BUSINESS AND OCCUPATION TAX
RCW 82.04

Tax Base — Gross receipts of all businesses operating in Washington, as a measure of the privilege of engaging in business. The term gross receipts means gross income, gross sales, or the value of products, whichever is applicable.

Tax Rate — Eight B&O tax rates apply to various classifications of business activities. These are summarized as follows:

Manufacturing, wholesaling, and certain other activities*	0.484%
Retailing, environmental cleanup, and radioactive waste cleanup for the U.S.	0.471%
Manufacturing/selling commercial aircraft and components:**	
October 1, 2005 - June 30, 2007	0.4235%
July 1, 2007 - July 1, 2024	0.2904%
Travel agents, tour operators, stevedoring, freight brokers, licensed boarding homes, repair of aircraft, manufacturing of semiconductor materials, international investment management services	0.275%
Processing meat (at wholesale); processing soybeans, canola and dry peas; manufacturing wheat into flour and raw seafood; warehousing/reselling of prescription drugs, manufacturing biodiesel/alcohol fuel, and manufacturing fresh fruit, vegetables, and dairy products	0.138%
Disposal of low-level radioactive waste	3.3%
Services, public/nonprofit hospitals, and all other activities	1.5%

*Extracting, extracting and processing for hire, commissions of insurance agents/ brokers, printing and publishing, child care, income derived from royalties, warehousing, radio and TV broadcasting, public road construction, government contracting, treatment of chemical dependencies, and retailing of interstate transportation equipment.

**NOTE: alternate dates may apply, depending upon when production of a super-efficient airplane commences in Washington. Also, manufacturers of aluminum qualify for the 0.2904 percent rate from July 1, 2004 until January 1, 2007.

Businesses are taxable according to the activities in which they engage and may be subject to more than one tax rate, depending upon the source of their income. Further, firms are taxed according to their final level of activity in Washington. Thus, a firm that manufactures a product and sells it at wholesale within the state is taxed as a wholesaler, not a manufacturer. (Technically, such firms report on both the manufacturing and wholesaling tax lines, but take a multiple activities tax credit for the manufacturing activity.)

Four principal tax classifications accounted for over 90 percent of total B&O tax liability, prior to credits, in 2003: manufacturing, 6.0 percent; wholesaling, 21.5 percent (including in-state sales by manufacturers); retailing, 25.6 percent; and services (including financial, insurance, and real estate), 37.8 percent.

Levied by State

Traditionally, there has been no statutory or administrative relationship between the state B&O tax and the local gross receipts taxes levied by some cities. However, legislation adopted in 2003 required cities to adopt their local business taxes according to a model ordinance, which is linked with the state B&O tax definitions. (See following chapter.)

Administration Department of Revenue. Firms register with the Department by filing a Master Business Application (Form #BLS 700-028) with the Department of Licensing before they commence operations. The fee for the Master Business License is $15 ($20 if the firm is registering a trade name). The Department of Revenue assigns the applicant to monthly, quarterly, or annual reporting frequency for state excise tax purposes depending upon the type and estimated level of business activity. Also, the firm is assigned to the appropriate industrial classification, based on the applicant's description of the firm's primary activity. The six-digit number reflects the North American Industrial Classification System (NAICS), an identification system used by the federal governments of the U.S., Canada, and Mexico.

The B&O tax is generally reported on the Combined Excise Tax Return which is sent to registered taxpayers. (Other specialized tax returns may be sent to selected types of taxpayers, e.g., a "B&O Activities" return or a "Retailing and Other Activities" return.) The excise tax return for monthly reporters is due on the 20th of the following month. Quarterly filers report by the end of the month following the close of the quarter, and annual taxpayers file by the end of January for the prior calendar year. Firms are encouraged to file their tax returns and submit payments electronically; more information on "E-file" is available on the Department's webpage: http://dor.wa.gov/content/doingbusiness/filing/efile/.

Firms whose annual gross income does not exceed $28,000 are relieved of the obligation to file excise tax returns if they have no other state excise taxes to report, e.g., retail sales tax collected from customers (RCW 82.32.045(4)). Also, a small business tax credit (RCW 82.04.4451) relieves a major portion of B&O tax liability for many small firms. For example, a firm subject to the 0.484 percent tax rate would incur no B&O tax liability until annual income exceeds $86,777. During fiscal year 2004 an estimated 60,700 firms paid no B&O tax and an additional 14,900 firms had their tax liability reduced because of this credit.

Recent Collections ($000)

Fiscal Year	Collections	% Change	% of All State Taxes
2004	$2,067,872	7.5%	15.9%
2003	1,923,370	(1.8)	15.9
2002	1,958,283	(2.7)	16.6
2001	2,012,403	8.5	16.9
2000	1,854,948	1.5	15.7
1999	1,827,459	(1.4)	15.8
1998	1,853,815	7.6	16.6
1997	1,722,802	4.9	16.4
1996	1,642,403	3.3	16.5
1995	1,590,477	7.9	16.5

Distribution of Receipts

State general fund, except the 1.5 percent tax on public and nonprofit hospitals which goes to the health services account.

Exemptions, Deductions and Credits

The B&O tax is basically a tax on gross business receipts with no deduction for costs of doing business, such as payments for raw materials or wages paid to employees. Nonetheless, many exemptions, deductions, and credits are provided for specific types of business activities. Some of the major ones are summarized below.

EXAMPLES OF EXEMPTIONS:
- income from the sale or rental of real estate;
- agricultural producers who grow crops or raise animals for sale at wholesale;
- operating income of public utilities (subject instead to public utility tax);
- international banking facilities;
- insurance premiums (subject instead to insurance premiums tax);
- production of agricultural or horticultural products for sale at wholesale;
- commuter ride-sharing and nonprofit transportation of persons with special needs;

- salaries and wages received by employees (not considered as engaging in business);
- fund-raising activities of nonprofit organizations;
- day care provided by churches;
- income of the American Red Cross;
- nonprofit sheltered workshops and group training facilities;
- credit unions;
- grants and income received by local governments (except for proprietary activities);
- direct sales by out-of-state firms via manufacturer's representatives;
- accommodation sales between firms that sell the same type of product;
- income of small timber harvesters;
- health maintenance organizations (subject to insurance premiums tax);
- federal grants for small business for R&D purposes.

EXAMPLES OF DEDUCTIONS:
- income which the state may not tax for constitutional reasons (e.g., interstate commerce);
- membership dues, contributions and donations, and tuition fees;
- investment income of nonfinancial businesses and dividends of subsidiary firms;
- network advertising representing the out-of-state income of radio/TV broadcasters;
- cash discounts taken by purchasers;
- credit losses incurred by taxpayers who use accrual accounting;
- sales representing federal and state gas taxes;
- interest from first mortgage residential loans and certain agricultural loans;
- government grants for nonprofit social and health programs;
- income of nonprofit artistic and cultural organizations;
- income associated with processing of beef (temporary deduction).

EXAMPLES OF TAX CREDITS:
- small business credit ranging from $35 to $70 per month;
- payments for ride-sharing/commute trip reduction programs (expires 7/1/2013);
- gross receipts taxes paid in other states or countries;
- R&D expenditures by certain high technology firms (expires 1/1/2015);
- $3,000 credit for new jobs created by international service firms;
- $2,000 credit for new jobs by manufacturing, R&D, or computer firms in rural areas;
- $1,000 credit for new jobs by software developers in rural counties (expires 1/1/2011);
- $3,000 credit for new jobs by manufacturers of semiconductor materials;
- income from providing help-desk services in rural counties (expires 1/1/2011);
- pre-production expenses associated with super-efficient aircraft (expires 7/1/2024);
- property tax paid on facilities used to produce super-efficient aircraft (expires 7/1/2024);
- property tax paid on aluminum smelters (expires after 2006 taxes);
- purchases of electricity/natural gas by aluminum smelters.

History

The Business Activities Tax of 1933 was the state's first gross receipts tax on business. It was adopted as a temporary, emergency revenue measure during the Depression. The gross receipts form of taxation was upheld by the State Supreme Court in 1933. The Court determined that the tax was a proper measure of the privilege of engaging business.

Two years later, the Revenue Act of 1935 included the current B&O tax as a replacement for the Business Activities Tax. Initial tax rates were 0.25 percent for all business activities, except services which were taxed at 0.5 percent. Subsequent rate increases were enacted via surtaxes in 1951, 1955, 1959, 1976, 1982, and 1983. Over the years a number of specialized tax rates, typically at lower levels, were created for particular business activities, so that by the mid-1990s there were as many as 13 different B&O tax rates. In 1998, many of the specialized rates were consolidated into the existing 0.275 or 0.138 percent rates.

Two major attempts to broaden the B&O tax base - one successful, one not - occurred just before and just after the 1960s. In 1959, the Legislature attempted to extend the tax to income derived from the rental of real estate. However, the State Supreme Court ruled that the tax constituted double taxation, because the income was essentially derived from the real estate itself and this was already subject to property taxes. In 1970 the tax was broadened to include financial institutions under the service classification.

The initial tax incentive to encourage economic development was enacted in 1965. This manufacturers tax credit was intended to help manufacturing firms invest in new facilities. Another credit was adopted two years later; this continues to assist firms with costs incurred in upgrading pollution control facilities. The B&O tax was used to help deal with personal property taxes on business inventories; from 1974 through 1983 an increasing percentage of the inventory tax was creditable against B&O tax liability until inventories were exempted outright from property tax.

In the mid-1980s a major issue arose concerning the potential for double taxation of the same income for firms that operate in multiple states. The U.S. Supreme Court ruled in 1987 that Washington's B&O tax presented this possibility. In response, tax credits were enacted for in-state firms that both manufacture and sell at wholesale or retail and for firms that operate both in Washington and in other states.

Major changes to the B&O rate structure occurred in 1993. New classifications for business services were created with rates as high as 2.5 percent, and existing rates were increased. By 1997 the new classifications were eliminated and the tax rates for all activities were returned to the pre-1993 levels. Also, in 1993 public and nonprofit hospitals were made fully taxable at the service rate, with the receipts dedicated to health care programs.

Prior to 1994 the B&O tax featured a threshold equivalent to $1,000 of taxable income per month. If a firm had gross receipts above this level, the B&O tax fully applied to all of the firm's income. In 1994 the existing small business tax credit mentioned above was adopted; this had provided significantly broader tax relief for very small companies.

A major change in the tax for the distribution industry was enacted in 1998. The B&O tax intentionally pyramids, i.e., different firms at different levels in the chain of production are each subject to the tax. Thus, the same product can be subject to tax multiple times. This can present an advantage for integrated firms, e.g., those that distribute products they own to their retail outlets. To help offset that advantage, since 1955 a tax on "internal distributions" was applied to firms that distribute products they own to two or more of their own outlets. However, the internal distribution tax was repealed in 1998.

Discussion/Major Issues

As of July 2004, there were 692,845 firms registered with the Department for state excise tax purposes (excluding timber tax and other taxes in lieu of property tax). However, many of the registered firms are temporarily inactive or are below the $28,000 filing threshold. During 2003 there were approximately 251,850 firms that actually had B&O tax liability (prior to credits) during the year.

Washington's B&O tax is unique; no other state levies a comprehensive gross receipts tax on all businesses. (West Virginia used to levy a similar gross receipts tax on all businesses, but their Business and Occupation Tax is now confined to utilities.) Most other states rely upon a corporate net income tax, plus a personal income tax for the income of noncorporate firms, similar to the federal tax. Washington's business tax generates a much larger portion of total state revenues than do corporate income taxes in most other states. This, plus the fact that businesses pay a significant share of the retail sales tax on supplies and non-manufacturing equipment, results in a relatively heavy initial tax burden for businesses in Washington, compared with many other states.

A gross receipts tax has several important advantages. It is easy to understand, simple to calculate for taxpayers, and auditing is relatively uncomplicated. The complex determination of net income is avoided, and there is no need to apportion business income among states for most multistate operations. (Some interstate service businesses may apportion their income, based on separate accounting or the cost of doing business within Washington and in other states.) The tax is deductible for federal income tax purposes as a cost of doing business. There is no discrimination due to the structure of the firm - corporations and noncorporate firms are treated alike. It is generally easier for a company to forecast its sales than its profits, so it may be easier to include the amount of the tax in its prices, if market conditions permit. A gross receipts tax assures that profitable businesses and those organized as nonprofit are taxed the same for engaging in the same activity. And it assures that even firms that are intentionally operated at low profit margins, e.g., by paying abnormally high salaries to its owners, will pay some tax to the state for the government services they enjoy. Economically, the tax encourages firms to operate with maximum efficiency. Finally, a gross receipts tax can be more productive in terms of revenue generation, and it is one of the more stable revenue sources because collections do not typically fluctuate to the same degree that many other forms of business taxes do over the course of the business cycle.

However, negative features of the B&O tax can be significant. Most importantly, it imposes a heavy burden on new and small businesses that may not have reached their maximum level of operating efficiency or have yet to fully develop their markets and as a result are less profitable. Because established, profitable firms are favored at the expense of new, start-up businesses, the tax is often viewed as a detriment to economic development.

Because the tax does not consider profit potential, there is continual pressure on the Legislature to grant new preferential tax rates or provide other incentives to industries that have difficulty competing either in local or global markets. One of the state's primary industries, agricultural production, is entirely exempt from the tax. The tax pyramids for sales to other firms at each level of the chain of production and thus favors vertically integrated firms.

Finally, the tax favors low-volume, high-profit types of business activities. For example, compare the profit margins of two different service industries: legal services, with typical net profits before taxes of, say, 18 percent, and barber/beauty shops with an average margin of about 5 percent. The applicable B&O tax rate is the same for both industries. But the effective tax rate (B&O liability compared with the firm's profits) is very different: 8.3 percent for the legal services firm and 30 percent for the barber/beauty shop.