August 2021 Meeting

Date	August 18, 2021
Attendees	The following people attended the meeting via WebEx or on the phone:

Technical Advisory Group	Department of Revenue
Katie Baird	Preston Brashers
Doug Conrad	Richard Dadzie
Hart Hodges	Sara del Moral
Sharon Kioko	Braden Fraser
Rachel Knutson	Steven Lee
Jeff Mitchell	Valerie Torres
Mike Nelson	
Pete Parcells	
Rick Peterson	
Nick Tucker	

Business Taxes – shift to consumers

Presenter: Richard Dadzie

Statement: Big lift with the literature we have found.

Question: Have we explored the universe of literature?

Answer: There are a couple other articles that were found involving Germany. We can send those out after the meeting.

Comment: I wonder if this review tells us that we may be biting off a pretty ambitious nut to try to answer the question of tax incidence and be able to translate in a meaningful way for the TSWG to use that information.

Comments:
You are right about the B&O – the big pieces are the wholesaling & retailing & service B&O. Wholesaling & retailing are like a small additional sales tax on the vendor. This vendor sales tax applies to products sold.

Service has become more important over time in Washington. Depending on the surtax, the service B&O also like a vendor sales tax but on services occurring in Washington. The manufacturing B&O is unique. For manufacturers that manufacture in Washington but sell elsewhere, it is not just destination-based apportionment, so it does not just act like a hidden sales tax.

Thus you are on the right track to think of the B&O tax components like a hidden sales tax.

Policy makers like the corporate income tax – as they believe it falls on the wealthy - owners (those that hold stock) - and thus they believe it taxes higher income people.

Business Taxes – shift to consumers, *continued*	Comments continued: If we had a sudden switch from the B&O to a Corporate Income/Net Receipts tax – then the stock value would drop for current owners to absorb the tax and any new owners would purchase at a lower value thus not facing the tax incidence. This doesn't get to what happens over time – and that gets really difficult. Within the previous modeling the Department has done, the corporate/net receipts tax is the hard one. Because we add up all the taxes and assign them to a household. However, for the corporate/net receipts tax burden falls on people all over the country. The old owners lost wealth, but new owners buy at a lower rate. So how do you quantify that over time? Response: Thank you, the perceived progressivity – corporate is a small portion, so if we wanted to change progressivity – where sales tax in Washington is the biggest total tax. Additional comment: Corporate rate would likely not cover B&O – even if Washington had a corporate net income tax at the higher end of what the state could get away with, it may only raise half of the revenues Washington now raises from the B&O. If you think of the B&O as a vendor sales tax then eliminating it reduces the vendor sales tax. What else are you going to use to replace the B&O tax with that is large enough to make up the lost revenues? Response: Thank you, which is part of the issue with that capital and labor could move. Additional comment: The business community often states Washington is over reliant on business taxes, including groups like COST (Council on State Taxation). We usually rank high because of the B&O tax. These groups make the argument that capital will move if business taxes are raised. However, these studies don't really go back and look at how our economy has grown. Washington and Oregon with two disparate tax structures, yet we have grown nearly the same. Many in the business community also have really benefitted from Washington not having a personal income tax. It's no coincidence that some of the state's billionaires ended up here. Comments: Agree with above commenter that the B&O acts as a sales tax on the vendor, especially for manufacturers selling products or retailing. By labor, I am assuming this means the cost of labor. As we know, the cost of U.S. labor has been repressed for at least the last three decades. Thus, most corporations have a choice of labor and a choice of the cost of labor. Workers have to take what they can get. This is leading to greater income inequality in the U.S.

Business Taxes – shift to consumers, *continued*	The papers assume that the advantage is with the corporations, but not with labor – as labor may not be as mobile. In particular, if we consider the wages of retail workers, who are less mobile and subject to the lowest wages. So this will depend on the sector of the economy. Thus, labor bears the greatest burden. The owners pay corporate income/net receipts taxes, but they also have the advantage over labor and labor costs. Corporate income/net receipts taxes would leave the advantage with corporations. Making the choice for labor on mobility non-existent. Unless there is federal tax reform, labor will bear the burden of corporate taxes, because of the lack of labor mobility. Response: The literature brought up this argument. With the decline in union membership and unions being unable to negotiate the cost of labor this lessens the impact of labor resulting in the burden falling on labor. Additionally, capital may not move as swiftly – but it has more ability to move, just slower. Thus the burden falls on labor, especially over time. Your comments show the difficulty of doing this type of analysis.
Property Taxes – shift to renters	Presenter: Richard Dadzie Question: In the paper that was sent out, there was a table on the last page, how could this table (Table 8) be used to impact the modeling? The problem here is that you have a bunch of property taxes that you want to assign out to households and how this table could help to pass the taxes onto renters. In past modeling, up to 50 percent of the property tax burden was passed on to renters. Answer: In this table (Table 8) the labor represents workers that are renting. So with a 5 percent increase in property taxes, 46% would be absorbed by renters. However, we will look into this further and get back to you. Response: The current model connects homeowners, but needs more work related to renters. Answer: Yes, however, we don’t have data about owners that also have renters in the household. Comment: Yes, though with businesses, you likely have some of the same issues as with the corporate taxes. That is that the taxes initially apply to a business, but where do they eventually land.

Property Taxes – shift to renters, *continued*

Response:
Correct, with a business rented property, the property tax initially falls on the owner. As described in the literature, if the owner increases the rent to cover the tax then does the business pass on the higher rent through the cost of products or services – becomes the question.

Comments:
Is not the question then how to limit the incidence on one group rather than another?

For example, in Indiana there is a renter's deduction that adjusts for the property tax incidence. Other states – like California apply this to only low income earners. So if there are concerns about raising the property taxes, then at the federal level the deduction for homeowners helps with this, but there is no deduction for renters. So at the state level we could address this for renters.

Also, would not the commercial taxes allow a deduction for property taxes as an expense?

Response:
Washington's current B&O tax would not allow a deduction for property taxes unless specified in the law. However, as we discuss changes to the tax structure this would then become part of the discussion on what is and is not included in a cost of goods sold (COGS) deduction.

Continued Comments:
Additionally, local governments have been trying to get businesses to pay taxes. However, some non-profits that could afford to pay taxes are exempt. Some of these are large employers but because they are a 501-3-c they are exempt.

What I would like to highlight is the concern about increasing the property tax for lower income earners. Homeowner have a deduction, but a renter's deduction would create some equity for renters.

https://www.rent.com/blog/states-with-a-renters-tax-credit/

Note: A renter's deduction applies to a state personal income tax. And this makes the renter tax more complicated, since Washington currently does not have a personal income tax.

Question:
In the studies, are they measuring burden as how much tax is borne by that entity versus other entities?

Answer:
In the studies, they are looking at the burden borne by the renter – as in how much extra does the renter pay in rent because of the increase in property taxes.

Property Taxes – shift to renters, *continued*	Additionally, in other studies, they evaluated the burden accruing to the factors of production given whether or not the renter resided in the taxed jurisdiction. This is meant to account for the fact that residents are mobile and do factor community benefits into their rental decisions. The burden certainly depends on the elasticities, and their (i.e. the renters) ability to move from one production sector to another and from one jurisdiction to another. Question: If the tax shifts then what are the consequences of that on the tax collections? If we don't capture the behavioral responses, we may underestimate the tax collections. Answer: The changes in taxpayer behavior that result in tax shifts and that could impact tax collections is one the Department has explored many times with the Office of Financial Management. As you know, fiscal notes only include the impact from the initial incidence of the tax change.
Next Meeting	We are planning to have our next meeting the week of September 20. The topics for that meeting are not totally set yet. We may be discussing some of the updates to the tax alternative model.