

DRAFT FOR DISCUSSION PURPOSES

**COMPREHENSIVE TAX STRUCTURE CHANGES: SOME
CALIBRATION CALCULATIONS**

**TABLE 1. POTENTIAL AND ACTUAL ECONOMIC TAX BASES FOR
WASHINGTON STATE (CY 2000)**

| | Billions of Current \$ | |
|--|-------------------------------|--------------|
| <i>Gross State Product (GSP)</i> | | (est.) 220.0 |
| <i>State Personal Income (SPI)</i> | | 184.3 |
| <i>Earnings</i> | 129.4 | |
| <i>Dividends, Interest and Rents</i> | 33.2 | |
| <i>Transfers</i> | 21.7 | |
| <i>Wage and Salary Disbursements</i> | | 109.7 |
| <i>Wages and Salary (Federal Personal AGI)</i> | | 99.0 |
| <i>Total Federal Personal AGI</i> | | 143.1 |
| <i>Federal Taxable Personal Income</i> | | 107.7 |
| <i>Federal PIT Liability</i> | | 25.4 |
| <i>Gross Federal CIT Collections</i> | | 3.3 |
| <i>Gross Business Income (GBR)</i> | | 415.8 |
| <i>Taxable Gross Business Income (GBRX)</i> | | 326.8 |
| <i>Accrued B&O/PU Tax</i> | | 2.1 |
| <i>Gross Retail Sales</i> | | 67.9 |
| <i>Taxable Gross Retail Sales</i> | | 43.0 |
| <i>Accrued RST</i> | | 5.6 |

**TABLE 2 EARNINGS, GROSS STATE PRODUCT, GROSS BUSINESS REVENUE,
TAXABLE GBR AND ACCRUED B&O/PU TAX BY INDUSTRY CLASSIFICATION
FOR CY 2000 (IN BILLIONS \$)**

| Industry | Earnings | GSP (est.) | GBR | GBRX | Acc. B&O |
|---------------------------------------|-----------------|-------------------|------------|-------------|---------------------|
| <i>Agriculture, Forestry, Fishing</i> | 1.5 | 4.6 | 2.9 | 2.2 | .015 |
| <i>Mining</i> | .2 | .3 | .5 | .5 | .003 |
| <i>Construction</i> | 9.1 | 10.7 | 27.6 | 25 | .123 |
| <i>Manufacturing</i> | 19.1 | 27.6 | 84.0 | 73.1 | .354 |
| <i>Transportation and Utilities</i> | 9.4 | 17.4 | 23.9 | 13 | .098 |
| <i>Wholesale Trade</i> | 7.9 | 15.2 | 96.5 | 73.2 | .369 |
| <i>Retail Trade</i> | 12.6 | 21.7 | 89.1 | 74.1 | .370 |
| <i>FIRE</i> | 8.8 | 38.3 | 22 | 14.3 | .179 |
| <i>Services</i> | 42.1 | 55 | 65 | 51.2 | .549 |
| <i>Government and G.E.</i> | 23 | 29 | | | |
| <i>Total</i> | 133.7 | 220 | 415.8 | 326.8 | 2.060 |
| <i>Total less Government</i> | 110.7 | 191.0 | | | |

TABLE 3 B&O/PU TAX AS A PERCENT OF EARNINGS, GSP, GBR AND GBRX BY INDUSTRY CLASSIFICATION (CY 2000)

| Industry | %Earnings | %GSP (est.) | %GBR | %GBRX |
|---------------------------------------|------------------|--------------------|-------------|--------------|
| <i>Agriculture, Forestry, Fishing</i> | 1.0 | .3 | .7 | .7 |
| <i>Mining</i> | 1.5 | 1.0 | .6 | .6 |
| <i>Construction</i> | 1.4 | 1.1 | .4 | .5 |
| <i>Manufacturing</i> | 1.9 | 1.3 | .4 | .5 |
| <i>Transportation and Utilities</i> | 1.0 | .6 | .4 | .8 |
| <i>Wholesale Trade</i> | 4.7 | 2.4 | .4 | .5 |
| <i>Retail Trade</i> | 2.9 | 1.7 | .4 | .5 |
| <i>FIRE</i> | 2.0 | .5 | .8 | 1.3 |
| <i>Services</i> | 1.3 | 1.0 | .8 | 1.1 |
| | | | | |
| <i>Total</i> | 1.5 | .9 | .5 | .6 |
| <i>Total less Government</i> | 1.9 | 1.1 | | |

REPLACEMENT OPTIONS

1) Replace the RST with a State Personal Income Tax

a) Levied as a "surtax" (a percentage of federal income tax liability), \$1 billion of revenue is 3.9%. Thus replacing the entire RST would be 21.8% surtax. This approach adopts federal deductions, exemptions and tax rate structure.

b) Levied as a tax on federal taxable income, \$1 billion requires a tax rate of just under 1 percentage point. A flat of 5.2% would be needed to replace the entire RST. This approach adopts federal exemptions and deductions but applies a state defined tax rate structure.

c) Levied as a tax on Federal AGI less state deductions and exemptions, each \$ billion requires a tax rate of .7 percentage points. This approach adopts federal measure of AGI and applies state defined deductions, exemptions and rate structure. Calibrated flat tax rates for replacing entire RST with different levels of state exemptions shown in table.

| | |
|-----------------------------------|------|
| All AGI taxed | 3.9% |
| AGI over \$20K per taxpayer taxed | 4.1% |
| AGI over \$30K per taxpayer taxed | 4.5% |

d) Levied as a payroll tax on earnings. If wages and salaries reported on federal tax return (excludes many fringe benefits) only are taxed, each \$billion of revenue requires a tax rate of 1 percentage point. Replacing the entire RST would require a rate of 5.6%. If all earnings (payrolls, fringe benefits, SE earnings etc) are taxed, the rate is 5%.

2) Replace B&O/PU tax with a Net Business Income Tax.

For calibration calculations, we need to research the size of tax base under a given apportionment formula (say, UDIPTA). Note however, Federal CIT only raises \$3.3 from WA corporations on

their worldwide income. This suggests relatively high tax rates would be needed to replace the existing B&O/PU tax.

3) Replace B&O/PU with a invoice method multi-stage goods and service tax (VAT).

a) Levied on the broadest base (GSP excluding government), the rate would be 1.1% to replace the B&O/PU tax rate. Such a tax is implemented by taxing GBR and allowing a credit for the tax paid on inputted materials (according to invoices).

b) Levied on a business income base, the rate would be higher. Such a tax is implemented by taxing GBR less depreciation and allowing a credit for the tax paid on inputted materials {according to invoices).

c) Levied on Earnings {and Profit) component of value added. Such as tax is implemented by taxing GBR for a credit on the tax paid (according to invoices) on all purchased inputs except labor (i.e., both materials and producer durables). To replace the existing B&O/PU tax would require a rate less than 1.9%.

This is a broad version of the most commonly levied VAT sometimes called a "consumption" VAT, but henceforth called a *conventional* VAT

Other VATs include subtraction method (business transfer) tax and addition method (Michigan unified business tax).

4) Integrate the RST and B&O/PU into a "Unified Goods and Services" Tax.

Basically, this would replace both RST and B&O/PU taxes with an invoice credit VAT.

a) Levied on broadest base, the rate would be 4%. On the "conventional" base it would be less than 7.2%

Main differences from current system would be i) the extension of the tax base to services, food, and fringe benefits and ii) the removal of pyramiding.

b) Levied on broadest base reduced by the same "average" narrowing of the existing tax base (68% of total, or \$130 billion), the rate would be 5.9%

c) On broadest base plus allowing wage and salary recipients to receive a "rebate" for up to \$20K (based on federal tax return), the rate would be 4.2%. Up to \$30K, rate would be 4.4%.

d) On "conventional" base allowing wage and salary recipients to receive rebate on up to \$20K the rate would be less than 7.9%. Up to \$30K, it would be less than 8.7%.

Data Sources:

WA GSP, SPI and Earnings Data, *Bureau of Economic Analysis*

Federal Tax Data, *Internal Revenue Service*

WA Gross Business Income, Retail Sales, and Tax Data, *WA DOR*