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**SECOND SUBSTITUTE HOUSE BILL 2117**

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**State of Washington 66th Legislature 2019 Regular Session**

**By** House Appropriations (originally sponsored by Representatives Frame, Tarleton, Sullivan, Springer, Walen, Macri, Orwall, Wylie, Chapman, Morris, Doglio, Peterson, Senn, Valdez, Ortiz-Self, Stanford, Pollet, and Santos)

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; adding a new section to chapter 82.32 RCW; creating new sections; and providing an expiration date.

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

NEW SECTION. **Sec.**  (1) The legislature finds that the Washington tax structure, developed at the turn of the twentieth century, is no longer adequate, equitable, stable, or transparent.

(a) In the early 1930s, the Washington supreme court overturned an initiative of the people that approved a tax intended to reduce the over-reliance on the property tax, in the midst of the great depression. In response to the court decision, the 1933 legislature adopted a gross receipts tax on businesses as a temporary measure to balance the state budget. This temporary tax measure, now referred to as the business and occupation tax, remains in law to this day. Because this tax does not allow a deduction for the cost of doing business, the tax penalizes new businesses, small businesses, and low margin businesses with high capital costs.

(b) Two years after the enactment of the temporary business tax and amidst deepening financial crisis, the legislature enacted the most comprehensive tax bill in state history, the revenue act of 1935. The act shifted the state's primary revenue source from property tax to excise taxes, making permanent the business and occupation tax and enacting the retail sales and use tax. Excise taxes have resulted in our state tax code being overly regressive. In other words, with a heavy reliance on sales tax and other excise taxes, households at the lowest end of the income spectrum pay more of their income to taxes compared to the wealthiest households in the state.

(c) Since the creation of our regressive tax structure, individual taxpayers and businesses have sought relief from the business and occupation tax, retail sales and use tax, property tax, and other taxes. Over the years, the legislature has adopted approximately seven hundred tax preferences including exemptions, deductions, deferrals, credits, exclusions, and preferential tax rates. While some of those tax preferences have a broad and positive impact, such as the voter-approved decision not to charge sales tax on food, many are targeted to benefit a very small number of taxpayers. The need for tax preferences to mitigate the consequences of the state tax structure has created structural deficits along with "winners" and "losers" within the code. According to the 2016 tax exemption study completed by the department or revenue, these tax preferences forego 50.4 billion dollars in revenue per biennium. This means the state foregoes more revenue in tax preferences than it collects from its remaining revenue sources, leaving those taxpayers without preferential tax treatment to assume a disproportionate share of the responsibility to fund critical local and state investments.

(2) The legislature further finds that in 2001, the Washington state tax structure study committee under section 138, chapter 7, Laws of 2001 2nd sp. sess., was established to study the elasticity, equity, and adequacy of the state's tax structure.

(a) The tax structure study committee produced a comprehensive report of their research, economic modeling, and resulting tax policy prescriptions. The legislature has adopted some of the recommended changes, including establishing the budget stabilization account, limiting new tax preferences with ten-year expiration dates, and streamlining online retail sales tax administration. While these incremental changes were made, none of the major alternatives have been adopted, including the recommendation to replace the business and occupation tax with a business value added tax.

(b) Since the tax structure study committee's final report was published in November 2002, Washington's population, economy, and communities have changed dramatically. Our state population has increased by more than twenty percent (an estimated 1.3 million additional people). In the decade since the great recession, some business sectors have rebounded, stronger than ever, while many other Washington industries have not recovered. Five Washington counties have captured seventy-four percent of all new jobs created since 2001. Economic analysis indicates state revenues are decoupling from the state's economic activity, creating structural revenue declines that undermine the state's ability to provide essential services to the people and communities of the state. Washington state and local revenue collections as a share of personal income has dropped approximately ten percent since the late 1990s. Legislative policy choices, voter initiatives, consumer behavior, federal changes, low interest rates, and our transition from a manufacturing economy to a service based economy have all contributed to the erosion of the state general fund revenue.

(3) The legislature further finds that in 2017, the Washington state house tax structure work group under section 101, chapter 1, Laws of 2017 3rd sp. sess., was established to facilitate public discussions throughout the state about the advantages and disadvantages of the state's current tax structure and potential options to improve the current structure for the benefit of individuals, families, and businesses in Washington state. Legislators traveled across the state to hear directly from taxpayers about key challenges in the tax structure that should be studied and addressed in the future.

(a) The taxpayers recommended finding solutions to address the:

(i) Regressive nature of the tax code;

(ii) Negative impact of the business and occupation tax on small, start-up, and low-margin businesses;

(iii) Need to modernize the tax structure to reflect the changing economy; and

(iv) Excessive number of tax preferences and exemptions;

(b) The taxpayers also recommended conducting economic modeling and comparative research of major alternatives to current revenue sources, including but not limited to replacing:

(i) The business and occupation tax with an alternative taxing mechanism such as corporate income tax or margins tax;

(ii) The one percent revenue growth limit on regular property taxes with a limit based on population growth and inflation;

(iii) A portion of the state property tax with a capital gains tax; and

(iv) Other existing revenue sources with alternative revenue sources.

(4) Therefore, it is the intent of the legislature to modernize and rebalance our state tax structure. To accomplish this, the legislature will:

(a) Directly engage in robust conversations with taxpayers, stakeholders, and experts across the state about how to make our tax structure more equitable, adequate, stable, and transparent;

(b) Expand upon the successes of the 2017 tax structure work group by increasing outreach and involving more taxpayers in the conversation;

(c) Reevaluate the state tax structure, taking into particular consideration the modernizing economy and changing economic reality we currently face as individuals, communities, businesses, and the state;

(d) Develop alternatives to our current tax structure for consideration by taxpayers and policymakers, considering the principles of equity, adequacy, stability, and transparency, while also taking into consideration the effect on economic vitality and the harmony with neighboring state's tax system; and

(e) Recommend policies that consider the principles named in (d) of this subsection and reduce the tax burden on low-income and middle-class households and small, start-up, and low-margin businesses.

NEW SECTION. **Sec.**  A new section is added to chapter 82.32 RCW to read as follows:

(1) The tax structure work group created within the 2017-2019 operating budget (chapter 1, Laws of 2017 3rd sp. sess. (Substitute Senate Bill No. 5883)) is reauthorized and expanded to include nine voting members, appointed as follows:

(a) The president of the senate must appoint two members from each of the two largest caucuses of the senate;

(b) The speaker of the house of representatives must appoint two members from each of the two largest caucuses of the house of representatives; and

(c) The governor must appoint one member who represents the office of the governor.

(2) The work group must also include the following nonvoting members:

(a) One representative of the department of revenue;

(b) One representative of the association of Washington cities; and

(c) One representative of the Washington state association of counties.

(3) All work group members must indicate, in writing, their interest in serving on the tax structure work group and provide a statement of understanding that the commitment to serve on the tax structure work group is through December 31, 2024. Elected officials not reelected to their respective offices may be relieved of their responsibilities on the tax structure work group.

(4) Vacancies on the tax structure work group must be filled within sixty days of notice of the vacancy.

(5) The work group must choose a chair or cochairs from among its legislative membership. The chair is responsible for convening the meetings of the work group.

(6) Voting on recommendations and other decisions of the work group are to be agreed upon by a simple majority vote. All work group members may have a representative attend meetings of the tax structure work group in lieu of the member, but voting by proxy is not permitted.

(7) The duties of the work group are:

(a) Update the information contained in the final report of findings and alternatives submitted by the Washington state tax structure study committee to the legislature under section 138, chapter 7, Laws of 2001 2nd sp. sess., and investigate other matters that may be material to changing the state tax structure, such as those recommended in the final report of the 2018 tax structure work group; and

(b) Based on the update to the final report, provided in (a) of this subsection, and other information gathered by the work group, make recommendations to the legislature for changes to the state tax structure. Any recommendation provided by the work group may not result in a loss of revenue to the state as compared to the most recent biennial revenue forecast published by the economic and revenue forecast council.

(c) In making the recommendations under (b) of this subsection, the work group must be guided by the following principles for a well-designed tax system: Equity, adequacy, stability, and transparency.

(8) To assist the work group with its duties, the department of revenue must create one or more technical advisory group(s) that may include academic scholars from state research institutions or regional universities and other recognized experts in the fields of economics, taxation, business administration, public administration, public policy, or other relevant disciplines as determined by the department of revenue. It is the legislature's intent to include in a technical advisory group both experts in economic theory as well as tax law practitioners, such as certified public accountants, tax attorneys, and other tax preparation professionals.

(9) The work group must complete its duties on the following schedule:

(a) By July 1, 2020, the work group and technical advisory group must prepare a summary of their preliminary findings and alternatives, including:

(i) Updates to the findings and alternatives in the final report submitted by the Washington state tax structure study committee to the legislature under section 138, chapter 7, Laws of 2001 2nd sp. sess., to include current information and data, and to account for any of the original findings that have been addressed through legislation since the original submission of that report; and

(ii) Economic modeling or other comparable analysis addressing key challenges of the Washington state tax code (as reflected in the final report of the tax structure work group submitted on December 3, 2018, as required by chapter 1, Laws of 2017 3rd sp. sess. (Substitute Senate Bill No. 5883));

(b) Between July 1, 2020, and December 31, 2020, the work group must:

(i) Hold no less than two meetings in Olympia to review the preliminary report described in (a) of this subsection. Some of these meetings must include stakeholder groups. These stakeholder groups must include, at a minimum, organizations and individuals representing the following:

(A) Small, start-up, or low-margin business owners and employees and/or associations expressly dedicated to representing these businesses; and

(B) Individual taxpayers with income at or below one hundred percent of area median income in their county of residence and/or organizations expressly dedicated to representing low-income and middle-income taxpayers;

(ii) Present the report described in (a) of this subsection with findings and alternatives related to changes to the state tax system, in compliance with RCW 43.01.036, to the appropriate committees of the legislature; and

(iii) Begin to plan strategies to engage taxpayers and key stakeholder groups to encourage participation in the public meetings described in (d)(ii) of this subsection;

(c) During the 2021 legislative session, the work group must:

(i) Be available to deliver a presentation to the appropriate committees of the legislature including:

(A) The findings and alternatives included in the report described in (a) of this subsection; and

(B) The preliminary plan to engage taxpayers directly in a robust conversation about the state's tax structure, including presenting the findings and alternatives in the report described in (d) of this subsection, and collecting feedback to inform development of recommendations; and

(ii) Finalize the logistics of the engagement strategies described in (d) of this subsection;

(d) Between the conclusion of the 2021 legislative session and December 31, 2021, the work group must:

(i) Hold no less than five public meetings in geographically dispersed areas of the state;

(ii) Present the report and findings described in (a) of this subsection and alternatives to the state's current tax structure at the public meetings;

(iii) Provide an opportunity at the public meetings for taxpayers to engage in a conversation about the state tax structure, including but not limited to, providing feedback on possible recommendations for changes to the state tax structure and asking questions about the report and findings and alternatives to the state's current tax structure presented by the work group;

(iv) Utilize methods to collect taxpayer feedback before, during, or after the public meetings that may include, but is not limited to: Small group discussions, in-person written surveys, in-person visual surveys, online surveys, written testimony, and public testimony;

(v) Encourage legislators to inform their constituents about the public meetings that occur within and near their legislative districts;

(vi) Inform local elected officials about the public meetings that occur within and near their communities; and

(vii) Summarize the feedback that taxpayers and other stakeholders communicated during the public meetings and other public engagement methods, and submit a final summary report, in accordance with RCW 43.01.036, to the appropriate committees of the legislature. This report may be submitted as an appendix or update to the report described in (a) of this subsection;

(e) During the 2022 legislative session, the work group must:

(i) Present the reports described in (a) and (d) of this subsection to the appropriate committees of the legislature; and

(ii) Be available to deliver a presentation to and/or participate in a work session for the appropriate committees of the legislature; and

(f)(i) Between the conclusion of the 2022 legislative session and December 31, 2022, the work group is directed to finalize policy recommendations and develop legislation to implement modifications to the tax structure, informed by the findings described in (a) of this subsection and the feedback received from taxpayers as reflected in the port described in (d) of this subsection;

(ii) During the 2023 legislative session, it is the intent of the legislature to consider the proposal described in (f)(i) of this subsection;

(iii) If the proposal is not adopted during the 2023 legislative session, the work group is directed to host no less than three public meetings to collect feedback on the legislation proposed in the 2023 session, and may also collect feedback on other proposals under consideration by the work group. The work group is directed to modify the proposal to address the feedback collected during the public meetings;

(iv) During the 2024 legislative session, it is the intent of the legislature to consider the modified proposal described in (f)(iii) of this subsection; and

(g) By December 31, 2024, the work group is directed to submit a final report that is a compilation of all other reports previously submitted since July 1, 2019, and may include additional content to summarize final activities of the tax structure work group and related legislation, in compliance with RCW 43.01.036, to the appropriate committees of the legislature.

(10) Staff support for the work group must be provided by the department of revenue, subject to the degree such support is funded through appropriation. The department of revenue may engage one or more outside consultant(s) to assist in providing support for the work group.

(11) Members of the work group must serve without compensation but may be reimbursed for travel expenses under RCW 44.04.120, 43.03.050, and 43.03.060.

(12) The expenses of the work group must be paid jointly by the senate and the house of representatives. Work group expenditures are subject to approval by the senate facilities and operations committee and the house of representatives executive rules committee, or their successor committees.

(13) This section expires December 31, 2024.

NEW SECTION. **Sec.**  If specific funding for the purposes of this act, referencing this act by bill or chapter number, is not provided by June 30, 2019, in the omnibus appropriations act, this act is null and void.

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