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Washington State Legislature Passes Massive Tax Increases

Tax Legal Update

In the closing days of April, the Washington legislature passed one of the [most extensive set of tax increases](#) in recent memory. The increases were enacted through five primary bills and are intended to raise about \$2.1 billion over the next four years. While the capital gains tax proposal that many feared was not among the tax bills that passed, virtually every industry is impacted through major increases to the business and occupation (B&O) tax and the real estate excise tax (REET).

Large financial institutions took the biggest hit from the tax legislation. This was due in large part to a last minute bill aimed exclusively at big banks, those part of a consolidated financial group with more than \$1 billion of net income in the prior year. Under HB 2167, the B&O tax burden for these financial institutions increased by approximately 80 percent, raising the rate from roughly 1.5 percent to 2.7 percent starting January 1, 2020. The bill is predicted to raise an estimated \$100 million per year, from approximately 20 taxpayers. As no Washington-based financial institutions met the \$1 billion net income threshold last year, the tax currently falls exclusively on financial institutions based outside of Washington.

The bill was passed within 72 hours of the first publication of the language, despite numerous complaints from stakeholder groups regarding the lack of notice and concerns regarding the constitutionality of only taxing non-Washington based financial institutions. The timing raises the question of whether the bill complied with the Washington Constitution, which requires bills to be introduced at least ten days before the end of session unless there is a super-majority.

Another bill, SB 6016, raised approximately \$30 million per year by severely restricting the qualifications for the international investment management service (IIMS) classification. The bill adds a number of requirements aimed at limiting the rate to larger firms that provide services to investment funds and have more than 25 percent of their workforce in Washington. These changes mean that most firms that previously qualified for the IIMS will become subject to a tax rate almost six times higher.

Commercial property and apartment building owners also took a significant tax hit with the passage of Washington's first graduated excise tax rate. SB 5998 generates approximately \$175 million a year in new revenue by establishing a graduated REET starting January 1, 2020. For most real estate, the rate for the state portion rises from 1.28 percent to 3 percent for selling prices above \$3 million dollars. In many locations the combined state and local rate will go up to 3.5 percent. The rate for agricultural and timberland remains the same at 1.28 percent. In addition to raising the rate, the bill also contains a number of administrative provisions designed to eliminate many traditional REET minimization strategies.

The largest tax increase came from a B&O tax surcharge levied on service oriented and high-tech businesses to fund a number of higher education initiatives related to workforce development. HB 2158 imposes a B&O tax surcharge on a wide variety of service industries (see list of affected NAICS codes below) and large "advanced computing businesses" starting January 1, 2020. Unlike the previous B&O tax surcharge levied on service businesses between 2010 and 2014, this surcharge is permanent.

The selected service businesses are subject to a 20 percent surcharge on their general service revenues, raising the effective B&O tax rate from 1.5 percent to 1.8 percent. "Advanced computing businesses" with affiliated group revenues between \$25 billion and \$100 billion are subject to a 33.33 percent surcharge and those with consolidated group revenues over \$100 billion are subject to a 66.66 percent surcharge. If either of the "advanced computing" surcharges apply, the surcharge has a floor of \$4 million per year and a cap of \$7 million per year.

In an unprecedented move, the Legislature also altered the burden of proof and rules of statutory construction for the surcharge. In Washington, courts have historically applied the long-standing rule of statutory construction that any ambiguity in a taxing statute is construed in favor of the taxpayer. However, HB 2158 changes that rule by explicitly directing courts and administrative agencies to construe any ambiguity in favor of applying the surcharge. Additionally, the bill raises the standard of proof to overcome the Department of Revenue's application of the surcharge from preponderance of the evidence to clear, cogent and convincing evidence, the highest standard of proof in civil cases. The business community and the Tax Section of the Washington State Bar Association objected to this language. While the Legislature decided to keep the language in the bill for the current biennium, it added an amendment to sunset the burden of proof and statutory construction provisions in 2021.

HB 2158 B&O Surcharge Fiscal Impact by Industry^[1]

Category	FY 2020	FY 2021
Advanced Computing	\$19,000,000	\$19,000,000
Specified Businesses		
Medical	\$21,200,000	\$55,800,000
Financial	\$9,200,000	\$24,100,000
Everyone else	\$63,700,000	\$168,000,000
Fiscal Note Totals	\$113,100,000	\$266,900,000

“Everyone Else”

3-Digit NAICS	NAICS Title	Count of Businesses	FY 2020
221	Utilities	80	\$450,000
336	Transportation Equipment Manufacturing	30	\$50,000
423	Merchant Wholesalers, Durable Goods	310	\$510,000
454	Nonstore Retailers	280	\$290,000
511	Publishing Industries (except Internet)	580	\$620,000
515	Broadcasting (except Internet)	40	\$890,000
517	Telecommunications	380	\$6,340,000
518	Data Processing, Hosting and Related Services	830	\$1,570,000
519	Other Information Services	80	\$580,000
521	Monetary Authorities-Central Bank	10	\$320,000
522	Credit Intermediation and Related Activities	1,810	\$10,630,000
523	Securities, Commodity Contracts, and Other Financial Investments and Related Activities	2,180	\$4,140,000
524	Insurance Carriers and Related Activities	970	\$1,970,000

525	Funds, Trusts and Other Financial Vehicles	230	\$190,000
533	Lessors of Nonfinancial Intangible Assets (except Copyrighted Works)	80	\$150,000
541	Professional, Scientific and Technical Services	53,460	\$34,400,000
551	Management of Companies and Enterprises	440	\$290,000
813	Religious, Grantmaking, Civic, Professional and Similar Organizations	420	\$160,000
921	Executive, Legislative and Other General Government Support	60	\$150,000
	Total "Everyone Else"	62,270	\$63,700,000

If you would like to know more about these tax increases and how they might affect your business, please contact one of our Washington tax attorneys: [Scott Edwards](#) (206.223.7010) or [Brett Durbin](#) (206.223.7041).

[1] Estimates prepared by Washington State Legislature non-partisan staff.