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**SUBSTITUTE HOUSE BILL 2940**

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**State of Washington 65th Legislature 2018 Regular Session**

**By** House Finance (originally sponsored by Representatives Lytton, Chapman, Frame, Tarleton, Tharinger, Ormsby, Pollet, and Macri)

AN ACT Relating to making the business and occupation tax more progressive; amending RCW 82.32.045 and 82.33.010; reenacting and amending RCW 34.05.328; adding new sections to chapter 82.04 RCW; creating new sections; repealing RCW 82.04.4451; and providing an effective date.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec.**  (1) The legislature recognizes that as a result of the state's regressive tax structure, Washington's small businesses are overburdened. Despite low profit margins, the legislature finds that small businesses are taxed at the same rate as our high profit corporations, without benefiting from the special tax preferences that many of our large corporations enjoy.

(2) It is the intent of the legislature to make the state's business tax system more fair for small businesses by reforming the current business and occupation tax or eventually implementing a new, more equitable business activities tax. The legislature also intends to take the necessary steps to evaluate the continuing need for business and occupation tax preferences.

**Sec.**  RCW 82.32.045 and 2010 1st sp.s. c 23 s 1103 are each amended to read as follows:

(1) Except as otherwise provided in this chapter, payments of the taxes imposed under chapters 82.04, 82.08, 82.12, 82.14, and 82.16 RCW, along with reports and returns on forms prescribed by the department, are due monthly within twenty-five days after the end of the month in which the taxable activities occur.

(2) The department of revenue may relieve any taxpayer or class of taxpayers from the obligation of remitting monthly and may require the return to cover other longer reporting periods, but in no event may returns be filed for a period greater than one year. For these taxpayers, tax payments are due on or before the last day of the month next succeeding the end of the period covered by the return.

(3) The department of revenue may also require verified annual returns from any taxpayer, setting forth such additional information as it may deem necessary to correctly determine tax liability.

(4) Notwithstanding subsections (1) and (2) of this section, the department may relieve any person of the requirement to file returns and pay the tax otherwise due if the following conditions are met:

(a) The person's value of products, gross proceeds of sales, or gross income of the business, from all business activities taxable under chapter 82.04 RCW, is less than((~~:~~

~~(i) Twenty-eight thousand dollars per year; or~~

~~(ii) Forty-six thousand six hundred sixty-seven dollars per year for persons generating at least fifty percent of their taxable amount from activities taxable under RCW 82.04.255, 82.04.290(2)(a), and 82.04.285~~)) one hundred twenty-five thousand dollars per year;

(b) The person's gross income of the business from all activities taxable under chapter 82.16 RCW is less than twenty-four thousand dollars per year; and

(c) The person is not required to collect or pay to the department of revenue any other tax or fee which the department is authorized to collect.

NEW SECTION. **Sec.**  A new section is added to chapter 82.04 RCW to read as follows:

(1) In computing the amount of tax due under this chapter, beginning January 1, 2020, a person must calculate its margin for purposes of determining eligibility for a credit or liability for a surcharge, as provided in this section. A person's margin for the current tax year is determined by deducting the person's cost of goods sold and cost of labor, accrued for the immediately preceding tax year, from the greater of the person's total gross income of the business, or value of products manufactured or extracted, for that same tax year.

(2) If the person's margin is:

(a) Less than two hundred fifty thousand dollars, a person is eligible for a credit equal to the tax otherwise due under this chapter for the reporting period;

(b) Equal to or greater than two hundred fifty thousand dollars but less than one million dollars, no credit under (a) of this subsection is allowed, and the surcharge in (c) of this subsection does not apply; or

(c) One million dollars or more, a surcharge is imposed. Except as provided in subsection (3) of this section, the surcharge is equal to the tax otherwise payable under this chapter by the person, multiplied by six percent.

(3)(a) Before the surcharge under (c) of this subsection takes effect, the department may adjust the surcharge rate by rule if, as a result of the rule making to implement this section, the department determines that estimated collections of tax under this chapter will fall below or exceed projections by at least one percent during the first eighteen months in which the surcharge under subsection (2)(c) of this section is effective, based on the latest published fiscal note for chapter . . ., Laws of 2018 (this act).

(b) Within the first twelve months of the surcharge under (c) of this subsection taking effect, the department may adjust the surcharge rate by emergency rule if the department estimates that collections of tax under this chapter will fall below or exceed projections by at least one percent during the first eighteen months in which the surcharge under (c) of this subsection is effective, based on the latest published fiscal note for chapter . . ., Laws of 2018 (this act).

(c) Surcharge rate adjustments under (a) and (b) of this subsection must:

(i) Be no more than the amount necessary for chapter . . ., Laws of 2018 (this act) to achieve revenue neutrality for the period beginning January 1, 2020, through June 30, 2021, as projected by the department;

(ii) Be carried to the fourth decimal place; and

(iii) Take effect on the date determined by the department by rule. A surcharge rate adjustment is prospective only and must take effect on the first day of a calendar quarter that is at least sixty days following the date that the department publishes the adjusted surcharge rate on its public web site.

(d) The director of the office of financial management must approve any surcharge rate adjustment under (a) or (b) of this subsection.

(4) The surcharge rate in effect on January 1, 2021, shall be the surcharge rate imposed for calendar years 2021 and 2022.

(5) A new business is exempt from this section.

(6) By October 1, 2019, the department must adopt rules it deems necessary for the administration of this section. Such rules must include:

(a) Definitions of the terms "cost of goods sold" and "cost of labor." Such definitions must:

(i) Include items of costs that are commonly maintained by prudent businesses in their books and records. However, the department may, in its discretion, exclude items of direct and indirect costs it deems useful in simplifying the margin calculation for taxpayers, reducing the likelihood of disputes between the department and taxpayers, and preventing inflated cost deductions in the margin calculation under this section; and

(ii) Ensure that no items of costs are deducted twice in determining a person's margin under this section.

(b) Include a definition of the term "new business," which must, to the extent possible, limit the exemption under subsection (5) of this section to bona fide new businesses and prevent existing businesses from avoiding a surcharge or claiming a credit under this section.

(c) Provide for a reasonable method of allocating or apportioning costs of goods sold and labor, consistent with the purposes of this section.

(d) Include provisions intended to deny taxpayers the tax benefits of engaging in arrangements or transactions that take advantage of the provisions of this section to unfairly avoid taxes under this chapter.

NEW SECTION. **Sec.**  A new section is added to chapter 82.04 RCW to read as follows:

(1) In computing the tax imposed under this chapter, an eligible new business is entitled to a credit under this section. The amount of the credit under this section is equal to the tax otherwise due under this chapter for the person's initial taxable year.

(2) Persons who believe they will qualify for the credit under this section and whose reporting frequency for the taxes imposed under this chapter is less than annual may claim the credit under this section on each of the person's tax returns for the person's initial taxable year. However, as soon as any person claiming the credit under this section has reported a gross taxable amount of at least two hundred fifty thousand dollars in the initial year, the person may no longer claim the credit under this section and must also correct its prior tax returns to eliminate the credit claimed under this section on the original tax returns.

(3) The definitions in this subsection apply throughout this section unless the context clearly requires otherwise.

(a) "Eligible new business" means a new business that is exempt from the provisions of section 3 of this act and whose gross taxable amount for the initial taxable year is less than two hundred fifty thousand dollars.

(b) "Gross taxable amount" means a person's combined gross income of the business and value of any products manufactured or extracted, from engaging in business activities within this state, less the amount of any gross proceeds of sales of products manufactured or extracted by the person to the extent that such gross proceeds of sales are included both in the person's gross income of the business and value of products manufactured or extracted.

(c) "Initial taxable year" means the first year in which the eligible new business engages within this state in business activities taxable under this chapter.

NEW SECTION. **Sec.**  A new section is added to chapter 82.04 RCW to read as follows:

(1) By August 1, 2022, and each even-numbered year thereafter, the department must estimate what the amount of collections under this chapter for the two previous completed calendar years would have been had the changes in this act not been enacted. The requirements for the calculations of the estimated collections for a calendar year under this subsection are:

(a) The department must use the actual business and occupation tax collections for calendar year 2019 as the baseline;

(b) The department must adjust the calendar year 2019 baseline by the total percentage change in state personal income from calendar year 2019 to the calendar year for which the department is calculating the estimated collections for this subsection;

(c) The department must use the total percentage change in state personal income as reported by the economic and revenue forecast council, utilizing the most recent forecast available at the time the calculation is made.

(2) By August 1, 2022, and each even-numbered year thereafter, the department must calculate the adjusted actual collections under this chapter for the previous two calendar years. The requirements for the calculations for the adjusted actual collections in this subsection are:

(a) The department must deduct from the actual collections for a calendar year the amount of collections resulting from the imposition of a surcharge under this act;

(b) The department must add an adjustment restoring any decrease in collections resulting from changes to the tax imposed under this chapter since December 31, 2019, excluding this act. If available, the department must use the most recent fiscal note reflecting the legislation as enacted in calculating the adjustment; and

(c) The department must add an adjustment deducting any increase in collections resulting from changes to the tax imposed under this chapter since December 31, 2019, excluding this act. If available, the department must use the most recent fiscal note reflecting the legislation as enacted in calculating the adjustment.

(3) By August 1, 2022, and each even-numbered year thereafter, the department must calculate the surcharge rate that would have been required for the two previous calendar years in order for tax collections under this chapter to have been within one percent of the estimate calculated pursuant to subsection (1) of this section for those years. For the next two calendar years, the surcharge rate must be the lesser of the surcharge rate from the previous calendar year and the surcharge rate calculated under this section for the next two calendar years; however, the surcharge rate must not be less than zero nor more than the maximum established in subsection (6) of this section.

(4) By September 1, 2022, and each even-numbered year thereafter, the department must notify the economic and revenue forecast council of the surcharge rate being proposed for the next two calendar years and as calculated in subsection (3) of this section.

(5) If the economic and revenue forecast council approves the surcharge adjustment pursuant to section 6 of this act, the department must adjust the rate by emergency rule and must publish the adjusted surcharge rate on its public web site.

(6) The surcharge imposed in any calendar year must not be less than zero and must not exceed the greater of:

(a) Six percent; or

(b) The final surcharge adopted by the department pursuant to section 3 of this act.

(7) Any adjustment to the surcharge rate made under this section must:

(a) Be no more than the amount necessary to achieve revenue neutrality for business and occupation tax collections in the biennium based on the estimate in subsection (1) of this section and collections in subsection (2) of this section;

(b) Be carried to the fourth decimal place; and

(c) Take effect on the first day of the ensuing odd-numbered year and only after approval by the economic and revenue forecast council.

**Sec.**  RCW 82.33.010 and 2012 1st sp.s. c 8 s 2 are each amended to read as follows:

(1) The economic and revenue forecast council is hereby created. The council shall consist of two individuals appointed by the governor, the state treasurer, and four individuals, one of whom is appointed by the chairperson of each of the two largest political caucuses in the senate and house of representatives. The chair of the council shall be selected from among the four caucus appointees. The council may select such other officers as the members deem necessary.

(2) The council shall employ an economic and revenue forecast supervisor to supervise the preparation of all economic and revenue forecasts and the presentation of state budget outlooks. As used in this chapter, "supervisor" means the economic and revenue forecast supervisor. Approval by an affirmative vote of at least five members of the council is required for any decisions regarding employment of the supervisor. Employment of the supervisor shall terminate after each term of three years. At the end of the first year of each three-year term the council shall consider extension of the supervisor's term by one year. The council may fix the compensation of the supervisor. The supervisor shall employ staff sufficient to accomplish the purposes of this section.

(3) The economic and revenue forecast council shall oversee the preparation of and approve, by an affirmative vote of at least five members, the official, optimistic, and pessimistic state economic and revenue forecasts prepared under RCW 82.33.020. If the council is unable to approve a forecast before a date required in RCW 82.33.020, the supervisor shall submit the forecast without approval and the forecast shall have the same effect as if approved by the council.

(4) The economic and revenue forecast council shall oversee the preparation of and approve, by an affirmative vote of at least five members, the state budget outlook prepared under RCW 82.33.060. If the council is unable to approve a state budget outlook before a date required in RCW 82.33.060, the supervisor shall submit the outlook prepared under RCW 82.33.060 without approval and the outlook shall have the same effect as if approved by the council.

(5) The economic and revenue forecast council must adopt and make available any estimates of state personal income needed to perform the calculations in section 5 of this act.

(6) By September 30, 2022, and each even-numbered year thereafter the economic and revenue forecast council must consider and approve, by an affirmative vote of at least five members, any change to the surcharge rate recommended by the department of revenue pursuant to section 5 of this act.

(7) A councilmember who does not cast an affirmative vote for approval of the official economic and revenue forecast or the state budget outlook may request, and the supervisor shall provide, an alternative economic and revenue forecast or state budget outlook based on assumptions specified by the member including, for purposes of the state budget outlook, revenues to and expenditures from additional funds.

((~~(6)~~)) (8) Members of the economic and revenue forecast council shall serve without additional compensation but shall be reimbursed for travel expenses in accordance with RCW 44.04.120 while attending sessions of the council or on official business authorized by the council. Nonlegislative members of the council shall be reimbursed for travel expenses in accordance with RCW 43.03.050 and 43.03.060.

**Sec.**  RCW 34.05.328 and 2011 c 298 s 21 and 2011 c 149 s 1 are each reenacted and amended to read as follows:

(1) Before adopting a rule described in subsection (5) of this section, an agency must:

(a) Clearly state in detail the general goals and specific objectives of the statute that the rule implements;

(b) Determine that the rule is needed to achieve the general goals and specific objectives stated under (a) of this subsection, and analyze alternatives to rule making and the consequences of not adopting the rule;

(c) Provide notification in the notice of proposed rule making under RCW 34.05.320 that a preliminary cost-benefit analysis is available. The preliminary cost-benefit analysis must fulfill the requirements of the cost-benefit analysis under (d) of this subsection. If the agency files a supplemental notice under RCW 34.05.340, the supplemental notice must include notification that a revised preliminary cost-benefit analysis is available. A final cost-benefit analysis must be available when the rule is adopted under RCW 34.05.360;

(d) Determine that the probable benefits of the rule are greater than its probable costs, taking into account both the qualitative and quantitative benefits and costs and the specific directives of the statute being implemented;

(e) Determine, after considering alternative versions of the rule and the analysis required under (b), (c), and (d) of this subsection, that the rule being adopted is the least burdensome alternative for those required to comply with it that will achieve the general goals and specific objectives stated under (a) of this subsection;

(f) Determine that the rule does not require those to whom it applies to take an action that violates requirements of another federal or state law;

(g) Determine that the rule does not impose more stringent performance requirements on private entities than on public entities unless required to do so by federal or state law;

(h) Determine if the rule differs from any federal regulation or statute applicable to the same activity or subject matter and, if so, determine that the difference is justified by the following:

(i) A state statute that explicitly allows the agency to differ from federal standards; or

(ii) Substantial evidence that the difference is necessary to achieve the general goals and specific objectives stated under (a) of this subsection; and

(i) Coordinate the rule, to the maximum extent practicable, with other federal, state, and local laws applicable to the same activity or subject matter.

(2) In making its determinations pursuant to subsection (1)(b) through (h) of this section, the agency must place in the rule-making file documentation of sufficient quantity and quality so as to persuade a reasonable person that the determinations are justified.

(3) Before adopting rules described in subsection (5) of this section, an agency must place in the rule-making file a rule implementation plan for rules filed under each adopting order. The plan must describe how the agency intends to:

(a) Implement and enforce the rule, including a description of the resources the agency intends to use;

(b) Inform and educate affected persons about the rule;

(c) Promote and assist voluntary compliance; and

(d) Evaluate whether the rule achieves the purpose for which it was adopted, including, to the maximum extent practicable, the use of interim milestones to assess progress and the use of objectively measurable outcomes.

(4) After adopting a rule described in subsection (5) of this section regulating the same activity or subject matter as another provision of federal or state law, an agency must do all of the following:

(a) Coordinate implementation and enforcement of the rule with the other federal and state entities regulating the same activity or subject matter by making every effort to do one or more of the following:

(i) Deferring to the other entity;

(ii) Designating a lead agency; or

(iii) Entering into an agreement with the other entities specifying how the agency and entities will coordinate implementation and enforcement.

If the agency is unable to comply with this subsection (4)(a), the agency must report to the legislature pursuant to (b) of this subsection;

(b) Report to the joint administrative rules review committee:

(i) The existence of any overlap or duplication of other federal or state laws, any differences from federal law, and any known overlap, duplication, or conflict with local laws; and

(ii) Make recommendations for any legislation that may be necessary to eliminate or mitigate any adverse effects of such overlap, duplication, or difference.

(5)(a) Except as provided in (b) of this subsection, this section applies to:

(i) Significant legislative rules of the departments of ecology, labor and industries, health, revenue, social and health services, and natural resources, the employment security department, the forest practices board, the office of the insurance commissioner, and to the legislative rules of the department of fish and wildlife implementing chapter 77.55 RCW; and

(ii) Any rule of any agency, if this section is voluntarily made applicable to the rule by the agency, or is made applicable to the rule by a majority vote of the joint administrative rules review committee within forty-five days of receiving the notice of proposed rule making under RCW 34.05.320.

(b) This section does not apply to:

(i) Emergency rules adopted under RCW 34.05.350;

(ii) Rules relating only to internal governmental operations that are not subject to violation by a nongovernment party;

(iii) Rules adopting or incorporating by reference without material change federal statutes or regulations, Washington state statutes, rules of other Washington state agencies, shoreline master programs other than those programs governing shorelines of statewide significance, or, as referenced by Washington state law, national consensus codes that generally establish industry standards, if the material adopted or incorporated regulates the same subject matter and conduct as the adopting or incorporating rule;

(iv) Rules that only correct typographical errors, make address or name changes, or clarify language of a rule without changing its effect;

(v) Rules the content of which is explicitly and specifically dictated by statute;

(vi) Rules that set or adjust fees under the authority of RCW 19.02.075 or that set or adjust fees or rates pursuant to legislative standards, including fees set or adjusted under the authority of RCW 19.80.045;

(vii) Rules of the department of social and health services relating only to client medical or financial eligibility and rules concerning liability for care of dependents; ((~~or~~))

(viii) Rules of the department of revenue that adopt a uniform expiration date for reseller permits as authorized in RCW 82.32.780 and 82.32.783 ; or

(ix) Rules of the department of revenue authorized in section 3 of this act.

(c) For purposes of this subsection:

(i) A "procedural rule" is a rule that adopts, amends, or repeals (A) any procedure, practice, or requirement relating to any agency hearings; (B) any filing or related process requirement for making application to an agency for a license or permit; or (C) any policy statement pertaining to the consistent internal operations of an agency.

(ii) An "interpretive rule" is a rule, the violation of which does not subject a person to a penalty or sanction, that sets forth the agency's interpretation of statutory provisions it administers.

(iii) A "significant legislative rule" is a rule other than a procedural or interpretive rule that (A) adopts substantive provisions of law pursuant to delegated legislative authority, the violation of which subjects a violator of such rule to a penalty or sanction; (B) establishes, alters, or revokes any qualification or standard for the issuance, suspension, or revocation of a license or permit; or (C) adopts a new, or makes significant amendments to, a policy or regulatory program.

(d) In the notice of proposed rule making under RCW 34.05.320, an agency must state whether this section applies to the proposed rule pursuant to (a)(i) of this subsection, or if the agency will apply this section voluntarily.

(6) By January 31, 1996, and by January 31st of each even-numbered year thereafter, the office of regulatory assistance, after consulting with state agencies, counties, and cities, and business, labor, and environmental organizations, must report to the governor and the legislature regarding the effects of this section on the regulatory system in this state. The report must document:

(a) The rules proposed to which this section applied and to the extent possible, how compliance with this section affected the substance of the rule, if any, that the agency ultimately adopted;

(b) The costs incurred by state agencies in complying with this section;

(c) Any legal action maintained based upon the alleged failure of any agency to comply with this section, the costs to the state of such action, and the result;

(d) The extent to which this section has adversely affected the capacity of agencies to fulfill their legislatively prescribed mission;

(e) The extent to which this section has improved the acceptability of state rules to those regulated; and

(f) Any other information considered by the office of financial management to be useful in evaluating the effect of this section.

NEW SECTION. **Sec.**  (1)(a) A taskforce on business and occupation tax fairness is established. The task force is composed of the following twelve members:

(i) A representative of the governor's office;

(ii) A representative of the department of revenue;

(iii) A representative of the department of commerce;

(iv) A representative from each of the two largest caucuses of the senate, who must be appointed by the president of the senate; and

(v) A representative from each of the two largest caucuses of the house of representatives, who must be appointed by the speaker of the house of representatives.

(b) The governor must appoint the remaining five members of the task force, taking into consideration representation from: Large businesses, small and independent businesses, advocates of policies advancing the interests of economic security and social opportunity, and persons with expertise in Washington state tax law and policy in an academic or private sector setting.

(c) The task force may seek input or collaborate with any other parties it deems necessary.

(d) The terms of legislative members of the task force continue until such members no longer wish to serve on the task force or no longer serve in the legislature, whichever occurs first. A legislative vacancy must be filled by the appointment of a legislator from the same legislative chamber and caucus as the original appointment. The appropriate appointing authority must make the appointment within thirty days of the vacancy occurring.

(2) The task force must choose its chair from among its membership. The task force meets at the call of the chair. The chair of the task force must cause all meeting notices and task force documents to be sent to the task force members.

(3) The department of revenue must provide staff support for the task force.

(4) Legislative members of the task force are reimbursed for travel expenses in accordance with RCW 44.04.120. Nonlegislative members of the task force, except those representing an employer or organization, are entitled to be reimbursed for travel expenses in accordance with RCW 43.03.050 and 43.03.060.

(5) The task force must:

(a) Review existing business and occupation tax preferences to determine whether any are no longer needed as a result of the enactment of this act;

(b) Make decisions by a simple majority of the task force; and

(c) Provide a report, in compliance with RCW 43.01.036, to the appropriate fiscal committees of the house of representatives and senate by January 1, 2022.

(6) The report required in subsection (5) of this section may include:

(a) Recommendations for the elimination of business and occupation tax preferences;

(b) Additional or alternative options for improving the fairness of the business and occupation tax or replacing the business and occupation tax with a more equitable business activities tax;

(c) Recommendations for future legislative oversight of the department of revenue's implementation of this act; and

(d) A minority report if the task force does not reach complete agreement on the contents of the report.

NEW SECTION. **Sec.**  RCW 82.04.4451 (Credit against tax due—Maximum credit—Table) and 2010 1st sp.s. c 23 s 1102, 1997 c 238 s 2, & 1994 sp.s. c 2 s 1 are each repealed.

NEW SECTION. **Sec.**  This act may be known and cited as the small business tax fairness act.

NEW SECTION. **Sec.**  RCW 82.32.805 and 82.32.808 do not apply to this act.

NEW SECTION. **Sec.**  Sections 2, 4, 8, and 9 of this act take effect January 1, 2020.

**--- END ---**