

LITTER TAX COMPLIANCE

Report of the Department of Revenue

*Prepared Pursuant to
Chapter 257, Laws of 1998 (2SHB 3058)*

**Washington State Department of Revenue
William N. Rice, Director**

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January 2005

December 13, 2004

TO: The Honorable Joseph Zarelli, Chair
Senate Ways and Means Committee

The Honorable Jim McIntire, Chair
House Finance Committee

FROM: William N. Rice, Director

SUBJECT: LITTER TAX COMPLIANCE REPORT

Legislation enacted in 1998 directed the Department to prepare a report on litter tax compliance once every two years. This is the Department's fourth report on the subject.

The 1998 legislation changed taxpayer reporting of litter taxes. Beginning in 1999, taxpayers reported the tax on each tax return filed. Previously, taxpayers reported litter tax annually, while reporting their other excise taxes on an annual, quarterly, or monthly reporting cycle. During 1999, the Department of Revenue's Taxpayer Account Administration ([TAA](#)) Division conducted an intensive education effort by contacting taxpayers from selected industries and informing them of their potential litter tax liability. TAA corrected any tax return with an error of \$2.50 or more and sent a balance due notice, if necessary. This report indicates that the 1998 statutory change and the education effort continue to have an extremely positive effect on litter tax reporting.

While the number of filers remained constant, total collections through voluntary compliance reached an all-time high of almost \$6 million in 2003. Noncompliance with the litter tax has declined from about 40 percent in the 2001 study to an adjusted 4 percent in the current study. The Department concludes that taxpayer compliance with the litter tax is within normal levels of compliance with other excise taxes.

Tables in the study also report the following:

- ◆ Tax reported voluntarily versus tax obtained through enforcement activities,
- ◆ The number of taxpayers and amount of tax paid by major industry, and
- ◆ Total estimated litter tax noncompliance.

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We will distribute copies of the report to the members of your committees and to the Governor and his staff. If you have any questions about the findings, please contact Donald Gutmann, Revenue Analysis Manager, Research Division, at 570-6073.

cc: The Honorable Gary Locke, Governor
Linda Hoffman, Director, Department of Ecology

LITTER TAX COMPLIANCE

The 1998 Legislature established a requirement that a report covering litter tax compliance be prepared beginning in 1999 and in odd-numbered years thereafter (Section 7 of 2SHB 3058, codified in RCW 82.19.010(2)). This report is the Department of Revenue's fourth submission in response to that requirement.

OVERVIEW OF THE LITTER TAX

The litter tax was adopted in 1971 as part of the Model Litter Control and Recycling Act of 1971. The tax is imposed upon manufacturers, wholesalers, and retailers who sell any item from a list of 13 categories of products. The categories, as listed in RCW 82.19.020, are:

1. Food for human or pet consumption
2. Groceries
3. Cigarettes and tobacco products
4. Soft drinks and carbonated waters
5. Beer and other malt beverages
6. Wine
7. Newspapers and magazines
8. Household paper and paper products
9. Glass containers
10. Metal containers
11. Plastic or fiber containers made of synthetic material
12. Cleaning agents and toiletries
13. Nondrug drugstore sundry products

Taxpayers compute the amount of tax due by multiplying the gross proceeds of sales of the listed items by the tax rate of fifteen one-thousandths of one percent (0.00015). By comparison, this tax rate is only 3 percent of the typical B&O tax rate (0.484 percent for manufacturing/wholesaling), so the amount of tax liability for many firms is quite low.

The tax receipts are devoted to litter-related programs conducted by the Department of Ecology and other state agencies and for grants to local governments for similar programs (Waste Reduction, Recycling and Litter Control Account per RCW 70.93.180).

The Department of Revenue received many complaints from taxpayers regarding the difficulty of sorting through their inventory and sales data to determine which items are included in the list of 13 taxable products. Certain businesses were relieved of this task by an administrative rule adopted by the Department pursuant to authority granted in the litter tax statutes. The rule, WAC 458-20-243, allows grocery stores and drug stores to report and pay the litter tax measured by a percentage of total sales (95 and 50 percent, respectively).

TABLE 1 – LITTER TAX COMPLIANCE

Table 1 shows litter tax receipts for Calendar Years 1991–2003. It compares the actual amount of tax reported voluntarily by taxpayers to the amount obtained from Department enforcement activities. Department enforced liability is defined as tax collected through Department enforcement actions or the tax filed on a supplemental return to report the litter tax after the normal due date. Such liability results from assessments (usually in conjunction with a field audit), corrections to the taxpayer’s account (usually by an office audit), tax warrants, or supplemental returns.

Table 1
LITTER TAX COMPLIANCE
Tax Reported Voluntarily vs.
Tax Obtained via Enforcement

Estimates for Calendar Years 1991–2003
Dollars in Thousands

<u>Year</u>	<u>Total Tax</u>	<u>Tax Reported Voluntarily</u>		<u>Tax from Enforcement*</u>	
		<u>Amount</u>	<u>% of Total</u>	<u>Amount</u>	<u>% of Total</u>
1991	\$3,904.0	\$3,104.8	79.5%	\$799.2	20.5%
1992	3,884.9	3,215.4	82.8	669.5	17.2
1993	3,851.3	3,273.3	85.0	578.0	15.0
1994	4,017.9	3,304.5	82.2	713.4	17.8
1995	4,401.1	3,988.6	90.6	412.5	9.4
1996	4,298.6	3,539.0	82.3	759.6	17.7
1997	4,143.2	3,477.2	83.9	666.0	16.1
1998	4,873.1	4,309.9	88.4	563.2	11.6
1999	5,509.1	4,493.4	81.6	1,015.7	18.4
2000	5,730.3	5,598.3	97.7	132.0	2.3
2001	5,785.1	5,733.8	99.1	51.3	0.9
2002	5,422.4	5,383.3	99.3	39.1	0.7
2003	6,415.7	5,979.5	93.2	436.2	6.8

*Enforcement includes audit assessments, corrections to account adjustments, warrants, and supplemental returns (due to amnesty program in 1991).

For Calendar Year 1999, tax from enforcement exceeded \$1 million for the first time. Tax reported voluntarily also reached an all-time high of nearly \$4.5 million. Historically, enforcement activities have accounted for approximately 10 to 20 percent of total litter tax receipts. For 1999, enforcement provided 18.4 percent of total litter receipts. This increase in enforcement resulted from the education effort conducted by the Department's Taxpayer Account Administration Division during 1999.

For Calendar Years 2000 and 2001 total taxes continued to grow and reached \$5.7 million and \$5.8 million, respectively. The split between the amount of taxes collected voluntarily and through enforcement changed drastically. In 2000, taxes reported voluntarily accounted for \$5.6 million or 98 percent of the total \$5.73 million. Enforcement activities accounted for only \$132,000 or 2.3 percent of the total collected. In 2001, taxes collected voluntarily reached \$5.7 million or 99 percent of the total. This change in collection patterns can be attributed directly to the legislative change in reporting frequencies and the Department's education efforts in 1999.

These trends continued for total taxes collected in Calendar Years 2002 and 2003. Total taxes reached a new high of \$6.4 million in Calendar Year 2003. Taxes reported voluntarily accounted for \$5.98 million or 93.2 percent of the total \$6.42 million. Enforcement activities accounted for \$436,000 or 6.8 percent of the total collected.

TABLE 2 – LITTER TAX REPORTERS BY YEAR AND INDUSTRY

Table 2 contains a recent history of the number of taxpayers reporting litter tax liability. This table shows the wide range of industries that report the tax, as well as fluctuations in the number of firms that report from year to year. The total number of reporting taxpayers increased dramatically in Calendar Year 1999. The 20,927 taxpayers reporting litter tax in 1999 constituted a 56 percent increase. Much of this large increase can be attributed to a change in filing requirements adopted by the 1998 Legislature.

The Legislature changed the reporting frequency for litter tax so that it coincided with the taxpayer's reporting frequency for other state excise taxes. This change took effect on January 1, 1999. The 56 percent increase in the number of filers in 1999 indicates that this statutory change had an extremely positive effect on litter tax reporting. The number of taxpayers reporting litter tax has remained relatively constant at 19,329 for Calendar Year 2002 and at 19,220 for Calendar Year 2003.

Table 2
LITTER TAX REPORTERS BY YEAR AND INDUSTRY
Includes Voluntary and Involuntary Reporting

Calendar Years 1998-2003

SIC GROUP	INDUSTRY DESCRIPTION	1998	1999	2000	2001	2002	2003
1-14	Agricultural & Fishing	290	490	452	443	459	463
15-17	Construction	150	662	586	540	505	441
20	Food & Kindred Products	198	235	238	233	344	349
24,25	Lumber, Wood Products & Furniture	20	33	24	22	23	19
26	Paper & Allied Products	32	35	38	38	44	46
27	Printing & Publishing	229	330	282	257	252	253
28,29	Chemical & Petroleum Mfg.	10	17	16	16	27	24
31,32	Leather, Stone Products	2	10	6	7	8	4
33,34	Primary & Fabricated Metals	7	16	17	17	21	15
35,36	Industrial & Electrical Machinery	12	24	19	21	13	10
37	Transportation Equipment	9	27	20	19	21	23
39	Misc. Manufacturing Industries	10	20	18	22	15	20
41-47	Transportation	54	85	75	79	76	78
49	Electric, Gas, & Sanitary Services	7	24	23	24	9	7
50	Wholesale Trade Durable Goods	166	332	251	235	233	220
51	Wholesale Trade Nondurable Goods	1,417	1,738	1,660	1,655	1,581	1,598
52	Building Materials & Garden Supplies	139	200	190	180	167	156
53	General Merchandise Stores	153	190	147	141	127	122
54	Food Stores	2,503	3,219	2,870	2,922	2,934	3,037
55	Automotive Dealers & Service Stations	660	911	1,131	1,082	1,027	934
56	Apparel & Accessory Stores	40	86	86	84	77	81
57	Furniture & Home Furnishings Stores	72	191	168	147	141	120
58	Eating & Drinking Places	4,646	7,521	7,162	7,125	7,316	7,434
59	Miscellaneous Retail	1,314	2,128	2,070	2,104	1,973	1,908
60-67	Finance, Insurance & Real Estate	38	81	77	78	62	66
70	Hotels & Other Lodging Places	107	175	149	162	153	157
72	Personal Services	364	518	453	450	406	400
73	Business Services	220	479	394	398	323	308
75	Auto Repair, Services & Parking	81	258	230	197	188	166
76	Miscellaneous Repair Services	39	138	113	101	96	83
78	Motion Pictures	54	80	66	67	77	72
79	Amusement & Recreation Services	153	258	232	234	246	239
80	Health Services	44	79	78	90	85	75
82	Educational Services	12	26	21	18	21	20
83	Social Services	5	18	25	22	25	13
86	Membership Organizations	68	120	108	100	96	93
87	Engineering & Management Services	41	80	93	75	72	72
89	Services, Not Elsewhere Classified	3	13	12	10	17	14
99	Other and Not Classified	21	80	61	52	69	80
Total Reporters		13,395	20,927	19,661	19,467	19,329	19,220

TABLE 3 – LITTER TAX LIABILITY BY INDUSTRY

Table 3 gives detailed industry information on litter tax reporters for Calendar Year 2003. It provides a count of litter taxpayers and compares reported litter tax activity by industry groups.

While the majority of litter tax liability is concentrated in a small number of industries, most industries have some activity subject to litter tax. Eating and drinking firms represent the industry with the most litter taxpayers, followed by grocery stores, miscellaneous retail firms, and wholesalers of nondurable goods. Wholesalers of nondurable goods, grocery stores, eating and drinking establishments, and food processing firms paid over 70 percent of the tax.

The average annual litter tax liability for all firms is approximately \$334 per firm. Many firms owe tax based on their selling activities, but the amount of tax owed tends to be small. Only six industries had an average litter tax liability per firm of more than \$1,000. The industry with the highest average litter tax liability per firm was primary and fabricated metals. Nineteen of the 40 industries in Table 3 had an average annual tax of less than \$100.

Table 3
LITTER TAX LIABILITY BY INDUSTRY
Calendar Year 2003

SIC GROUP	INDUSTRY DESCRIPTION	NO. OF LITTER TAX TAXPAYERS	LITTER TAX LIABILITY	AVERAGE
1-14	Agricultural & Fishing	463	\$39,402	\$85
15-17	Construction	441	6,369	14
20	Food & Kindred Products	349	469,117	1,344
24,25	Lumber, Wood Products & Furniture	19	3,125	164
26	Paper & Allied Products	46	121,440	2,640
27	Printing & Publishing	253	127,602	504
28,29	Chemical & Petroleum Mfg.	24	11,727	489
31,32	Leather, Stone Products	4	3,512	878
33,34	Primary & Fabricated Metals	15	104,612	6,974
35,36	Industrial & Electrical Machinery	10	12,493	1,249
37	Transportation Equipment	23	200	9
39	Misc. Manufacturing Industries	20	1,808	90
41-47	Transportation	78	5,021	64
49	Electric, Gas, & Sanitary Services	7	544	78
50	Wholesale Trade Durable Goods	220	84,911	386
51	Wholesale Trade Nondurable Goods	1,598	2,221,449	1,390
52	Building Materials & Garden Supplies	156	17,276	111
53	General Merchandise Stores	122	547,101	4,484
54	Food Stores	3,037	1,503,631	495
55	Automotive Dealers & Service Stations	934	108,743	116
56	Apparel & Accessory Stores	81	11,977	148
57	Furniture & Home Furnishings Stores	120	8,282	69
58	Eating & Drinking Places	7,434	468,891	63
59	Miscellaneous Retail	1,908	401,000	210
60-67	Finance, Insurance & Real Estate	66	7,993	121
70	Hotels & Other Lodging Places	157	7,404	47
72	Personal Services	400	17,762	44
73	Business Services	308	58,438	190
75	Auto Repair, Services & Parking	166	4,890	29
76	Miscellaneous Repair Services	83	1,186	14
78	Motion Pictures	72	1,044	15
79	Amusement & Recreation Services	239	8,228	34
80	Health Services	75	5,631	75
82	Educational Services	20	2,400	120
83	Social Services	13	843	65
86	Membership Organizations	93	2,355	25
87	Engineering & Management Services	72	6,472	90
89	Services, Not Elsewhere Classified	14	137	10
99	Other and Not Classified	87	10,973	181
	Total Reporters	19,220	\$6,415,655	\$334

TABLES 4, 5, AND 6 – ESTIMATED LITTER TAX NONCOMPLIANCE

During the 1990s the Department of Revenue developed a methodology for measuring excise tax noncompliance among registered taxpayers. A representative sample of accounts stratified by size and industry was selected annually. Estimates of overall noncompliance were derived from the results of audits of the sample accounts.

The estimate of litter tax noncompliance reported here is based on the same sampling methodology. Audit results for the annual stratified random sample drawn in 2003 were analyzed and statistically projected to Calendar Year 2003. The results analyzed included audits by Taxpayer Account Administration as well as the Audit Division. As litter tax is concentrated in a few major industry sectors, only four industry categories were used. The resulting estimates are reported in Table 4.

Table 4
ESTIMATED NONCOMPLIANCE BY MAJOR INDUSTRY SECTOR
Projected to Calendar Year 2003

<u>Major Industry Sector</u>	<u>Noncompliance Found Through Enforcement</u>	<u>Estimated Undetected Noncompliance</u>	<u>Total Estimated Noncompliance</u>
Manufacturing	\$ 105,352	\$ 19,977	\$ 125,329
Wholesale	\$ 265,926	\$ (7,698)	\$ 258,228
Retail	\$ 56,565	\$ 206,311	\$ 262,876
All Other	\$ 8,323	\$ (81,234)	\$ (72,911)
Total	\$ 436,166	\$ 137,356	\$ 573,522

Enforcement activities found \$436,166 in unreported litter tax for Calendar Year 2003. The amount of undetected litter tax liability was estimated at \$137,356. Estimates of both undetected and total noncompliance were highest for the retail sector.

Several considerations need to be stressed when interpreting these results:

- ◆ These estimates are statistical projections of what could be found if an audit was performed on every single firm currently registered and reporting excise tax to the Department of Revenue. For 2003, that encompassed more than 280,000 firms.
- ◆ The noncompliance estimates are based on multi-year audits performed over a period of several years. The results are based on annualized numbers projected to 2003.



Table 5
TOTAL VOLUNTARY REPORTING AND NONCOMPLIANCE
Projected to Calendar Year 2003

	<u>Amount</u>	<u>% of Total</u>
Noncompliance Found Through Enforcement	\$ 436,166	6.7%
Estimated Undetected Noncompliance	<u>\$ 137,356</u>	<u>2.1%</u>
	\$ 573,522	8.8%
Tax Reported Voluntarily	<u>\$5,979,489</u>	<u>91.2%</u>
Total Estimated Liability	\$6,553,011	100.0%

As Table 5 indicates, litter tax noncompliance is estimated to be about \$573,522. This represents 8.8 percent of total liability among registered taxpayers. Taxes reported voluntarily totaled \$5,979,489 or 91.2 percent of the total estimated liability.

Table 6
TOTAL VOLUNTARY REPORTING AND NONCOMPLIANCE
2001-2005 Litter Tax Studies

	<u>2001 Litter Tax Study</u>	<u>2003 Litter Tax Study</u>	<u>2005 Litter Tax Study</u>
Noncompliance Found Through Enforcement	13.5%	0.8%	6.7%
Estimated Undetected Noncompliance	<u>26.5%</u>	<u>2.2%</u>	<u>2.1%</u>
	40.0%	3.0%	8.8%
Total Reported Voluntarily	<u>60.0%</u>	<u>97.0%</u>	<u>91.2%</u>
Total Estimated Liability	100.0%	100.0%	100.0%

This is in contrast to the 2001 Litter Tax Study which found the noncompliance level to be about 40 percent of total liability among registered taxpayers. As Table 6 shows, the 2003 Litter Tax Study estimated noncompliance at 3 percent.

This growth in noncompliance from 3 percent in the 2003 Litter Tax study to 9 percent in 2005 can be explained by investigating the \$436,166 in taxes collected through enforcement in Calendar Year 2003. The major component of the Department's enforcement activities is audit assessments. In 2003, there were eight audit assessments that totaled almost \$298,000. These audits covered periods before 1999. It was in 1999 that taxpayers were required to report litter

tax on their excise tax returns and the Department started an intense education effort on litter taxpayers.

Removing this \$298,000 in audit assessments would lower the total from \$436,166 to \$138,166. This would lower the percent of total estimated liability collected through enforcement from 6.7 percent to 2.1 percent. Litter tax noncompliance would then total only 4.2 percent. This is much more in line with the level of compliance (3 percent) found in the 2003 Litter Tax Study.

CONCLUSION

The estimate of litter tax noncompliance has declined from about 40 percent before statutory change and taxpayer education to 4 percent as measured in this study. Overall, noncompliance for all other excise taxes reported on the excise tax return averages almost 3 percent. The Department concludes its objective has been met, and the litter tax is within normal levels of noncompliance for excise taxes.