

Washington State Tax Structure Study

Summaries of Adjustment Alternatives

Administrative and Policy Adjustments

These alternatives were developed by the Department of Revenue at the request of the Washington State Tax Structure Study Committee. These alternatives describe adjustments to the existing tax system to align the tax system with administrative and policy simplification goals.

User Fees and Dedicated Taxes

1. Eliminate dedicated product-based taxes.

Description: Under this alternative, certain taxes imposed on specific products and dedicated to specific purposes would be eliminated. These taxes include the hazardous substance tax, the carbonated beverage tax, and the oil spill tax. The revenue loss would be replaced by a surtax on a mainstream tax, such as the business and occupation tax or the sales tax. This proposal does not include doing away with the so-called “sin” taxes on alcohol and tobacco.

Proposed tax base: The surtax would apply to the B&O tax or retail sales tax.

Proposed tax rate: Tax rate to be determined by the amount of revenue needed to replace the dedicated taxes.

Estimated Collections: Revenue neutral

Advantages:

- Noncompliance rates for dedicated taxes are high. Compliance will increase with a surtax on mainstream taxes.
- This proposal will result in fewer legal challenges.
- A mainstream surtax is less complex and reduces the administrative burden on taxpayers and the Department.
- This is a broad-based tax.

Disadvantages:

- Taxes would no longer adhere to the "polluter pays" principle.

Principles Most Advanced:

- Stability
- Long Term Adequacy
- Simplicity

Principles Most Eroded:

Washington State Tax Structure Study

2. Reduce number of B&O rates and classifications

Description: This alternative calls for simplifying the current business and occupation tax structure by eliminating all classifications except for (a) one classification and tax rate for selling activities, including both retailing and wholesaling; (b) another classification and tax rate for manufacturing and extracting activities; and, (c) a third classification and tax rate for services and all other activities. Each classification would have its own rate.

Proposed tax base: The B&O tax base would remain the same.

Proposed tax rate: Tax rate to be determined (some taxpayers would pay a higher rate, some would pay less).

Estimated Collections: This option can be revenue neutral depending on the rates determined.

Advantages:

- This will result in fewer disagreements about which business activities fall under which classifications and tax rates.
- More flexible rate and classification structure. As new technology and new business activities develop, the structure does not have to be revised further to accommodate.

Disadvantages:

- There may be competitive reasons for lower tax rates and multiple classifications that would be affected.

Principles Most Advanced:

- Simplicity

Principles Most Eroded:

- Competitiveness

Washington State Tax Structure Study

3. Reform B&O apportionment

Description: Currently, only income subject to tax under the service and other activities classification may be apportioned. This alternative calls for allowing apportionment of income for all business and occupation tax classifications. The apportionment would be accomplished by formula.

Proposed tax base: The B&O tax base would remain the same.

Proposed tax rate: The B&O tax rates would remain the same.

Estimated Collections: TBD

Advantages:

- All businesses with business activity in Washington would be treated fairly (includes both in state and out-of-state businesses).
- This would result in less litigation on apportionment issues for both taxpayers and the Department.
- Most other states apportion business taxes.
- Attributes value fairly to Washington and other states.

Disadvantages:

- May be a fiscal loss.
- Some businesses may end up paying more tax.

Principles Most Advanced:

- Competitiveness
- Harmony with other states
- Neutrality

Principles Most Eroded:

- Long term adequacy

Washington State Tax Structure Study

4. Eliminate the Public Utility Tax and tax activities under the B&O tax

Description: Under this alternative, the public utility tax (chapter 82.16 RCW) would be eliminated and all businesses currently paying public utility tax would pay business and occupation tax.

Proposed tax base: The tax base will expand because the gross income of all public service businesses will be subject to tax because of the pyramiding nature of the B&O tax.

Proposed tax rate: The tax rate will depend on the rates and classifications determined by the legislature.

Estimated Collections: TBD

Advantages:

- Consolidates the current two different “privilege of doing business” tax systems into a single tax system.
- The original reason for the PUT is no longer relevant (most utilities and utility tax rates are no longer regulated).

Disadvantages:

- May initially be confusing for former PUT taxpayers because of different reporting responsibilities under the B&O tax.
- May be perceived as unfair because of the pyramiding nature of the B&O tax.

Principles Most Advanced:

- Simplicity (long term)

Principles Most Eroded:

Washington State Tax Structure Study

5. *Remove sales tax from construction contracts*

Description:

Under the present law, construction contractors collect sales tax on construction services. The tax applies to the total contract price, including labor and materials. These contractors and their subcontractors do not now pay sales or use tax for their purchases of either construction materials or labor and services rendered in respect to the construction.

This alternative provides that contractors would not collect sales tax from their customers on the construction services. Instead, contractors and subcontractors would pay sales or use tax on materials that they incorporate into the construction project. Labor and services rendered in respect to constructing would not be subject to sales tax. This alternative would tax commercial, residential and state public road construction the same way federal construction and other public road construction is currently taxed.

Proposed tax base: Construction activities would be removed from the retail sales tax base. Each contractor would be considered a consumer of any construction materials that the contractor incorporated into.

Proposed tax rate: A determination would need to be made regarding under which B&O classification contractors would report.

Estimated Collections: TBD

Advantages:

- Encourages business investment.
- Encourages homeownership (lower home costs if contract price is not subject to sales tax).
- Most states do not tax construction labor.
- All construction within this state will be taxed in a uniform manner.
- If contractors are required to pay sales tax on all purchases, there will be increased sales tax compliance.

Disadvantages:

- May increase up-front costs for contractors (additional out-of-pocket expense for sales tax).
- May risk federal contracting revenue.

Principles Most Advanced:

- Competitiveness
- Harmony with other states
- Simplicity

Principles Most Eroded:

- Long term adequacy

Washington State Tax Structure Study

6. Simplify exemptions and credits

Description: This alternative calls for reducing the complexity of, and simplifying qualification for, existing exemptions and credits. Also, it promotes shifting away from credits and toward exemptions and deductions as a simpler way of providing tax incentives.

Proposed tax base: Where possible, B&O credits would be changed to a B&O exemption or deduction, thus changing the tax base.

Proposed tax rate: The B&O tax rates would remain the same.

Estimated Collections: This option could be revenue neutral.

Advantages:

- Reduce confusion for taxpayers by simplifying qualification requirements for tax incentives.
- Fewer requirements means less paperwork and simpler administration for both the Department and taxpayers.
- Retains tax incentives and business competitiveness.

Disadvantages:

- It is harder to target exemptions and deductions to particular business activities that currently have B&O credits (such as the B&O credit for job creation).

Principles Most Advanced:

- Competitiveness
- Simplicity

Principles Most Eroded: