

# HOUSE BILL REPORT

## HB 2117

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### As Reported by House Committee On: Finance

**Title:** An act relating to providing a pathway to modernize and rebalance the Washington state tax structure so that it is equitable, adequate, stable, and transparent for the people of Washington state.

**Brief Description:** Providing a pathway to modernize and rebalance the Washington state tax structure so that it is equitable, adequate, stable, and transparent for the people of Washington state.

**Sponsors:** Representatives Frame, Tarleton, Sullivan, Springer, Walen, Macri, Orwall, Wylie, Chapman, Morris, Doglio, Peterson, Senn, Valdez, Ortiz-Self, Stanford, Pollet and Santos.

#### **Brief History:**

##### **Committee Activity:**

Finance: 2/26/19, 2/27/19 [DPS].

#### **Brief Summary of Substitute Bill**

- Reauthorizes and expands the Tax Structure Work Group, created within the 2017-19 Operating Budget.

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### 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.

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

**Staff:** Richelle Geiger (786-7139).

#### **Background:**

Washington State Tax Structure Study Committee.

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*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.*

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 Department of Revenue (Department) from relevant disciplines, after consulting with leadership in the largest caucuses in each chamber of the Legislature; and
- one member appointed by each the Governor and the chairs of the largest caucuses in each chamber of the Legislature.

Additionally, the Department 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 business and occupation 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.

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#### **Summary of Substitute Bill:**

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 Department, 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 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 Department must create one or more technical advisory groups to assist the Work Group with its duties. The advisory groups may include academic scholars and other recognized experts in relevant fields. The Legislature intends to include both economic theory experts and tax practitioners in an advisory group.

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

The duties of the Work Group are to:

- update the final report of the Committee and investigate other matters that may be material to changing the state tax structure;
- 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, compiling of all other reports previously submitted since July 1, 2019.

The Work Group expenses must be jointly paid by each house of the Legislature. Members of the Work Group must serve without compensation but may be reimbursed for travel expenses.

This act expires December 31, 2024.

**Substitute Bill Compared to Original Bill:**

The term "new businesses" is replaced with "start-up businesses." The Department is required to form one or more technical advisory group(s), instead of making it optional. The Work Group and technical advisory group are directed to prepare a summary of their preliminary findings and alternatives by July 1, 2020, in lieu of a report. Owners, employees, and/or associations expressly dedicated to representing small and start-up businesses to the list of required stakeholders at the meetings held in Olympia between July 1, 2020 and December 31, 2020.

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**Appropriation:** None.

**Fiscal Note:** Available. New fiscal note requested on February 27, 2019.

**Effective Date of Substitute Bill:** The bill 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 overdue for holistic reform. This bill takes a bipartisan and bicameral approach and gives taxpayers a more prominent role than ever. Members of the Finance Committee listened to taxpayers about the tax structure. This bill is a direct response to the Work Group and to what was heard on the road. This bill does not presuppose any outcome. Equity, especially vertical equity, must help guide our work here. This is a principle that the amount of tax paid by taxpayers with different income levels should be related to their ability to pay. Washington has a regressive tax code, because the lowest income Washingtonians pay a high percentage of their income to taxes. Horizontal equity is another important guiding principle that says that people with similar ability to pay should pay similar tax amounts. Tax preferences create winners and losers in the tax code. The Finance Committee spends a lot of time responding to completely rational requests from businesses and organizations for exemptions. Adequacy of the tax code to provide normal growth in public services is important. Washington has one of the strongest economies in the nation, but state revenues are not keeping up. Stability is critical. Our tax system needs to maintain the revenue necessary to provide services during both a strong economic period and a poor economic period; it is currently in a boom and bust cycle. A good tax system is transparent, making tax burdens clear and evident. It is nearly impossible for taxpayers to know how much they owe and when they owe it. Washington has one of the least transparent systems in the nation. Some recommendations from the 2002 report have been adopted, very little has been done to consider previous proposals for intervention.

Small business owners have asked for an amendment to help clarify that startups and other small, low-margin business will be represented during the conversations. The business community has complained for a longtime about the business and occupation (B&O) taxes. The B&O tax was supposed to be temporary, and it is full of many loopholes. It is really important to take a serious look at the B&O tax system. The B&O tax is the single largest factor in making Washington auto dealers less competitive compared to out-of-state dealers. The average profit for dealerships is only 2 percent, and the B&O tax makes this net effective tax way too high.

There is some concern that the technical work groups for the Department to convene is permissive. That should be required, along with including technical advisers such as accountants. This is the first step, hopefully the next step is looking at the state's local revenue structure. It has been too long since the 2002 study, because that study provided very valuable information about how taxes keep pace and how taxes affect different communities. Recommendations for this bill would be to explicitly include a tax incidence analysis that shows how taxes get passed on from businesses to consumers. It should also include a racial equity analysis and a regional equity analysis.

The current tax structure cannot keep pace to fully fund education or other essential services. Citizens feel strongly that the state tax structure should be fair. Any imposition of taxes should be fair and transparent. The state's revenue system is badly broken because there is no longer much discretion in the Legislature's ability to write budgets. People feel that the only way to get their needs met is to file lawsuits. The mental health system and foster care system require more funding than our current tax structure can provide. Citizens with developmental disability need more respite care. The Legislature needs to figure out how to raise sufficient funding to provide these services so that stakeholders are not fighting amongst themselves to divide up a very small pie.

(Opposed) None.

(Other) Retailers are the chief tax collectors of the state, they collect billions of dollars in the sales tax each year. Retailers incur costs to do this collection. Retailers are not fans of the B&O tax on gross receipts, despite the fact that it is easy to calculate, it is unfair if you don't make a profit. Retail sales tax is broad-based but regressive. Much of the 2002 group is admirable, and changes should be made to this bill to emulate the 2002 study group. The bill should be revenue neutral and contain no income tax. Alternatives in response to the Work Group should have a wide range of scope, from incremental to overhaul. It is recommended that the Legislature remove all of section 1; it is not a good idea to include language about adequacy in the charge of the work group. The charge of adequacy will result in debate about what to fund rather than how to fund it.

**Persons Testifying:** (In support) Representative Frame, prime sponsor; Patrick Connor, National Federation of Independent Business; Scott Hazlegrove, Washington Auto Dealers Association; Lisa Thatcher, Washington Society of Certified Public Accountants; Mellani McAleenan, Washington State Association of Counties; Andy Nicholas, Washington State Budget and Policy Center; Lorrell Noahr, Washington Education Association; Mark Johnson, Washington Retail; Madeline Bishop; and Seth Dawson.

(Other) Clay Hill, Association of Washington Business.

**Persons Signed In To Testify But Not Testifying:** None.