Fiscal Impact Statement for Initiative 732

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Summary

During the first six fiscal years, state General Fund revenue would decrease by a net amount of $797.2 million. This results from implementing a new carbon tax, reducing the state retail sales tax rate by 1 percentage point and reducing certain manufacturing business and occupation taxes. The Working Families Tax Exemption Program would be funded. Sales tax revenue for the state Performance Audits of Government Account would decrease by $8.9 million. Local tax revenue would increase by $156.1 million. State expenditures would increase by $37.4 million.

General assumptions

- The effective date of the initiative is July 1, 2017.
- Estimates use the state's fiscal year of July 1 through June 30. Fiscal year 2016 is July 1, 2015, to June 30, 2016.
- The provisions of the initiative apply prospectively, not retroactively.

State revenue assumptions

- Revenue estimates are based on the February 2016 Economic and Revenue Forecast, Department of Revenue tax return data and the Washington State Department of Commerce, State Energy Office, Carbon Tax Assessment Model (CTAM) – version 3.1c.

State revenue impacts

The initiative contains four provisions that affect state revenue — increased revenues from a new carbon tax, reduced state revenue from a 1 percentage point retail sales tax rate reduction, reduced state revenues from a business and occupation (B&O) tax reduction for certain manufacturing taxpayers and decreased revenues from expansion of the Working Families Tax Exemption Program.

Carbon tax

Estimates are based on the CTAM and the Global Insight forecast for the consumer price index for all urban areas (CPI-U), November 2015. The Department of Commerce periodically updates data in the CTAM. Any data updates to the CTAM made between preparation and publication of this fiscal impact statement are not reflected in the estimates displayed here.

Revenue assumptions:

- The carbon tax rate is equal to $15 per metric ton of carbon dioxide as of July 1, 2017.
- The carbon tax rate is equal to $25 per metric ton of carbon dioxide as of July 1, 2018, and increases by 3.5 percent, plus the inflation rate, each year thereafter.
- The inflation rate is equal to the CPI-U.
- The phased-in tax rates associated with several fuel uses are not reflected in this analysis, although lowering the carbon tax rate for the specific fuel uses outlined in the bill would result in lower carbon tax revenues.

- No carbon tax reductions or refunds are made for long-term storage of carbon emissions (qualified sequestration).
- No credits are granted for payment of a similar carbon tax in another state.
- The following assumptions are made in the CTAM for modeling purposes:

    - Year One is set to calendar year 2017 to most closely correspond to the July 1, 2017, effective date of the proposed carbon tax.
    - The baseline reference energy forecast (option A) is specified in the CTAM.
    - Industrial process emissions are not included.
    - Jet fuels are not exempted.
    - Marine fuels are not exempted.
    - "Transition coal" is not exempted.
    - The additional 11.9 cents of state gasoline/diesel taxes that became law in 2015 are included in the model as a supplemental fuel tax, as the CTAM does not include this in its current baseline assumptions.

The carbon tax increases revenues that are deposited in the state General Fund. Table 1 provides estimates of the carbon tax revenue during the next six fiscal years to the state General Fund. Revenues deposited in the state General Fund may be used for any government purpose such as education; social, health and environmental services; and other general government activities.

Table 1 – Carbon tax revenues deposited in the state General Fund

FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
$0	$0	$1,455,135,000	$1,972,166,000	$2,089,715,000	$2,189,309,000

Business and occupation tax

The state B&O tax is a gross receipts tax measured on the value of products, gross proceeds of sales or gross income of the business.

Revenue assumptions:

- The following B&O tax classifications are reduced to a rate of 0.001 percent:
    - Manufacturing
    - Manufacturing Dairy/Biodiesel/Alcohol/Split Peas/Fresh Fruit & Vegetables
    - Slaughter-Breaking-Processing Perishable Meat Wholesaling and Manufacturing
    - Manufacturing Commercial Airplanes, Components & Aero Tooling
    - Wholesaling Commercial Airplanes, Components & Aero Tooling
    - Retailing Commercial Airplanes, Components & Aero Tooling
    - Processing for Hire Timber Products
    - Manufacturing of Timber Products
    - Manufacturing of Semiconductors
- As a result of these tax rate changes, the multiple activities tax credit has been recalculated and factored into this analysis.
- The growth rate mirrors the total B&O taxable activity forecast reflected in the Economic and Revenue Forecast Council's February 2016 forecast.
- All B&O tax rate changes are effective July 1, 2017, and none of these changes is retroactive.

Table 2 provides estimates of the decrease in state B&O tax revenue for the next six fiscal years to the state General Fund, rounded to the nearest $1,000.

Table 2 – Reductions in state B&O tax revenues deposited in the state General Fund

FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
$0	$0	($371,907,000)	($426,871,000)	($449,128,000)	($472,545,000)

Sales tax
The state retail sales tax rate decreases from 6.5 percent to 6.0 percent on July 1, 2017, and from 6.0 percent to 5.5 percent on July 1, 2018. This change reduces revenues deposited in two funds: the state General Fund and the state Performance Audits of Government Account.

In addition, changes in the state retail sales tax rate could affect the amount of goods purchased, which would affect state and local tax revenue. The Department of Revenue prepared the revenue estimates assuming a price elasticity of 1.01. Price elasticity is a method used to calculate the change in consumption of a good when price increases or decreases. Due to price elasticity, state B&O tax revenue could increase with the change in the state retail sales tax rate.

Table 3 provides estimates of the decrease in state retail sales tax revenue for the next six fiscal years to the state General Fund.

Table 3 – Reductions in state retail sales tax revenues deposited in the state General Fund

FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
$0	$0	($678,294,000)	($1,493,684,000)	($1,638,849,000)	($1,716,348,000)

Table 4 provides estimates of the decrease in state retail sales tax revenue for the next six fiscal years to the state Performance Audits of Government Account. This account is used by the Washington State Auditor to conduct comprehensive performance audits required under RCW 43.09.470.

Table 4 – Reductions in state retail sales tax revenues deposited in the Performance Audits of Government Account

FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
$0	$0	($1,087,000)	($2,394,000)	($2,626,000)	($2,751,000)

Table 5 provides estimates of the increase in state B&O tax revenue deposited in the state General Fund over the next six fiscal years.

Table 5 – Increases in state B&O tax revenues deposited in the state General Fund

FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
$0	$0	$3,404,000	$7,458,000	$8,181,000	$8,568,000

Working Families Tax Exemption
Estimates are based on 2013 individual income tax returns filed with the Internal Revenue Service. The initiative modifies the Working Families Tax Exemption Program, which is an exemption in the form of a refund for eligible taxpayers. Under current law, the exemption amount for a qualified taxpayer for the prior federal tax year is the greater of 10 percent of the federal earned income tax

credit (EITC) or $50. The initiative increases that amount to the greater of 15 percent of the EITC or $100 for exemptions claimed in 2017, and the greater of 25 percent of the EITC or $100 for exemptions claimed in 2018 and thereafter.

Revenue assumptions:

- Applications for calendar year 2016 would be received beginning July 1, 2017.
- Applications for calendar year 2017 would be received beginning Jan. 1, 2018.
- Calendar year 2016 and calendar year 2017 refunds would both be paid during fiscal year 2018.
- The participation rate in the Working Families Tax Exemption Program is assumed at 90 percent in the first year, 93 percent in the second year and 95 percent in the third year and thereafter.
- The Working Families Tax Exemption is based on the EITC from the prior year.
- The number of qualified applicants grows 3 percent annually.
- All refunds are paid by June 30 of the year that the Working Families Tax Exemption is claimed. However, applications for the first year cannot be submitted until July 1, 2017. This estimate assumes refunds for calendar year 2016 (requested in 2017) will be paid by Dec. 31, 2017.

Table 6 provides estimates of the decrease in state General Fund revenues due to the changes in the Working Families Tax Exemption Program.

Table 6 – Decreases in state General Fund revenues due to changes in the Working Families Tax Exemption Program

FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
$0	$0	($420,639,000)	($279,150,000)	($287,525,000)	($296,151,000)

Local government revenue

Due to price elasticity from the change in the state retail sales tax rate, local retail sales tax revenue could increase. Table 7 provides estimates of the increased local government revenues collected during the next six fiscal years.

Table 7 – Increases in local retail sales tax revenue

FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
$0	$0	$19,245,000	$42,165,000	$46,251,000	$48,439,000

State expenditure assumptions

- Expenditures for staff salaries reflect a general wage increase of 1.8 percent effective July 1, 2016, and corresponding adjustments to benefits reflecting 30 percent of the salary adjustment.
- One full-time equivalent (FTE) employee equates to 2,080 hours of work for one calendar year.

State expenditures

To implement the initiative, the Department of Revenue will incur expenditures of about $37.4 million and need additional FTEs during the first six fiscal years. Table 8 provides cost estimates and FTEs by fiscal year. Expenditures are rounded to the nearest $1,000.

Table 8 – Department of Revenue implementation costs

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
FTEs	0.0	49.6	72.8	60.1	58.7	60.4
Dollars	$0	$7,380,000	$11,435,000	$6,204,000	$6,078,000	$6,256,000

About 200,000 taxpayers are affected by changes in the retail sales tax rate and about 12,000 taxpayers are affected by changes in manufacturing B&O tax rates. Costs for implementing the B&O tax and retail sales tax changes include:

- Programming and testing computer system changes.
- Creating a special notice for affected taxpayers and updating publications and web pages.
- Printing and mailing special notices to affected taxpayers who do not file electronically.
- Responding to questions from affected taxpayers.

About 1,500 taxpayers are affected by the carbon tax. Costs for implementing the carbon tax include:

- Programming and testing computer system changes, including new addenda for calculation of the carbon tax and a new software application to submit fuel mix reports.
- Creating new educational and informational materials for affected taxpayers in hard copy and electronic formats, including updates to these materials, as needed.
- Responding to questions and assisting affected taxpayers with return preparation and other compliance assistance.
- Technical advice for implementation, including procedures, forms, worksheets and guidance documents, and development of the carbon calculation.
- Additional work with affected parties and coordinating implementation among several state agencies during the startup process.
- Preparation of required reports to the governor and Legislature.
- Adoption of two new administrative rules.

For the Working Families Tax Exemption, the initiative modifies several provisions affecting program administration by the Department of Revenue. The Department of Revenue assumes 460,600 individuals will file a claim the first year applications are accepted, beginning July 1, 2017. Costs to operate the program will change if the number of claims increases or decreases substantially.

The Department of Revenue is in the middle of its tax and licensing system replacement project. The timing of the initiative means only a minimum level of functionality of the new system is in place by July 1, 2017, to accept Working Families Tax Exemption applications. Other costs for implementing the Working Families Tax Exemption provisions of the initiative include:

- Programming (through contracting with third-party programmers) to set up, test and verify the computer systems to process refund applications for payment, including an Internet-based application process, processing queues, tracking, imaging and electronic funds transfers.
- Creating printed materials, Web information and media advertising.
- Designing and developing forms and other materials to process exemption claims.
- Organizing a group to receive and process claims for remittance.
- Responding to questions and assisting affected taxpayers.
- Preparing and training new staff to begin processing applications July 1, 2017.
- Adopting one new administrative rule.
- Printing and mailing notices to those who would qualify for the Working Families Tax Exemption, based on the best available information.
- Processing applications, including verification of claims.
- Processing and sending refund checks to eligible claimants.
- Collecting refunds processed in error or fraudulently filed.