

HB 2150, to reform the business and occupation tax to promote fairness and administrative simplicity

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March 2015

Key Findings

1. *House Bill 2150 is a variation of the Single Business Tax reform that Washington Policy Center first proposed in a 2010 study.*
2. *Under HB 2150 the dozens of current B&O tax rates and preferences would be replaced with three new tax rates.*
3. *Business owners could choose one of three ways to determine their taxable amount each year, or an owner could choose a flat \$500,000 tax exemption, meaning about 286,000 businesses would pay no B&O tax.*
4. *HB 2150 would keep the current preferential B&O tax treatment for the agriculture and aerospace sectors.*
5. *The bill is crafted to be revenue neutral for the state.*

Introduction

A major reform to the state's business and occupation (B&O) tax has been introduced by Rep. Drew MacEwen. The proposal, House Bill 2150, is a variation of the Single Business Tax reform that Washington Policy Center first proposed in its 2010 study.¹

Under HB 2150 the dozens of current B&O tax classifications and numerous preferences would be replaced with three new tax rates. Every business owner could choose one of three standard deductions to determine their taxable amount each year, or an owner could choose a flat \$500,000 exemption from its gross receipts, meaning business activity up to this point would be exempt from tax. According to the bill

sponsor, this would exempt nearly 286,000 small businesses from paying any B&O tax at all.² The proposal has been crafted to be revenue neutral for the state.

Overview of the B&O tax

Washington's Department of Revenue (DOR) describes the B&O tax as a tax on the "gross receipts of all business operating in Washington, as a measure of the privilege of engaging in business. The term gross receipts means gross income, gross sales, or the value of products, whichever is applicable."³

The current B&O rate descends from the Business Activities Tax of 1933, which was the state's first gross receipts

1 "Replacing the Business and Occupation Tax with a Single Business Tax," by Jason Mercier and Carl Gipson, Policy Brief, Washington Policy Center, May 2010 at <http://www.washingtonpolicy.org/publications/brief/replacing-business-and-occupation-tax-single-business-tax-0>.

2 "Representative MacEwen B&O Proposal," February 2015 at <https://www.washingtonpolicy.org/sites/default/files/BODData.pdf>.

3 "Business & Occupation Tax RCW 82.04," Washington Department of Revenue, 2005 at http://dor.wa.gov/docs/reports/2005/Tax_Reference_2005/24bando.pdf.

tax on businesses. The tax was adopted as a temporary, emergency revenue measure during the Depression. After an unsuccessful court challenge, the Supreme Court upheld the tax later that year.

Too often lawmakers try to soften the state's hated B&O tax with targeted credits, deductions and preferences to reduce the economic distortions it creates and anti-competitive position it puts Washington's employers in, especially small and start-up businesses. The reform that Washington Policy Center first proposed in 2010, which is included in HB 2150, is a better way to improve the state tax system.

Analysis of HB 2150

Under HB 2150, dozens of B&O tax classifications and numerous preferences would be replaced on a revenue neutral basis with three new rates. Every business owner could choose one of three standard deductions to determine their taxable amount each year.⁴ The three new rates would be:

- Services: 3.75 percent
- Retail/wholesale/manufacturing/banking: 1.60 percent
- Telecom: 1.20 percent

Every business owner would be allowed to deduct the first \$500,000 from gross receipts, meaning about 286,000 businesses would pay no B&O tax.

To determine the taxable amount for businesses with activity greater than \$500,000, a business owner would be allowed to deduct his or her choice of either (whichever is greater):

- The cost of goods sold
- The total compensation (up to \$200,000 per employee)
- 30 percent of revenue

Each year a business owner would be able to choose which of these deductions to apply.

With political realities in mind, HB 2150 would maintain the current preferential B&O tax treatment for agriculture and aerospace sectors. All other B&O tax preferences would be repealed. The proposal is crafted to be revenue neutral for the state.

According to Rep. MacEwen:

“This is a fundamental reform of our business tax structure that simplifies our code, eliminates the tax for over 60% of businesses, and remains revenue neutral. This bill will accelerate job growth, grow a strong economy, and make WA a national leader and global competitor.”⁵

Combined with the new reform recently adopted by the legislature to require tax preference performance statements for new tax preferences, enacting HB 2150 would bring an improvement in how the State of Washington taxes businesses. A tax preference performance statement requires an explicit legislative purpose to be defined for a new tax preference along with providing “clear, relevant, and ascertainable metrics and data requirements” to help measure its effectiveness.⁶

4 “HB 2150: Reforming the business and occupation tax to provide fairness and administrative simplicity,” Washington State Legislature, introduced February 19, 2015 at <http://apps.leg.wa.gov/billinfo/summary.aspx?bill=2150&year=2015>.

5 E-mail to the author from Rep. MacEwen, February 17, 2015 (copy available on request).

6 “Legislature requires Tax Performance Statement for new tax preferences,” by Jason Mercier, Washington Policy Center, July 2, 2013 at <http://www.washingtonpolicy.org/blog/post/legislature-requires-tax-performance-statement-new-tax-preferences>.

Tax Foundation endorsement

Washington's B&O tax is nationally recognized as one of the worst ways to tax businesses. Among the B&O's national critics are the tax experts at the non-partisan Tax Foundation. Washington Policy Center asked the Tax Foundation for its analysis of HB 2150. Here are the comments of the Tax Foundation's Scott Drenkard, Economist and Manager of State Projects:

*"The reform proposed by HB 2150 is a better alternative to Washington's current B&O tax and brings the state closer to adherence with the principles of sound taxation. By allowing businesses the ability to deduct some expenses, the state could start to mitigate some of the economically damaging effects of tax pyramiding. By collapsing Washington's 35 B&O business categories, the proposal brings some sanity back to the tax system."*⁷

As noted by the Tax Foundation, it is important for any tax reform efforts to focus on sound principles of taxation (such as simplification and transparency) – not simply be an excuse take more money from businesses for government spending.

These principles include tax-code building blocks such as simplicity, fairness, accountability, economic neutrality, competitiveness and reliability.⁸

Conclusion

HB 2150 would consolidate today's confusing array of B&O tax rates on business activities, repeal many of the special interest tax credits and exemptions that have built up over the years and provide welcome relief to small businesses with a flat \$500,000 exemption.

This reform, combined with the requirement for new tax preferences to adhere to a performance statement with detailed legislative intent, would help bring more transparency and simplicity to the state's B&O tax and would provide a saner tax structure for Washington employers to navigate.

"A fair field and no favors" is a good motto for a strong tax system and one Washington lawmakers should embrace. Enacting HB 2150 would move the state in this direction.

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Nothing here should be construed as an attempt to aid or hinder the passage of any legislation before any legislative body.

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⁷ E-mail to the author from Scott Drenkard, Economist and Manager of State Projects, Tax Foundation, March 9, 2015 (copy available on request).

⁸ "Principles of Taxation for Elected Officials," by Paul Guppy and Jason Mercier, Washington Policy Center, October 2008 at <http://www.washingtonpolicy.org/publications/notes/principles-taxation-elected-officials>.