Washington’s Tax System

Presented at Governor’s Economic & Workforce Development Conference, September 7, 2006
Summary of Washington’s Tax Advantages

- No Personal Income Tax
- No Tax on Intangibles
- No Capital Gains Tax
- B&O Tax Has Low Flat Rates & Easy to Calculate
- Average Property Taxes with Protections for Business
- Many Tax Incentives
Personal Income Taxes are imposed in 43 states
Washington Has No Personal Income Tax

- Reduces the administrative costs associated with employees
- Reduces the cost of labor since employees pay no income taxes
- Substantial benefit for entrepreneurs running their own business and highly compensated executives
- No double taxation of business income (via corporate and personal income taxes)
Corporate Income Taxes are imposed in 46 states.
Washington is One of Two States with a Gross Receipts (Business and Occupation) Tax
Business and Occupation Tax

- B&O tax is broad-based with low flat rates, which can be a great benefit for firms with high profit margins.

- B&O rate for most activities is just under one half of one percent.

- Flat rate is easy to calculate.

- Rate of many service businesses is higher, 1.5%, but there is no sales tax charged.

- More beneficial system to established firms than start-ups.
Business and Occupation Tax

- B&O tax is not a unitary tax.
- B&O tax only taxes activities that occur within Washington.
- B&O tax compared to corporate income tax is more beneficial to businesses with large profit margins and WA headquartered business not engaged in service activities.
- B&O tax compared to corporate income tax is less beneficial to businesses with small profit margins and start-ups.
Washington does not tax intangibles such as financial assets

- Thus there is generally no tax on income from stocks, bonds, or investment portfolios

Washington has no capital gains tax

- Substantial benefits for investors and retirees
- No capital gains tax and no tax on financial assets together reduce the costs of raising capital in Washington
Property Taxes are imposed in all 50 states
Property Tax

- Property tax rates are moderate, predictable, and are near the national average.
- Tax imposed on assessed value, which is approximation of fair market value
- Washington has various property tax limitations result in rates that are generally declining
  - Constitutional limit of 1% of property value
  - Constitutional requirement that all property be taxed uniformly. Businesses and residential property are taxed the same.
  - Statutory limit of 1% growth in property tax levies
Sales Taxes are imposed in 46 states
Retail Sales & Use Tax

- Applies to purchases of tangible personal property and some services, including construction labor.

- Tax Rate (varies according to location):
  
  State: 6.5% (no change since 1983)
  
  Local: 0.5% - 2.4% (average of 1.9%)
  
  Maximum: 8.9% (Lynnwood)

- Most of Puget Sound area 8.4%-8.8%
Maximum Combined State and Local Sales Tax Rates Among Highest in Nation

Nine states are higher: Arkansas up to 11.5%, Alabama up to 11%, Arizona, up to 10.6%, Oklahoma up to 10.5%, Louisiana up to 10.25%, Colorado, up to 9.9%, Tennessee up to 9.75%, and Illinois, up to 9%

Washington: maximum 8.9%

Source: Comparative State and Local Taxes, 2000
Types of Tax Incentives

- Exemptions
- Preferential B&O Tax Rates
- B&O Tax Credits
- Sales/Use Tax Deferrals & Waivers

*Washington’s tax incentives generally focus on B&O tax and sales tax because these taxes impose the greatest burden on business*
Types of Tax Incentives

- Incentives by Industry
- Tax Incentives by Activity
- Tax Incentives by Location

Or a combination of
one or more of these elements
<table>
<thead>
<tr>
<th>Rate</th>
<th>Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exempt</td>
<td>Fresh Fruit &amp; Vegetable Manufacturing</td>
</tr>
<tr>
<td>Exempt</td>
<td>Dairy Products Manufacturing</td>
</tr>
<tr>
<td>Exempt</td>
<td>Seafood Product Manufacturing</td>
</tr>
<tr>
<td>Exempt</td>
<td>Investment Income by Non-financial Firms</td>
</tr>
<tr>
<td>Exempt</td>
<td>Interest Income on First Mortgages</td>
</tr>
<tr>
<td>Exempt</td>
<td>Sales of Real Estate</td>
</tr>
<tr>
<td>.00138%</td>
<td>Reselling Prescription Drugs</td>
</tr>
<tr>
<td>.00138%</td>
<td>Processing/Wholesaling Perishable Meat Products</td>
</tr>
</tbody>
</table>
**Preferential Rates Continued**

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<tr>
<th>Rate</th>
<th>Activity</th>
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</thead>
<tbody>
<tr>
<td>.00138</td>
<td>Processing Dried Peas</td>
</tr>
<tr>
<td>.00138</td>
<td>Manufacturing flour &amp; oil</td>
</tr>
<tr>
<td>.00138</td>
<td>Manufacturing Biofuel</td>
</tr>
<tr>
<td>.00275</td>
<td>International Freight Brokers, Stevedoring</td>
</tr>
<tr>
<td>.00275</td>
<td>Travel Agent Commissions</td>
</tr>
<tr>
<td>.00275</td>
<td>International Management Services</td>
</tr>
<tr>
<td>.002904</td>
<td>Manufacturing Aluminum</td>
</tr>
<tr>
<td>.002904</td>
<td>Commercial Aircraft Repair &amp; Maintenance</td>
</tr>
<tr>
<td>.002904</td>
<td>Manufacturing Solar Energy Systems</td>
</tr>
</tbody>
</table>
## Preferential Rates Continued

<table>
<thead>
<tr>
<th>Rate</th>
<th>Industry Description</th>
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</thead>
<tbody>
<tr>
<td>.004235*</td>
<td>Manufacturing &amp; Selling Commercial Airplanes &amp; Component Parts.</td>
</tr>
<tr>
<td>.004235*</td>
<td>Forest &amp; Timber Products Industry</td>
</tr>
<tr>
<td>.00484</td>
<td>Child Care, Insurance Agent Commissions, Radio &amp; TV Broadcasting, Royalties, Warehousing (Instead of .015)</td>
</tr>
</tbody>
</table>

### PENDING PREFERENTIAL RATES

<table>
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<th>Rate</th>
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</thead>
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<tr>
<td>.00275</td>
<td>Manufacturing Semiconductor Materials</td>
</tr>
<tr>
<td>.002904</td>
<td>Manufacturing &amp; Selling Commercial Airplanes &amp; Component Parts</td>
</tr>
<tr>
<td>.002904</td>
<td>Forest &amp; Timber Products Industry</td>
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</tbody>
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Tax Incentives

- Manufacturing*
- Aerospace
- High Tech
- Biomedical
- Food Processors
- Clean Energy
- Forest Products
- Miscellaneous

* “Manufacturing” also includes R&D facilities, commercial testing laboratories, computer programming & the production of computer software
Tax Incentives by Industry: Manufacturing*

- **Sales/Use Tax Exemption for Machinery and Equipment Used Directly in the Manufacturing Operation (The “M&E Exemption”)**
- **Sales/Use Tax Deferral/Waiver for Construction of Facilities and Purchase of Equipment for Manufacturing Operations in Rural Counties & Counties with CEZs.**
- **B&O Tax Credit for New Jobs in Rural Counties/CEZs**

* Includes R&D facilities, commercial testing laboratories, computer programming and the production of computer software
Tax Incentives by Industry: Aerospace

In addition to general manufacturing incentives:

- Preferential B&O rate for aerospace product (airplanes and their components) manufacturing and wholesale sales of products (.004235 instead of .00484, and reduce to .002904 by July 1, 2007)

- Preferential B&O rate for FAR Part 145 Repair Stations (.00275 instead of .00471)

- B&O credit for property taxes paid on aerospace product manufacturing facilities

- B&O credit for preproduction development costs for anyone engaged in aerospace design, development, and engineering of aerospace products

- Sales/use tax exemption for computers and software for anyone engaged in aerospace design, development, and engineering of aerospace products
Tax Incentives by Industry:
High Technology

In addition to general manufacturing incentives:

- B&O tax credit for qualifying research and development activities (advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology)

- Statewide sales/use tax deferral/waiver for construction of facilities and acquisition of equipment used in qualifying research and development operations

- B&O credits for software development and help-desk services in rural areas

- Preferential rate for income from royalties and licenses
Tax Incentives by Industry: Clean Energy (Manufacturing)

In addition to general manufacturing incentives:

- Preferential B&O rate for manufacturers of biodiesel fuel, biodiesel feedstock, alcohol fuel, and wood biomass fuel (.00138 instead of .00484)

- Preferential B&O rate for manufacturers of solar energy systems using photovoltaic modules or silicon components of these systems (.002904 instead of .00484)

- Statewide sales/use tax deferral/waiver for construction of facilities and acquisition of equipment used in manufacturing operations of biodiesel fuel, biodiesel feedstock, alcohol fuel, and wood biomass fuel
Tax Incentives by Industry: Clean Energy (Distribution & Retail)

- Sales/use tax exemption for construction of facilities and acquisition of equipment used directly in the retail sale of such fuels.
- Sales/use tax exemption for purchase of fuel delivery vehicles and labor/services charges related to such vehicles provided that 75% of fuel distributed is biodiesel fuel, wood biomass fuel, or alcohol fuels.
- B&O tax deduction for income received from the distribution or retail sale of biodiesel fuel, wood biomass fuel, or alcohol fuels.
Tax Incentives by Industry:
BioTech

In addition to all High Technology tax incentives:

- Statewide sales/use tax deferral/waiver for construction of facilities and acquisition of equipment used for biotechnology product or medical device manufacturing
Tax Incentives by Industry:
Food Processing

- (B&O) tax exemption for income from:
  - Canning, preserving, freezing, processing, or dehydrating fresh fruits and vegetables or to wholesale sales by the persons performing these activities;
  - Manufacturing seafood products when the seafood products remain in a raw, frozen, or raw salted state at the end of the manufacturing process; or
  - Manufacturing dairy products, *when* the sales are to purchasers who transport the goods out of this state in the ordinary course of business
- Results in tax only be due on in-state sales
Tax Incentives by Industry: Food Processing

In addition to general manufacturing incentives:

- Statewide sales/use tax deferral/waiver for construction of facilities and acquisition of equipment used in:
  - Canning, preserving, freezing, processing, or dehydrating fresh fruits and vegetables
  - Manufacturing seafood products when the products remain in a raw, frozen, or raw salted state after manufacturing; or
  - Manufacturing dairy products

- Rebate of all state sales tax paid on construction of cold storage warehouses with square footage of 25,000 or more and purchases of material-handling equipment and racking equipment
Tax Incentives by Industry: Forest Products

In addition to general manufacturing incentives:

- Preferential B&O rate (.004235 instead of .00484, and will drop to .002904 by July 1, 2007). Applies to:
  - Extracting timber or extracting timber for-hire;
  - Manufacturing or processing timber into timber products or wood products;
  - Manufacturing or processing timber products into other timber products or wood products;
  - Selling at wholesale:
    - timber extracted by the seller;
    - timber products manufactured by the seller from timber or other timber products; and
    - wood products manufactured by the seller from timber or timber products.
Tax Incentives by Activity

Miscellaneous

- Rebate of 100% of state sales tax paid on the of a third-party warehouses with square footage of 200,000 or more and 50% of state sales tax paid on purchases of material-handling equipment and racking equipment.

- B&O tax credit for half of the amount repaid for customized employment training through community and technical colleges. Participating employers are required to increase their employment in this state by a minimum of 75 percent of the number of employees enrolled in the training program.
Where to Get Help

- DOR Tax Incentive Page at:
  http://dor.wa.gov/content/taxes/incentives/default.aspx

- Gary Grossman, Department of Revenue,
  360-705-6646
  garyg@dor.wa.gov