TAX STRUCTURE ADVISORY GROUP
MEETING NOTES
February 20, 2020

Participants: Katie Baird (first half), Kris Bitney, Keri Boyer, Preston Brashers, Doug Conrad, Lucy Dadayan, Sara del Moral, Bob Heller, Hart Hodges, Sharon Kioko, Ashley Kittrell, Adam Klein, Steve Lerch, Andy Nicholas, Pete Parcells, Jim Schmidt, Kriss Sjoblom, Braden Fraser (second half), Valerie Torres

Personal Income Tax Model Presentation (Sara del Moral)

Will PIT conform to Internal Revenue Code?

- Will Washington have a penalty and interest system like federal tax system?
  - The Legislature would decide if Washington followed the federal system or had its own system.
- B&O and sales taxes have penalty systems that differ from federal level
  - One particular part of the federal system mentioned was the federal reasonable cause penalty waiver.

Modeling additional policies

- Will we model a deduction for social security?
  - This too is a matter of policy, and the Legislature would need to decide if Washington would allow a deduction for social security.
- Will we model a state earned income tax credit?
  - Washington currently has an unfunded earned income tax credit (EITC), called the Working Families Tax Exemption (WFTE). The 2002 report observed that Washington could incorporate an EITC. The Department of Revenue models the WFTE in a separate model, but we are not planning to include an estimate for the WFTE in the December 2020 report.

Income of non-residents / out of state income

- Can we get W2's from Washington businesses?
  - Their data may be unreliable but could be helpful
- How much income is included in this category?
  - The Department only receives federal income tax data for those returns with an address in Washington, so we do not have data for non-resident Washington earned income.
- Other states may have estimates of non-resident income and income earned out of state
  - We can look into this and discuss with other states.
- Bureau of Economic Analysis (BEA) does residency adjustments for state/county income
- New York has done work (analysis) related to resident PIT filers and non-resident PIT filers, and probably California as well
- New York state has data → see New York Department of Taxation and Finance
- Also check Connecticut and New Jersey who may have done some work

Tax brackets

- If possible, estimate elasticities and base brackets on that. i.e. relationship between after-tax incomes and labor force participation (both from people dropping out of labor force and people moving to other states)
- Maybe replicate 2002 rates, or base on rates from bill proposals

- With graduated rates, increasing the rates between the brackets proportionally seems reasonable.

Economic behavior (other)

- Consider a simultaneous equations model
  - Consumers want to maximize post-tax income
  - State wants to maximize revenue
  - How do we expect behaviors to change in response to a change in taxes?
  - Is there a break-even point? When you maximize post-tax income and state revenues
- Do behaviors change over time as awareness of policy changes increases?
  - Particularly in the first year after the implementation of a PIT, compared to the second year and beyond (after taxpayers have changed behavior).
  - Makes the ten-year estimates more interesting than what occurs the first year.
- Need to factor in that a PIT is a calendar year based tax versus our Washington fiscal years. This may make some behaviors harder to see in the fiscal year.

Volatility

- Can we model past years to get model volatility empirically?
- Can we breakdown volatility in the different income brackets – is there more or less volatility in different brackets?

Information/data sources

- Yoram Barzel (1976) -> paper – An Alternative Approach to the Analysis of Taxation
- Caroline Weber -> Evans School professor
- Richard Conway -> publishes Puget Sound Forecaster – paper on tax dysfunction

Household Tax Burden Model Presentation (Kris Bitney)

Missing Data

- US Treasury uses matching model like 2002/2016 model for missing data

Home ownership

- Do some counties have home ownership data?
- If household qualifies for certain tax breaks that only apply to home owners, it should be in the assessor data
- What about other FTI deductions, etc. that indicate home ownership?
- Compare totals to ACS or other sources

Elasticities

- Consider searching for elasticities for consumption categories
- A limit is that most elasticity estimates are for full population, not specific income categories or regions
- How does the model adjust for changes in expenditures patterns into the future?
  - For example, as people have purchased electric vehicles and presuming they spend less on gas then do they go out to eat more?

Consumer Expenditure Survey

- Well known issue -> tends to underestimate income for low and high income households

- Survey of Consumer Finances, a household survey produced by Federal Reserve, has better estimates of aggregate consumption, and we may be able to use that to make adjustments
    - Also, they have data on the savings rate by income group then the model could apportion their income and verify total consumption.
    - The data does contain a household description similar to the CES.

More on consumption adjustments

- Maybe account for underrepresented populations by inflating consumption based on aggregate consumption estimates published by BEA
- BEA has consumption estimates by state
- Consider looking for private datasets, such as transaction-level data

Sales tax on food -> there are really two exemptions

- General exemption
- Food stamp exemption: which is a requirement of the federal food stamp program and so unlikely to be removed.
- How would this work in a VAT model/tax?
- Neal Bruce appendix about the B&O compared to the VAT in the 2002 Study is interesting

Center for public health nutrition

- Doug Conrad, the UW economist, will contact the Center for Public Health Nutrition at the UW
- The Center for Public Health Nutrition has researched survey biases in consumption surveys, such as under-reporting

ITEP

- Organization that assesses state/local tax burdens by income
- They do what we are doing, so are worth looking into
- May overstate B&O transferred to consumers

Tax system transparency

- There is a relationship between transparency and tax incidence
- Reminder, the budget proviso included a section on looking at tax shifting
- Richard Conway developed a transparency index (Doug will reach out to Richard)
    - Estimated more than 50% of B&O tax is shifted to consumers
    - Another source suggests a huge portion (65%) of Corporate Income Tax is shifted to consumers [35% stayed with business]
    - Another source suggests about 59% of payroll taxes are shifted to consumers

Richard Conway

- Conway (2014) "Washington State and Local Tax System Dysfunction & Reform"
- See 2017 version

IRS informational returns

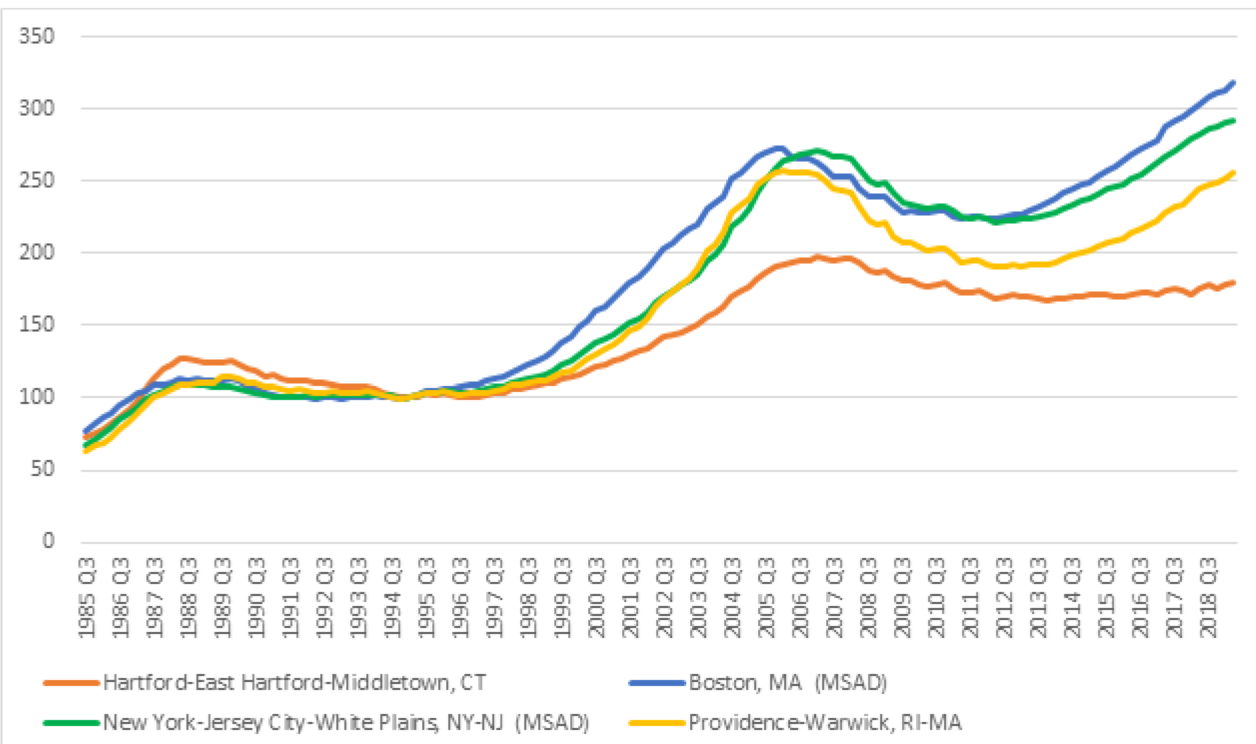
- Additional IRS dataset with people who may not file taxes

ADDITIONAL COMMENTS FROM PARTICIPANTS:

From Lucy Dadayan

- The chained CPI has been criticized by some. Have you considered using CPI instead?
  https://www.cbpp.org/blog/pros-and-cons-on-the-chained-cpi
  https://www.cbo.gov/publication/44088

- Proposal of possibly eliminating state sales tax
  - From a policy perspective, I would recommend against it. It's highly desirable to have a balanced tax structure, that doesn't rely on one source of tax.
- Personal income tax rates
  - Flat tax rate is not desirable as it's not progressive
  - Graduated tax rates are highly desirable and should be competitive regionally. But of course, need to look into overall expected tax burden. I have personal income tax rates / brackets by state. Happy to send it your way if helpful. Also, the Tax Foundation publishes tax rates for various tax sources. See for example sales tax rates in here: https://taxfoundation.org/publications/state-and-local-sales-tax-rates/
  - Of course it's necessary to look at state and local tax rates combined when estimating the tax burdens
  - While I think having an income tax is good, it might also have some drawbacks. CT was the last state to have introduced personal income tax in 1991. And CT's overall economy has been declining since; some argue because of the state no longer being regionally competitive. When you look at housing prices, you can see that in late 80s and early 90s, the housing prices in Hartford were above Boston, Providence, and NYC metro areas. The prices didn't decline as much as in the neighboring MSA's during the Great Recession, but haven't recovered either since recession. And currently house prices are substantially lower compared to neighboring metro areas. The chart below is what I put together for WSJ. Just a cautionary note…



    - I looked at IRS migration data, and WA has been continuously gaining taxpayers (particularly from California), which is good. I think if WA introduces personal income and/or corporate income tax, than the state might see some loss of taxpayers.

- Slide 12: I would consider breaking down income level even more by adding one more layer for taxpayers with or above $200,000. Also am surprised to see that taxpayers with less than $25K have higher business income compared to taxpayers earning above $25K but below $100K.
- Slide 17: Pardon my ignorance, but how did you end up with $1,600 tax due? If taxable income is $42,100 and the proposed rate is 3.4%, than tax due should be $1,431, no?
- Slide 18: In addition to IHS Markit, I would also suggest using Moody's forecasts. I think MA is the only state that uses both. And the forecasts from HIS Markit vs Moody's differ.
- For forecasting corporate income tax revenues, I would also suggest looking into business investments
- For personal income tax modeling, and in terms of conformity, I would suggest incorporating potential changes once some provisions of TCJA sunset.

- Few suggestions / thoughts: (1) consider using 5-year average from IRS data; (2) there are some expectations that some of the pass-through entities might corporate to take advantage of reduced federal corporate income tax rate; (3) consider demographic changes as well, perhaps using US Census Bureau population estimates and how it might impact income and sales taxes
- What about other credits like EITC?
- I think there is some deviation in some years in terms of withholding as share of total personal income tax. That was observed during the years of "fiscal cliff" and also TCJA

Taxing groceries

I think its not the best policy option and most states do not tax groceries.
https://www.taxpolicycenter.org/briefing-book/how-do-state-and-local-sales-taxes-work
https://www.cbpp.org/research/state-budget-and-tax/which-states-tax-the-sale-of-food-for-home-consumption-in-2017

Tobacco taxes

Raising the rate will encourage smokers to travel to Oregon or Idaho for buying cigarettes at a lower cost as both states have substantially lower tax rates.

ITEP

Happy to reach out to them and ask for technical documentation. I know most everyone working for ITEP.

From Hart Hodges

There is some discussion right now about finding a suitable chained price index. Doug Conrad and one other person have offered comments. I am also interested in helping with this question... and can work with Doug.

From others

Another policy/legislature question would be the federal deduction for contributions, particularly donations to colleges and universities.

NEXT MEETING

The next meeting of the Tax Structure Technical Advisory Group is scheduled for March 19, 2020, from 9:30 AM - 2:30 PM and will be held at the Department of Revenue in Tumwater. The agenda will include presentations on Corporate Conversions and Corporate Income Tax.

DOR TAX STUDY TEAM TO DO LIST

Reach out to other states regarding: non-resident personal income tax and resident filers with income earned out of state. In particular, New York, California, New Jersey, and Connecticut. (Possibly through the FTA List Serve)

The meeting adjourned at 2:42 PM.