AGENDA

Tax Structure Work Group Meeting – December 13, 2022, 9:00 a.m. – 12:00 p.m.

Virtual meeting via Zoom Webinar

1. **Work Group Members and Presenters**:
   - Only **WORK GROUP MEMBERS** and **PRESENTERS** will be able to enter the event as panelists. All others must enter the event as attendees.
   - Work group members and presenters will be able to enter the Webinar starting at 8:30 a.m.
   - **Panelists via Web:** https://us06web.zoom.us/j/86854270900
   - **Webinar ID:** 868 5427 0900

2. **Meeting Attendees:**
   - **Attendees via Web:** https://us06web.zoom.us/j/86854270900
   - **Webinar ID:** 868 5427 0900

3. **To join by audio or if there are technical computer issues**:
   - Attendees or Panelists via Phone: Dial (253) 215-8782, then enter: 868 5427 0900#

4. **Experiencing Technical Problems?** If you experience technical difficulties on the day of the Zoom Webinar, please contact Pauline Mogilevsky at pmogilevsky@triangleassociates.com or (206) 981-2217.

5. **Other Notes about Zoom Webinar Meeting:** *We encourage you to enter the Zoom Webinar room* ***at least 15 minutes prior to the start of the meeting*** *so we can address any technical issues.* ***To make sure you can connect to the webinar****, please test your system and connections online ASAP at: https://zoom.us/test*

6. Tax Structure Work Group Web Page: https://taxworkgroup.org/

7. TVW Recording: The meeting is being recorded and streamed live on TVW: https://www.tvw.org/schedule-main/ and can be viewed at a later time.

How can you participate?

We have allotted a limited amount of time at the end of the agenda for public comment. If you would like to provide a public comment, please send us your name and organization via the email: info@taxworkgroup.org

	Tax Structure Work Group Members
☐	Representative Noel Frame, Co-Chair
☐	Senator Keith Wagoner, Co-Chair
☐	Senator Joe Nguyen
☐	Senator Lisa Wellman
☐	Senator Phil Fortunato
☐	Representative Ed Orcutt
☐	Representative Amy Walen
☐	Representative Jesse Young
☐	Derek Young, Councilmember, Pierce County
☐	Scott Merriman, Legislative Liaison, Office of Financial Management
☐	Dean Carlson, Senior Tax Policy Coordinator, Department of Revenue
☐	Anne McEnerny-Ogle, Mayor, City of Vancouver

No	Agenda Item	Time	Lead	Meeting Instructions
Pre	Optional Technology Practice Session	8:30 – 9 a.m. (30 minutes)	Sophie Glass, Triangle Associates	• TSWG members and presenters are encouraged to sign on as early as 8:30 a.m. to make sure they can join the Zoom Webinar, test audio and video, etc. • TSWG members can drop in to ensure they are comfortable with Mentimeter polling technology.
1	Introductions and Meeting Overview	9:00 – 9:15 a.m. (15 minutes)	Rep. Frame and Sen. Wagoner Facilitator Sophie Glass, Triangle Associates	• Co-Chairs to call the meeting to order. • Facilitator conducts a roll call of work group members. (Please unmute when your name is called to acknowledge you are on the line and then re-mute yourself.) • Overview of technical ground rules. • Overview of meeting agenda. • Any member of the public who wants to provide public comment should email info@taxworkgroup.org your name and organization by 10 a.m. The public may also send any questions or comments regarding any of the topics covered during today's meeting to the above email. • Overview of meeting purpose and timeline.
2	Community Engagement Update	9:15 – 9:20 a.m. (5 minutes)	Facilitator Sophie Glass	• Consultant team briefly reviews public comments received.

No	Agenda Item	Time	Lead	Meeting Instructions
3	Margin Tax	9:20 – 10:00 a.m. (40 minutes)	Morgan Shook, ECONorthwest Kathy Oline, DOR	• DOR provides details and remaining specifications about the margin tax proposal.
4	Property Tax Limit Factor	10:00 – 10:25 a.m. (25 minutes)	Morgan Shook, ECONorthwest Kathy Oline, DOR	• DOR provides details and remaining specifications about the property tax limit factor.
5	Break	10:25 – 10:35 a.m. (10 minutes)		
6	Polling and Voting	10:35 – 11:10 a.m. (35 minutes)	Facilitator Sophie Glass	• TSWG members poll and vote on final policy recommendations to the full legislature.
7	2023 TSWG Efforts	11:10 – 11:25 a.m. (15 minutes)	Facilitator Sophie Glass	• TSWG members discuss approach for 2023 efforts. • TSWG members discuss 2023 membership.
8	Public Comment / Testimony	11:25 – 11:50 a.m. (25 minutes)	Attendees Facilitator Sophie Glass	• Any member of the public who wants to provide public comment should email info@taxworkgroup.org with your name and organization by 10 a.m. • Commenters will have up to three minutes to provide comments and may only be extended at the discretion of the Co-Chairs.
9	Wrap Up and Summary of Action Items	11:50 a.m. – 12:00 p.m. (10 minutes)	Rep. Frame and Sen. Wagoner Facilitator Sophie Glass	• Co-Chairs provide closing remarks. • Summary of action items and next steps.

Current Law

Washington levies its primary business tax, the business and occupation (B&O) tax, on gross income from Washington-based business activity.

A business must report B&O tax if the business meets any of the following thresholds in the current or prior calendar year:
- Has more than $100,000 in combined gross receipts sourced or attributed to Washington.
- Has physical presence nexus in Washington.
- Is organized or commercially domiciled in Washington.

Each legal entity must register and report taxes separately for affiliated entities.

For B&O tax purposes, businesses engaging in apportionable activities may apportion their income to determine the amount subject to B&O tax. The formula for apportionment is Washington gross apportionable receipts divided by worldwide gross apportionable receipts for the taxing period.

The B&O tax includes a flat rate structure with different rates by activity. There are several surcharges on certain industries and activities, including the Workforce Education Surcharge. The B&O tax also includes approximately 200 tax preferences in the form of credits, deductions, exclusions, exemptions, and preferential rates.

While most businesses with activity in Washington are subject to the B&O tax, some businesses are instead subject to the public utility tax. The public utility tax is a tax on public service businesses, including businesses that engage in transportation and the supply of energy, natural gas, and water. This tax is in lieu of the B&O tax, meaning that businesses would pay one or the other but not both taxes on the same activity.

Proposal

This proposal replaces Washington's B&O tax with a margin tax modeled after Texas's franchise tax. A margin tax is often considered a modified gross receipts tax.

Under this margin tax proposal, businesses are taxed on their margin, which is calculated as gross income minus the greater of four deductions:
- Cost of goods sold,
- Compensation paid,
- A fixed percentage of gross receipts (e.g., 30%), or
- A flat amount (e.g., $1 million).

Unlike Texas's franchise tax, for this margin tax proposal the compensation and cost of goods sold deductions are based on federal reporting.

After the deduction amount is subtracted, a single-factor sales apportionment method is used to determine the amount of the business's worldwide margin that is attributable to Washington. For combined groups, each member of the group is included for purposes of attributing Washington income, if any member of the combined group has nexus in Washington. This is referred to as the Finnigan apportionment method. The amount attributable to Washington is multiplied by a flat revenue neutral rate to determine the tax due.

Under this proposal, the margin tax is imposed on the same entities that are subject to B&O tax, including corporations, partnerships, limited liability companies, sole proprietorships, and nonprofits. Activities subject to public utility tax under current law remain subject to public utility tax and are excluded from the margin tax. This proposal maintains Washington’s surcharges which are imposed on certain industries and activities. It also maintains Washington’s current registration and nexus thresholds.

Washington’s definition of gross income is unchanged. Most of Texas’s exclusions from total revenue are not qualified exclusions from gross income under this proposal, with the exception of bad debts and cash and trade discounts.

This margin tax proposal also:
- Changes the filing frequency for all entities to an annual return due April 15th.
- Requires entities with gross income over $500,000 to file an annual return.
- Requires quarterly estimated payments.
- Requires combined reporting for corporations required to file consolidated federal returns.
- Eliminates all preferential rates.
- Eliminates all deductions, exclusions, and exemptions except those that are necessary for legal compliance or practical administration.
- Allows businesses to carryover earned but unused B&O tax credits to be credited from margin tax due for a limited amount of time.
- Compensates retailers by creating a retail sales tax credit.

Effective Date

The B&O tax is eliminated starting January 1, 2027, and the margin tax begins for gross income earned in 2027. The first quarterly estimated payments are due in April 2027, with the annual tax return for 2027 due April 15, 2028.

Revenue Estimate

The table below shows the net revenue impact if we assume a margin tax rate of 2.9449% with revenue neutrality for the 2029-31 Biennium.

Shifting the revenue neutral biennium out allows for a lower overall rate, as we are assuming higher reporting compliance over time. We would expect to see revenue impacts similar to what is shown for Fiscal Year 2031 in the out years.

Fund - Source	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030	FY 2031
GF-State - NEW	0	1,585,300,000	6,733,600,000	7,645,400,000	7,915,800,000	8,289,600,000
GF-State - Retail Sales Tax	0	(17,400,000)	(43,300,000)	(45,000,000)	(46,800,000)	(48,600,000)
GF-State - Business and Occupation Tax	0	(2,853,000,000)	(7,181,200,000)	(7,514,500,000)	(7,869,700,000)	(8,240,000,000)
Fiscal Year Total	0	(1,285,100,000)	(490,900,000)	85,900,000	(700,000)	1,000,000
Biennial Total		(1,285,100,000)		(405,000,000)		300,000

Revenue Assumptions

- The margin tax revenue neutral tax rate for the 2030-31 Biennium is 2.9449%. This rate applies to all businesses paying the margin tax.
- Taxpayer affiliated groups that file a consolidated federal income tax return will file a combined margin tax return.
- Nexus applies to a combined group if one or more companies within the group have substantial nexus in Washington (RCW 82.04.067).
- Taxpayers (or taxpayer groups) first determine their total worldwide income before deductions.
- Businesses then choose the largest available deduction from:
  - Cost of goods sold,
  - Compensation paid,
  - 30% of gross income, or
  - $1 million.
- Compensation is capped at $400,000 per person (individual).
- After subtracting the chosen deduction from total worldwide income, the business apportions the portion of worldwide margin attributable to Washington.
- The percentage of a business's worldwide taxable margin apportioned to Washington under the margin tax equals the percentage of the business's worldwide taxable gross receipts apportioned to Washington under the B&O tax.
- Taxpayers with a negative margin in a given fiscal year have no tax liability for that fiscal year. These taxpayers are not able to accrue a deduction or credit against the tax for future years.
- The growth of income and deduction line items follows the growth of before-tax corporate profit forecasts from the Bureau of Labor Statistics (BLS) with an

adjustment to account for the higher forecast of Washington employment vs. U.S. employment.
- Because of this significant change in Washington's business tax, a compliance factor of 90% is applied to the first year of collections and 95% for each subsequent year.
- Earned but unused B&O tax credits that have a carry-over provision under B&O law are allowed as a credit against the margin tax due for a limited amount of time.
- Retailers are compensated through a retail sales tax credit.
- Taxpayers with a margin tax liability more than $20,000 are required to make quarterly estimated payments. Other than the first year, estimated payments will be based on the taxpayer's prior year margin tax due. Taxpayers with a liability $20,000 or less pay tax annually when they file a return.

Data Sources

- Economic and Revenue Forecast Council: November 2022 forecast
- Internal Revenue Service (IRS): Form 1120, Form 1120S, and Form 1065 returns
- IRS: W2 wage data
- Washington State Department of Revenue: Excise tax data
- Bureau of Economic Analysis (BEA): Before-tax corporate profits with IVA and capital consumption
- Economic Revenue forecast Council: nonfarm payroll employment, Washington

Local Government Impact

None

Expenditure Estimates

The estimate of the Department's implementation and administration costs are in process and will be finalized once we have a final proposal and bill language.

Note

Please note that our review, comments, and any estimates provided are not intended to reflect a policy position by the Department and are solely to assist you in exploring options under development.

Further Information

KATHY OLINE
Research and Fiscal Analysis Division
(360) 534-1534

Tax Structure Work Group

Update the Property Tax Limit Factor for Changes in Population and Inflation Local Levies Only @ 3% Maximum

Current Law

Current law annually limits taxing districts property tax levy increases to the levy growth limit, often referred to as the “101% levy limit” or the “1% growth limit,” plus any increase in levy capacity for the following add-ons:
- New construction.
- Construction of wind turbine, solar, biomass, and geothermal facilities.
- Improvements to property.
- Increased value of state-assessed property.
- Increases in real property value within a local tax increment finance area designated by a local government.

Current law also defines:
- Inflation as the percentage change in the implicit price deflator (IPD) for personal consumption expenditures for the United States as published for the most recent 12-month period by the Bureau of Economic Analysis of the Federal Department of Commerce by September 25th of the year before the taxes are payable.
- The limit factor:
  - For taxing districts with a population of less than 10,000 as 101%.
  - For all other districts as the lesser of 101% or 101% plus inflation. If the IPD is less than 1% then taxing districts who adopt a substantial need resolution can have a limit factor up to 101%.

Proposal

Except for the state property tax levies, this proposal revises the 101% levy limit for all local taxing districts’ regular property tax levies, as follows:
- Revises the definition of “inflation” to mean the annual percentage increase in the consumer price index for all urban consumers (CPI-U) in the western region for all items as provided for the most recent 12-month period by the Bureau of Labor Statistics of the United Stated Department of Labor by July 25 of the year before the year the taxes are payable.
- Revises the definition of “limit factor” to mean 100% plus population change and inflation, but not to exceed 103%.
- Defines “population change” to mean the annual percent increase in the population of a taxing district between the two most recent years as provided in the official population estimates published by the Office of Financial Management for April 1 of the year before the taxes are payable. It also provides the following:
  - If a taxing district’s population decreases, the population change in zero.
  - Allows for population change for districts in more than one county or city.
  - Excludes changes in population resulting from an annexation by a city.
  - Repeals existing substantial need resolution requirements.
  - Requires local taxing districts to include the district population change as part of the district’s annual budget resolution to their county legislative authority, or the county assessor if required.
  - Requires county assessors to calculate the levy limit calculations, except for the state school levies and intercounty rural library levies.

Effective Date	This proposal takes effect beginning with property taxes due for Calendar Year 2024.
Revenue Assumptions	- The limit factor for the state levies remains unchanged. - Taxing districts taking less than the current 1% limit will not utilize the increased limit factor. - No prorationing occurs under the $5.90 aggregate limit due to the increase in the limit factor. - No prorationing occurs under the $10 constitutional aggregate limit due to the increase in the limit factor. - The calculation of population growth will not include growth due to annexation. - Based on five years of state property tax collections, 52.36% of property tax collections occur in April and 47.64% occur in October. When converting from calendar year to fiscal year, this estimate assumes revenue gains and losses follow this trend. - The Economic and Revenue Forecast Council predicts the state property tax levy remains below the $3.60 limit throughout the 2025-27 Biennium. PROPERTY TAX SHIFTS: This legislation results in no state or local property tax levy shifts.
Data Sources	- Economic and Revenue Forecast Council, November 2022 forecast - Office of Financial Management, April 1, 2022, Population Estimates - Office of Financial Management, State Population Forecast - Department of Revenue, State Property Tax Model - Department of Revenue, State Levy Calculations for Property Taxes Due in 2023 - County assessor data
Local Government Impact	Local Government, if applicable (cash basis, $000): FY 2024 - $ 60,800 FY 2025 - $ 181,300 FY 2026 - $ 309,800 FY 2027 - $ 444,300 FY 2028 - $ 584,900 FY 2029 - $ 734,800

Calendar Year Detail

DETAIL OF REVENUE IMPACT FOR PROPERTY TAX BILLS, Calendar Year Basis

State Government, Impact on Revenues ($000): None

State Government, ($000), Shift of Tax Burden: None.

Local Government, Impact on Revenues ($000)
CY 2024 - $ 116,200
CY 2025 - $ 240,600
CY 2026 - $ 372,800
CY 2027 - $ 509,400
CY 2028 - $ 653,600
CY 2029 - $ 808,700

Local Government, ($000), Shift of Tax Burden: None.

Expenditure Estimate

The table shows the FTE staff years and expenditures for this proposal:

FTE	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
FTE Count	0.63	1	1	1	1	1
Biennial FTE		0.82		1		1
Fund						
GF-State 001	76,800	118,600	114,400	114,400	114,400	114,400
Fiscal Total	76,800	118,600	114,400	114,400	114,400	114,400
Biennial Total		195,400		228,800		228,800

First Year Costs

The Department will incur total costs of $76,800 in Fiscal Year 2024. These costs include:

Labor Costs - Time and effort equate to 0.6 FTE.
- Assist in rulemaking process.
- Provide technical advice, guidance, training, and assist in auditing all regular levy limit factors used by county assessors to calculate levies.

Second Year Costs

The Department will incur total costs of $118,600 in Fiscal Year 2025. These costs include:

Labor Costs - Time and effort equate to 1 FTE.
- Provide technical advice, guidance, training, and assist in auditing all regular levy limit factors used by county assessors to calculate levies.

Ongoing Costs

Ongoing costs are $228,800 per biennia and include similar activities described in the second-year costs. Time and effort equate to 1 FTE per year.

Rules

Should this legislation become law, the Department will use the expedited process to amend WAC 458-19-005, titled: "Definitions," WAC 458-19-020, titled: "Levy limit - Method of Calculation," WAC 458-19-030, titled: "Levy limit - Consolidation of districts," and WAC 458-19-035, titled: "Levy limit - Annexation."

Persons affected by this rulemaking would include property owners and county assessors.

Exp Detail

Expenditures by Object or Purpose:

Expense Objects	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Salaries and Wages	46,200	73,300	73,300	73,300	73,300	73,300
Benefits	15,300	24,200	24,200	24,200	24,200	24,200
Supplies & Material	9,500	13,000	10,800	10,800	10,800	10,800
Travel	1,500	3,000	3,000	3,000	3,000	3,000
Office Equipment	4,300	5,100	3,100	3,100	3,100	3,100
Fiscal Year Total	76,800	118,600	114,400	114,400	114,400	114,400
Biennial Total		195,400		228,800		228,800

Exp Detail

FTE Detail:

Job Classes	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
EMS BAND 4	0.01	0	0	0	0	0
MGMT ANALYST4	0.02	0	0	0	0	0
PROPERTY AND ACQUISITION SP 5	0.5	1	1	1	1	1

TAX POLICY SP 2	0.01	0	0	0	0	0
TAX POLICY SP 3	0.06	0	0	0	0	0
TAX POLICY SP 4	0.02	0	0	0	0	0
WMS BAND 3	0.01	0	0	0	0	0
Fiscal Year Total	0.63	1	1	1	1	1
Biennial Total		0.82		1		1

Note

Please note that our review, comments, and any estimates provided are not intended to reflect a policy position by the Department and are solely to assist you in exploring options under development.

Further Information

KATHY OLINE
Research and Fiscal Analysis Division
(360) 534-1534

Tax Structure Work Group

Update the Property Tax Limit Factor for Changes in Population and Inflation Locals Levies Only @ 5% Maximum

Current Law

Current law annually limits taxing districts property tax levy increases to the levy growth limit, often referred to as the "101% levy limit" or the "1% growth limit," plus any increase in levy capacity for the following add-ons:

- New construction.
- Construction of wind turbine, solar, biomass, and geothermal facilities.
- Improvements to property.
- Increased value of state-assessed property.
- Increases in real property value within a local tax increment finance area designated by a local government.

Current law also defines:

- Inflation as the percentage change in the implicit price deflator (IPD) for personal consumption expenditures for the United States as published for the most recent 12-month period by the Bureau of Economic Analysis of the Federal Department of Commerce by September 25th of the year before the taxes are payable.
- The limit factor:
  - For taxing districts with a population of less than 10,000 as 101%.
  - For all other districts as the lesser of 101% or 101% plus inflation. If the IPD is less than 1% then taxing districts who adopt a substantial need resolution can have a limit factor up to 101%.

Proposal

Except for the state property tax levies, this proposal revises the 101% levy limit for all local taxing districts' regular property tax levies, as follows:

- Revises the definition of "inflation" to mean the annual percentage increase in the consumer price index for all urban consumers (CPI-U) in the western region for all items as provided for the most recent 12-month period by the Bureau of Labor Statistics of the United Stated Department of Labor by July 25 of the year before the year the taxes are payable.
- Revises the definition of "limit factor" to mean 100% plus population change and inflation, but not to exceed 105%.
- Defines "population change" to mean the annual percent increase in the population of a taxing district between the two most recent years as provided in the official population estimates published by the Office of Financial Management for April 1 of the year before the taxes are payable. It also provides the following:
  - If a taxing district's population decreases, the population change in zero.
  - Allows for population change for districts in more than one county or city.
  - Excludes changes in population resulting from an annexation by a city.
  - Repeals existing substantial need resolution requirements.
  - Requires local taxing districts to include the district population change as part of the district's annual budget resolution to their county legislative authority, or the county assessor if required.
  - Requires county assessors to calculate the levy limit calculations, except for the state school levies and intercounty rural library levies.

Effective Date	This proposal takes effect beginning with property taxes due for Calendar Year 2024.

Revenue Assumptions

- The limit factor for the state levies remains unchanged.
- Taxing districts taking less than the current 1% limit will not utilize the increased limit factor.
- No prorationing occurs under the $5.90 aggregate limit due to the increase in the limit factor.
- No prorationing occurs under the $10 constitutional aggregate limit due to the increase in the limit factor.
- The calculation of population growth will not include growth due to annexation.
- Based on five years of state property tax collections, 52.36% of property tax collections occur in April and 47.64% occur in October. When converting from calendar year to fiscal year, this estimate assumes revenue gains and losses follow this trend.
- The Economic and Revenue Forecast Council predicts the state property tax levy remains below the $3.60 limit throughout the 2025-27 Biennium.

PROPERTY TAX SHIFTS:
This legislation results in no state or local property tax levy shifts.

Data Sources

- Economic and Revenue Forecast Council, November 2022 forecast
- Office of Financial Management, April 1, 2022, Population Estimates
- Office of Financial Management, State Population Forecast
- Department of Revenue, State Property Tax Model
- Department of Revenue, State Levy Calculations for Property Taxes Due in 2023
- County assessor data

Local Government Impact

Local Government, if applicable (cash basis, $000):

FY 2024 -	$ 121,600
FY 2025 -	$ 364,700
FY 2026 -	$ 586,500
FY 2027 -	$ 769,600
FY 2028 -	$ 945,900
FY 2029 -	$ 1,134,700

Calendar Year Detail

DETAIL OF REVENUE IMPACT FOR PROPERTY TAX BILLS, Calendar Year Basis

State Government, Impact on Revenues ($000): None

State Government, ($000), Shift of Tax Burden: None.

Local Government, Impact on Revenues ($000)

CY 2024 -	$ 232,200
CY 2025 -	$ 485,200
CY 2026 -	$ 678,600
CY 2027 -	$ 852,400
CY 2028 -	$ 1,031,000
CY 2029 -	$ 1,229,000

Local Government, ($000), Shift of Tax Burden: None.

Note

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Further Information

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