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Business tax should be simplified to flat rate

by Jason Mercier, Director, Center for Government Reform
and Erin Shannon, Director, Center for Small Business

In 1972, Washington voters considered an amendment to the state constitution to automatically end all special tax exemptions after 10 years unless they were reauthorized. That measure failed by a vote of 45 percent to 55 percent.

The rejection of this proposal was based on the understanding that automatically ending tax cuts and exemptions creates financial unpredictability for taxpayers from one year to the next. Ultimately, when tax cuts and exemptions are set to expire, it is the same as building automatic future tax increases into the law. This problem is one that many in Congress ran into in dealing with the national fiscal cliff.

Forty years after the state's voters rejected automatically ending all tax exemptions, the debate over the state's tax system rages on.

In fact, you can count on this topic receiving a lot of attention during the 2013 Legislative Session in the new House Finance Committee. According to its chairman, Rep. Reuven Carlyle (D-36), his goal "is to rejuvenate legislative oversight, policy analysis and action with regard to fundamental policy questions of whether they [tax exemptions] work or not for taxpayers."

Reviewing tax exemptions is not new in Washington.

In 2006, lawmakers created the Citizen Commission for Performance Measurement of Tax Preferences assisted by professional audit staff.

This is an important process. Just as state spending should identify performance outcomes, tax preferences should as well. This is why Washington Policy Center has been supportive of and has served on the Commission.

While reviewing tax exemptions is important, our ultimate goal is to one day replace our state's Business and Occupation (B&O) tax and its hundreds of tax preferences with a simple Single Business Tax. While still based on total receipts, a Single Business Tax would eliminate the current system's unfair and confusing morass of multiple tax rates and business tax breaks in favor of a simplified system that treats all businesses equally and uses one fair flat rate.

WPC analysts used economic modeling to determine the impacts of various B&O replacement taxes on a revenue-neutral basis. Any repeal of tax preferences should follow sound principles of taxation (such as simplification and transparency), not simply take more money from businesses for government spending.

Not surprisingly, economic models showed a state income tax to be the worst policy, causing the most job loss and economic distortion. With other options showing minimal job or economic impact, we turned to meaningful reform based on sound principles of taxation. These principles include tax code building blocks such as simplicity, accountability, economic neutrality, competitiveness, balance and reliability. The result is our recommendation to replace the B&O tax with a constitutionally defined Single Business Tax (a gross receipts margins tax) that would:

- Be revenue neutral
- Treat all business owners equally by using one flat rate
- Eliminate all loopholes and special treatment
- Eliminate favoritism by policymakers
- Repeal all existing state and city business taxes
- Centralize administration of the tax to reduce compliance costs for business

Here is how the Single Business Tax would work. Each year business owners would choose one of three ways to calculate their taxable receipts, selecting the one that results in the lowest tax burden. Calculating the taxable margins would be based on the business':

- Total gross receipts minus labor costs, or
- Total gross receipts minus all production costs except labor, or
- 60 percent of total gross receipts

The business owner would then multiply the taxable receipts by the Single Business Tax rate. Cities could levy their own business tax, but the same uniformity standard would apply; any local business tax would have to be based on a single rate applied equally to all business owners, with no political favoritism. The final amount owed for each taxing jurisdiction would be sent to the state in one payment. State officials would then distribute the funds to different local governments.

This proposal would eliminate today's confusing multiple rates on business activities, repeal the special-interest tax credits and exemptions that have built up over the years, and provide relief to small businesses with low profitability. The Single Business Tax would be phased in over several years to allow employers and public officials time to adjust to the new system.

By embracing solid tax principles and meaningful reform — both in the short and long term — we can encourage future economic growth. We hope our proposed Single Business Tax will start a meaningful conversation about alternatives to the burdensome B&O tax and how to create a saner tax for our state's businesses, while providing funding for core functions of government.

In the meantime, the existing tax preference review process by the Citizen Commission should continue and the legislature should consider its recommendations.

Our state's complex system favors interests that are able to exert influence in the state Capitol, and whic can negotiate narrow tax benefits. Meanwhile, most small business owners don't have time to go to Olympia, let alone hire their own lobbyist.

"A fair field and no favors" is a good motto for a strong tax system and one Washington should embrace. Enacting a Single Business Tax will help bring equity and fairness to the tax code.