

Business and Occupation Tax (B&O Tax)

Overview – Washington state levies a unique Business and Occupation Tax (B&O Tax) on all businesses operating in the state. It is a tax on gross receipts (gross income, gross sales or value of products), meaning no deduction is allowed for costs of doing business such as raw materials or employee wages. No other state relies exclusively on a comprehensive gross receipts tax as its principal business tax. But several other states feature elements of a gross receipts tax and, Ohio is transitioning to a state gross receipts tax similar to Washington's.

The B&O tax is easy to calculate and auditing is relatively simple. The process of calculating and apportioning net income is avoided and the tax is deductible for federal income tax purposes as a cost of doing business. The B&O tax does not discriminate by firm structure since it treats corporations and non-corporately structured firms the same.

On the other hand, the B&O tax imposes a heavy burden on small businesses that have thin profit margins and firms with high overhead costs. The tax tends to favor low-volume, high profit business activities. There is no deduction for losses, so a business must pay taxes on its receipts regardless if it turns a profit.

The B&O tax is the second-largest source of state revenue behind sales and use taxes. In fiscal year 2009, the B&O tax is forecast to generate over \$2.8 billion (February 2008 forecast) and accounts for 19 percent of all state general fund revenues.

Major Rates – There are five major business classifications, each carrying a different rate:

-- Manufacturing, wholesaling, and other activities	0.484%
-- Retailing, environmental cleanup	0.471%
-- Travel agents, stevedoring, freight brokers, international investment management services	0.275%
-- Agricultural manufacturing, meat processing, reselling of prescription drugs	0.138%
-- Services, public/nonprofit hospitals, all other activities	1.5%

There are lower rates for certain specialized businesses. Some firms engage in more than one type of business activity and are therefore eligible for the Multiple Activities Credit which ensures a business pays B&O tax only once on its receipts. There are also 38 cities that levy a local B&O tax.

Small Business Credit – There is a Small Business B&O tax credit that allows firms to take a \$35 per month (\$420 annual) credit on their B&O tax liability. This exempts from all B&O taxes service businesses with \$28,000 a year or less in gross receipts and retailing businesses with about \$89,000 a year or less in gross receipts. Currently, over 96,000 firms pay no B&O tax because of the small business credit. However, the credit has not been adjusted since 1994.

Legislative History – The B&O tax was enacted in 1935. Over the years, numerous exemptions, deductions, and credits have been enacted for specific business activities. There are 161 B&O tax preferences as of 2007, with estimated taxpayer savings of more than \$8.6 billion. Only about \$2.1 billion of this amount would actually be realized as new revenue if the preferences were repealed. Other preferences are required by federal law or for other reasons would not generate revenue.

The last major change to B&O tax rates occurred in 1993 when a Democrat-led Legislature and Governor raised rates and imposed a rate surcharge of \$437 million. The Legislature began repealing those increases in 1994 with removal of the rate surcharge and the Legislature in 1995, and rollback of the rate increases in 1996.

House Republicans have tried unsuccessfully to increase the small business B&O credit to cover more businesses.

Issues and Outlook – Other states are slowly moving towards elements of a gross receipts tax and away from corporate net income taxes because of the reliability of the B&O tax as a revenue source and the difficulties associated with corporate income taxes. The tax is viewed as a detriment, however, to economic development because it tends to favor established, profitable businesses over new, start-up firms. The tax also pyramids throughout the different levels of production, meaning taxes are paid on taxes. The sheer volume of deductions, credits, and exemptions can make it difficult to administer the tax.