Department of Revenue Fiscal Note

Bill Number: 6138 E S SB	**Title:** Tax pref elim and compliance	**Agency:** 140-Department of Revenue

Part I: Estimates

☐ **No Fiscal Impact**

Estimated Cash Receipts to:

Account	FY 2016	FY 2017	2015-17	2017-19	2019-21
GF-STATE-State 01 - Taxes 01 - Retail Sales Tax	37,510,000	48,007,000	85,517,000	105,947,000	117,842,000
GF-STATE-State 01 - Taxes 05 - Bus and Occup Tax	25,908,000	50,902,000	76,810,000	135,835,000	194,894,000
GF-STATE-State 01 - Taxes 75 - Penalties and Intrst	10,420,000	12,510,000	22,930,000	25,020,000	25,020,000
Performance Audits of Government Account-State 01 - Taxes 01 - Retail Sales Tax	59,000	75,000	134,000	167,000	188,000
Total $	73,897,000	111,494,000	185,391,000	266,969,000	337,944,000

Estimated Expenditures from:

	FY 2016	FY 2017	2015-17	2017-19	2019-21
FTE Staff Years	15.7	23.4	19.6	30.8	35.7
Account					
GF-STATE-State 001-1	1,835,600	2,762,100	4,597,700	7,066,500	7,803,900
Total $	1,835,600	2,762,100	4,597,700	7,066,500	7,803,900

Estimated Capital Budget Impact:

NONE

This bill was identified as a proposal governed by the requirements of RCW 43.135.031 (Initiative 960). Therefore, this fiscal analysis includes a projection showing the ten-year cost to tax or fee payers of the proposed taxes or fees.

The cash receipts and expenditure 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.

Legislative Contact:		Phone:	Date: 07/01/2015
Agency Preparation:	Rachel Knutson	Phone: 360-534-1532	Date: 07/02/2015
Agency Approval:	Kim Davis	Phone: 360-534-1508	Date: 07/02/2015
OFM Review:	Kathy Cody	Phone: (360) 902-9822	Date: 07/06/2015

Part II: Narrative Explanation

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

Briefly describe, by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

Note: Note: This fiscal note reflects language in ESSB 6138, 2015 Legislative Session.

PART I - Repealing the Preferential B&O Tax Rate for Royalty Income
This part repeals the preferential business & occupation tax rate for royalties under RCW 82.04.2907 and would tax royalties under the service and other activities classification.

PART II - Nexus
This part extends the business and occupation (B&O) tax to out-of-state businesses with no physical presence in Washington, but who engage in wholesale activities or make wholesale sales into Washington. These businesses with more than $267,000 of receipts from this state will have economic nexus with Washington and will be required to remit B&O tax.

This part also provides greater clarity for certain out-of-state sellers by providing clear statutory guidelines for determining when they are required to collect Washington's retail sales or use tax and are subject to B&O taxes. "Click-through nexus" provisions are established, which provide that remote sellers are presumed to have a substantial nexus with this state for sales and use tax collection purposes if:
- They have relationships with in-state persons who refer potential customers to the remote seller through links on websites or otherwise; and
- Sales to purchasers in this state under those relationships exceed $10,000 in the preceding calendar year.

Part III - Manufacturing Machinery and Equipment Exemption for Software Manufacturers
Under current law, the manufacturers' machinery and equipment (M&E) sales and use tax exemption provides retail sales and use tax exemptions for:
- Machinery and equipment used directly in a manufacturing operation or research and development operation by a manufacturer or processor for hire;
- Sales of or charges made for labor and services rendered in respect to installing, repairing, cleaning, altering, or improving qualifying machinery and equipment; and
- Qualifying machinery and equipment used directly in a testing operation by a person engaged in testing for a manufacturer or processor for hire.

This part amends the M&E exemption by:
1. Clarifying that the exemption applies to persons engaged in developing prewritten software delivered to customers electronically rather than by means of tangible storage media.
2. Making businesses ineligible for the exemption if:
    a. They are a member of an affiliated group having at least one member who was registered to do business in Washington before July 1, 1981;
    b. The combined employment in the state of the affiliated group exceeds 40,000 full-time and part-time employees as of August 1, 2015; and
    c. The business activities of the affiliated group primarily include development, sales and licensing of computer software and services.

Part IV - Late Payment Penalties
Under current law, late tax returns receive a penalty of:
- 5 percent from one day after the due date to the last day of the month following the due date,
- 15 percent from the first day of the second month following the due date to the last day of that month, or

- 25 percent penalty from the first day of the third month and thereafter.

This proposal increases penalties on late tax returns to:
- 9 percent from one day after the due date to the last day of the month following the due date,
- 19 percent from the first day of the second month following the due date to the last day of that month, or
- 29 percent from the first day of the third month to the last day of that month.

Part V - Miscellaneous Provisions
This legislation is effective August 1, 2015, except for Part II which takes effect September 1, 2015.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

PART I - Repealing the Preferential B&O Tax Rate for Royalty Income
ASSUMPTIONS
- Growth rate will mirror the B&O tax growth rate reflected in the Economic & Revenue Forecast Council's November 2014 forecast.
- In Fiscal Year 2014, there were 1,313 taxpayers assumed to be reporting under this classification correctly.
- There are 10 months of cash collections for Fiscal Year 2016 due to the August 1, 2015 effective date.

DATA SOURCES
- Economic & Revenue Forecast Council November 2014 Forecast
- Fiscal Year 2014 Department of Revenue taxpayer data

REVENUE ESTIMATES
If this proposal passes, state revenues will increase by approximately $13.9 million in Fiscal Year 2016 and $17.5 million in Fiscal Year 2017.

Part II - Economic Nexus for Out-of-State Wholesalers
ASSUMPTIONS
- September 1, 2015 effective date, resulting in 9 months of impact for Fiscal Year 2016.
- Compliance is assumed to be 13 percent in Fiscal Year 2016, 26 percent in Fiscal Year 2017, 33 percent in Fiscal Year 2018, 39 percent in Fiscal Year 2019, and 52 percent thereafter.
- No firms will modify their behavior or cease doing business with Washington based on establishing economic nexus.
- Washington's share of national gross for wholesale activity mirrors that of its share of United States Gross Domestic Product (GDP).

DATA SOURCES
- Washington State Department of Revenue excise tax returns
- Washington State Economic and Revenue Forecast Council
- United States Census Bureau
- United States Bureau of Economic Analysis

REVENUE ESTIMATES
This proposal increases state revenues by an estimated $12 million in Fiscal Year 2016 and by $33.4 million in Fiscal Year 2017.

Part II - "Click-Through Nexus"
ASSUMPTIONS
- A number of states have either considered or passed similar legislation to this proposal in the past several years.

Notably, New York State passed legislation and is now collecting sales tax from remote sellers. For FY 2013, $142 million was collected from 35 taxpayers. As New York State has population approaching 20 million residents and includes the largest, most densely populated city in the nation, New York City, additional research was conducted to look at other states with similar laws that more closely resemble Washington.
- Both Georgia (population 9.9 million) and North Carolina (9.8 million) are more comparable by population to Washington, and each has evaluated similar proposals in recent years. In 2012, Georgia estimated an impact ranging from $0 to $19 million for FY 2014, depending on if or how many remote sellers chose to terminate their relationships with Georgia-based affiliates. In 2009, North Carolina estimated an impact of $ 3.8 million for FY 2010 and $8.5 million for FY 2011. In 2010, North Carolina enacted a program to give retailers who operate an affiliate program in North Carolina an opportunity to resolve their tax liability. This resulted in registering 32 retailers generating an additional $12 to $14 million in sales tax revenue.
- Unlike Washington, neither New York, Georgia, nor North Carolina had previously established nexus with some of the largest internet retailers. In 2013, one of the largest internet retailers did approximately $67.9 billion in remote sales in the US, accounting for 26 percent of total US remote sales.
- An estimate for the potential increase in revenue generated from the “click-through nexus” portion of this proposal was generated by:
- Using revenue estimates derived from the experience of New York, Georgia, and North Carolina's similar "click-through nexus" legislation and prorating and adjusting these values to Washington State based on population size and per capita personal income.
- Further adjusting these values to account for the fact that Washington already has nexus with one of the largest internet retailers.
- Finally, an additional 10 percent adjustment was made to account for Washington having higher than average voluntary compliance with remote sellers and an active out-of-state audit presence compared to many other states.
- After these adjustments were made, a three state average value was computed to represent Washington's potential revenue increase from the passage of the "click-through nexus" portion of this bill.

DATA SOURCES
- Georgia State University Fiscal Research Center, Fiscal Note for House Bill 386 Substitute (LC 34 3477S), March 19, 2012
- North Carolina General Assembly, Fiscal Research Division, remote seller fiscal estimates and revenue generation data, 2009 & 2010
- New York State Department of Taxation and Finance data
- Internet Retailer Top 500 Guide, 2013
- US Census Bureau Population Estimates, 2013
- Economic and Revenue Forecast Council, June 2014 forecast
- Department of Revenue data
- Census Bureau E-States data

REVENUE ESTIMATES
"Click-through nexus" will increase state revenues by an estimated $11.8 million in the 9 months of collections in Fiscal Year 2016, and by $16.5 million in Fiscal Year 2017, the first full year of impacted collections. Local revenues will increase by $4.4 million in Fiscal Year 2016.

Part III - Manufacturing Machinery and Equipment Exemption for Software Manufacturers
ASSUMPTIONS
- Proposal will be effective August 1, 2015, resulting in 10 months of collections in Fiscal Year 2016.

DATA SOURCES
- Department of Revenue tax data
- November 2014 Economic and Revenue Forecast Council revenue forecast

REVENUE ESTIMATES
State revenues will increase by $25.7 million in Fiscal Year 2016 and by $31.5 million in Fiscal Year 2017. Local revenues will increase by $9.7 million in Fiscal Year 2016.

Part IV - Late Payment Penalties
ASSUMPTIONS
- Based on a review of tax return data from 2012, 2013, and 2014, on average penalty revenues do not fluctuate greatly from year to year.
- This proposal passes the Legislature effective August 1, 2015, impacting 10 months of collections in Fiscal Year 2016.

DATA SOURCES
- Department of Revenue, excise tax return data

REVENUE ESTIMATE
This bill increases state revenues by an estimated $10.4 million in the 10 months of impacted collections in Fiscal Year 2016, and by $12.5 million in Fiscal Year 2017, the first full year of impacted collections. There is no impact to local government revenues.

TOTAL REVENUE IMPACT:
The overall revenue gain for state government is $73.9 million in Fiscal Year 2016 and $111.5 million in Fiscal Year 2017. Local governments will gain $14.1 in Fiscal Year 2016 and $18.1 million in Fiscal Year 2017.

State Government (cash basis, $000):

FY 2016 -	$ 73,897
FY 2017 -	$ 111,494
FY 2018 -	$ 126,302
FY 2019 -	$ 140,667
FY 2020 -	$ 165,027
FY 2021 -	$ 172,917

Local Government, if applicable (cash basis, $000):

FY 2016 -	$ 14,116
FY 2017 -	$ 18,057
FY 2018 -	$ 19,288
FY 2019 -	$ 20,570
FY 2020 -	$ 21,448
FY 2021 -	$ 22,890

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing functions.

ASSUMPTIONS
This bill affects approximately 122,300 taxpayers. This includes:
- 108,000 taxpayers receiving penalties,
- 12,000 out of state wholesalers,

- 1,300 taxpayers that report royalty payments, and
- 1,000 new internet retailers

For both nexus provisions compliance is assumed to be 13 percent in Fiscal Year 2016, 26 percent in Fiscal Year 2017, 33 percent in Fiscal Year 2018, 39 percent in Fiscal Year 2019 and 52 percent in all subsequent years.

These expenditure levels assume that there are no FTE cuts for the Department of Revenue in the final budget.

FIRST YEAR COSTS
The Department will incur total costs of $1,835,600 in Fiscal Year 2016. These costs include:

Labor Costs – Time and effort equates to 15.7 FTEs.
- Additional staff to amend five administrative rules and create two new rules,
- Identify affected businesses to create mailing lists to send special notices and other educational information,
- Create a special notice and update web content,
- Provide technical advice, interpretation and other guidance for the Department's operating divisions,
- Create a new tax discovery unit to identify, contact, assess and collect from unregistered out-of-state taxpayers,
- Create a new audit unit to investigate and audit out-of-state companies,
- Prepare for and conduct taxpayer appeals of notices and assessment, and
- Provide Department representation by the Attorney General's Office.

Object Costs - $406,900.
- Mail letters to businesses exceeding any of the economic nexus thresholds to advise them of the need to file returns and provide efile instructions.
- Print and mail special notice to affected businesses,
- Office supplies and materials,
- Legal support from the Attorney General's Office,
- Filing fees for tax warrants,
- Additional funding to assist in recruitment and retention of individuals providing out-of-state audit services.

SECOND YEAR COSTS
The Department will incur total costs of $2,762,100 in Fiscal Year 2017. These costs include:

Labor Costs – Time and effort equates to 23.4 FTEs.
- Additional staff to provide technical advice, interpretation and other guidance for the Department's operating divisions,
- Identify, contact, assess and collect from unregistered out-of-state taxpayers,
- Investigate and audit out-of-state companies,
- Prepare for and conduct taxpayer appeals of notices and assessments, and
- Provide Department representation by the Attorney General's Office.

Object Costs - $713,700.
- Mail letters to businesses exceeding any of the economic nexus thresholds to advise them of the need to file returns and provide efile instructions.
- Office supplies and materials,
- Legal support from the Attorney General's Office,
- Filing fees for tax warrants, and
- Additional funding to assist in recruitment and retention of individuals providing out-of-state audit services.

ONGOING COSTS
Ongoing costs for the 2017-19 Biennium equal $7,066,500 and include similar activities described in the second year costs. Time and effort equates to 30.8 FTEs.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2016	FY 2017	2015-17	2017-19	2019-21
FTE Staff Years	15.7	23.4	19.6	30.8	35.7
A-Salaries and Wages	855,700	1,264,300	2,120,000	3,410,100	3,938,400
B-Employee Benefits	256,600	379,300	635,900	1,023,100	1,181,200
C-Professional Service Contracts		300,000	300,000	600,000	600,000
E-Goods and Other Services	555,600	544,200	1,099,800	1,254,400	1,319,900
G-Travel	62,100	182,800	244,900	616,100	630,600
J-Capital Outlays	105,600	91,500	197,100	162,800	133,800
Total $	$1,835,600	$2,762,100	$4,597,700	$7,066,500	$7,803,900

III. B - Detail: *List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA*

Job Classification	Salary	FY 2016	FY 2017	2015-17	2017-19	2019-21
ADM ASST 5	47,014	0.0		0.0		
COMMUNICATIONS CNSLT 4	53,146	1.0	1.0	1.0		
EMS BAND 4	103,896	0.0		0.0		
EMS BAND 5	121,645	0.0		0.0		
EXCISE TAX EX 2	42,583	1.2	1.1	1.2	1.1	1.1
EXCISE TAX EX 3	50,563	3.3	3.2	3.3	3.7	4.1
HEARINGS SCHEDULER	32,688	0.1		0.0		
IT SPEC 4	63,195	0.3		0.2		
IT SPEC 5	69,756	0.7		0.4		
REVENUE AGENT 2	47,014	3.4	3.6	3.5	4.1	4.6
REVENUE AGENT 3	51,861	1.0	3.0	2.0	3.5	8.0
REVENUE AGENT 4	54,505		1.0	0.5	2.0	2.0
REVENUE AUDITOR 2	48,164	0.2	0.2	0.2	0.2	0.2
REVENUE AUDITOR 3	54,505		5.0	2.5	10.0	10.0
TAX INFO SPEC 1	36,757	0.5	0.6	0.6		
TAX INFO SPEC 4	54,505	0.8	1.0	0.9	1.0	
TAX POLICY SP 2	61,628	0.0		0.0		
TAX POLICY SP 3	69,756	2.5	2.5	2.5	2.5	2.5
TAX POLICY SP 4	75,080	0.7	1.2	1.0	1.2	1.2
WMS BAND 2	77,790				1.5	2.0
Total FTE's	1,216,051	15.7	23.4	19.6	30.8	35.7

Part IV: Capital Budget Impact

Identify acquisition and construction costs not reflected elsewhere on the fiscal note and dexcribe potential financing methods

NONE

None.

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

Should this legislation become law, the Department will use the complex process to create two new administrative rules; titled "Economic nexus - sales of tangible personal property" and "Remote sellers".

Further, the Department will use the expedited process to amend WAC 458-20-19401, titled: "Minimum nexus thresholds for apportionable activities"; WAC 458-20-101, titled: "Tax registration and tax reporting"; WAC 458-20-135, titled: "Extracting natural products"; WAC 458-20-24003, titled: "Tax incentives for high technology businesses"; and WAC

458-20-13601, titled: "Manufacturers and processors for hire - Sales" and WAC 458-20-228 , titled: " Returns, payments, penalties, extensions, interest, stay of collection". Persons affected by this rule making would include persons with royalty income, sellers of tangible personal property through the internet, out-of-state wholesalers, all taxpayers incurring a penalty, and prewritten computer software developers.