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fund Washington's future"*

Corporate Income/Net Receipts Tax: Microsimulation

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Background

- DOR developed a VAT/margins tax microsimulation model that matches IRS microdata with DOR excise tax data for 2017 (latest year available).
 - DOR projected growth for 2018-19
- A microdata model of **corporate income/net receipts tax** (CINRT) using 2017 data doesn't easily handle impacts of the Dec. 2017 tax reform (TCJA).
 - 2018 IRS microdata (post-TCJA) is expected to be available to DOR in early 2021.

Data

- 2017-2018 IRS business tax return microdata
 - Form 1120 (and 1120-S/1065 as of secondary importance)
- 2017-2018 DOR excise tax data
- Before-tax corporate profits with IVA & capital consumption adjustment, BEA (forecasts from ERFC)
- 2018-2019 SEC Form 10-K tax provision/tax paid data, Fortune 500 companies (to account for substantial deviations from average)

Corporate Inc./Net Receipts Tax Assumptions

Assumptions

- Single-factor apportionment
- Post-2018 baseline growth based on corporate profit growth
 - Adjust for WA % of employment?
- Apply JCT estimates of evolving impact by year
 - Based on YOY change in estimated impact
 - Weighted by apportionment
- Match IRS data to closest 4 quarters in DOR B&O data

Initial Parameters (Variable)

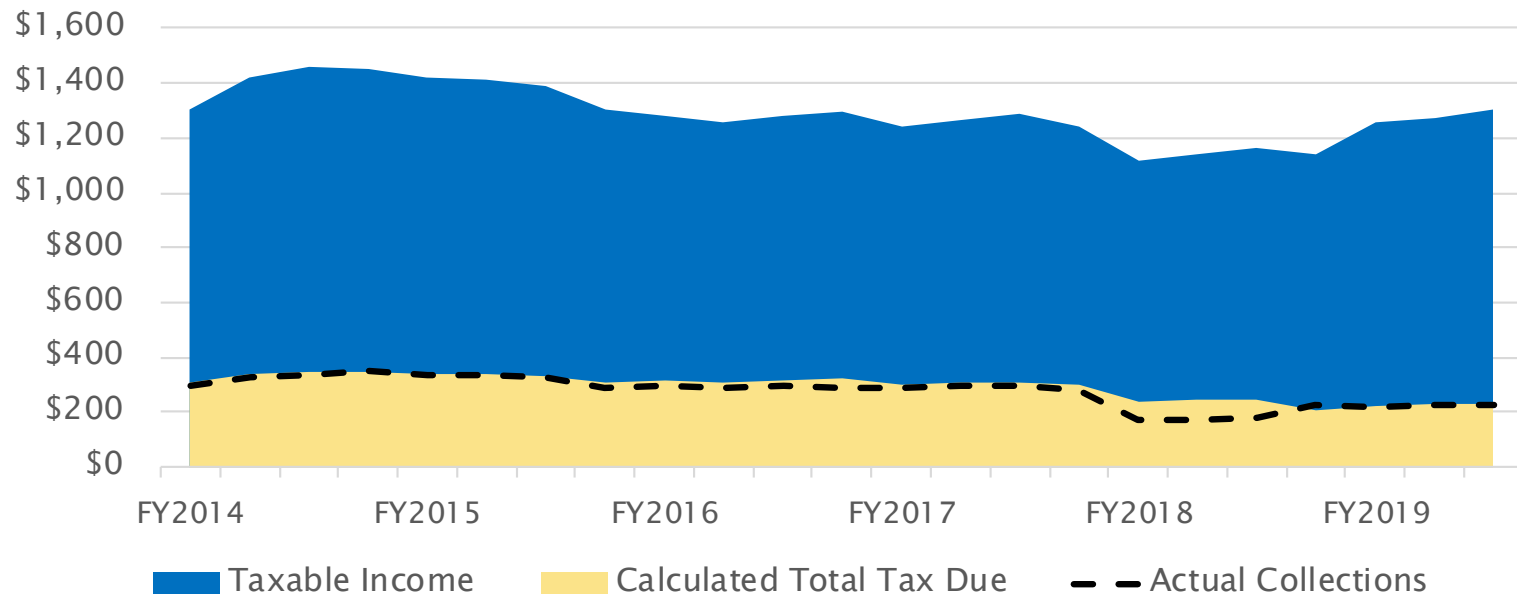
- Flat tax rate
- Not applied to pass-through entities
- 2017-19 biennium collections
 - 95% compliance (as existing tax)
- Estimated payments based on average state timing of collections
- Only deductions are those implicit in federal tax code
- No tax credits/alternative tax

Data Approach

- Once available, 2018 IRS microdata (+TCJA changes) **should** be best starting point to extend model 2019- .

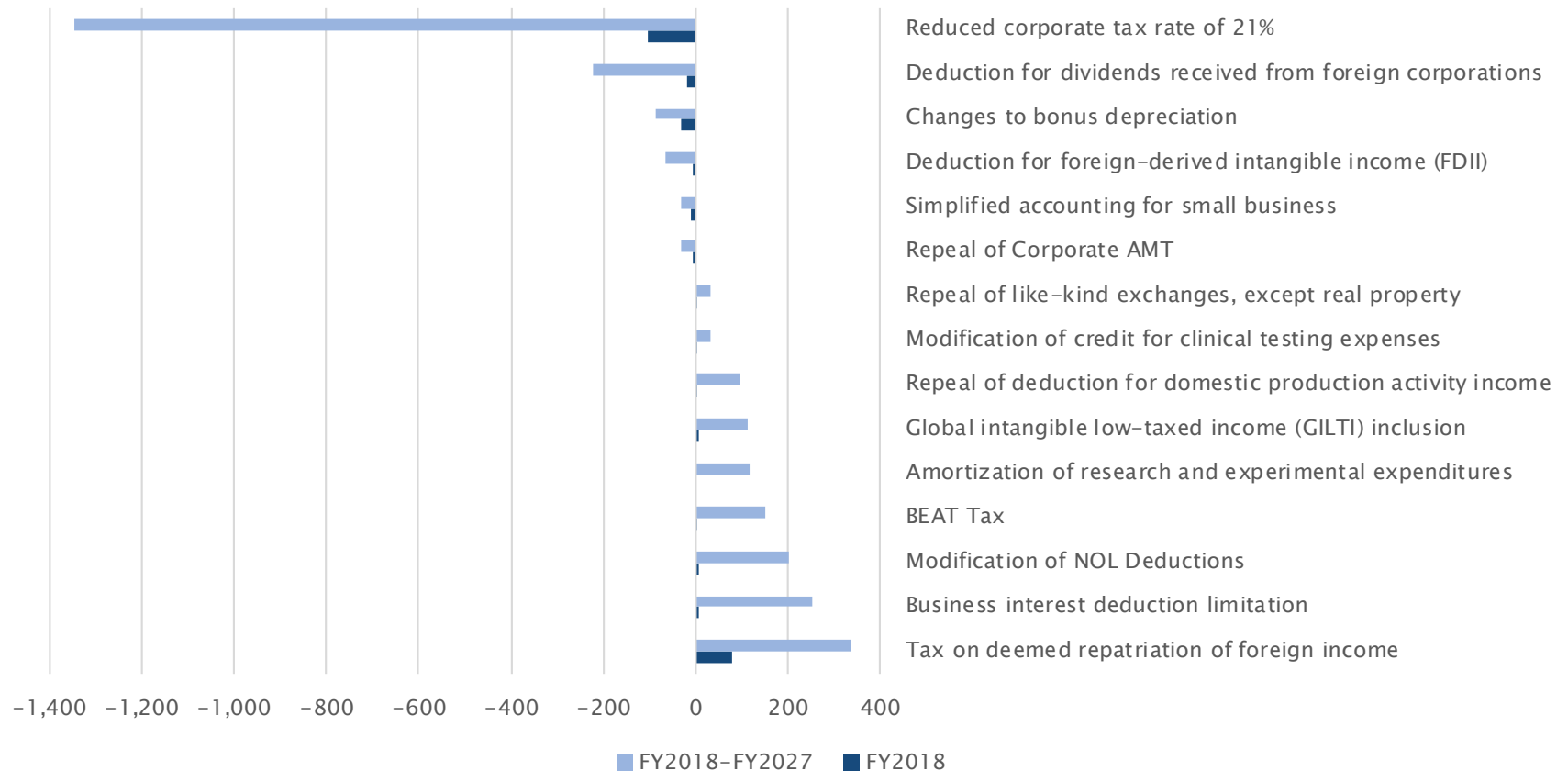
Issue: US corporate collections fell below forecasts in 2018.

US Taxable Income & Taxes 2014–19: With JCT TCJA Impacts (\$B)



Key TCJA Impacts to Model

Forecasted budget impacts of tax reform provisions (\$B)

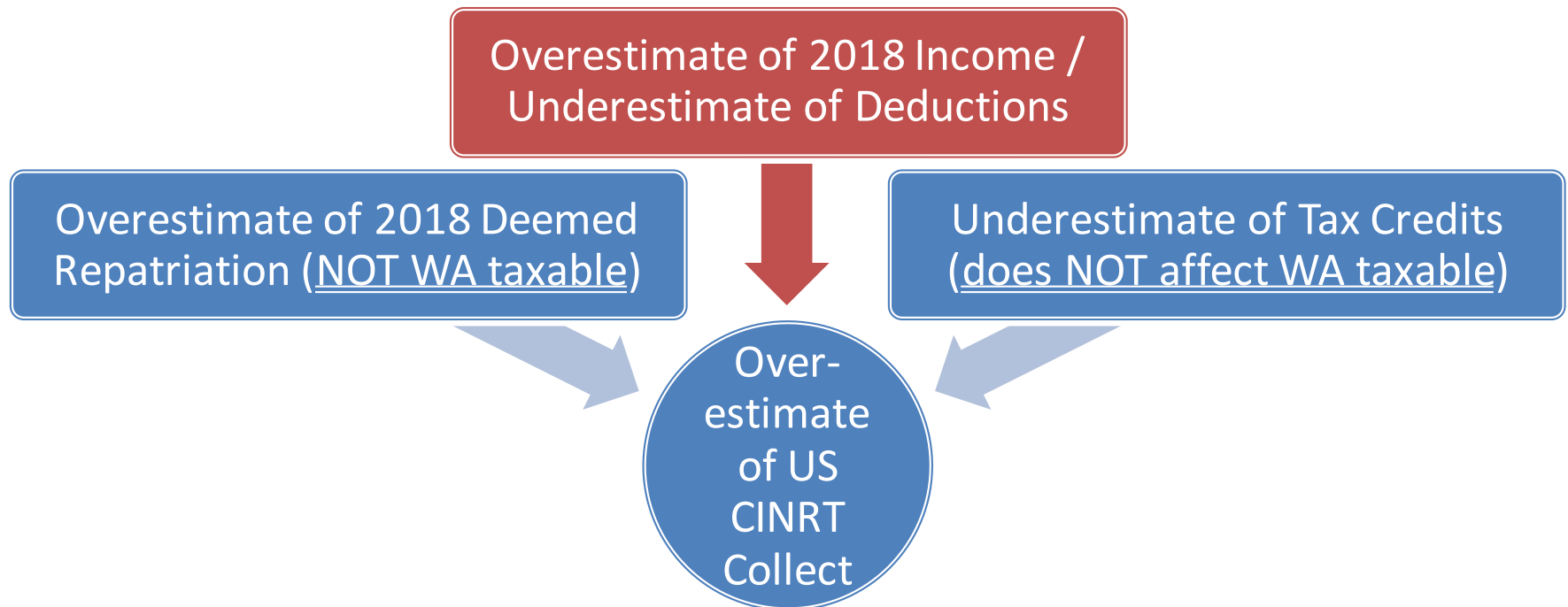


[1] Source: JCT (2017).

[2] Does not include budget effects related to changes in outlays.

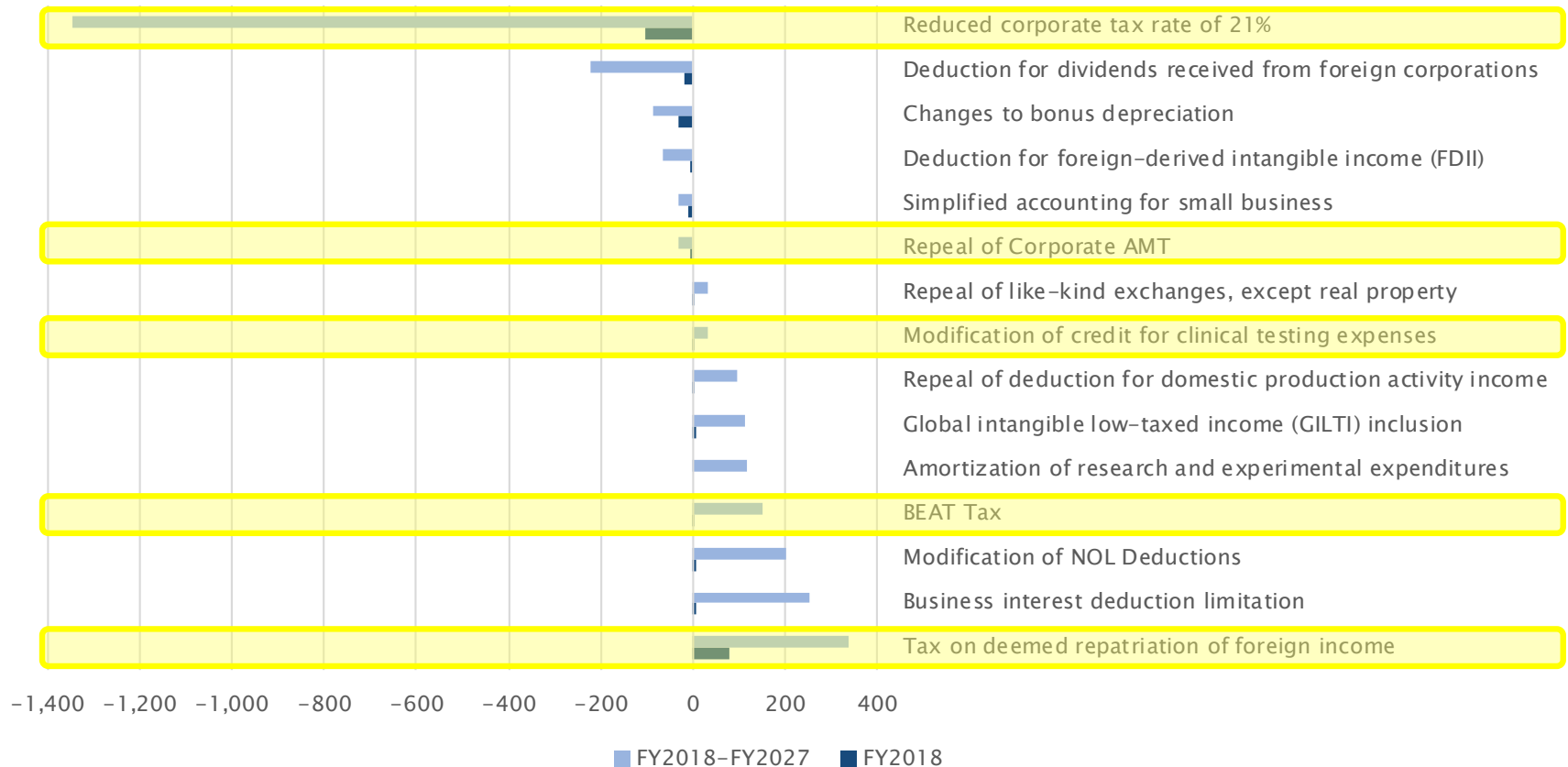
Data Exploration – Macro vs. Micro Approach

- Comparisons of 2018 IRS microdata (+TCJA changes) vs. CINRT macro model will offer insights into the overestimation of 2018 collections.



Data Exploration – Macro vs. Micro Approach

Forecasted budget impacts of tax reform provisions (\$B)

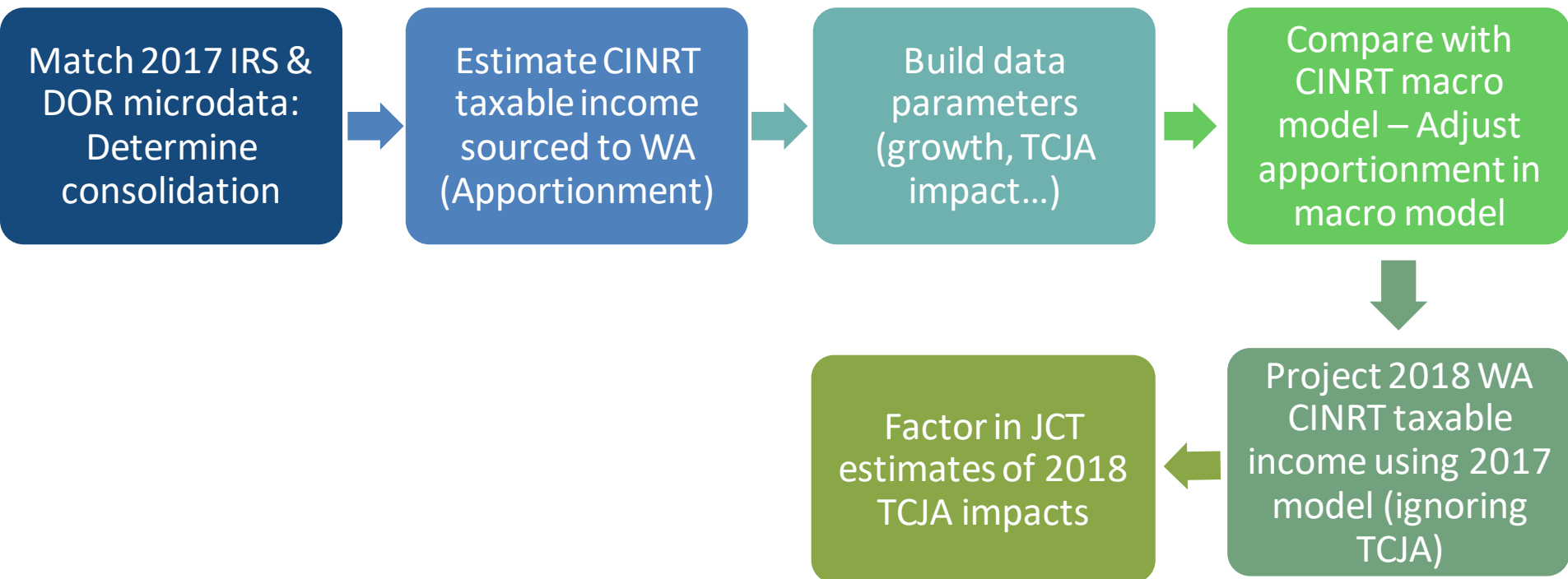


[1] Source: JCT (2017).

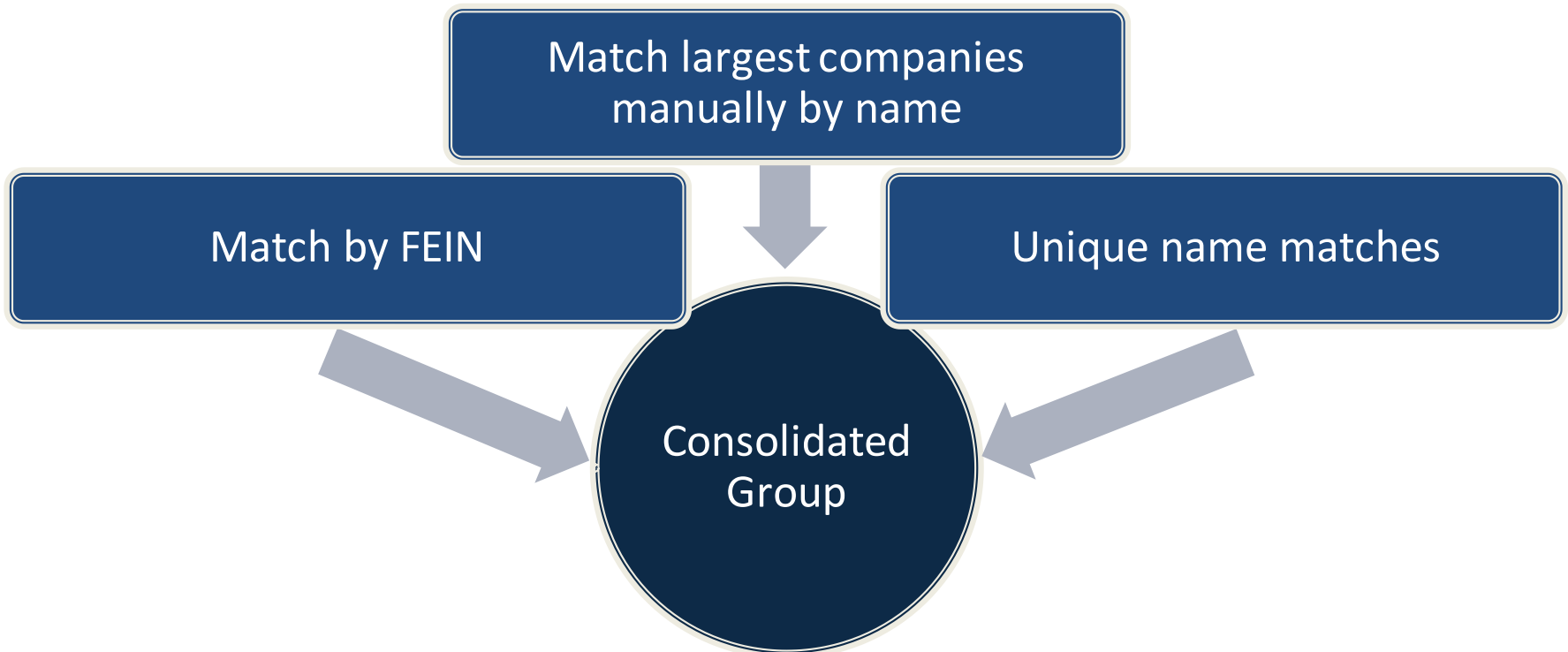
[2] Does not include budget effects related to changes in outlays.

Does not impact federal taxes through taxable income

2018 CINRT Taxable Using 2017 Micro Data

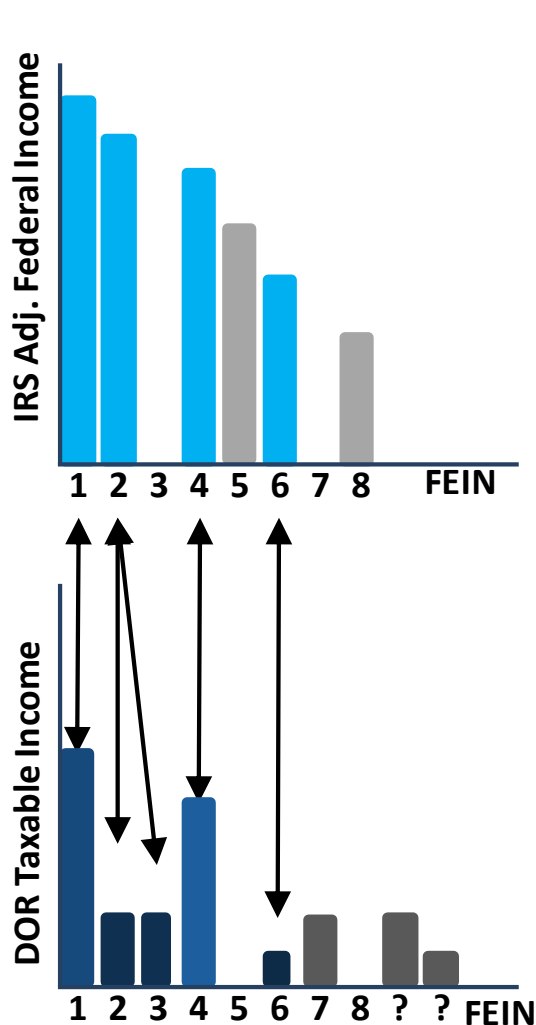


Matching

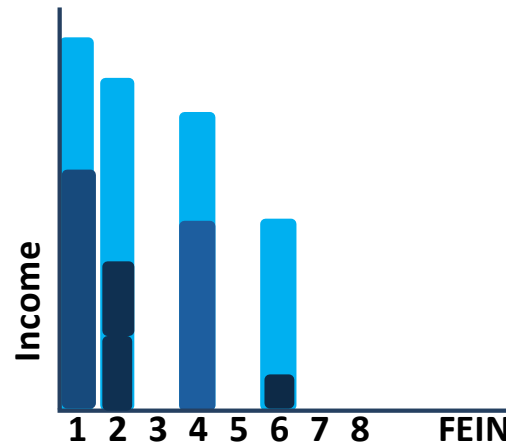


Positive IRS–B&O matches accounted for ~75% of Washington B&O taxable income in preliminary modeling of the VAT/margins tax.

Matching and Apportionment

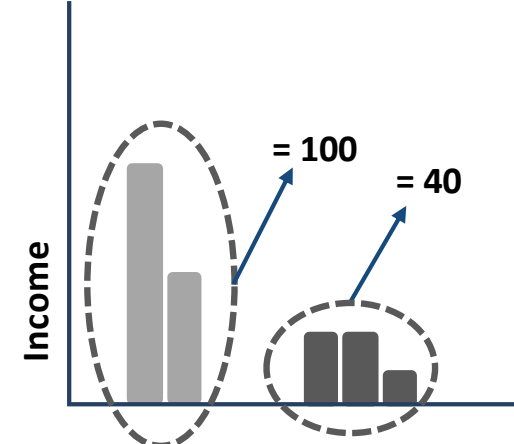


Matched Taxpayers



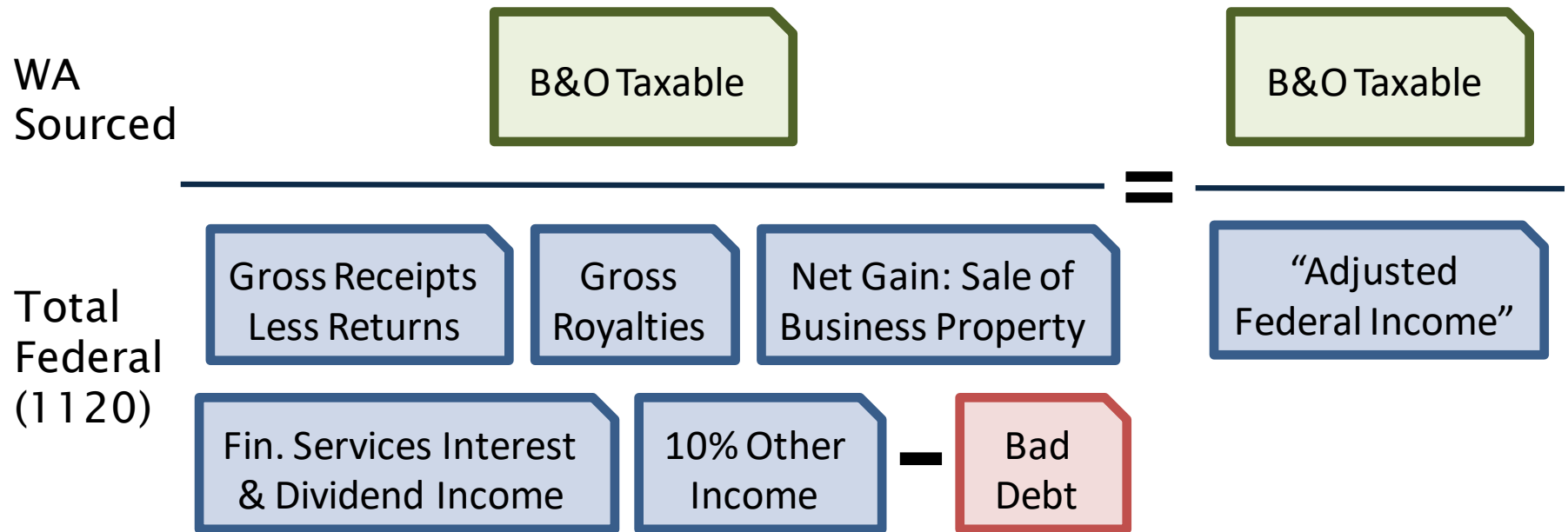
The dark blue shaded portions represent the percent of each matched taxpayer's total IRS income (and deductions) that is apportionable to Washington.

Unmatched Taxpayers



Within a category of unmatched taxpayers, each taxpayer will have the same apportionment percent (i.e., 40%), based on the ratio of unmatched B&O taxable income to unmatched IRS adjusted federal income.

Apportionment



Data Parameters

Baseline Growth Rates 2019–

- Based on Corporate Profits
- Differential growth by line item?

New Taxpayers?

- % of corporate growth from new vs. existing taxpayers
- Based on 2017 vs. 2018

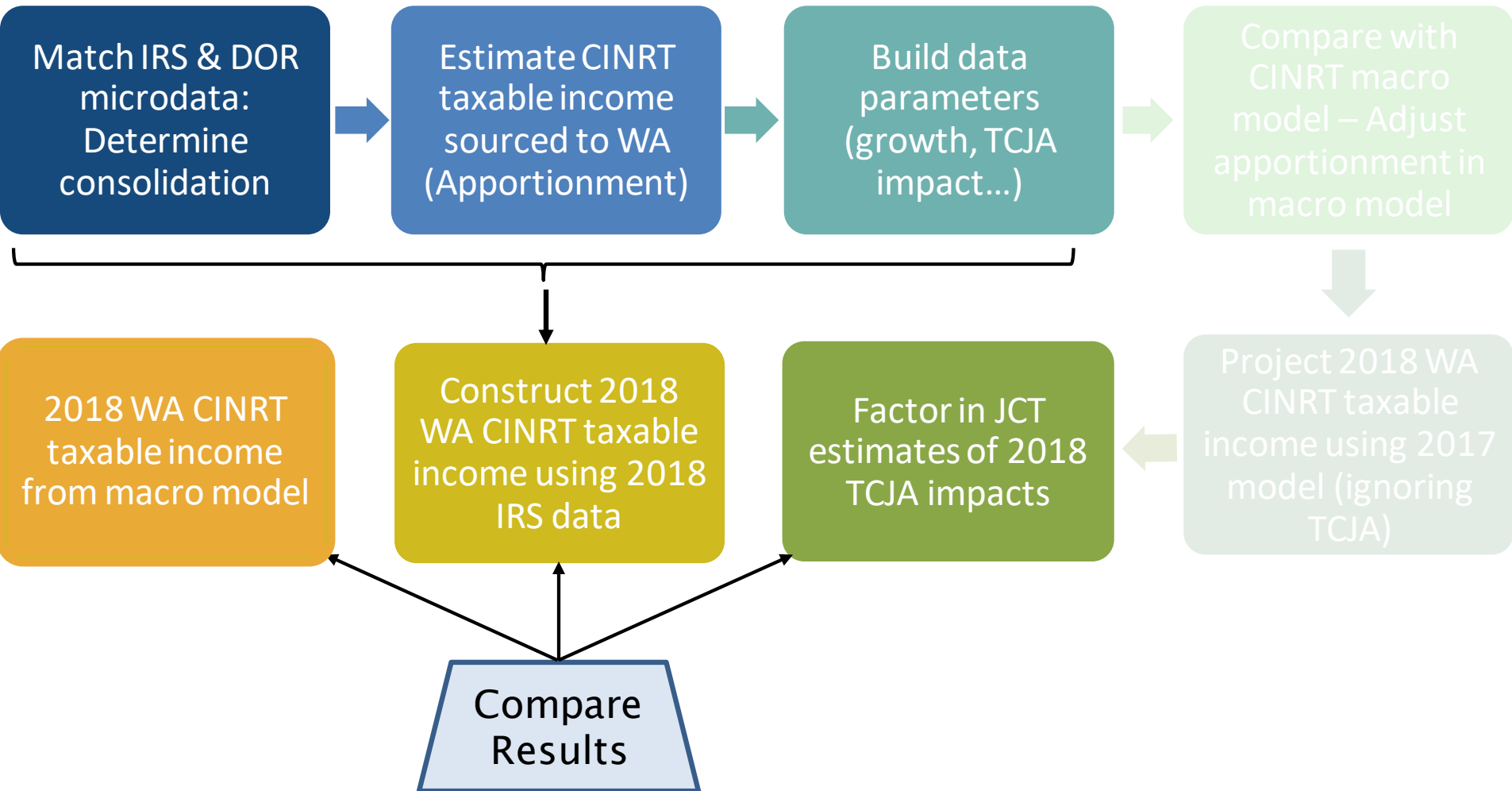
TCJA On/Off

- Turn on/off specific provisions?

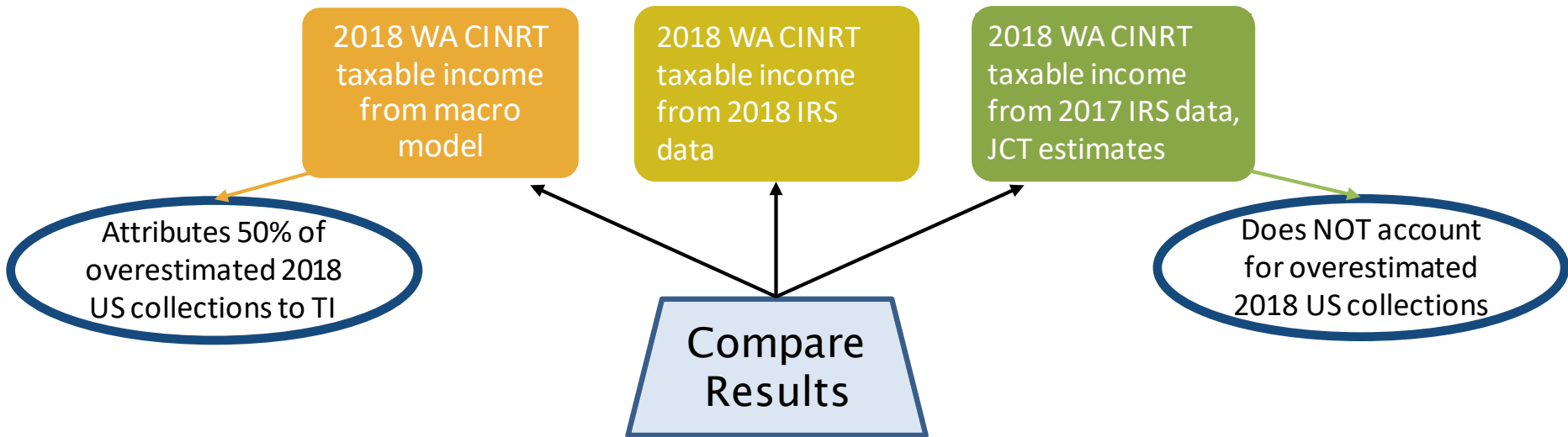
Impacts of Specific TCJA Provisions

- Allow % increase/decrease relative to JCT?

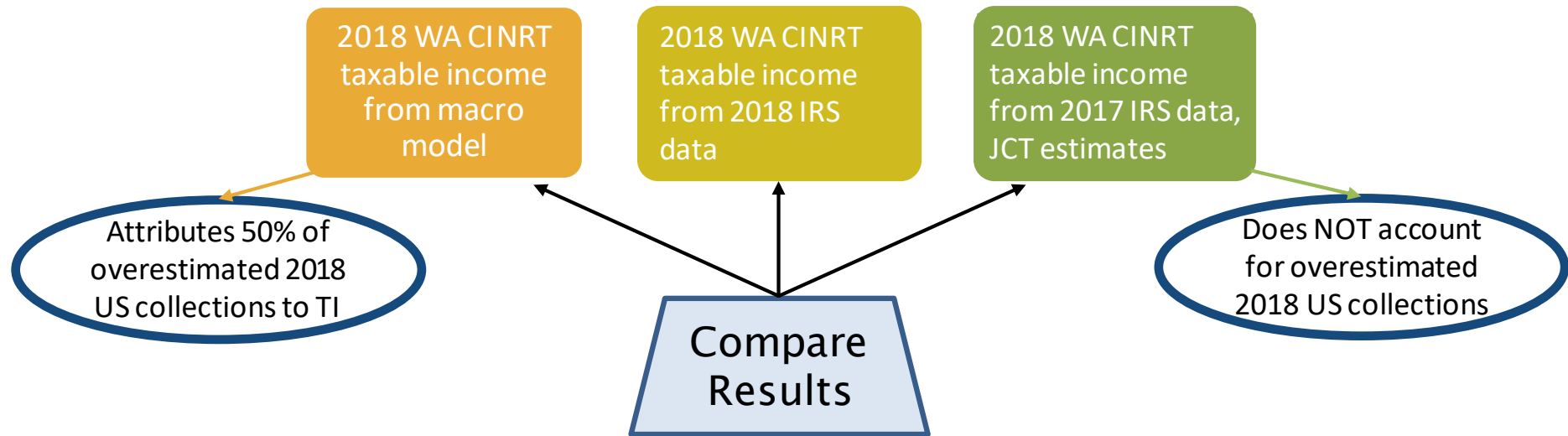
Comparison of Taxable Using 2018 Micro Data



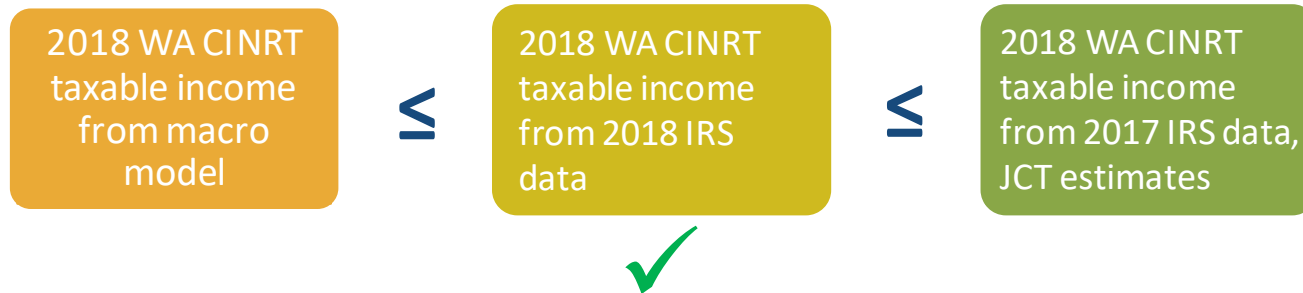
Comparison of Taxable Using 2018 Micro Data



Comparison of Taxable Using 2018 Micro Data



- Most likely result?



CINRT Microsimulation vs. Macro Model

Potential unexplained differences?

- Specific 2018 Form 1120 line items that particularly deviate from 2017/JCT expectations?
 - Permanence?
- Results of large companies in WA having very good/bad tax year in 2018
 - Permanence? Refer to 2019 (2020?) 10-Ks.
 - Macro model should largely capture this in apportionment adjustments

CINRT Microsimulation Basic Approach 2019-

* Start from model based on 2018 IRS microdata

Baseline YOY growth of all line items in 2019- based on US before-tax corporate profit statistic/forecast

Adjust relevant line items based on JCT estimates of annual budget impact of TCJA, relative to estimated 2018 budget impact (weighted by WA apportionment)

Factor in 2018-2019 changes of the largest Washington taxpayers (from 10-K analysis in CINRT macro model)

* Assumes no major surprises in comparison with CINRT macro model

Tax Parameters

Implementation & Collections Period

- Collections timing adjustment based on states with existing CINRT
- (Initially set to start w/ 2018 fiscal year)

Tax Rate(s)

- Flat/Graduated
- Brackets?
- (Initially set to Flat)

Entities Subject to Tax

- C-Corps
- S-Corps?
- Partnerships?
- (Initially set to C-Corps only)

Inclusions / Deductions / Credits

- Inclusion of federal deductions?
- WA share of federal credits?
- New credits / deductions as % of gross receipts?

Compliance %

- By year
- (Initially set to 95%)

Other Considerations and Questions

- Potential roll-back of TCJA provisions?
 - Dependent on control of US Senate in 2021?
 - Attempt to model flexibly to allow for such a scenario
- Does COVID-19 affect model beyond its effect on corporate profit forecasts?
- Include financial services interest & dividend income of companies from large to small up to the point where NAICS 52 accounts for same % of federal/B&O income?
 - B&O allows deduction for investment income, but deduction is not available to banking, lending, or security businesses.
 - Loan interest secured by first mortgages are subject to B&O tax only if originated by a person located in more than ten states, or an affiliate of such person

Questions for us?