

Tax Adjustment Package

Administrative and Policy Adjustments to Keep the Tax System Viable

This package was developed at the request of the Tax Study Committee to provide information on adjustments to the existing tax system. The following package of adjustments provides a cohesive list of adjustments tailored to keep the existing tax system viable over the long term. These adjustments maintain the existing tax system but suggest structural changes to individual taxes and to general tax programs that the Department feels are essential to the long-term sustainability of the system.

This package addresses the following tax principles:

- Fairness;
- Simplification;
- Harmony with other states; and
- Business competitiveness.

The suggested alternatives only include structural changes to the tax system. Certain policy goals and suggestions, while worthwhile as improvements, were left off as more appropriate in a separate arena of policy decision making. These adjustments also only address components of the state tax system rather than any local government components.

The package of alternatives includes structural changes to the tax system that follow the themes below:

- Modernize the tax system to keep pace with the contemporary economy as business models and trends, including regulatory climates, change;
- Increase Washington's harmony with other state tax systems, therefore increasing business competitiveness;
- Broaden the tax base to make the system more viable as business practices change; and
- Reduce complexities in the tax system, removing areas of dispute and confusion and simplifying the administration of the tax system for both taxpayers and the Department.

This package is designed to be revenue neutral (complete fiscal estimates will follow). In the event that some elements as written are not revenue neutral, this package is also designed to accommodate adjustments to achieve revenue neutrality.

Description	Annual Estimated Impact	Advantages	Disadvantages	Problems Solved
<p>1. Remove sales tax from construction services Shift incidence of sales tax on construction from income to materials purchased at the point of purchase.</p>	<p>\$400 million loss</p>	<ul style="list-style-type: none"> • Encourages business investment • Encourages homeownership (lower home costs) • Result is consistent with how most states tax construction activities 	<ul style="list-style-type: none"> • Increases up-front costs for contractors (tax is paid on materials prior to receiving income for construction services) 	<ul style="list-style-type: none"> • Simplifies collection and administration of the sales tax from contractors. • Increased compliance with construction-related tax liabilities.
<p>2. Reform B&O apportionment methods Reform apportionment methods for businesses taxed under the service B&O classification.</p>	<p>May be a fiscal loss</p>	<ul style="list-style-type: none"> • Fair to all service businesses with activity in WA • Less litigation/fewer disputes re: apportionment • Most other states apportion business taxes 		<ul style="list-style-type: none"> • Aligns Washington with other states' tax systems. • Improves business competitiveness.
<p>3. Reduce number of B&O tax rates and classification Create one selling class and rate (0.484%), one manufacturing class and rate (0.484%), and two service classes and rates (0.484% and 1.5%).</p>	<p>\$294 million gain</p>	<ul style="list-style-type: none"> • Less litigation/fewer disputes re: classifications and rates • More flexible, keeps pace with new technology 	<ul style="list-style-type: none"> • Preferential tax rates were provided for policy reasons. 	<ul style="list-style-type: none"> • Reduces administrative complexity for both taxpayers and DOR.

<p>4. Eliminate the PUT Shift all PUT taxpayers into B&O service class @ 1.5% and a newly created B&O utility classification @ 3.8%.</p>	<p>\$32 million gain</p>	<ul style="list-style-type: none"> • Consolidates the current two different “privilege of doing business” tax systems into a single tax system • The reason for the PUT is no longer relevant - most utilities are no longer regulated. 	<ul style="list-style-type: none"> • Adds pyramiding to the tax system. 	<ul style="list-style-type: none"> • Broadens B&O tax base by including utilities. • Modernizes tax system.
<p>5. Extend sales tax to personal services Tax on personal services, e.g. beauty/barber, cable TV, residential phone.</p>	<p>\$270 million gain</p>	<ul style="list-style-type: none"> • Captures the shift from a goods- to service-based economy • Broadens the tax base 	<ul style="list-style-type: none"> • Few states tax services 	<ul style="list-style-type: none"> • Modernizes tax system. • Broadens the sales tax base.
<p>6. Streamline sales tax Enact uniform legislation along with other sales tax states: <ul style="list-style-type: none"> • Common definitions • Simplified administration </p>	<p>TBD</p>	<ul style="list-style-type: none"> • WA relies more heavily on sales tax than almost all other states • Simplicity for multi-state retailers 	<ul style="list-style-type: none"> • May be some loss of flexible state and local authority over sales tax. 	<ul style="list-style-type: none"> • Modernizes tax system. • Increases business competitiveness.
<p>7. Rainy day fund</p>	<p>Revenue neutral</p>	<ul style="list-style-type: none"> • 	<ul style="list-style-type: none"> • 	<ul style="list-style-type: none"> •
<p>Net estimated impact:</p>	<p>\$194 million gain</p>			