



# Taxing Times

In the new year, the legislature must balance a growing budget deficit with the voters' strong anti-tax sentiment.

The 2010 Washington state legislative term was extended by a special session as the House and the Senate battled over whether to raise sales taxes as part of balancing the budget. While the Legislature did not raise sales taxes, it did pass a final budget in April that included an \$800 million package of piecemeal tax increases, which contained the largest number and most wide-ranging set of tax changes seen in the state in at least a decade. The biggest increases (in terms of new tax revenue) were directed at the service sector. This included a temporary 20 percent increase in the service business and occupation (B&O) tax rate, and a permanent change in the method that service businesses must use to calculate the portion of their gross receipts that are taxed as Washington revenue.

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Since the 1930s, service businesses with customers inside and outside Washington have used a formula that is based on their cost of doing business to calculate the portion of their gross income attributable to Washington. On June 1, 2010, with less than two months' notice, service businesses were required to change to a completely different formula that asks where their customers "receive the benefit" of the services that are provided. The short time period to make such a major transition resulted in the Department of Revenue enacting emergency rules in an attempt to provide guidance to businesses struggling to comply with the change. The public rulemaking process for permanent rules has not yet been scheduled.

Another tax increase that has consumed the time and attention of both the Department of Revenue and Washington businesses is the extension of service B&O tax of fees and travel expenses paid to people serving on a corporation's board of directors. Ironically, the department has concluded that because of the new sourcing regime,

the new tax on directors' fees generally applies only to directors of companies incorporated in Washington. A description of these and nearly 70 other 2010 tax changes can be found on the Department of Revenue's website at [www.dor.wa.gov](http://www.dor.wa.gov), and by clicking on the link titled "Complete List of 2010 Legislative Changes." While the department is working hard to educate businesses about these changes, there are many questions raised by the legislation that both the department and taxpayers will be struggling with for awhile.

Economic recovery remains elusive and budget forecasts for the 2011 to 2013 biennium continue to decline. The most recent figures, which were released in September, lowered revenue projections by more than \$660 million, resulting in a projected budget deficit around \$4.5 billion. Budget problems seem likely to worsen. A number of 2010 tax increases were repealed, including the new taxes on soda, gum, candy, bottled water, locally grown fruit, and vegetable and meat products. Voters also reinstated the two-thirds majority requirement for raising taxes—a requirement that the Legislature suspended in 2010. A proposed state personal income tax was also defeated.

With declining revenue projections, voter repeal of recent tax increases and many believing that deep cuts have already been made to the expense side of the equation, new tax increases are almost certain to be a major focus of the 2011 legislative session. However, the particular details are anyone's guess at this time. Consistent with the Economic and Revenue Forecast Council's projections, increased uncertainty would appear to be the order of the day for 2011.

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