WASHINGTON STATE AND LOCAL TAX UPDATE

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Today’s presenters

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Agenda

- Introductions
- Washington B&O tax summary and update
- Voluntary disclosure agreement
- Seattle payroll expense tax
- Long term care trust act
- Captive insurance law
- Capital gains tax

Washington – Business & occupation tax

The Washington B&O tax is a gross receipts tax measured on the value of products, gross proceeds of sales or gross income of the business

There is no deduction for your cost of doing business

Activity based tax

No P.L. 86-272 protection

It takes very little to establish nexus in Washington – most activities are now subject to economic nexus thresholds

Washington – Business & occupation tax (cont.)

- Tax is imposed on all forms of business enterprise
- There is no consolidated or combined reporting
- Each legal entity is treated as a separate entity
  - Must be careful - transactions between separate entities are subject to B&O tax, ex. Management fees
- Washington has a higher effective tax rate than most income tax state

Washington – Business & occupation tax: Economic nexus

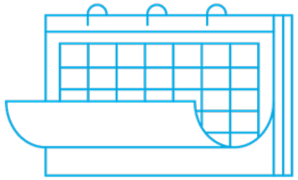
Effective January 1, 2020

- All thresholds will be $100,000 in combined sales
  - Property, payroll or transaction thresholds are eliminated

Thresholds for 2018 and 2019

- $285,000 in combined sales, $57,000 of Payroll/Property
- Sales Tax thresholds are $100,000 in retail sales or 200 transactions

Nexus is determined based on the current or previous year's data



Recent Department of Revenue court cases

- *LendingTree, LLC v. State of Washington, Department of Revenue*, 12 Wn. App. 2d 887, 460 P.3d 640 (App. Div. 1 2020)
  - Sourcing of loan referral services for lenders
    - DOR sourced as marketing services to the location of the potential borrower
      - Court found it a referral service and should be sourced to the location of the lender
- *Arup Laboratories, Inc. v. State of Washington, Department of Revenue*, 12 Wn. App. 2d 269, 457 P.3d 492 (App. Div. 2 2020)
  - Sourcing of medical testing services
    - Arup argued the testing sample was tangible personal property sourced to the location of the property in Utah
    - DOR claimed the benefit of the service was the result of the testing and not the sample itself, therefore the service is sourced to where the testing result is used
    - The court sided with the DOR

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Recent Department of Revenue court cases (cont.)

- *FPR II, LLC v. State of Washington, Department of Revenue*, 16 Wn. App. 2d 706, 482 P.3d 320 (App. Div. 2 2021)
  - FPR II, LLC provides personnel and management to businesses in the recycling industry, their employees process the recycling materials for further sale by sorting, removing waste, bundling and strapping
  - They filed for refund of taxes paid under the service and other rate, claiming instead they are a processor for hire
    - DOR has long held through informal guidance that recyclers are service providers as they do not create new, different or useful products
    - The court found instead that they do create a more useful product and are performing manufacturing activities as a processor for hire

Voluntary disclosure agreements

Must disclose identity before acceptance into program

Will be disqualified if any contact for an enforcement purpose occurred with entity applying or an affiliate

If disqualified, assessment will be issued with penalties of 34 percent if allowed into the program, the process will be comparable to a regular audit with detailed revenue information and exemption certificates required

Seattle payroll expense tax

Effective January 1, 2021, on every business with $7,386,494 or more in Seattle-based payroll for the prior calendar year

The tax applies to the payroll expense of only those employees earning $158,282 or more annually

The first tax return and payment were due January 31, 2022 to include all four quarters of 2021. Quarterly tax returns are now required for 2022 and subsequent years

Tax rates range from .7 percent to 2.4 percent depending upon the total payroll expense of the business and the annual payroll of the employee

Seattle payroll expense tax (cont.)

- In stakeholder meetings Seattle stated remote worker’s wages will not be considered Seattle payroll if not residing in Seattle
- A previous version of the rule does not support this same conclusion
- Concern is the projections of tax collections will be much less than anticipated due to the large number of remote workers during covid closures
  - Will Seattle take a different position on remote work in the future?
- Court Challenges
  - King County Superior Court ruled the tax is constitutionally permissible
  - Appeal has been filed in the Washington State Court of Appeals

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Washington long term care trust act

- Delayed premium collection for 18 months
  - Payroll deductions to begin July 1, 2023
  - Benefit payouts begin July 1, 2026
- Maximum Benefit $36,500
    - Must pay into program for 10 years for full benefit
      - Prorated benefits available to those born prior to 1968
  - Tax Rate .58 percent
    - Assessed on total wages with no cap
- Additional exemptions added
  - Disabled veterans
  - Active-duty military spouses and domestic partners
  - Non-resident individuals working in WA
  - Nonimmigrant visa holders

Washington premium tax on captive insurers

- SSSB 5315 (May 12, 2021) confirms that eligible captive insurers are subject to the state's 2 percent premium tax on premiums for insurance directly procured by and provided to its parent or another affiliate covering in-state risks
- Who are eligible captive insurers?

Insurance companies in good standing and licensed as a captive insurer by their domicile jurisdiction

Are wholly or partially owned by a captive owner as defined in RCW 48.201.020(2)(a)(b)

Insures risks of the captive owner, the captive owner's other affiliates, or both

Has one or more of its insureds who have their principal place of business in Washington

Has assets that exceed its liabilities by at least $1 million and has the ability to pay its debts as they come due

Provides only property and casualty insurance to the captive owner, the captive owner's other affiliates, or both

Washington premium tax on captive insurers (cont.)

Eligible captive insurers required to register

- All "eligible captive insurers" who have issued a policy covering Washington risks after September 9, 2021, must register with OIC within 120 days of issuing the policy

Retroactivity

- The premiums tax is due for all insured Washington risks for any period after January 1, 2011
- SSSB 5315 provides for what looks like an amnesty program. Under SSSB 5315, premium taxes are due for any period after January 1, 2011; penalties and fees will not be imposed

Washington capital gains tax

- Seven percent tax on long term capital gains reported on the Individual's federal income tax return
  - First $250,000 of long-term gains are exempt for both single filers and joint filers
    - Filing status follows the federal return
    - Loss carryovers are not allowed
- Common exemptions and deductions from the tax:
  - Real Estate
  - Retirement accounts
  - Qualified small family businesses
  - Property used in a trade or business that is depreciable or expensed
  - Charitable contributions in excess of $250,000 to a Washington qualified non-profit
    - Capped at $100,000

Washington capital gains tax: Court challenges

- Douglas county superior court found the tax unconstitutional on March 1, 2022
  - Basis of the opinion:
    - The tax was found to be an income tax based on its characteristics
      - An income tax violates the Washington constitution because it exceeds the one percent limit on taxes of personal property without a vote of the people

- The state has indicated they will appeal the decision
  - Parties are filing motions to expedite the case to the Washington supreme court and bypass the court of appeals
    - If the Washington supreme court declines, the case will revert back to the court of appeals

Washington capital gains tax: What's next?

The democratic-majority legislature was using the capital gains tax as a test to clear the way for a graduated income tax

- If the capital gains tax was found to be constitutional, a graduated income tax could be passed with a simple majority avoiding the current requirement for a super majority and vote of the people

A wealth tax bill has been introduced in the last two legislative sessions

- Likely some of the same issue as the capital gains tax will exist in the wealth tax although the rate was 1 percent thus meeting the constitutional requirement of a maximum rate of 1 percent

THANK YOU FOR YOUR TIME AND ATTENTION

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