

Washington State Tax System – An Overview

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Doing Business in Washington

- Register your business with various state agencies, including the Department of Revenue, by completing a Master Business Application. Registration is required if:
 - Conduct business in WA and sell any item at retail;
 - Earn gross income of \$12,000 or more before expenses; or
 - Owe other taxes or fees (such as use tax).
- The Department of Revenue will send you a packet of information, including your filing frequency and UBI or tax account number.

Taxpayer Responsibilities

- As a taxpayer in Washington, you are required to file a tax return and pay the tax owed on a timely basis.
- If your tax liability is zero because you had no business activity or received no income, you must still file a tax return.
- You must notify the Department of Revenue and any other state agencies if there are any changes to the mailing address, business structure, ownership, additional locations, business activity, business name, or if you go out of business.

Taxpayer Rights

- As part of your rights as a taxpayer, you can ask for a refund if you overpaid taxes provided the taxes were paid within 4 calendar years of the request.
- If you disagree with the results of an audit or your refund request was denied, you can file an appeal with the Department's Appeals Division.

Active Non-reporting Status

- The Department may not require you to file any tax returns if:
 - Your gross income or gross sales < \$28,000 per year and
 - You are not required to collect sales tax or certain other taxes.
- If you meet these requirements, the Department must notify you that it has placed you on active non-reporting status. This is the Department's decision.

Audit

- An audit by the Department of Revenue will normally cover the four preceding calendar years, plus the current year. The auditor will review taxes, deductions, and exemptions reported on your excise tax return.
- An audit of your business activities will cover several major areas, including:
 - **Gross income:** verification of proper amounts and classifications reported on the return.
 - **Deductions, credits, and exemptions:** verification of proper amounts, classifications, and documentation.
 - **Purchases:** verification of retail sales or use tax paid on capital assets, consumable supplies, or articles manufactured for your own use.

Recordkeeping

- Keeping complete records makes it easier to complete your tax returns as well as help defend yourself during an audit.
- Keep the original records that support the amount of gross receipts and sales from all sources, and the amount of all deductions, exemptions, or credits claimed.
- How long? Keep all business records for 5 years. There may be reasons to keep them longer.

Recordkeeping

- Types of records to keep:
 - Washington State excise tax returns and work papers
 - Federal income tax returns for the business
 - Summary accounting records and source journals, such as the check register, general ledger, sales journal, general journal, cash receipts journal, and any other records you use to record income and expenses
 - Sales invoice
 - Purchase invoices (accounts payable, receipts)
 - Depreciation schedules listing all assets acquired or disposed of during the audit period along with purchase or sales invoices for those assets
 - Resale certificates for any wholesale sales
 - Supporting documentation for all deductions and exemptions

Business & Occupation Tax

- The Business & Occupation tax (or B&O tax) applies to anyone engaged in business activities in Washington, regardless of business structure. It is a gross receipts tax, meaning there are no deductions for labor, materials, delivery or travel costs, or any other cost of doing business.
- Calculating the B&O tax
 - The B&O tax is computed by multiplying the tax rate by the amount of gross receipts, gross volume of sales, or other taxable amounts.

B&O Tax

- Determining the B&O tax rate
 - There are different B&O tax rates. The tax rate depends on the B&O tax classification that applies to the business activity.
 - Typically, the Department will assign a B&O tax classification based on the information provided in the Master Business Application.
- The most common B&O tax classifications and the applicable rates:

| | |
|---------------------|--------|
| ▪ Retailing | .00471 |
| ▪ Wholesaling | .00484 |
| ▪ Manufacturing | .00484 |
| ▪ Service and Other | .015 |

B&O Tax – Other tax classifications

- There are many other B&O tax classifications. If you expand your business, you should review the B&O tax classifications to determine whether there is another classification that applies.
 - Royalties .00484
 - Income from royalties or charges in the nature of royalties for the granting of intangible rights are subject to B&O tax.
 - The term *royalties* means compensation for the use of intangible property such as copyrights, patents, licenses, franchises, trademarks, trade names, and similar items.
 - This B&O classification does not include licenses for canned software nor compensation relating to natural resources, such as mining or drilling rights.

B&O Tax – Retailing Classification

- Selling or renting goods and certain services to consumers (anyone who will not resell the goods and services to others).
- Examples of services that are sold at retail: Landscaping, personal services such as physical fitness, tanning, tattoos, and others
- Businesses making retail sales are subject to the Retailing B&O tax, even when the sales are exempt from retail sales tax.
- $B\&O\ tax = .00471\ tax\ rate * gross\ receipts\ from\ retailing\ activities$

B&O Tax – Wholesaling Classification

- Selling goods and certain services to anyone who will resell them to others in the regular course of business.
- Wholesalers are required to keep a resale certificate on file from each buyer to document that the transaction was a wholesale sale.
- B&O tax = .00484 tax rate * gross receipts from wholesaling activities

B&O Tax – Manufacturing Classification

- Making articles, substances, or commodities in Washington State for the manufacturer's own use or for sale as tangible personal property.
- Products manufactured in Washington but sold and delivered out of state are still subject to the Manufacturing B&O tax.
- If the manufacturer sells and delivers the manufactured product within Washington, then the income is also reported under either the Wholesaling or Retailing B&O tax classifications. (The Multiple Activities Tax Credit offsets the double tax payment when reporting under 2 B&O tax classifications.)
- $\text{B\&O tax} = .00484 \text{ tax rate} * \text{gross receipts from manufacturing activities}$
 - Manufacturing gross receipts are usually determined by the selling price of the products.

B&O Tax – Service and Other Activities Classification

- Personal and professional services (unless specifically taxed as a retail service)
- Activities not specifically taxed under any other B&O classification
- Examples: Consulting, management services, medical services, legal services, beautician services, computer programming
- B&O tax = rate of 0.015 * gross receipts from services and other activities

B&O Tax – Deductions

- Bad Debts
 - Amounts previously reported and determined to be uncollectible. These amounts must also be written off for IRS purposes.
- Interstate and Foreign Sales
 - Goods sold and delivered to customers outside of Washington. Transportation of persons or goods across state or international boundaries. Documentation is necessary. Service providers must physically render the service outside state boundaries.
- Accommodation Sales
 - Amounts received by a business for selling goods at cost to a like business to fill an existing order.

B&O Tax – Deductions

- Returns
 - When the customer returns the product and the entire selling price is refunded or credited to the customer.

- Casual Sales
 - Amounts received for sales of tangible personal property by persons not usually selling such items. Note: The seller must collect and remit the sales tax.

- Advancements/Reimbursements
 - Amounts received as advancements or reimbursements when the customer alone is liable to pay for the goods and services. The person making the payment cannot have primary or secondary liability, other than as agent, to pay for the goods and services.

Small Business Tax Credit

- The Small Business Tax Credit is available for businesses whose combined B&O tax liability for all classifications is less than:
 - \$71 for Monthly taxpayers
 - \$211 for Quarterly taxpayers
 - \$841 for Annual taxpayers
- The credit is determined after all other B&O tax credits have been taken.
- The credit amount may not exceed amount of B&O tax due (no refunds).
- Unused portions of the credit may not be carried into the next reporting period.

Multiple Activities Credit

- When a business performs more than one taxable activity for the same product (such as manufacturing and selling the product at wholesale in Washington), it reports each activity under the proper classification.
- The business can take the MATC credit so that B&O tax is not paid twice on the same amount.
- The credit also applies to a business that has paid a gross receipt tax to another state.
- Completion of the *Multiple Activities Tax Credit, Schedule C* is necessary each time the credit is claimed.

High Technology B&O Tax Credit

- Annual credit up to \$2 million
- Must conduct research and development (R&D) in Washington State in the fields of:
 - Advanced computing
 - Advanced materials
 - Biotechnology
 - Electronic device technology
 - Environmental technology
- Must incur certain Qualifying Expenses:
 - Operating expenses, such as wages, benefits, supplies, and computer expenses
 - Directly incurred in qualified R&D by a person claiming the credit
 - Does not include amounts paid to a person to conduct qualified research and development, other than a public educational or research institution
 - Does not include capital costs and overhead, such as expenses for land, structures, or depreciable property
- Reporting/Documentation:
 - No application
 - Annual Survey must be filed by March 31st of the following year
 - Electronic filing of all documents required

Common Questions

- Can I deduct my expenses for inventory, shipping, contract labor, etc? No. The B&O tax is a gross receipts tax; no expenses are deducted.
- What if my business did not make a profit? Do I still have to pay the B&O tax? Yes. The B&O tax is due whether or not your business makes a profit.
- If I sell both services and products to customers, do I calculate the B&O tax using one classification? No. Each source of income must be accounted for separately and reported under the classification that applies to each activity.

Retail Sales Tax

- A business must collect sales tax on the selling price of an item unless they receive a resale or other exemption certificate from the buyer.
- Subject to tax: tangible goods and certain services (improving or repairing real or personal property such as buildings, equipment, and automobiles; landscaping; and others).
- Sales tax rates vary depending on the location where the sale occurs. This is because there are two components of the sales tax – the **state** sales tax rate and **local** sales tax rate. The state sales tax rate is 6.5 percent (.065). Local sales tax rates range from 0.5 to 2.5 percent (.005 to .025). Seattle's combined sales tax is currently 9%.

Retail Sales Tax

- Party responsible for paying the sales tax? The buyer.
- What are the seller's responsibilities?
 - To collect sales tax from the buyer.
 - To remit the collected sales tax to the Department of Revenue. The funds are considered to be held in trust for the state until reported and remitted with the seller's tax return.
 - NOTE: The seller is liable to the Department of Revenue for sales tax due, whether it is collected from the buyer or not.
- Businesses pay retail sales tax on the purchase or rental price of items (or certain services) for their own use, such as supplies or equipment, which will not be resold or used as an ingredient in producing a product for sale.

Use Tax

- Use tax is complimentary to the retail sales tax.
- Purchases made from out of state vendors: If no sales tax is charged, then use tax is owed from the buyer to the Department of Revenue.
- Very common audit item.

High Technology Sales & Use Tax Deferral/Waiver

- Must conduct R&D or pilot scale manufacturing in the fields of:
 - Advanced computing
 - Advanced materials
 - Biotechnology
 - Electronic device technology
 - Environmental technology
- Qualifying Activity:
 - Certain construction and equipment purchases for new and expanding businesses. Available to tenants.
- Reporting/Documentation:
 - High Technology Application For Sales and Use Tax Deferral must be filed before building permit is issued
 - All businesses must maintain a qualified activity at the site of the investment project for the year in which the investment project is certified operationally complete plus seven additional years.
 - Annual Survey must be filed by March 31st of the following year in which the project is certified and for the following seven years.
 - Electronic filing not required

Internet Based Businesses

- Washington businesses that sell tangible personal property or provide services over the Internet are taxable in the same manner as any brick and mortar business.
- Internet Services
 - Gross income received for Internet services provided in this state are subject to service and other activities B&O tax.
 - "Internet service" is a service furnished by an Internet service provider (ISP) for access to the Internet. An ISP provides the service through the use of computer processing applications that either provides the user with additional or restructured information or permits the user to interact with stored information through the Internet or a proprietary subscriber network. "Internet service" includes the following services furnished by the ISP: provision of Internet electronic mail, access to the Internet for information retrieval, and hosting of information for retrieval over the Internet.
 - Washington's definition of the Internet
 - "Internet" means the international computer network of both federal and nonfederal interoperable packet switched data networks, including the graphical subnetwork called the World Wide Web.

Internet Based Businesses

- **Web Site Development or Hosting Services**

- Gross income received for web site development or hosting services in this state are subject to service and other activities B&O tax (sales tax does not apply). "Web site development service" means the design and development of a web site provided by a web site developer to a customer. "Web site hosting service" means the service of a provider offering server space to host a customer's web site.

- **Data Processing Services**

- Charges for data processing services performed in this state are subject to service and other activities B&O tax (sales tax does not apply). "Data processing services" include, word processing, data entry, data retrieval, data search, information compilation, payroll processing, business accounts processing, data production, and other computerized data and information storage or manipulation. "Data processing services" also includes the use of a system for data processing.

Internet Based Businesses

- **Subscription Income**

- The taxability of subscription income depends on what the subscription provides to the customer. Some examples are:
 - **Retail Sales:** If the subscription entitles the subscriber to download a product or publication, including standard information sold to any consumer, the income is subject to retailing B&O tax and retail sales tax if the subscriber/purchaser is in Washington. Examples of retail downloads include music files, video files, and information files that are sold to multiple users.
 - **Access Charges (Application Service Providers):** If the subscription entitles the subscriber to read, use, or access information or software applications online but does not allow for the subscriber to download software applications, products, or publications, the income is subject to B&O tax under the service and other activities classification (sales tax does not apply) based on the service being provided in Washington (not dependent on where the customer is located).

Internet Based Businesses

- **Services Performed In Washington**
 - Many Internet businesses provide or perform services rather than sell tangible personal property, for instance, web design businesses.
 - Income earned from providing services over the Internet is generally subject to service and other activities B&O tax if the service is performed in Washington. In such cases, the customer's location does not matter.

- **Advertising Income**
 - Subject to the business and occupation (B&O) tax under the service and other activities classification.

Internet Based Businesses

- **Items Delivered In Washington**
 - Washington sales tax must be collected on all sales of items delivered to customers in Washington. Income from such sales is also subject to Retailing B&O tax.

- **Items Delivered Outside Of Washington**
 - When items are delivered to the buyer at a location outside of Washington, the sale is considered an interstate or foreign sale and is not subject to Washington sales tax. The sale is also deductible for Retailing B&O tax.

Digital Products – Status

- The dilemma: What is a digital product?
 - To be compliant with the Streamlined Sales and Use Tax Agreement by 01/01/2010, Washington cannot impose sales or use tax on certain digital goods as the sale of tangible personal property. Instead, taxes on digital products must be separately imposed.
- The solution: Unknown
 - The Washington Committee for the Study of the Taxation of Electronically Delivered Products released its final report on issues relating to the tax treatment of digital goods.
 - Issues addressed by the Committee: alternatives for digital products taxation, digital products and tangible equivalents, digital automated services, digital codes, B&O tax implications, user rights, sourcing, bundled digital products, multiple points of use, Washington server farms, information services and standard information, and exemptions for businesses using digital products and services.
 - The Washington State Legislature will address these issues during the current legislative session.

City Taxes on Business

- Seattle, Bellevue, and other cities impose their own business taxes:
 - gross receipts or gross income;
 - fees based on a particular type of activity;
 - fees based on the number of employees; and
 - fees based on floor space (square footage of buildings).
- Own rules and forms; generally definitions should tie to state laws.
- Other cities and towns impose business license fees.

Personal Property Taxes

- Applies to all personal property used in business.
 - Includes machinery, equipment, furniture and supplies
 - Excludes business inventory and exempt property
- Administered by county assessor's office.
- Uniform application overseen by Department of Revenue.

Q&A