Department of Revenue Washington State

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Washington Tax Law Changes Since 2002

Legislation & Policy

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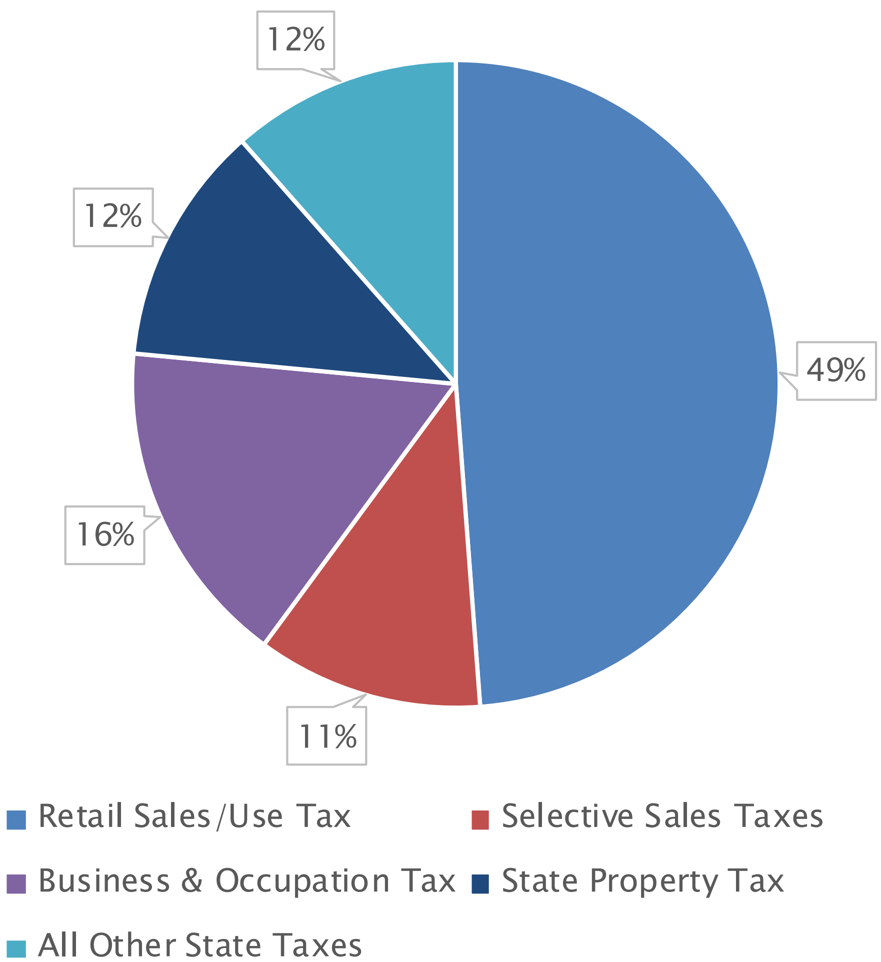
1. Changes in Washington Taxes Since 2002
2. Excise Tax Changes
   A. Sourcing of Sales
   B. Nexus
3. Property Tax Rate Changes
4. Discussion

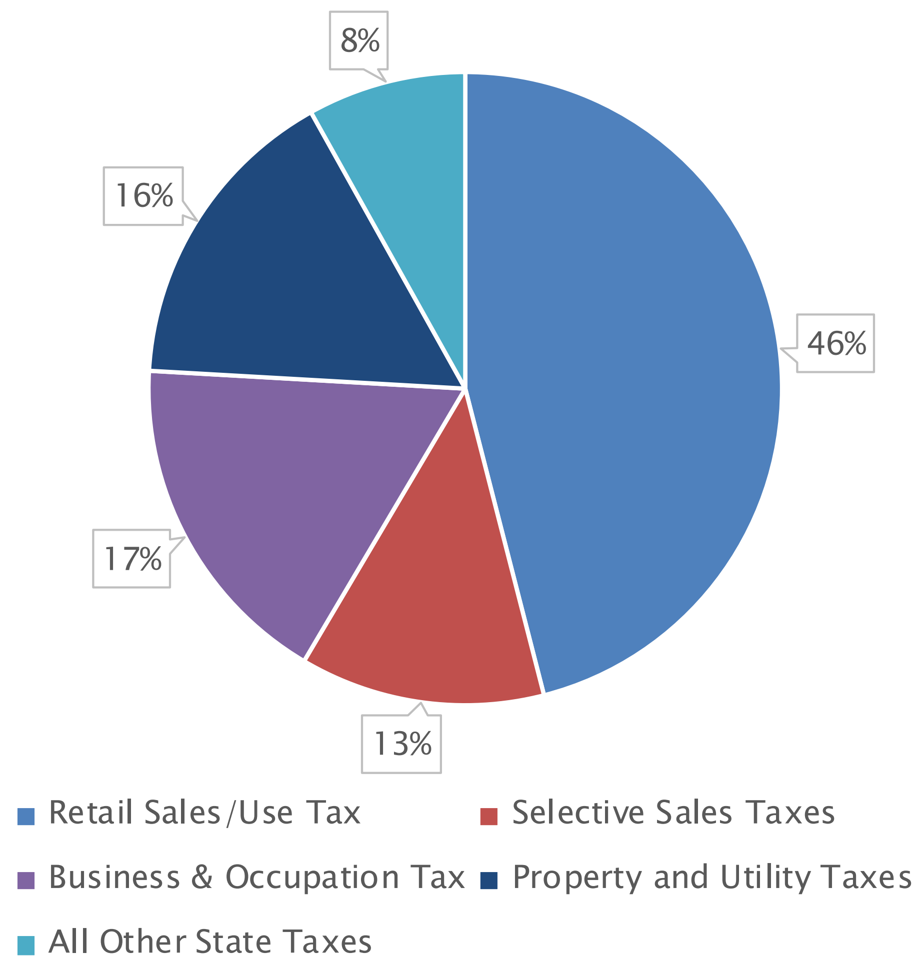
Washington Tax Reliance

- Washington State and local governments rely primarily on property and excise taxes.
    - Property taxes are generally levied annually on the assessed value of taxable real and personal property within the state or a taxing district authorized by law.
    - Excise taxes are generally levied on the value of transactions and include such taxes as sales and use, real estate excise, utilities, and business and occupations tax.

2002 Major Washington State Taxes



2018 Major Washington State Taxes



Major Changes

- Sourcing of sales
  - Whether a sale is considered to have occurred at the point of origin or at the destination
- Nexus
  - Whether a nonresident business must remit taxes to a particular jurisdiction, based on the Due Process and Dormant Commerce Clauses of the U.S. Constitution
- Changes to property taxes
  - Changed the state specific portion of the property tax, based on the Washington constitutional requirement to use property tax to fund common schools

Major Changes

- Service Income Apportionment
  - Whether the service is apportioned to the place where the cost to perform the service occurred or the place where the benefit of the service was received.
- Graduated Real Estate Excise Tax (REET)
  - The state specific portion of the REET used to be a flat rate for all real estate sales transactions taxable under REET, now uses a graduated rate for such transactions.

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Historical Conditions

- The two major excise taxes on sales transactions are sales and B&O taxes. In 2002:
  - Sales tax was the largest source in Washington.
    - Represented 49 percent of state tax revenues in this state.
    - Washington was heavily reliant on this tax.
    - Combined state and local tax rate was between 7 and 8.9 percent.
  - B&O tax was the next largest excise tax in Washington.
    - Represented 17 percent of state tax revenues.
    - Most common rates were 0.484 percent for wholesale and 0.471 percent for retail sales of goods and was 1.5 percent for services.

Historical Conditions

- Retail sales have implications for both B&O and sales taxes. While originally applied to sales at retail of tangible personal property (tangible goods), over the years, the definition of retail sales has expanded to services such as construction labor, repair, lodging, and some recreational activities. The following are exempt from the definition of sale at retail:
  - Most professional and personal services
  - Motor vehicle fuel and utilities
  - Most food items
  - Manufacturing machinery and equipment

Important Distinctions Between Sourcing and Nexus

- Sourcing applies to both resident and nonresident companies and relates to where a sale is considered to have occurred for purposes of taxation.
- Nexus applies only to nonresident companies and relates to whether the company has sufficient connections to the taxing jurisdiction for the company to be required to remit taxes to the jurisdiction.
- When determining whether or not a particular company must remit taxes to a particular jurisdiction, we should first consider where the company's sales are sourced and then whether the company has nexus.

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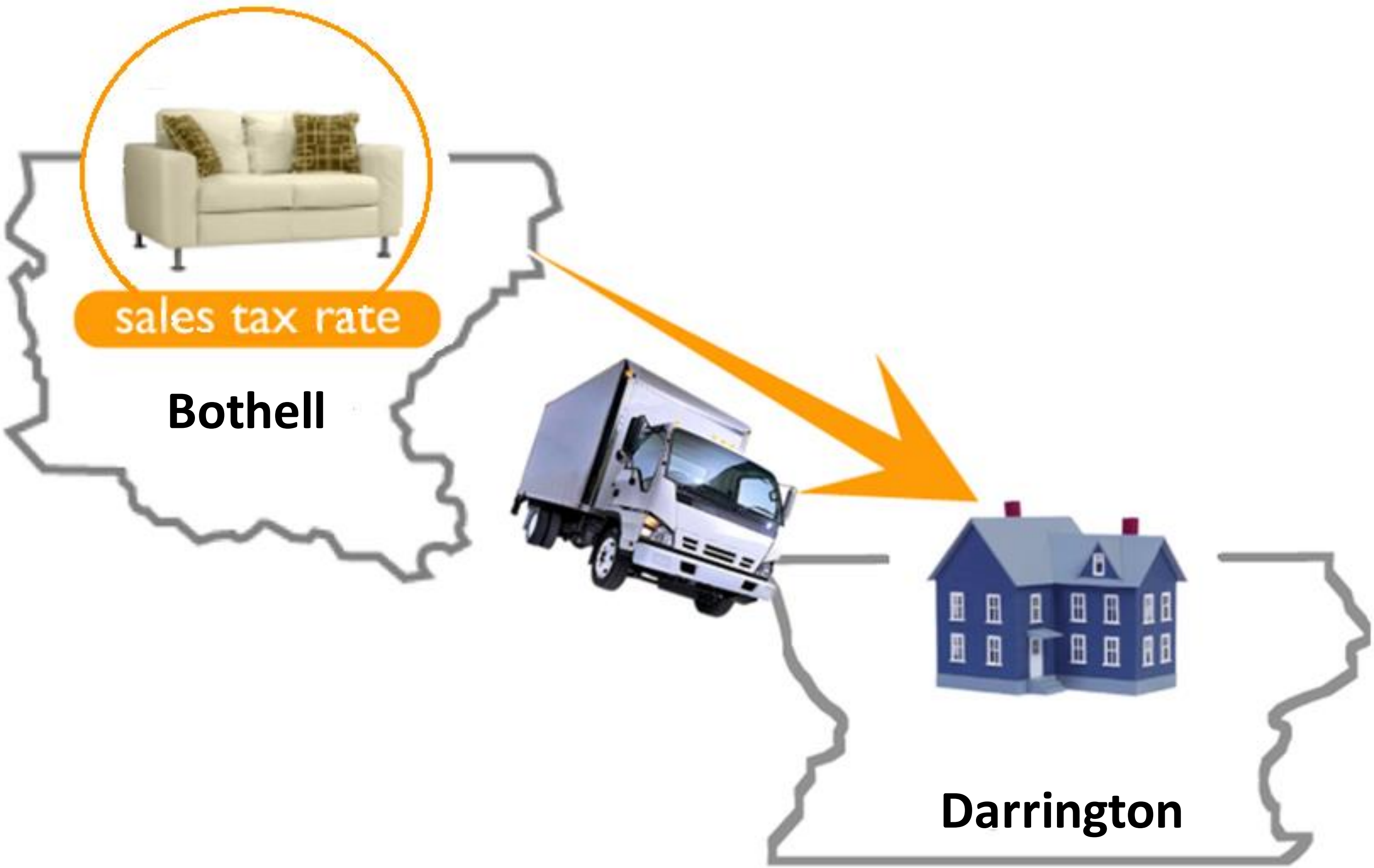
Sales & Use Tax Sourcing

- Sourcing tells us which taxing jurisdiction has the authority to tax a particular transaction, based on the laws regulating that taxing jurisdiction. Sourcing is generally broken down into two main categories, origin-based and destination-based. Washington moved from origin-based to destination-based sourcing during this period.
  - Origin-based—sourced to the place of origin, which is often the place from which a product was shipped or the place at which a service was performed.
  - Destination-based—sourced to the destination of the product or the place at which the benefit of the service was received.

Origin-Based Sourcing

- Sales tax was sourced to the retail outlet at or from which delivery was made. Services were sourced where they were primarily performed.
    - **Example 1**: In 2002, an individual purchases a couch from a retailer in Bothell and requests that the item be shipped to their home address in Darrington.
    - **Example 2**: In 2002, a Vancouver resident purchases a computer from the website of a Seattle retailer and requests the computer be shipped to her son in Pullman. The retailer transmits the order to the company warehouse in Kent which sends the computer to the son in Pullman.

Example 1: Origin-based sales tax



Example 2: Origin-based sales tax

Seattle

Kent

Pullman

Historical Conditions

- In the early 2000s and earlier, out-of-state and internet purchases were growing, diminishing the sales tax base.
  - This was a growing trend throughout the U.S., many states were seeing similar drops in revenue.
- In March of 2000, a cooperative effort of 44 states, the District of Columbia, local governments, and representatives of the business community began collaborating to simplify sales tax systems across the nation, these discussions developed into the Streamlined Sales Tax Project and eventually ended in the Streamlined Sales and Use Tax Agreement (SSUTA).

Historical Conditions

- Measures included in SSUTA include common definitions, simplified rate structures, destination-based sourcing, centralized automated registration and reporting, monetary allowances for sellers, amnesty for sellers who voluntarily agree to collect sales taxes, and many others.

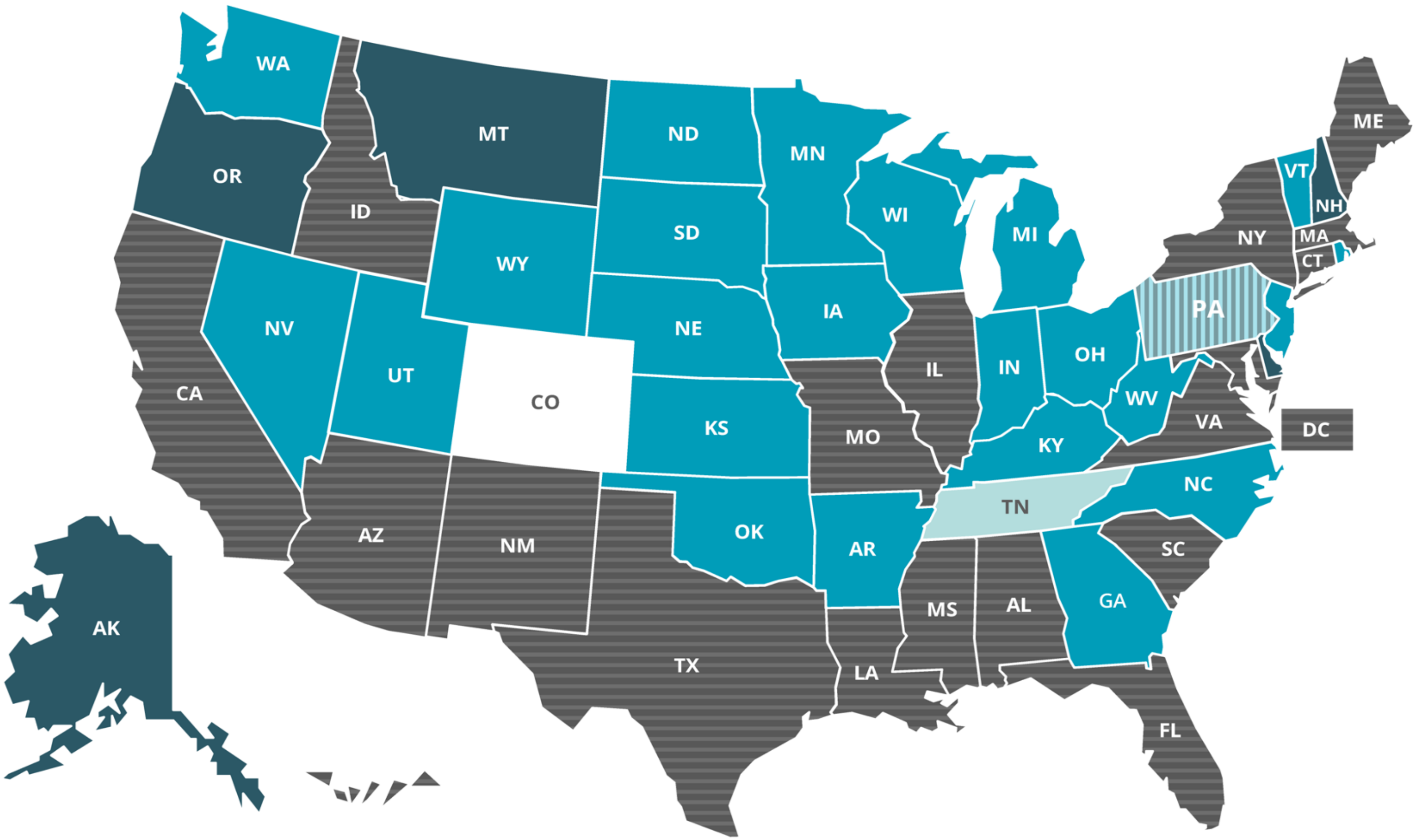
- The SSUTA became effective October 1, 2005, when the requisite number of states were found to be in full compliance with the agreement.

- Washington began implementing required changes to become a full member of SSUTA and passed SSB 5089 in 2007 which instituted the final required changes to become a full member of SSUTA.

    - This included making Sales and Use and B&O Taxes destination-based.

- The changes became effective on July 1, 2008 on that same date, Washington became a signatory to SSUTA.

Map of States participating in SSUTA



Full Member States
Associate Member States *flex to full*
Advisory States *not conforming*
Non-Sales Tax States
Project States *not advisory*
Non-Participating States

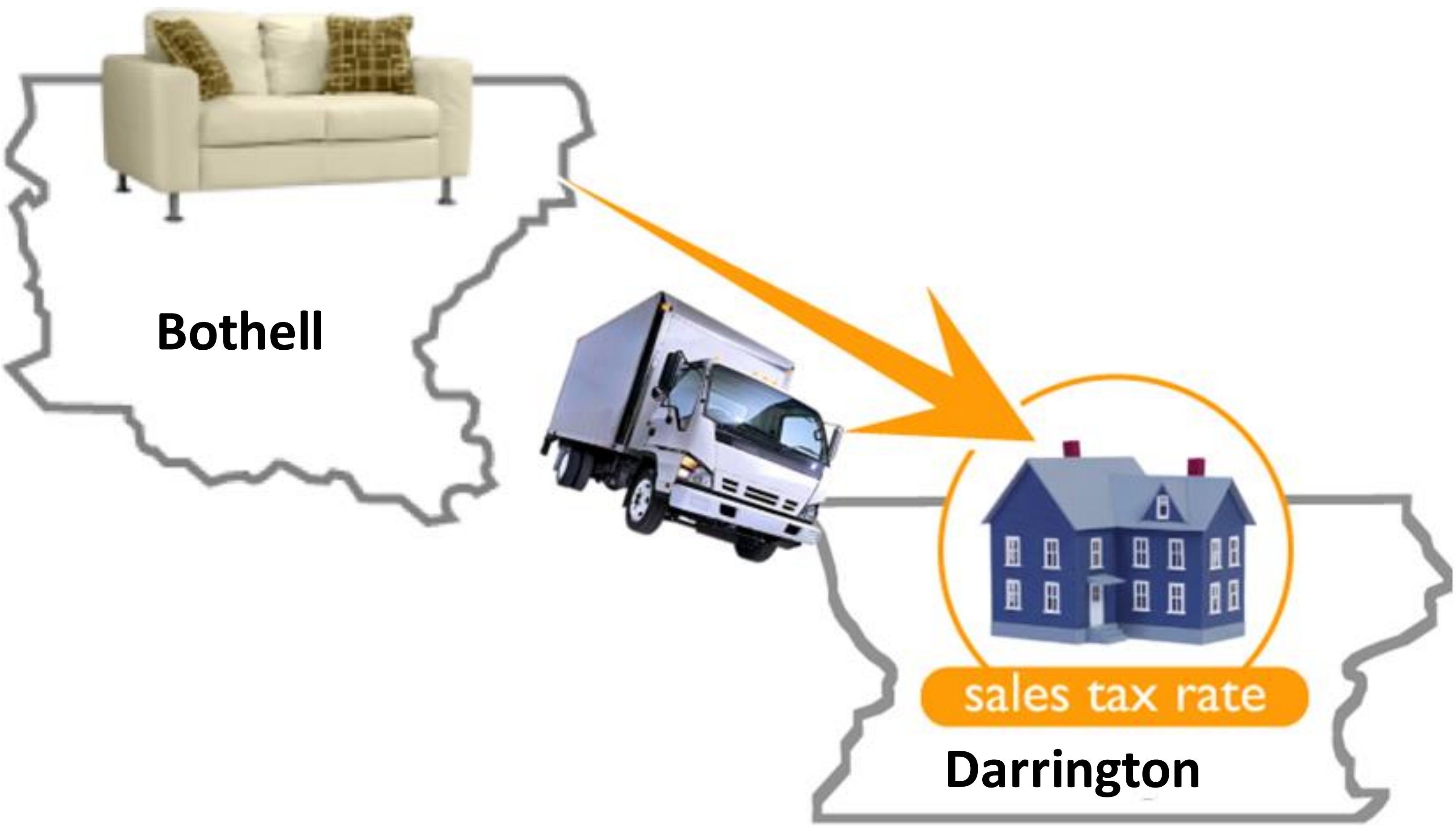
Destination-Based Sourcing

- As of July 1, 2008, retailers generally must collect sales tax using the rate for the location where the customer receives the merchandise or receives the benefit of taxable services. The change did not affect:
  - Goods received at the seller's location
  - Sales of most services
  - Motor vehicles
  - Trailers
  - Semi trailers
  - Aircraft
  - Watercraft
  - Modular, manufactured, and mobile homes
  - Towing services
  - Florists (more than 50% of sales must be flowers)

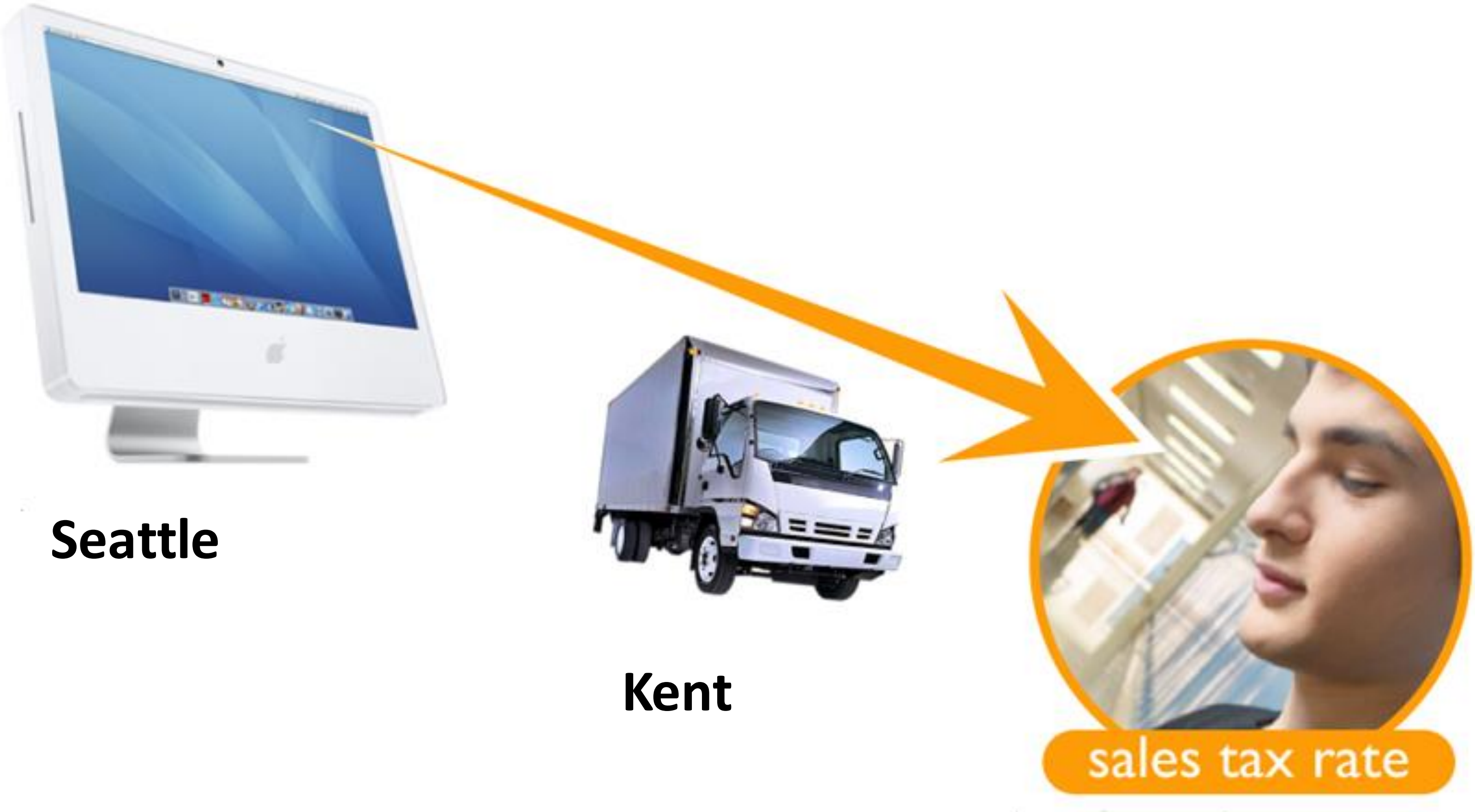
Destination-Based Sourcing

- Sales tax is now sourced to the destination. Services are now sourced to where the buyer receives the primary benefit of the services.
  - **Example 1**: In 2020, an individual purchases a couch from a retailer in Bothell and requests that the item be shipped to their home address in Darrington.
  - **Example 2**: In 2020, a Vancouver resident purchases a computer from the website of a Seattle retailer and requests the computer be shipped to her son in Pullman. The retailer transmits order to company warehouse in Kent which sends the computer to the son in Pullman.

Example 1: Destination-based sales tax



Example 2: Destination-based sales tax



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Nexus

- Generally, nexus is the standard for determining if a nonresident business could be required to remit taxes to Washington state. The concept is based on:
  - Due Process Clause of the U.S. Constitution which the U.S. Supreme Court has determined requires some connection between the business to be taxed and the taxing jurisdiction.
    - For resident businesses, that connection is residency.
    - For nonresident businesses, that connection is nexus.
  - Dormant Commerce Clause a legal doctrine which the Supreme Court has determined prohibits states from discriminating against nonresident sellers, it includes a requirement that the nonresident seller have nexus to the state.

Types of Nexus

- Nexus can be based on various factors but the factors must ultimately establish a sufficient connection between the activities of a company and a particular state.
    - Physical presence—generally, the physical presence of property (offices) or people (employees or representatives, who are often sales people) within the state
    - Economic—based on a threshold of economic activity within a state which can be based on either total volume or value of sales within the state

Physical Presence Nexus

- In 1992 the Supreme Court decided *Quill v. North Dakota* in which it outlined the general provisions that a seller must have some physical presence in the state for the state to be able to require the remote seller to collect sales or use tax on products delivered to consumers in the state.
- Physical presence includes the presence of employees or representatives, property, or other physical connections to the state.

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Changes to Nexus Prior to 2018

- While *Quill* was the law of the land, Washington and other states began implementing different nexus standards in an attempt to reach remote sellers without a physical presence. Washington's initial changes were to nexus for B&O tax but eventually with the Market Place Fairness Act, it sought to reach sales tax as well.
  - In 2010, Washington moved to economic nexus for service B&O tax. Under the new standard, an out-of-state company would have nexus in Washington if it had at least $50,000 of property or payroll, or $250,000 of sales in Washington, or it had at least 25% of its total property, payroll, or sales in Washington. 2010 ESSB 6143.
  - In 2015, Washington moved to economic nexus for wholesaling B&O tax under 2015 ESSB 6138.

Market Place Fairness Act and *Wayfair* Decision and Effects

- In 2017, Washington moved to economic nexus for retailing B&O tax under the Market Place Fairness Act, 2017 EHB 2163.
  - Sales threshold had moved to $285,000 for economic nexus.
  - Required remote sellers and market place facilitators (Amazon, eBay, Wayfair, etc.) with more than $10,000 in Washington gross receipts to collect and remit sales tax
- In 2018 the Supreme Court decided *South Dakota v. Wayfair*, in which the Court overturned *Quill* and held that economic nexus was sufficient to require a nonresident seller to collect and remit sales or use tax.
  - South Dakota economic nexus standard that was upheld was $100,000 in gross sales or 200 transactions for requiring remote sellers or marketplace facilitators to collect and remit sales tax.

Post-*Wayfair* Conditions

- In 2019, Washington further changed the state's economic nexus threshold requirements to align with *Wayfair*, 2019 SSB 5581. The standard is now that a remote seller or marketplace facilitator has nexus if they have gross receipts of $100,000 in a given year for both sales and B&O tax purposes.
- Washington is now able to collect significantly more sales tax on remote sales.
- Still collecting very little use tax from individuals on their out of state purchases.
  - Such as Vancouver residents shopping in Portland to avoid sales tax
- Current combined state and local sales tax rates are between 7% and 10% for sales tax collection purposes.

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Historical Conditions

- Washington levies a property tax at the state level. In 2002, the state portion of the property tax constituted a quarter of all property tax.
- The state levy is for the support of common schools. The levy comprised less than 30% of the state's funding of public k-12 education.
    - County treasurers collect the tax on behalf of the state, based on a county's market value of property in relation to the statewide market value of all property.

Levy Limit - aka 101% Growth Limit

(Chapter 84.55 RCW)

- Early 1970s: annual increase in regular property tax levies of local taxing districts limited to 6% (106%).
- 1979: State levy for common school support is subject to 106% limitation.
- 1997: revised 106% limitation requiring taxing districts with population over 10,000 to levy the lesser of 106% *or* inflation. Increases over inflation by district must have “substantial need" by ordinance or resolution.
- 2001: voters approved Initiative 747, reducing allowable maximum annual increases in regular levies from 6% to 1% - i.e. 101% growth limit.
- 2006: Initiative 747 found unconstitutional - growth limit returns to 106%.
- 2007: the Legislature reinstated the annual increase for all taxing districts regular levies to a maximum of 1% - aka 101% growth limit.

Levy Limit - aka 101% Growth Limit

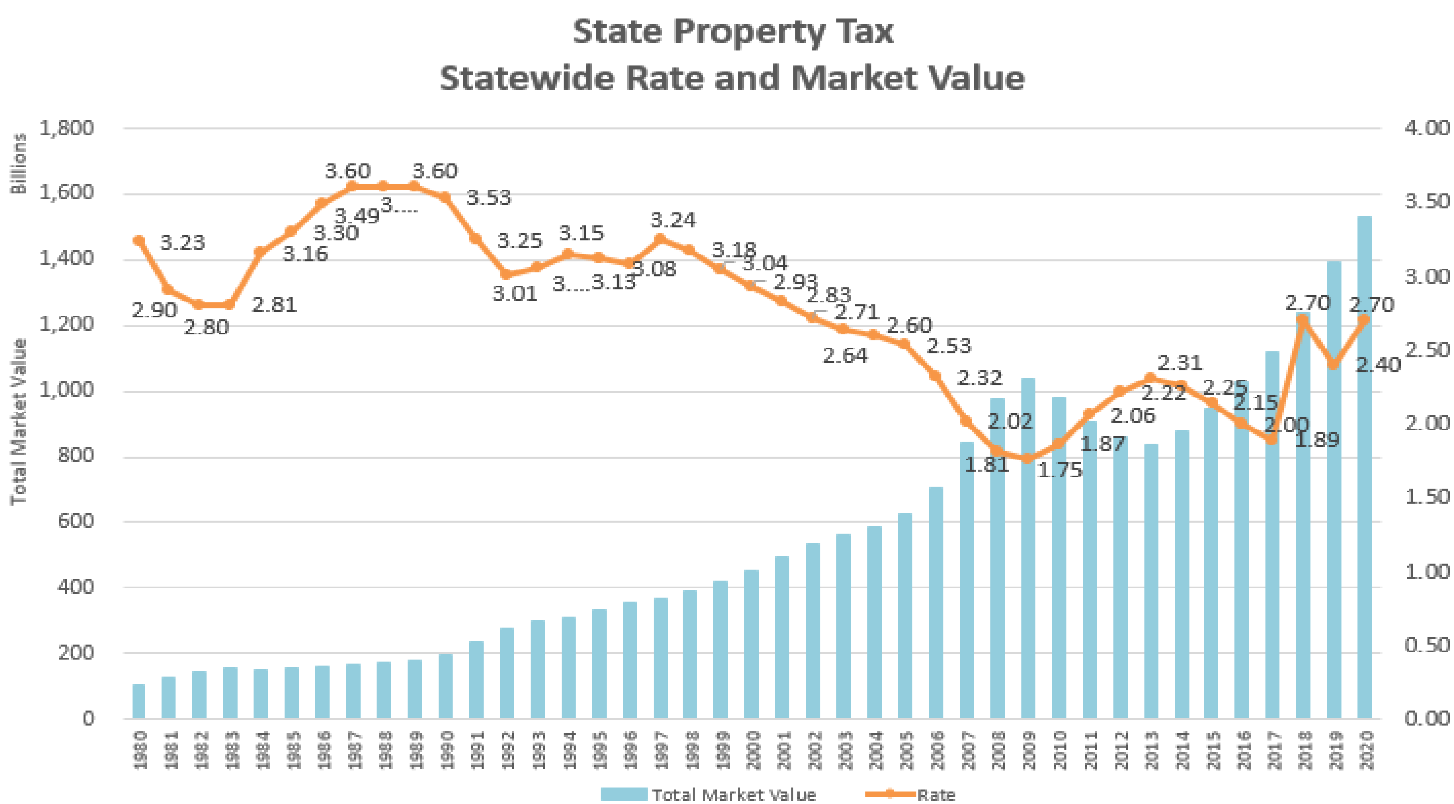
(Chapter 84.55 RCW)

- 2017: the State levy became "rate-based" for tax collection years 2018 through 2021 (EHB 2242) - not subject to the 101% limit until after 2021.

- In addition to the 101% growth limit, taxing districts, both state (after 2021) and local, may increase their levy by an additional amount based on the increase in assessed value due to:
  - New construction;
  - Construction of wind turbines, solar, biomass, and geothermal facilities;
  - Improvements to property; and
  - State-assessed property.

State School Levy Rates

- 2001 – state rate was $2.83, went down to $1.75 in 2009, when property values peaked, and then went up to $2.31 in 2013 when property values fell, and then back down to $2.00 as values rose again.
- In 2017, the state rate was $1.89 per $1,000 of value.



State School Levy Rates

- Under 2017 EHB 2242, the rate increased from $1.89 to $2.70 per $1,000 of value for 2018 through 2021.
  - In 2018, the property tax revenues increased 31%.
  - In 2018, the Legislature lowered the 2019 levy rate to $2.40 per $1,000 under 2018 ESSB 6614.
  - The maximum state property tax rate is $3.60 per $1,000 of market value for the 2022 tax year and thereafter under RCW 84.52.065.

McCleary Decision

- *McCleary v. State of Washington*
  - Decided in 2012 by the Washington State Supreme Court that the Legislature had failed to fulfill its constitutional obligation to fund commons schools.
  - In 2014 the Court found the Legislature in contempt for failing to create and authorize a plan to fund schools.
  - In 2017, under EHB 2242, the Legislature and the Governor formalized a plan to fully fund schools. Including the following two parts:
    - Temporarily changing the State School Levy from budget-based to a rate-based system
    - Changing Enrichment Levies from percentage-based to rate-based

Budget-Based vs. Rate-Based Systems

- Rate-Based: property tax rate fixed and district revenues fluctuate based on increases and decreases in property value.
  - Levy amount = Levy rate x taxable assessed value
- Budget-Based: taxing jurisdictions determine their property tax budget (levy amount) in advance and the levy rate is determined using a more complicated formula.
  - Levy rate = Levy amount / taxable assessed value
- Washington's property tax system is budget-based except for the State School Levy, which is temporarily rate-based through 2022 tax year collections.

Enrichment Levies

- Enrichment levies are one-to four-year levies used for day-to-day operations of the school. Such levies were formerly known as “maintenance and operation” (M&O) levies.

- Prior to *McCleary*, enrichment levies were based on a percentage of the amount school district revenues received from other sources. That levy lid ranged from 10% to 28% throughout the years.

- In 2019, the enrichment levies were changed to maximum of $1.50 per $1,000 of assessed value or a per pupil rate, that rate was increased for 2020 and thereafter to $2.50 per $1,000 of assessed value or $2,500 per student for districts with less than 40,000 students or $3,000 per student in districts with more than 40,000 students.

Limitations

- Beginning in 2022 tax collections, the State School Levy will become subject to the 101% Growth Limit, once it goes back to being budget-based.

- The State School Levy is subject to the 1% constitutional limit, which limits the total levy amount on an individual parcel of property to 1% – or a regular levy rate of $10 per $1,000 of its value.

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