repeal the sales tax exemption on sales of bottled water to consumers. The tax would apply to both portable-sized bottles *and* to bulk bottled water sales (sales of water in large, reusable containers).

Current Law Under current law, sales tax does not apply to retail sales of bottled water.

- Until Jan. 1, 2004, sales of bottled water were subject to sales tax.
 - At that time, legislation to conform to the Streamlined Sales and Use Tax Agreement (SSUTA) took effect and sales of bottled water became exempt from sales tax.
 - In 2010, the SSUTA was amended to allow member states to separately tax bottled water sales.
- In 2010, Senate Bill 6143 imposed sales tax on sales of bottled water beginning July 1, 2010, until Dec. 2, 2010, when the sales tax on bottled water was repealed by Initiative 1107.

Original Purpose and Current Analysis To conform to definitions of SSUTA. However, SSUTA has been amended to allow taxation of bottled water.

Citizen Commission Recommendation Not reviewed by Citizen Commission.

Revenue Impact General Fund impacts (\$ millions)

| Fiscal Year 2014 | Fiscal Year 2015 | 2013-15 Biennium | Fiscal Year 2016 | Fiscal Year 2017 | 2015-17 Biennium |
|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| \$24.4 | \$27.1 | \$51.5 | \$27.5 | \$27.9 | \$55.4 |

- *This proposal impacts an estimated 195,000 taxpayers.*
 - *Estimates assume a July 1, 2013, effective date, resulting in 11 months of collections for FY 2014.*
-

Repeal use tax exemption for extracted fuel, except hog fuel

Description This proposal would limit the use tax exemption for fuel produced by the extractor or manufacturer when the fuel is directly used in the same extracting or manufacturing operation that produced the fuel. Only wood byproducts, also referred to as “hog fuel,” would be eligible for the exemption.

Current Law Fuel consumed by manufacturers or extractors is exempt from use tax when the fuel is used in the process of manufacturing or extracting at the same plant.

- The fuels for which the exemption applies are generally wood byproducts, also referred to as “hog fuel,” and refinery fuel.
- Approximately 180 wood product manufacturers and 5 petroleum products refineries are eligible for the exemption.
- In its preliminary 2011 Tax Preference Review Report, the Joint Legislative Audit and Review Committee notes that while no refineries existed in the state when the exemption was enacted in 1949, refinery fuels account for approximately 98% of the estimated value of the exemption.

Original Purpose and Current Analysis To support the fuel manufacturing and extracting industry.

However, the biggest beneficiaries of this exemption are oil refineries that did not even exist when this statute was originally enacted. Other industries pay tax when they use materials that they manufacture themselves.

Citizen Commission Recommendation The Citizen Commission recommended that the Legislature review and clarify because the public policy objective and intended beneficiaries are not clear.

Revenue Impact General Fund impacts (\$ millions)

| Fiscal Year 2014 | Fiscal Year 2015 | 2013-15 Biennium | Fiscal Year 2016 | Fiscal Year 2017 | 2015-17 Biennium |
|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| \$20.1 | \$20.7 | \$40.8 | \$20.3 | \$22.0 | \$42.3 |

- *This proposal impacts an estimated 5 taxpayers.*
 - *Estimates assume a July 1, 2013 effective date, resulting in 11 months of collections for FY 2014.*
-

Eliminate preferential tax rate for resellers of prescription drugs

Description This proposal eliminates the preferential business and occupation (B&O) tax rate of 0.138% for resellers of prescription drugs. It instead applies the wholesaling B&O tax rate of 0.484% or the retailing B&O tax rate of 0.471% to these activities.

Current Law A preferential B&O tax rate of 0.138% is provided in RCW 82.04.272 to persons who warehouse and resell prescription drugs to retailers, hospitals, clinics, health care providers or other providers of health care services.

Purpose This tax preference was enacted to encourage out-of-state prescription drug companies to build warehouses in Washington. Enacted in 1998.

The state was unable to restrict the preferential rate only to companies with in-state warehouses, so it now provides tax relief to out-of-state wholesalers with nexus in Washington. This negates the purpose of the preferential rate.

Citizen Commission Recommendation The Citizen Commission has not reviewed this tax preference.

Revenue Impact

General Fund Impacts (\$ millions)

| Fiscal Year 2014 | Fiscal Year 2015 | 2013-15 Biennium | Fiscal Year 2016 | Fiscal Year 2017 | 2015-17 Biennium |
|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| \$13.4 | \$15.6 | \$29.0 | \$16.6 | \$17.7 | \$34.3 |

Notes:

- *This proposal will impact an estimated 40 taxpayers.*
 - *Estimates assume a July 1, 2013, effective date, representing 11 months of collections for FY 2014.*
-

Repeal B&O tax exemption for long-term rental of commercial real estate

Description This proposal would apply business and occupation (B&O) tax at the service and other activities rate on income derived from all long-term (30 days or more) rentals of commercial real estate, such as:

- Rental of commercial buildings, mini-storage facilities, apartments and leased departments,
- Rental of a boat moorage slip, parking space or airplane hangar for assigned spaces where the rental is for 30 days or longer, and
- Sale of lodging by a hotel, motel or other lodging establishment for 30 continuous days or longer.

Current Law Under current law, income from long-term property rental is not taxed by the state, both for commercial and residential property, except income from granting a license to use real estate, for example, renting hotel rooms for fewer than 30 days or leasing space in a building.

Original Purpose and Current Analysis To reflect a court ruling. In 1959, the Legislature extended the B&O tax to the rental of real estate, but in Schumacher (1960), the Washington Supreme Court ruled that it was an unconstitutional non-uniform property tax.

Later court decisions have called into question the continued validity of the decision, but it remains unclear if the court would overturn Schumacher and uphold a B&O tax on long-term rental income.

Citizen Commission Recommendation The Citizen Commission has not reviewed this tax preference.

Revenue Impact

General Fund Impacts (\$ millions)

| Fiscal Year 2014 | Fiscal Year 2015 | 2013-15 Biennium | Fiscal Year 2016 | Fiscal Year 2017 | 2015-17 Biennium |
|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| \$8.6 | \$19.2 | \$27.8 | \$29.7 | \$40.8 | \$70.5 |

- *This proposal impacts an estimated 10,000 taxpayers.*
- *Estimates assume a July 1, 2013, effective date, resulting in 11 months of impact for FY 2014.*

Narrow tax exemption for import commerce

Description Amends the current exemption from business and occupation (B&O) tax and retail sales tax for imports and exports by companies with sufficient nexus in the state so that it applies only to exports and to imports of aerospace components.

Current Law RCW 82.04.610 provides an exemption from B&O tax for the sale of tangible personal property in import or export commerce.

RCW 82.08.990 provides an exemption from retail sales tax for sales of tangible personal property if the sale is exempt from B&O tax under RCW 82.04.610.

Original Purpose and Current Analysis To codify the Department of Revenue’s historical treatment of imports and exports as reflected in WAC 458-20-193C.

Under current law, importers with nexus in Washington have an unfair advantage over instate manufacturers and wholesalers because the latter must pay B&O tax on their instate sales and collect retail sales tax on retail sales to instate customers, while importers are exempt.

Citizen Commission Recommendation Not reviewed by the Citizen Commission.

Revenue Impact

General Fund impacts (\$ millions)

| Fiscal Year 2014 | Fiscal Year 2015 | 2013-15 Biennium | Fiscal Year 2016 | Fiscal Year 2017 | 2015-17 Biennium |
|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| \$7.4 | \$16.7 | \$24.1 | \$25.7 | \$35.3 | \$61.0 |

Notes:

- *This proposal impacts an estimated 1,000 taxpayers.*
 - *Estimates assume a July 1, 2013, effective date, representing 11 months of collections for FY 2014.*
-

Repeal sales and use tax exemption for farm auction purchases

Description This proposal would repeal the retail sales and use tax exemption for property bought at a farm auction.

Current Law Under current law, neither retail sales nor use tax applies to sales of tangible personal property sold at an auction conducted on a farm. The exemption applies to items used on a farm, including farm machinery, equipment, vehicles, recreational items and household goods.

Typically, farm auctions occur on a farm with several farmers owning the property to be auctioned. There is no requirement that persons purchasing property at a farm auction be a farmer.

Original Purpose and Current Analysis To support the agricultural industry.
Eliminating the exemption levels the playing field for sales of farm machinery, equipment and other farm implements sold by dealers or at on-farm auctions.

Citizen Commission Recommendations The Citizen Commission for Performance Measurement of Tax Preferences endorsed a 2008 Joint Legislative Audit and Review Committee recommendation that the Legislature should require the reporting of information for on-farm auction sales and review the policy of this exemption. The reason JLARC provided for this recommendation is that Washington does not have uniform tax treatment for used farm machinery and equipment.

Revenue Impact

General Fund impacts (\$ millions):

| Fiscal Year 2014 | Fiscal Year 2015 | 2013-15 Biennium | Fiscal Year 2016 | Fiscal Year 2017 | 2015-17 Biennium |
|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| \$2.6 | \$3.0 | \$5.6 | \$3.1 | \$3.1 | \$6.2 |

- This proposal impacts an estimated 10,000 taxpayers.
- Estimate assumes a July 1, 2013 effective date, representing 11 months of collections for FY 2014.