

2022 Year-End Planning: Washington State and Local Tax Updates

Washington's Nonprofit Corporation Act

On January 1, 2022, the Washington State Nonprofit Corporation Act took effect. The provisions include changes in the requirements for board structures, membership organizations, and fundamental transactions for nonprofits. The new Act may require the organization to review its governing documents and discuss the new provisions with its legal counsel. Read more [here](#).

Seattle Payroll Expense Tax

Effective January 1, 2021, Seattle imposes a payroll expense tax on businesses and organizations with at least \$7 million of Seattle annual "payroll expense," including not-for-profits. The payroll expense tax applies to the compensation paid to each Seattle employee in excess of \$150,000. The definition of "employee" includes individuals who are treated as independent contractors for purposes of Seattle business license tax. The tax rate ranges between 0.7% and 2.4% depending on both the annual compensation paid to each employee and the total Seattle payroll expense of the business. The term "payroll expense" means compensation paid to a Seattle employee.

Compensation is paid to a Seattle employee if:

- The employee is primarily assigned within Seattle;
- The employee is not primarily assigned to any place of business for the tax period and the employee performs 50% or more of his or her service for the tax period in Seattle; or
- The employee is not primarily assigned to any place of business for the tax period, the employee does not perform 50% or more of his or her service in any city, and the employee resides in Seattle.

An election is also available to compute the amount of each individual employee's compensation subject to the tax using an "[hours method](#)." Under the hours method, the business multiplies each employee's annual compensation by a ratio of the individual's hours worked in Seattle to the individual's total hours worked in all locations to determine the percentage of their compensation that is subject to the tax.

For the period of January 1, 2019 through December 31, 2023, certain nonprofit healthcare entities are exempted from the tax on the payroll expense of employees with annual compensation below \$400,000. Read more [here](#).

The 2021 payroll expense tax annual return and payment was due January 31, 2022. After that initial 2021 return, the payroll expense tax is due and payable on a quarterly basis, but businesses may be assigned an annual filing frequency at the city's discretion.

The constitutionality of this tax was challenged in a court case filed by the Seattle Chamber of Commerce. On June 21, 2022, the Washington State Court of Appeals ruled that the Seattle payroll expense tax is a lawful excise tax on businesses imposed under powers vested in the City by the state legislature and the state constitution. The Seattle Chamber of Commerce decided not to appeal the decision to the state supreme court according to a public statement dated July 18, 2022.

Washington Long-Term Care Act

On January 27, 2022, Governor Jay Inslee signed two bills that delayed the implementation of the Washington Cares Act. The original act implemented a new tax to support Washington residents with the costs of long-term care. Benefits included up to \$36,500 to Washington residents for long-term care costs, funded by a 0.58% payroll tax on Washington employees. The new bills came after legislative leaders announced an intention to delay premium collections for the Washington Cares Fund in December 2021 and to clarify employer obligations under the act. The goal of the delay is to give legislators more time to address the concerns that led to recent court challenges and a citizens' initiative aimed at improving the program.

House Bill (HB) 1732 delays implementation of the Washington Cares Act, including employers' obligation to deduct premiums from employee pay, until July 1, 2023. The original effective date of the tax was January 1, 2022. The new law effectively repeals that effective date and provides that any premiums already collected from Washington employees in 2022 be refunded within 120 days of being collected.

Under HB 1733, the Employment Security Department will begin accepting and approving applications for voluntary exemptions on January 1, 2023. These exemptions broaden those available under the act as originally enacted and will allow individuals who had private long-term care coverage in place as of November 1, 2021 or who are not likely to receive benefits to permanently opt out. Military spouses, employees with nonimmigrant visas, and employees working in Washington but living in another state may request an exemption from the tax.

In summary, employers are not required to collect premiums for the Washington Cares Fund from their Washington employees until July 1, 2023. Any employers that started collecting the payroll tax premiums from their Washington employees on January 1, 2022, are required to refund any collected premiums to employees.

Washington State Paid Family and Medical Leave Program

On January 1, 2019, the State of Washington began collecting premiums from both employers and employees to fund the Washington State Paid Family and Medical Leave program. This requirement is outlined in Chapter 50A.045 RCW and includes certain modifications for organizations with fewer than 50 employees. Premiums collected under the Act are used to fund paid time off for the birth or adoption of a child or for serious medical conditions.

We recommend reviewing how the Paid Family and Medical Leave provisions impact your organization's leave policies if you have not already done so. It is also possible to seek approval of a voluntary plan rather than participate in the State program.

Washington B&O Tax Rate Increase on Service and Other Activities

Effective April 1, 2020, the Washington business and occupation (B&O) tax on service and other activities increased to 1.75% for businesses and organizations with taxable gross income subject to the service and other B&O tax classification of \$1M or greater in the prior calendar year.

For purposes of determining whether the business or organization meets this threshold, taxable gross income subject to the service and other tax classification includes the taxable service income of all affiliates.

An affiliate is any person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with another person. Businesses or organizations with taxable income below the threshold continue to be subject to the 1.5% tax rate. Hospitals, as defined under state law, are not subject to the rate increase.

Changes to Washington State City B&O Tax Apportionment

Legislative changes enacted in 2019 require cities imposing a B&O tax to modify the method taxpayers are required to use to determine the amount of service and other income reportable to the city.

Since 2008, cities have been required to use a two-factor apportionment method consisting of payroll and service income. Under prior law, the service income factor was computed by assigning service receipts to the city based on a complicated and often unfair determination of “customer location.”

Effective January 1, 2020, the determination of customer location was simplified. For a customer not engaged in business, the customer location is where the service is performed if the customer is required to be present. If the customer is not required to be present, the customer's location is their residence, or, if the location is not known, the billing/ mailing address. For customers engaged in business, the customer location is where the services are ordered from, or, if not known, the customer's billing/ mailing address. If neither the location from where the services are ordered or the billing/ mailing address is known, then the customer's location is their commercial domicile.

The legislation also clarified and broadened the circumstances under which a taxpayer is considered taxable in the customer location for purposes of making a “throw-out” adjustment to the denominator of the service income factor.

Washington Disclose Act of 2018

Not-for-profit organizations making contributions or expenditures in Washington election campaigns may be subject to a filing requirement with the Washington State Public Disclosure Commission (PDC).

A not-for-profit organization must register with the PDC as an “incidental committee” if it spends, or expects to spend, \$25,000 or more in one calendar year on ballot measure campaigns or candidates for office and receives aggregate payments of \$10,000 or more from a single source.

Once registered, organizations must disclose their top 10 donors above \$10,000 to the PDC, regardless of whether the donations were intended for political or lobbying purposes.

More information is available on [the PDC website](#). Organizations who are required to register with the PDC should keep in mind that there are still federal tax laws for organizations engaging in political and lobbying activities.

Questions?

If you have questions regarding any of state and local tax issues, or if you would like to set up a meeting, please [contact any of our not-for-profit or SALT professionals](#).

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