HOUSE BILL REPORT
HB 2157

As Reported by House Committee On:
Finance
Appropriations

Title: An act relating to updating the Washington tax structure to address the needs of Washingtonians.

Brief Description: Updating the Washington tax structure to address the needs of Washingtonians.

Sponsors: Representatives Tarleton, Sullivan, Ormsby, Bergquist, Robinson, Appleton, Dolan, Frame, Macri, Pollet and Tharinger.

Brief History:

Committee Activity:

Finance: 4/4/19, 4/19/19 [DPS];
Appropriations: 4/22/19 [DP2S(w/o sub FIN)].

Brief Summary of Second Substitute Bill

- Modifies the preferential business and occupation tax rate for travel agents and tour operators.
- Provides a business and occupation tax exemption for qualifying hospitals.
- Changes the nonresidential retail sales tax exemption to an annual remittance.
- Reauthorizes and expands the Tax Structure Work Group, created within the 2017–19 Operating Budget.
- Modifies income qualifying thresholds for the property tax exemption, valuation freeze, and deferral programs for low-income senior citizens, individuals with disabilities, and disabled veterans.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 9 members: Representatives Tarleton, Chair; Walen, Vice Chair; Chapman, Frame, Macri, Morris, Orwall, Springer and Wylie.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Minority Report: Do not pass. Signed by 4 members: Representatives Orcutt, Ranking Minority Member; Young, Assistant Ranking Minority Member; Stokesbary and Vick.

Staff: Tracey O'Brien (786-7152), Richelle Geiger (786-7139), and Rachelle Harris (786-7137).

Background:

Business and Occupation Tax.
Washington's major business tax is the business and occupation (B&O) tax. The B&O tax is imposed on the gross receipts of business activities conducted within the state, without any deduction for the costs of doing business. Businesses must pay the B&O tax even though they may not have any profits or may be operating at a loss.

A taxpayer may have more than one B&O tax rate, depending on the types of activities conducted. Major B&O tax rates are 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent for services and for activities not classified elsewhere. Several preferential rates also apply to specific business activities.

In addition, a taxpayer may be eligible to utilize other tax preferences, including credits and deductions, to reduce their tax liability. For example, a taxpayer engaging in activities subject to different B&O tax rates may be eligible for a Multiple Activities Tax Credit. A taxpayer may also be eligible for a small business credit that will either eliminate or reduce their B&O tax liability. In general, the credit is $70 per month for service businesses and $35 per month for all other businesses, multiplied by the number of months in the reporting period. The amount of the credit available phases out based on the business's gross receipts.

A business does not have to file an annual B&O tax return if the business does not owe other taxes or fees to the Department of Revenue (DOR) and has annual gross proceeds of sales, gross income, or value of products for all B&O tax classifications of less than $28,000 per year, or less than $46,667 if at least 50 percent of its taxable income is from services or activities not classified elsewhere.

Retail Sales and Use Tax.
Retail sales taxes are imposed on retail sales of most articles of tangible personal property, digital products, and some services. A retail sale is a sale to the final consumer or end user of the property, digital product, or service. If retail sales taxes were not collected when the user acquired the property, digital products, or services, then use tax applies to the value of property, digital product, or service when used in this state. The state, all counties, and all cities levy retail sales and use taxes. The state sales and use tax rate is 6.5 percent; local sales and use tax rates vary from 0.5 percent to 3.9 percent, depending on the location.

Property Tax—General.
All real and personal property in the state is subject to property tax each year based on its value, unless specific exemption is provided by law. The Washington Constitution (Constitution) limits regular property tax levies to a maximum of 1 percent of the property's value ($10 per $1,000 of assessed value [AV]). Excess levies are not subject to this constitutional limit and require voter approval. There are statutory rate maximums for

individual taxing districts and aggregate rate maximums to keep the total tax rate of regular property taxes within the constitutional limit. All regular levies, except the state levies, are subject to a statutory revenue growth limit. If the taxing authority has a population of 10,000 or more, the revenue growth limit is the lesser of inflation or 1 percent plus the valuation of new construction. If the taxing authority has a population of less than 10,000, the revenue growth limit is 1 percent plus the value of new construction.

Property Tax—State Levies.
The state collects two regular property tax levies for common schools. The original state levy was first imposed when Washington achieved statehood in 1889. Over time the Legislature adopted limitations on the levy, including on the growth of revenue. In 1971 the Legislature adopted the first statutory revenue growth limit for regular levies. In 2007 the Legislature limited the revenue growth rate to the lesser of 1 percent or inflation, plus the value of new construction (revenue growth limit). In 2017 the Legislature adopted Engrossed House Bill 2242, which created the additional state levy.

For taxes levied for collection in calendar years 2020–2021, the combined rate for both state levies is $2.70 per $1,000 AV. The revenue growth limit does not apply to the state levies during this time. Beginning with taxes levied for collection in calendar year 2022 and thereafter, the revenue growth limit applies to both levies. Participants in the senior citizen, individuals with disabilities, and qualifying veterans property tax exemption program receive a partial exemption from the original state levy and a full exemption from the additional state levy.

Property Tax—Levy Lid Lift.
Voters may approve regular property tax increases above the revenue growth limit. This voter-approved increase is referred to as a levy lid lift. A levy lid lift may be authorized for a single year or for multiple years, not to exceed six years. A multi-year lid lift must be for a specific purpose, and lid lift funds may not supplant existing funds used for the purpose specified in the lid lift ballot proposition.

Property Tax—Senior Citizens Tax Relief.
Authorized by a constitutional amendment, qualifying senior citizens, persons retired due to disability, and veterans receiving compensation from the United States Department of Veterans Affairs at total disability rating for a service-connected disability are entitled to property tax relief on their principal residence. To qualify, a person must be 61 years old in the year of the application or retired from employment because of disability, own their principal residence, and have a combined disposable income of less than $40,000 a year. Eligible individuals may qualify for a partial property tax exemption and a valuation freeze.

Partial Tax Exemption. Partial tax exemptions for senior citizens and persons retired due to disability are provided as follows:
- If disposable income is $35,001 to $40,000, all excess levies and the additional state levy are exempted.
- If disposable income is $30,001 to $35,000, all excess levies, the additional state levy, and regular levies on the greater of $50,000 or 35 percent of assessed valuation ($70,000 maximum) are exempted.

- If disposable income is $30,000 or less, all excess levies, the additional state levy, and regular levies on the greater of $60,000 or 60 percent of assessed valuation of the principal residence are exempted.

Cities and counties are permitted to exempt participants in the property tax exemption program from any portion of their regular property tax levy attributable to a levy lid lift, with voter approval.

Valuation Freeze. In addition to the partial exemptions listed above, the valuation of the residence of an eligible individual is frozen, for the purpose of calculating property tax liability, at the assessed value of the residence on the later of January 1, 1995, or January 1 of the assessment year in which the person first qualifies for the program. To be eligible, the person must have a disposable income of less than $40,000.

Deferral. In addition to the exemption program, individuals who meet the requirements for the senior citizen and individuals with disabilities exemption program, except for the income and age requirements, are permitted to defer their property taxes if their combined disposable income is $45,000 or less and they are 60 years or older. Taxes that are deferred become a lien against the property and accrue interest at 5 percent per year. If deferred taxes are not repaid within three years after the eligible person ceases to own and live in the residence, the lien will be foreclosed and the residence sold to recover taxes.

Combined Disposable Income.
For property tax relief programs, combined disposable income is defined as the sum of federally defined adjusted gross income and the following, if not already included: capital gains; deductions for losses; depreciation; pensions and annuities; military pay and benefits; veterans benefits except attendant-care and medical-aid payments; Social Security and federal railroad retirement benefits; dividends; and interest income on state and municipal bonds. Payments for the care of either spouse received in the home, in a boarding home, in an adult family home, or in a nursing home; prescription drugs; and Medicare health care insurance premiums are deducted when determining combined disposable income.

Washington State Tax Structure Study Committee.
The Washington State Tax Structure Study Committee (Committee) was created in the 2001–03 Operating Budget. The Committee was directed to study the elasticity, equity, and adequacy of the state's tax system and develop multiple alternatives to the existing tax system.

The Committee membership was required to consist of 11 members:
- six academic scholars appointed by the DOR from relevant disciplines, after consulting with leadership in the largest caucuses in each chamber of the Legislature; and
- one member each appointed by the Governor and the chairs of the largest caucuses in each chamber of the Legislature.

Additionally, the DOR was directed to create an advisory group to provide advice and assistance to the Committee.

The Legislature directed the Committee to submit a final report including the results of and conclusions from the analysis and recommended tax structure alternatives. The Committee's recommendations included, but were not limited to, replacing the B&O tax with a business value added tax, establishing a rainy day fund, and streamline the sales tax.

Tax Structure Work Group.
The Tax Structure Work Group (Work Group) was created in the 2017–19 Operating Budget. The Work Group was directed to facilitate public discussions throughout the state regarding Washington's tax structure and report the results to the fiscal committees of the Legislature, upon request.

The Work Group membership consisted of a member from each of the major caucuses in the House of Representatives, appointed by the Speaker of the House of Representatives, who also served as co-chairs of the Work Group.

During the 2018 interim, the Work Group held public meetings in the following cities: Spokane, Yakima, Vancouver, and Seattle. The public meetings included a staff briefing on the general revenue structure, discussions among attending participants about the state of the current tax structure and ideas about how to change the structure, and individual oral testimony. The discussions, public testimony, and results of a follow-up survey of attending participants were summarized in a final report, adopted by the co-chairs in December 2018. The final report also included recommendations from the Work Group, including reauthorizing the Work Group and expanding the membership, to include multiple members from each chamber of the Legislature and various stakeholder groups, and scope, to include analysis, policy development and continued public meetings.

Tax Preference Performance Statement.
State law provides for a range of tax preferences that confer reduced tax liability upon a designated class of taxpayer. Tax preferences include: tax exclusions, deductions, exemptions, preferential tax rates, deferrals, and credits. Currently, Washington has over 650 tax preferences, including a variety of sales and use tax exemptions. Legislation that establishes or expands a tax preference must include a Tax Preference Performance Statement (TPPS) that identifies the public policy objective of the preference, as well as specific metrics that the Joint Legislative Audit and Review Committee (JLARC) can use to evaluate the effectiveness of the preference. All new tax preferences automatically expire after 10 years unless an alternative expiration date is provided.

Summary of Substitute Bill:

Tax Preferences. The preferential B&O rate for travel agents and tour operators is increased from 0.275 percent to 0.9 percent.

A B&O exemption is provided to hospitals owned by a county with a population greater than 2 million and managed by a state university. The exemption expires on January 1, 2030.

The nonresident sales tax exemption is converted to a remittance program. Refunds may only be requested by nonresidents for the immediately preceding Calendar Year (CY), and must be for at least $25. In addition, a nonresident may only make one refund request per CY. The request must include proof of nonresident status as prescribed by the DOR. Penalties are created for making fraudulent statements or submitting fraudulent documents.

Tax Structure Work Group. The Work Group is reauthorized and expanded, in membership and in scope.

The membership of the Work Group includes nine voting members, appointed as follows:
- two members of the two largest caucuses in each chamber of the Legislature, appointed by the President of the Senate and the Speaker of the House of Representatives, respectively; and
- one member who represents the Office of the Governor.

The membership must also include one nonvoting member representing each of the following organizations: the DOR, the Association of Washington Cities, and the Washington State Association of Counties. All Work Group members must submit a letter of interest and statement of understanding that the commitment to serve on the Work Group is through December 31, 2024. Elected officers not reelected to their respective offices may be relieved of their responsibilities. Vacancies must be filled within 60 days of notice of a vacancy.

The Work Group must choose a chair or co-chairs from among its legislative membership.

Decisions are made by a simple majority vote of the membership. Voting by proxy is not permitted.

The DOR must create one or more technical advisory groups to assist the Work Group with its duties. At least one advisory group must include academic scholars from research institutions, experts in international trade, economic theory, and federal Indian tax law selected by the Governor's Office of Indian Affairs, and a tax practitioner. The advisory group may also include other academic scholars and experts in relevant fields.

The DOR must provide staff support, subject to the degree such support is funded through appropriation. The DOR may engage with one or more consultants to provide Work Group support.

The DOR, with the assistance of the technical advisory group(s), is required to perform economic analysis and comparative research to estimate the potential impact of implementing an alternative tax structure.

The Work Group is required to:
- facilitate a series of public meetings in geographically dispersed locations to present the updated report and other findings, collect feedback from taxpayers about the tax structure, and summarize the feedback in a report; and
- make recommendations to the Legislature for changes to the state tax structure, based on the updated report and other findings. Recommendations may not result in an estimated loss in state revenue.

It is the intent of the Legislature to consider the recommended changes to the state tax structure during the 2023 Legislative Session. If the proposal is not adopted, the Work Group is directed to facilitate public meetings to collect feedback about the legislative proposal and modify the proposal to address the feedback. During the 2024 Legislative Session, it is the intent of the Legislature to consider the modified proposal.

By December 31, 2024, the Work Group is directed to submit a final report, a compilation of all other reports previously submitted since July 1, 2019.

Members of the Work Group must serve without compensation but may be reimbursed for travel expenses.

Senior Property Tax Exemption. Income thresholds for the senior citizen, individuals with disabilities, and veterans property tax exemption are modified. Income ceilings based on a percentage of county median household income are added to each threshold category as follows for tax collection year 2020:

- Income threshold one replaces the $30,000 income threshold. "Income threshold one" is defined as equal to the greater of income threshold one for the previous year or 45 percent of county median household income.
- Income threshold two replaces the $35,000 income threshold. "Income threshold two" is defined as equal to the greater of income threshold two for the previous year or 55 percent of county median household income.
- Income threshold three replaces the $40,000 income threshold. "Income threshold three" is defined as equal to the greater of income threshold three for the previous year or 65 percent of county median household income.

Beginning on March 1, 2024, and every tenth year thereafter, the income thresholds that are not adjusted based on percentage of county median household income must be adjusted to reflect the lesser of the annual growth in the Consumer Price Index for All Urban Consumer (CPI-U) or 1 percent. If the annual growth rate of CPI-U is negative, the threshold for the previous year continues to apply.

The disability rating qualification for disabled veterans to qualify for the property tax exemption program is changed such that it applies to all veterans receiving compensation at a combined service-connected evaluation rating of 80 percent or higher or with a total disability rating without regard to evaluation percent.

The income threshold for the valuation freeze is modified to be based off of income threshold three (a combined disposable income of up to 65 percent of county median household income). The income threshold for the deferral program is updated to up to 75 percent of county median household income. Heirs and devisees are added to the list of individuals who may maintain the tax exemption in the case of the original claimant's death. The requirement that a filing to continue a property's deferral status in case of the claimant's death within 90 days of the claimant's death is eliminated.

"County median household income" is defined as the median income estimates for the state of Washington, by county, of the legal address of the principal place of residence, as published by the Office of Financial Management.

The DOR is directed to publish updated income thresholds beginning August 1, 2019, and by March 1 every fifth year thereafter.

The changes to the exemption program apply to taxes levied for collection in 2020 and thereafter.

Substitute Bill Compared to Original Bill:

The repeal of the tax preferences for bullion, precious metals, travel agents, and tour operators are removed from the bill. The preferential B&O rate for travel agents and tour operators is changed from 0.275 percent to 0.9 percent. A B&O tax exemption is provided to eligible hospitals that are owned by a county with a population greater than 2 million and managed by a state university.

At least one Tax Structure Work Group advisory group must include an expert in federal Indian tax law.

The qualifying income thresholds for the senior citizen property tax exemption that are not adjusted based on county median income are adjusted beginning on March 1, 2024, and every 10 years thereafter to reflect the lesser of the annual growth in CPI-U or 1 percent.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill contains an emergency clause and takes effect on July 1, 2019, except for Part V, relating to Expanding Senior Citizen Property tax exemption, which takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) Our tax structure is the most upside down and regressive in the country. This is a broken revenue system. Currently, our tax structure is disconnected from the growth in the economy. Personal income is growing but it is not taxed in the state. This bill provides meaningful and overdue improvements to the tax code. Closing tax loopholes is a great step.

This proposal gets the state closer to meeting the basic needs of our citizens, including addressing the homeless crisis, increasing demand on long-term care services, and fully funding special education. The richest among us should pay their fair share. Washingtonians want action and will support the Legislature in making bold moves to improve our tax structure.

The capital gains tax is a sustainable, progressive revenue source. Some would prefer an expanded capital gains proposal but agree this bill is a good first step.

Using capital gains revenue to fund the Education Legacy Trust Account makes sense—the wealthiest among us have benefited the most from the higher education system. The cost of education disproportionately falls on those who can afford it least and has increased while the demand has increased and investment decreased. There are significant returns on investment in early learning. Schools are not fully funded and are at risk of losing critical staff and resources, including libraries, because of the budget shortfalls. This bill will enable us to invest in the future.

King County Assessors support exemptions for seniors, and tax relief should not be delayed.

There are no reporting or accountability measures for the bullion exemption, it is a blind gift to purchasers. This tax preference makes money laundering easy.

(Opposed) The bullion is appropriately classified because purchasing it is an investment that is accessible to low-income, unsophisticated investors. Prior to the current tax treatment, most sales occur across state lines. This change would result in the loss of most of the business of trading precious metals for the state, which means the state will not achieve the revenue gains that the fiscal note says. Customers that invest in bullion are not "fat cats" but are rather regular individuals. Businesses that facilitate these transactions operate on a slim margin. This is a big part of some people's investment strategy. The exemption allows our state industry to compete nationally. This would be double taxation because it could also be subject to capital gains.

Repeal of the nonresident sales tax exemption is a bad idea because sales will go elsewhere, especially in border communities with Oregon, and it will upset nonresidents. This will take jobs and revenues with it. If it were an online sale, the activity would still be exempt, which makes it unfair. Under this bill, customers would only get a rebate on the state tax paid, not any local sales taxes. Analysis shows that the tax exemption is accomplishing it's public policy objective.

When businesses sell property, it will be subject to both real estate excise tax and capital gains.

(Other) The preferential B&O rate for travel agents should remain as it is under current law or be increased, but not eliminated completely.

Changes to the tax code to make it more progressive are supported by many.

Persons Testifying: (In support) Representative Tarleton, prime sponsor; Jean Johnson; Ruth Lipscomb; Summer Stinson, Washington's Paramount Duty; Emily Carmichael; Cedar McKay; Sarah Reynevald; Cecelia and Arielle Lehmann; Michele Thomas, Washington Low Income Housing Alliance; Peter Shapiro; Alex Bond, Balance Our Tax Code; Erin Haick, Service Employees International Union 925; Morgan Steele Dykeman, National Abortion and Reproductive Rights Action League; Dave Knutson, Washington Health Care Association; Emily Murphy, Early Learning Action Alliance and Retired Public Employee Council; Donna

Patrick, Developmental Disabilities Council; Michael Moran, King County Assessor; and John Burbank, Economic Opportunity Institute.

(Opposed) Clay Hill, Association of Washington Business; Mark Johnson, Washington Retail; Brad Tower, Washington Coin and Bullion Association; Jason O'Brian, Bellevue Rare Coins; Karen Feldman, Tacoma Mall Boulevard Coin and Stamp; Dan Duncan, Pinnacle Rarities; Todd Hughes, Tacoma Lakewood Coin Club; Dan Smith, American Society of Travel Advisors and Travel By Dan; Amber Carter, Identity Clark County and Port of Vancouver; and Patrick Connor, National Federation of Independent Business.

(Other) Scott Hazlegrove, Washington State Auto Dealers Association; and Richard Lazaro, Expedia Group.

Persons Signed In To Testify But Not Testifying: None.

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: The second substitute bill be substituted therefor and the second substitute bill do pass and do not pass the substitute bill by Committee on Finance. Signed by 19 members: Representatives Ormsby, Chair; Bergquist, 2nd Vice Chair; Robinson, 1st Vice Chair; Cody, Dolan, Fitzgibbon, Hansen, Hudgins, Jinkins, Macri, Pettigrew, Pollet, Ryu, Senn, Springer, Stanford, Sullivan, Tarleton and Tharinger.

Minority Report: Do not pass. Signed by 14 members: Representatives Stokesbary, Ranking Minority Member; MacEwen, Assistant Ranking Minority Member; Rude, Assistant Ranking Minority Member; Caldier, Chandler, Dye, Hoff, Kraft, Mosbrucker, Schmick, Steele, Sutherland, Volz and Ybarra.

Staff: Meghan Morris (786-7119).

Summary of Recommendation of Committee On Appropriations Compared to Recommendation of Committee On Finance:

The second substitute bill makes the following changes:

- If the county income threshold for the senior property tax deferral program is not adjusted based on percentage of county median household income, it must instead be adjusted to reflect the lesser of the annual growth in the Consumer Price Index for All Urban Consumers (CPI-U) or 1 percent.
- If the annual growth rate of the CPI-U is negative, the threshold for the previous year continues to apply.

Appropriation: None.

Fiscal Note: Preliminary fiscal note available.

Effective Date of Second Substitute Bill: The bill contains an emergency clause and takes effect on July 1, 2019, except for Part V, relating to Expanding Senior Citizen Property tax exemption, which takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) The senior exemption portion of this bill is important for seniors, especially for those living along the urban corridor. The urban corridor is where most of the seniors in the state reside, but the cost of living there has increased much quicker than the rest of the state. The fixed thresholds are causing seniors that qualified before to fail out of the program because they have to pull more money out of retirement savings to live at the same standard of living. These seniors cannot afford to wait for a multi-year debate to continue.

(Opposed) The nonresident sales tax remittance program should be removed from the bill. A remittance program would decrease customers from Oregon, Alaska, Montana and various Canadian provinces, who will be less likely to come to Washington to make incidental purchases. With the additional sales tax, out-of-state consumers will make discretionary purchases at home rather than pay higher taxes. This will lead to less sales tax collections, not more, due to fewer retail sales. Lower sales will also lead to less business and occupation tax collections. There will be fewer business-to-business sales to firms in Oregon, Alaska, and Montana because small businesses will not purchase products in Washington to have hundreds or thousands of tax dollars held for a year before processing remittance application. This is nonsensical for cash flow purposes. The same small business located out of state can simply purchase the same product online and pay no sales tax.

Certain counties are directly affected by the narrowing of the nonresident sales tax exemption. There are very real economic consequences. The retail industry along the borders relies on the sales tax exemption and would have to lay off hundreds of employees with this remittance program. Major multi-state retail firms would shut their doors. There are $850 million in sales per year to out-of-state residents and it takes more than $700 million of sales to generate $45 million in state sales tax. Targeted geographic areas will see disproportionate impacts and suffer disproportionately from the change in consumer behavior. Further study is needed before passing this measure. This exemption is doing precisely what it was intended to do, which is bring out-of-state shoppers to Washington that otherwise would not be purchasing Washington goods, as evidenced by the Joint Legislative Audit Review Committee review. Narrowing the nonresident sales tax exemption was already rejected by voters through Initiative 1464 in 2016. There are alternatives, such as focusing on out-of-state vehicle registrations and making sure people moving here have Washington licenses.

The sale of equipment for boating gear and supplies starts with the sale of a boat. Automobiles and boats are specifically exempted through separate statutes from the collection of the sales tax for nonresidents, but there are concerns that the perception of Washington imposing sales tax on nonresidents will chill boat sales from out-of-state purchasers, particularly in border communities.

Persons Testifying: (In support) Steven Drew, Thurston County Assessor and Washington State Assessor Association.

(Opposed) Patrick Connor, National Federation of Independent Business; Amber Carter, Identify Clark County; Mark Johnson, Washington Retail Association; Clay Hill, Association of Washington Business; and Cliff Webster, Northwest Marine Trade Association.

Persons Signed In To Testify But Not Testifying: None.