# Department of Revenue Fiscal Note

| Bill Number: 1834 HB | Title: Reconciliation returns | Agency: 140-Department of Revenue |
|---|---|---|

## Part I: Estimates

☐ **No Fiscal Impact**

**Estimated Cash Receipts to:**

| Account | FY 2024 | FY 2025 | 2023-25 | 2025-27 | 2027-29 |
|---|---|---|---|---|---|
| GF-STATE-State<br>01 - Taxes 75 - Penalties and Intrst | (1,100,000) | (2,900,000) | (4,000,000) | (14,870,000) | (22,450,000) |
| **Total $** | (1,100,000) | (2,900,000) | (4,000,000) | (14,870,000) | (22,450,000) |

**Estimated Expenditures from:**

| | FY 2024 | FY 2025 | 2023-25 | 2025-27 | 2027-29 |
|---|---|---|---|---|---|
| FTE Staff Years | 1.3 | 0.6 | 0.9 | 0.6 | 0.6 |
| **Account** | | | | | |
| GF-STATE-State 001-1 | 226,200 | 64,800 | 291,000 | 129,600 | 129,600 |
| **Total $** | 226,200 | 64,800 | 291,000 | 129,600 | 129,600 |

**Estimated Capital Budget Impact:**

NONE

*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:

☒ 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: 03/01/2023 |
|---|---|---|
| Agency Preparation: Melissa Howes | Phone: 360-534-1518 | Date: 03/01/2023 |
| Agency Approval: Valerie Torres | Phone: 360-534-1521 | Date: 03/01/2023 |
| OFM Review: Cheri Keller | Phone: (360) 584-2207 | Date: 03/01/2023 |

Request # 1834-1-1

## Part II: Narrative Explanation

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

*Significant provisions of the bill and any related workload or policy assumptions that have revenue or expenditure impact on the responding agency by section number.*

CURRENT LAW:
Washington's primary business activities tax is the business and occupation (B&O) tax. Depending on the type of business activity, businesses generating gross income from sources in this state and sources in other states allocate/source their income to the state where the business activity occurred or use an apportionment formula to determine how much of their apportionable gross income is subject to B&O tax in Washington. For example, gross income from sales of tangible personal property is allocated/sourced to this state if the buyer receives the property in this state, while income from most services is subject to formulary apportionment. Businesses engaged in multiple types of business activities may need to both allocate/source and apportion income to Washington to calculate their B&O tax liability.

To apportion income for B&O tax purposes, Washington uses a single factor apportionment formula based on the taxpayer's gross receipts. Under this formula, taxable income is determined by multiplying a taxpayer's apportionable income from each apportionable activity by the receipts factor for that apportionable activity. In general, the receipts factor is determined by dividing gross receipts attributed to Washington by total apportionable worldwide gross receipts. For purposes of the receipts factor, gross receipts are generally attributed to Washington if they are received from a person who received the benefit of the taxpayer's services or used the taxpayer's intangible property in this state. A taxpayer may calculate the receipts factor for the current tax year either:
- Based on the most recent calendar year for which a full calendar year of information is available, or
- Based on the current tax year.

Once a taxpayer has the information necessary to determine the receipts factor for an entire calendar year, they are required to file an annual reconciliation of apportionable income (ARAI) form to correct their reporting by October 31 of the following calendar year, and either obtain a refund or pay any additional tax due. If there is additional tax due, interest applies and late payment penalties apply if not paid by the October 31st due date. The late payment penalty is a percentage of the additional tax due and is graduated based on the length of delinquency. The penalty rates are as follows:
- 9% when not paid by the October 31st due date,
- 19% when not paid by November 30th, and
- 29% when not paid by December 31st.

A waiver from the late payment penalty is available if:
- The failure to pay timely is a result of circumstances beyond the taxpayer's control, or
- The taxpayer has timely filed and paid taxes due for the 24-months immediately preceding the period for which a waiver is requested.

These penalty waivers do not apply just to delinquencies involving ARAI returns; rather, they apply broadly to most of the taxes that the department collects.

PROPOSAL:
This proposal modifies the current penalty and penalty waiver structure applicable to the ARAI.

Under the proposal, if a taxpayer does not pay the additional tax due on an ARAI by October 31, a penalty equal to the greater of 9% of the unpaid tax due, or $25, applies. This new delinquent penalty replaces the existing graduated penalty in cases involving ARAI delinquencies.

The proposal also creates two new penalty waivers for delinquent taxes due on an ARAI return. One of the new penalty waivers is very similar to the existing 24-month waiver and applies only to the ARAI. This new penalty waiver replaces the existing 24-month waiver for delinquencies involving the ARAI. The second new penalty waiver is for circumstances where the tax deficiency occurred due to the department's reclassification of the taxpayer's income to an apportionable tax classification from a non-apportionable tax classification resulting from a department audit or examination of the taxpayer's returns or records.

The reclassification waiver:
- May only be granted once, and
- Applies to all tax years included in the department's audit or examination.

Moreover, the reclassification waiver will not be granted if:
- The tax deficiency is due to the taxpayer's failure to follow specific written instructions provided to the taxpayer by the department, or
- The taxpayer had previously reported the apportionable income correctly.

The two new penalty waivers created in this proposal are in addition to the existing penalty waiver for delinquencies caused by circumstances beyond the taxpayer's control.

EFFECTIVE DATE:
The bill takes effect 90 days after final adjournment of the session in which it is enacted and applies beginning with ARAI returns due in 2023 for the 2022 tax year.

**II. B - Cash receipts Impact**

*Cash receipts impact of the legislation on the responding agency with the cash receipts provisions identified by section number and when appropriate, the detail of the revenue sources. Description of the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explanation of how workload assumptions translate into estimates. Distinguished between one time and ongoing functions.*

ASSUMPTIONS:
- This proposal applies to tax years beginning with 2022. It will take 10 years for all tax reporting periods included in an audit to be subject to the new penalty rate and waivers in this proposal.
- A 3-year average is used to estimate the annual amount of delinquent return penalties on ARAI returns.
- Of the ARAI penalties imposed under current law, 92% would qualify for a waiver of the penalty under proposed law.
- This legislation passes effective July 21, 2023. However, the new penalty and waivers in this proposal will begin to be applied after October 31, 2023.

DATA SOURCES:
- Department of Revenue excise tax return data, audit data, and annual reconciliation of apportionable income data
- Economic and Revenue Forecast Council November 2022 B&O tax forecast

REVENUE ESTIMATES:
This bill decreases state revenues by an estimated $1.1 million in the 10 months of impacted collections in fiscal year 2024, and by $2.9 million in fiscal year 2025, the first full year of impacted collections.

TOTAL REVENUE IMPACT:

State Government (cash basis, $000):

FY 2024 - ($ 1,100)
FY 2025 - ($ 2,900)
FY 2026 - ($ 6,000)
FY 2027 - ($ 8,870)

FY 2028 - ($ 10,300)
FY 2029 - ($ 12,150)

Local Government, if applicable (cash basis, $000): None

**II. C - Expenditures**

*Agency expenditures necessary to implement this legislation (or savings resulting from this legislation), with the provisions of the legislation that result in the expenditures (or savings) identified by section number. Description of the factual basis of the assumptions and the method by which the expenditure impact is derived. Explanation of how workload assumptions translate into cost estimates. Distinguished between one time and ongoing functions.*

ASSUMPTIONS:
This estimate affects 1,500 taxpayers.

FIRST YEAR COSTS:
The department will incur total costs of $226,200 in fiscal year 2024. These costs include:

Labor Costs – Time and effort equate to 1.28 FTEs.
- Computer system monitoring and maintenance.
- Set up, program, and test computer system changes.
- Provide training to work apportionment reconciliation returns.
- Routine audits will require additional time to verify they are valid.
- Amend two administrative rules.

Object Costs - $70,400.
- Contract computer system programming.

SECOND YEAR COSTS:
The department will incur total costs of $64,800 in fiscal year 2025. These costs include:

Labor Costs – Time and effort equate to 0.6 FTE.
- Additional time required for routine field audits.

ONGOING COSTS:
Ongoing costs for the 2025-27 biennium equal $129,600 and include similar activities described in the second-year costs. Time and effort equate to 0.6 FTE in each year.

## Part III: Expenditure Detail

**III. A - Expenditures by Object Or Purpose**

| | FY 2024 | FY 2025 | 2023-25 | 2025-27 | 2027-29 |
|---|---|---|---|---|---|
| FTE Staff Years | 1.3 | 0.6 | 0.9 | 0.6 | 0.6 |
| A-Salaries and Wages | 93,500 | 40,800 | 134,300 | 81,600 | 81,600 |
| B-Employee Benefits | 30,900 | 13,500 | 44,400 | 27,000 | 27,000 |
| C-Professional Service Contracts | 70,400 | | 70,400 | | |
| E-Goods and Other Services | 19,600 | 6,500 | 26,100 | 13,000 | 13,000 |
| G-Travel | 2,100 | 2,100 | 4,200 | 4,200 | 4,200 |
| J-Capital Outlays | 9,700 | 1,900 | 11,600 | 3,800 | 3,800 |
| **Total $** | $226,200 | $64,800 | $291,000 | $129,600 | $129,600 |

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

| Job Classification | Salary | FY 2024 | FY 2025 | 2023-25 | 2025-27 | 2027-29 |
|---|---|---|---|---|---|---|
| EMS BAND 4 | 126,619 | 0.0 | | 0.0 | | |
| IT SYS ADM-JOURNEY | 92,844 | 0.2 | | 0.1 | | |
| MGMT ANALYST4 | 73,260 | 0.4 | | 0.2 | | |
| REVENUE AUDITOR 3 | 68,076 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| TAX POLICY SP 2 | 75,120 | 0.0 | | 0.0 | | |
| TAX POLICY SP 3 | 85,020 | 0.0 | | 0.0 | | |
| TAX POLICY SP 4 | 91,524 | 0.0 | | 0.0 | | |
| WMS BAND 3 | 107,685 | 0.0 | | 0.0 | | |
| **Total FTEs** | | 1.3 | 0.6 | 1.0 | 0.6 | 0.6 |

**III. C - Expenditures By Program (optional)**

NONE

## Part IV: Capital Budget Impact

**IV. A - Capital Budget Expenditures**

NONE

**IV. B - Expenditures by Object Or Purpose**

NONE

**IV. C - Capital Budget Breakout**

*Acquisition and construction costs not reflected elsewhere on the fiscal note and description of potential financing methods.*

NONE

## Part V: New Rule Making Required

*Provisions of the bill that require the agency to adopt new administrative rules or repeal/revise existing rules.*

Should this legislation become law, the department will use the expedited process to amend WAC 458-20-19402, titled: "Single factor receipts apportionment - Generally" and WAC 458-20-19404, titled: "Financial institutions - Income apportionment." Persons affected by this rulemaking would include businesses required to apportion income.