Individual State Agency Fiscal Note

Bill Number: SB 5482	Bill Title: AN ACT Relating to the margin tax	Agency: 140 Department of Revenue

Part I: Estimates

[ ] No Fiscal Impact

Estimated Cash Receipts to:

Fund	Fiscal Year 2024	Fiscal Year 2025	2023-2025 Total	2025-27 Biennium	2027-29 Biennium
GF-State NEW				1,683,000,000	14,488,600,000
GF-State NEW2				(17,400,000)	(88,300,000)
GF-State Business and Occupation Tax				(2,853,000,000)	(14,715,500,000)
Total				(1,187,400,000)	(315,200,000)

Estimated Expenditures from:

	Fiscal Year 2024	Fiscal Year 2025	2023-2025 Total	2025-27 Biennium	2027-29 Biennium
FTE Staff Years	25.23	37.93	31.58	103.5	162.03
Fund					
GF-State 001	3,677,300	5,029,400	8,706,700	33,208,900	37,175,900
Total	3,677,300	5,029,400	8,706,700	33,208,900	37,175,900

The revenue and expenditures estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

[X] If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.

[ ] If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).

[ ] Capital budget impact, complete Part IV.

[ ] Requires new rule making, complete Part V.

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Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

CURRENT LAW:
Washington levies its primary business tax, the business and occupation (B&O) tax, on gross income from Washington-based business activity. For businesses engaged in manufacturing or extracting, the B&O tax is imposed on the value of products manufactured or extracted for sale or the taxpayer's own use.

A business must report B&O tax if the business meets any of the following "nexus" thresholds in the current or prior calendar year:
- Has more than $100,000 in cumulative gross receipts from Washington.
- Has physical presence in Washington.
- Is organized or commercially domiciled in Washington.

Each legal entity must register and report taxes separately for affiliated entities.

For B&O tax purposes, businesses engaging in apportionable activities in multiple states may apportion their income to determine the amount subject to B&O tax. The formula for apportionment is Washington gross apportionable receipts divided by worldwide gross apportionable receipts for the taxing period.

The B&O tax includes a flat rate structure with different rates by activity. There are several surcharges on certain industries and activities, including the workforce education surcharge. The B&O tax also includes approximately 200 tax preferences in the form of credits, deductions, exclusions, exemptions, and preferential rates.

While most businesses with activity in Washington are subject to the B&O tax, some businesses are instead subject to the public utility tax. The public utility tax is a tax on public service businesses, including businesses that engage in transportation and the supply of electrical energy, natural gas, and water. This tax is in lieu of the B&O tax, meaning that businesses would pay one or the other but not both taxes on the same activity.

PROPOSAL:
This proposal modifies Washington's B&O tax by converting it into a margin tax modeled after Texas's franchise tax. Many consider a margin tax a modified gross receipts tax.

Businesses pay taxes on their margin. Most businesses calculate their margin by subtracting from their gross income the greater of these four deductions:
- Cost inputs,
- Compensation paid,
- A fixed percentage (30%) of gross income, or
- A standard deduction, which is initially set at $1 million.

For businesses that engage in manufacturing or extracting in this state, they calculate their margin on this activity by subtracting one of the following amounts from the value of products that they manufactured or extracted in this state:
- Cost inputs,
- A fixed percentage (30%) of the value of products manufactured or extracted in this state, or
- A standard deduction, which is initially set at $1 million.

Manufacturers and extractors are taxed on all products they manufacture or extract in this state, whether or not the products are sold in this state. They are also subject to margin tax on the sale in this state of their manufactured or

extracted products. However, the bill provides credits so that manufacturers and extractors do not pay margin tax more than once with respect to the same end products.

For most taxpayers, cost inputs are the costs of goods sold properly reportable to the Internal Revenue Service for federal income tax purposes. For taxpayers who are not subject to federal income tax, cost inputs are the cost of goods sold that would be properly reportable for federal income tax purposes if the taxpayer were subject to federal income tax. For the margin tax on manufacturing and extracting, the cost inputs are limited to the costs of goods sold for products manufactured or extracted in Washington.

The compensation paid deduction equals the total compensation paid to the taxpayer's employees during the tax year, less any compensation over the compensation cap, which is initially set at $400,000. Compensation is Medicare wages properly reportable on box 5 of Internal Revenue Service Form W-2. The compensation cap is adjusted for inflation every two years starting January 1, 2029.

The fixed percentage deduction is equal to 30% of worldwide gross income and for businesses that engage in manufacturing or extracting, 30% of the value of products manufactured or extracted in this state.

The standard deduction equals $1,000,000 and is adjusted for inflation every two years starting January 1, 2029.

For a taxpayer engaging in business both within and outside of Washington, after subtracting all deductible amounts from its gross income, the taxpayer uses a single-factor sales apportionment method to determine the amount of its worldwide margin subject to the Washington margin tax. For combined groups, if any member of the combined group has nexus in Washington, then all members of the group are included in the apportionment calculation.

This proposal imposes the margin tax on the same types of entities subject to B&O tax, including corporations, partnerships, limited liability companies, sole proprietorships, municipal corporations, and nonprofits. Activities subject to public utility tax under current law remain subject to public utility tax and are excluded from the margin tax. This proposal maintains the existing B&O tax surcharges imposed on certain industries and activities. It also maintains the current registration and nexus thresholds.

This bill requires combined reporting for affiliated groups engaged in a unitary business.

The margin tax rate is 3.1966%.

This bill includes an option for taxpayers with gross income of $5,000,000 or less to calculate their tax due using gross income and a lower tax rate of 1.75%. Entities selecting this option may not claim any of the four elective deductions available to taxpayers that choose to pay the margin tax at the higher rate (cost inputs, compensation paid, 30% of gross income, or the standard deduction).

Tax credits earned under the B&O tax with a carry forward provision can carry forward and be claimed as a credit against the margin tax for a limited time. These carryforward credits may not exceed the amount of margin tax due. Taxpayers may claim these unused B&O tax credits through tax year 2031 or the latest tax year that the taxpayer could have used the credits under current law as existing on December 31, 2026, whichever is earlier.

Margin tax returns are reported on an annual basis and are due by April 15th of the year following the end of the tax year covered by the return. The bill requires estimated quarterly payments for a tax year when the taxpayer owes $20,000 or more in tax. Estimated payments are due by the last day of the month following the end of the calendar quarter. For taxpayers engaged in business in Washington during the entire preceding tax year, quarterly payments equal 25% of the taxpayer's prior year tax liability. Taxpayers with gross income over $500,000 must file an annual return, even if they do not have a tax liability.

The B&O tax surcharges are reported on the combined excise tax return either monthly, quarterly, or annually, as under current law.

This bill repeals the preferential B&O tax rates and most B&O tax deductions, exclusions, and exemptions, except those legally required or necessary for efficient tax administration.

This bill allows a credit against retail sales tax for taxpayers that collect and timely remit retail sales tax to the department. The credit equals 0.2528% of the total amount of the general state retail sales tax properly collected and remitted to the department.

EFFECTIVE DATE:
This bill eliminates the B&O tax starting January 1, 2027, and the margin tax begins for gross income earned in 2027. The first quarterly estimated payments are due April 30, 2027. The annual tax return for 2027 is due April 15, 2028.

II. B - Revenue Impact

ASSUMPTIONS:
- Taxpayer affiliated groups that file a consolidated federal income tax return will file a combined margin tax return.
- Nexus applies to a combined group if one or more companies within the group have substantial nexus in Washington (RCW 82.04.067).
- The percentage of a business's worldwide taxable margin apportioned to Washington under the margin tax equals the percentage of the business's worldwide taxable gross receipts apportioned to Washington under the B&O tax.
- Taxpayers with a negative margin in a given fiscal year have no tax liability for that fiscal year. These taxpayers do not accrue a deduction or credit against the margin tax for future years.
- The growth of the income and deduction components of the taxable margin follows the growth of before-tax corporate profit forecasts from the Bureau of Labor Statistics (BLS) with an adjustment to account for the higher forecast of Washington employment vs. U.S. employment.
- Because of this significant change in Washington's business tax, a compliance factor of 90% applies to the first year of collections and 95% for each subsequent year.

DATA SOURCES:
- Economic and Revenue Forecast Council, November 2022 forecast
- Internal Revenue Service, Form 1120, Form 1120S, and Form 1065 returns
- Internal Revenue Service, W2 wage data
- Washington State Department of Revenue, excise tax data
- Bureau of Economic Analysis (BEA), Before-tax corporate profits with inventory value adjustment (IVA) and capital consumption
- Economic and Revenue Forecast Council, nonfarm payroll employment

REVENUE ESTIMATES:
This bill decreases state revenues by an estimated $1.2 billion in the 2025-27 Biennium and by $315 million in the 2027-29 Biennium.

TOTAL REVENUE IMPACT:

State Government (cash basis, $000):
FY 2024 - $ 0
FY 2025 - $ 0
FY 2026 - $ 0

FY 2027 - ($ 1,187,400)
FY 2028 - ($ 316,500)
FY 2029 - $ 1,300

Local Government, if applicable (cash basis, $000): None

II. C - Expenditure Impact

ASSUMPTIONS:
The department will receive the first quarterly estimated payments in April 2027.

FIRST YEAR COSTS:
The department will incur total costs of $3,677,300 in Fiscal Year 2024. These costs include:
Labor Costs - Time and effort equate to 25.23 FTEs.
- Amend and adopt 213 administrative rules and advisories.
- Provide technical advice, interpretation, and analysis for internal use during the implementation process.
- Increase in payroll, human resources, and administrative functions to service new employees.
- Additional staff for system administration, service desk, network, and telephony.
- Meet with each tribe with a revenue-sharing compact entered under SHB 2803 (2020) to discuss changes in the compact or the authorizing legislation that might be appropriate to preserve the intended benefits of the negotiated compact.
- Integration of rulemaking impacts on system programming.

Object Costs - $334,500.
- Contract computer system preparation.
- Travel expenses for meetings with compacting tribes.
- Software.

SECOND YEAR COSTS:
The department will incur total costs of $5,029,400 in Fiscal Year 2025. These costs include:
Labor Costs - Time and effort equate to 37.93 FTEs.
- Continue to amend and adopt 213 administrative rules and advisories.
- Provide technical advice, interpretation, and analysis for internal use during the implementation process.
- Increase in payroll, human resources, and administrative functions to service new employees.
- Additional staff for system administration, service desk, network, and telephony.
- Continue to meet with each tribe.
- Integration of rulemaking impacts on system programming.

Object Costs - $327,500.
- Contract computer system preparation.
- Travel expenses for meetings with compacting tribes.
- Software.

THIRD YEAR COSTS:
The department will incur total costs of $14,553,500 in Fiscal Year 2026. These costs include:

Labor Costs - Time and effort equate to 67.33 FTEs.
- Continue to amend and adopt 213 administrative rules and advisories.
- Provide technical advice, interpretation, and analysis for internal use during the implementation process.
- Increase in payroll, human resources, and administrative functions to service new employees.

- Additional staff for system administration, service desk, network, and telephony.
- Continue to meet with each tribe.
- Setup, program, and test computer system changes.

Object Costs - $6,278,400.
- Contract computer system programming.
- Media campaign and translation services.
- Travel expenses for meetings with compacting tribes.
- Software.

FOURTH YEAR COSTS:
The department will incur total costs of $18,655,400 in Fiscal Year 2027. These costs include:
Labor Costs - Time and effort equate to 139.65 FTEs.
- Continue to amend and adopt 213 administrative rules and advisories.
- Assist taxpayers with reporting questions and respond to inquiries via email, web message, and paper correspondence.
- Process returns, payments and all associated work items, including issuing assessments for return errors and underpayments.
- Examine accounts and make corrections as necessary.
- Increase in payroll, human resources, and administrative functions to service new employees.
- Additional staff for system administration, service desk, network, and telephony.

Object Costs - $3,092,500.
- Contract computer system programming.
- Continue media campaign.
- Travel expenses for meetings with compacting tribes.
- Software.
- Acquire additional agent seat licenses at the Telephone Information Center.
- Print and mail notices, correspondence and returns to taxpayers who do not file returns electronically.

ONGOING COSTS:
Ongoing costs for the 2027-29 Biennium equal $37,175,900 and include similar activities described in the fourth-year costs. Time and effort equate to 162.03 FTEs.

Part III: Expenditure Detail

III. A - Expenditures by Object or Purpose:

	Fiscal Year 2024	Fiscal Year 2025	2023-2025 Total	2025-27 Biennium	2027-29 Biennium
Salaries and Wages	2,088,900	3,049,100	5,138,000	14,924,500	21,207,100
Benefits	689,300	1,006,300	1,695,600	4,925,200	6,998,300
Personal Service Contracts	275,000	275,000	550,000	7,125,000	500,000
Supplies & Material	435,800	511,400	947,200	4,965,600	6,770,900
Travel	11,700	16,500	28,200	162,800	400,400
Office Equipment	176,600	171,100	347,700	1,105,800	1,299,200
Total	3,677,300	5,029,400	8,706,700	33,208,900	37,175,900

III. B - FTE Detail:

Job Classification	Salary	FY 2024 FTEs	FY 2025 FTEs	2023 - 2025 Total	2025 - 2027	2027 - 2029
ADM ASST 3	44,808				.2	.9
COMMUNICATIONS CNSLT 4	66,420		2	1	2	

COMMUNICATIONS CNSLT 5	77,028	1	1	1	1	1
EMS BAND 4	126,619	.05	.05	.05	.05	.01
EMS BAND 5	147,919	.12	.12	.12	.12	.01
EXCISE TAX EX 1	44,808				1.05	1.2
EXCISE TAX EX 2	55,872				4.45	26.65
EXCISE TAX EX 3	61,632				2.35	10.7
EXCISE TAX EX 4	68,076		1	.5	1	1
FINANCIAL EX 3	85,020				.5	1
FISCAL ANALYST 1	44,808				.05	.1
FISCAL ANALYST 2	49,404	.2	.3	.25	.85	1.35
FISCAL ANALYST 3	57,324				.05	.1
FORMS AND RECORDS ANALYST 2	46,980				.05	.1
HUM RES CNSLT 1	51,888				1.5	1.5
HUM RES CNSLT 3	64,788				.5	
HUM RES CNSLT 4	71,520				1.5	1.5
IT APP DEV-ENTRY	82,260				1	
IT B A-JOURNEY	88,428	.3	.3	.3	1.75	.1
IT CUST SUP-ENTRY	66,228				.5	1
IT PROJ MGT-JOURNEY	92,844	.3	.3	.3	1	.5
IT QA-JOURNEY	88,428				4	1
IT SYS ADM-JOURNEY	92,844		.3	.15		
MGMT ANALYST4	73,260	3.21	10.71	6.96	26.76	9.77
MGMT ANALYST5	80,952	3.6	4.6	4.1	6.1	5.3
PROCUREMENT AND SUPPLY SP 2	50,592	.1	.1	.1	.4	.6
REVENUE AGENT 2	57,324				5.75	12.45
REVENUE AGENT 4	66,420				.5	1
REVENUE AUDITOR 2	61,632				5.5	22
REVENUE AUDITOR 3	68,076				6.5	23
TAX INFO SPEC 1	44,808				4.5	10.5
TAX INFO SPEC 2	48,156				1	1.5
TAX INFO SPEC 3	58,704				.5	.75
TAX POLICY SP 2	75,120	3.12	2.12	2.62	1.27	1.57
TAX POLICY SP 3	85,020	9.34	9.34	9.34	13.07	18.34
TAX POLICY SP 4	91,524	3.02	3.22	3.12	3.32	3.53
WMS BAND 2	94,669	.5	2	1.25	2.4	2
WMS BAND 3	107,685	.37	.47	.42	.47	.01
Total		25.23	37.93	31.58	103.51	162.04

III. C - Expenditures by Program (optional):

	Fiscal Year 2024	Fiscal Year 2025	2023-2025 Total	2025-27 Biennium	2027-29 Biennium
Total					

Part IV: Capital Budget Impact

None.

Part V: New Rule Making Required

Should this legislation become law, the department will use the standard process to create 20 new rules, use the expedited process to amend 122 rules, and will update approximately 71 excise tax advisories.

Persons affected by this rulemaking will include all persons subject to the B&O tax under current law or subject to the margin tax.

Revenue Impact Detail

			First Biennium		Second Biennium		Third Biennium	
FUND	SOURCE	CODE	1st YEAR	2nd YEAR	3rd YEAR	4th YEAR	5th YEAR	6th YEAR
GF-State	NEW	0000				1,683,000,000	6,919,600,000	7,569,000,000
GF-State	NEW2	0001				(17,400,000)	(43,300,000)	(45,000,000)
GF-State	Business and Occupation Tax	0105				(2,853,000,000)	(7,192,800,000)	(7,522,700,000)
Total						(1,187,400,000)	(316,500,000)	1,300,000
OTHER								
Total								
Net						(1,187,400,000)	(316,500,000)	1,300,000

Revenue Impact - by Biennium

FUND	SOURCE	CODE	1st Biennium	2nd Biennium	3rd Biennium
GF-State	NEW	0000		1,683,000,000	14,488,600,000
GF-State	NEW2	0001		(17,400,000)	(88,300,000)
GF-State	Business and Occupation Tax	0105		(2,853,000,000)	(14,715,500,000)
Total				(1,187,400,000)	(315,200,000)
OTHER					
Total					
Net				(1,187,400,000)	(315,200,000)