Washington Research Council

Policy Brief

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Preemptively Overhauling the Workforce Education Investment Surcharge

Briefly

One of the major new taxes adopted last year was the workforce education investment business and occupation (B&O) tax surcharge. Appropriations were also made last year from the new workforce education investment account (WEIA) to fund higher education programs.

The Legislature is now working to overhaul the surcharge to address three issues: (1) Administrative and compliance complexities that may make revenue collection difficult; (2) a late amendment last year reduced the 2021–23 revenue estimate so much that a significant shortfall is expected in the account in the biennium; and (3) caseload increases may create a shortfall in 2019–21—depending on what account those increases are charged to.

The Senate has passed a bill that would repeal the surcharge (except for advanced computing) and apply a 1.75 percent tax rate to a broader category of businesses while exempting those with less than $1 million in gross income. Unfortunately, the Senate did not act to include the WEIA in the four-year balanced budget requirement as we have previously recommended.

Last year the Legislature increased 2019–21 taxes by over $1 billion. A significant part of that came from the new workforce education investment business and occupation (B&O) tax surcharge (E2SHB 2158). The surcharge is meant to fund appropriations "to supplement, not supplant" other spending on higher education. This includes making the state need grant (now the "Washington College Grant") an entitlement.

Now the Legislature is scrambling to overhaul the surcharge to address three issues: (1) Administrative and compliance complexities that may make revenue collection difficult; (2) a late amendment last year reduced the 2021–23 revenue estimate so much that a significant shortfall is expected in the account in the biennium; and (3) caseload increases may create a shortfall in 2019–21—depending on what account those increases are charged to.

The Surcharge Under Current Law

As adopted last year, 43 sectors that "depend on higher education" in the "other business or service activities" category are subject to a surcharge of 20 percent of the tax payable, on top of current B&O taxes. Effective Jan. 1, 2020, their B&O tax rate increased from 1.5 percent to 1.8 percent. (The first returns at the new rate are due Feb. 25, 2020.)

Affiliated groups of advanced computing businesses with worldwide gross revenue of more than $25 billion and up to $100 billion are subject to a surcharge of 33.3 percent of the tax payable and affiliated groups of advanced computing businesses with worldwide gross revenue of more than $100 billion are subject to a surcharge of 66.7 percent. (Their tax rates increased to 2.0 percent and 2.5 percent, respectively.) These affiliated groups are required to pay surcharges of at least $4 million but not more than $7 million annually.

The act requires any ambiguity as to whether the surcharges apply to a taxpayer to "be construed in favor of application of the surcharges." Because of a floor amendment the day the bill was passed, this unusual, high standard of proof expires Dec. 31, 2021. As a result of the expiration, the Department of Revenue (DOR) assumes there will be refunds and reduced compliance beginning in FY 2022. Further, DOR "anticipates that a significant number of taxpayers will contest letter rulings, assessments and determinations" (DOR 2019).

Originally, the bill was expected to increase revenues to the new workforce education investment account (WEIA) by $380.0 million in 2019–21 and $565.7 million in 2021–23. After the floor amendment, the 2021–23 revenue estimate was reduced to $393.1 million.

E2SHB 2158 also appropriated $374.7 million from the WEIA in 2019–21. Ways and Means Committee staff estimated that the cost of continuing those appropriations in 2021–23 would be $557.0 million (SCS 2019), leaving a projected shortfall in the WEIA of approximately $158.6 million.

Table 1: WEIA Balance Sheet When Enacted (Dollars in Millions)

	2019-21	*2021-23*
Beginning Balance	-	5
Revenue		
E2SHB 2158	380	393
Total Resources	*380*	*398*
Spending		
Washington College Grant	160	250
Foundational Support (Compensation and Central Services)	66	72
Capacity in High Demand Programs at Four-Year Institutions	17	22
Student Support Services at Four-Year Institutions	2	2
WSU Medical School Completion and Expansion	14	23
Nurse Educator and Faculty Salary Increase at CTCs	61	81
Guided Pathways	32	76
Career Connected Learning	11	13
Working Connections Child Care	4	16
Other	6	3
Total Spending	*375*	*557*
Ending Fund Balance	5	(159)

ESSB 6492

The Senate passed ESSB 6492 on Jan. 30. The bill would repeal the current surcharge (retroactive to Jan. 1, 2020), but affiliated groups of advanced computing businesses with worldwide gross revenue of more than $25 billion would be subject to a surcharge of 1.22 percent of gross income in the "other business or service activities" category, up to $9 million annually (effective April 1, 2020). The bill specifies that financial institutions are not considered advanced computing businesses.

Additionally, the bill would increase the regular B&O tax rate in this category from 1.5 percent to 1.75 percent (effective April 1, 2020). However, the 1.5 percent rate would still apply to hospitals, businesses with less than $1 million in gross income, and advanced computing businesses subject to the 1.22 percent surcharge (their taxes due under the surcharge would be in addition to those due at the 1.5 percent rate). The revenues from the advanced computing surcharge and 14.3 percent of the revenues from the 1.75 percent rate would be deposited in the WEIA. The increased evidentiary standard would be repealed.

The fiscal note for ESSB 6492 estimates that the bill would reduce WEIA revenues by $29.6 million in 2019–21 and increase WEIA revenues by $234.3 million in 2021–23. Together with the original estimates of WEIA revenues under E2SHB 2158, if ESSB 6492 is enacted, WEIA revenues would total an estimated $350.4 million in 2019–21 and $627.4 million in 2021–23.

According to the fiscal note, at least 89,100 taxpayers are subject to the surcharges under current law. It estimates that 14,800 taxpayers would pay the 1.75 percent rate under ESSB 6492. The 1.75 percent rate would represent a reduction in the tax for 10,400 of the affected taxpayers under E2SHB 2158 and it would represent an increase in the tax for 4,400 taxpayers (who are not subject to the E2SHB 2158 surcharge). The fiscal note also states, "A small number of taxpayers will be subject to the simplified advanced computing surcharge and will pay a higher rate than under E2SHB 2158" (DOR 2020).

Surcharge Administration

In a presentation at the Nov. 21, 2019 Senate Higher Education and Workforce Development Committee meeting, DOR said that the "[s]ignificant volume of ambiguity in the bill jeopardizes the Department's ability to administer and taxpayer's ability to comply." Further, DOR noted that the bill violates several principles of sound tax policy. For example, its language is ambiguous, the multiple tax rates will increase errors, and similar taxpayers will pay different rates (Duvall 2019). Indeed, there was never a public explanation of how the 43 sectors subjected to the surcharges were chosen.

Ultimately, DOR's David Duvall said, "what this means is that we have doubts about actually collecting revenues as estimated. . . . While these are significant challenges, the Department will do its best, but it's going to be messy and there will be disputes."

Table 2: WEIA Balance Sheet Assuming Passage of ESSB 6492
(Dollars in Millions)

	2019-21	*2021-23*
Beginning Balance	-	(24)
Revenue		
E2SHB 2158	380	393
ESSB 6492	**(30)**	**234**
Total Revenue	*350*	*627*
Total Resources	*350*	*603*
Spending		
Washington College Grant	160	250
Foundational Support (Compensation and Central Services)	66	72
Capacity in High Demand Programs at Four-Year Institutions	17	22
Student Support Services at Four-Year Institutions	2	2
WSU Medical School Completion and Expansion	14	23
Nurse Educator and Faculty Salary Increase at CTCs	61	81
Guided Pathways	32	76
Career Connected Learning	11	13
Working Connections Child Care	4	16
Other	6	3
Total Spending	*375*	*557*
Ending Fund Balance	(24)	46

Shortfalls in the Account

There are two potential shortfalls in the WEIA under current law, with different origins.

First, the late amendment to E2SHB 2158 that ended the heightened standard of proof after 2021 left an estimated shortfall in 2021–23. Expected revenues were reduced by $172.6 million, but the appropriations in the bill were not adjusted. While the estimated costs in 2021–23 have not actually been appropriated, the current estimates represent the continuing costs of the appropriations made for 2019–21. At the time E2SHB 2158 was enacted, the 2021–23 cost of its 2019–21 appropriations was estimated to be $557.0 million. The resulting 2021–23 shortfall is $158.6 million, as shown in table 1 on page 2. If ESSB 6492 is enacted, it would reverse this shortfall and leave a surplus of $46.1 million in 2021–23, as shown in table 2. (However, ESSB 6492 would leave a shortfall of $24.3 million in 2019–21.)

Second, the possible shortfall in 2019–21 under current law has to do with increased caseload estimates and raises a question about how they should be funded. Because E2SHB 2158 made the Washington College Grant an entitlement, it must be funded for all eligible students, regardless of whether WEIA funds are available. There is no statutory requirement for the WEIA to fund all caseload changes in the program. Indeed, about three-quarters of the cost of the grant program is funded from other accounts. (According to the Washington Student Achievement Council, the college grant was estimated to cost a total of $468.0 million in FY 2021, of which $120.4 million comes from the WEIA.)

For the first time in Nov. 2020, the Caseload Forecast Council forecast the number of students eligible for the Washington college grant (there will be a new forecast in February). Based on the November forecast, Gov. Inslee's 2020 supplemental operating budget proposal increased maintenance level (the cost of continuing current services) spending on the program by $28.1 million in 2019–21. According to the Office of Financial Management, the caseload forecast also increased the program's cost estimate for 2021–23 by $88.8 million.

Gov. Inslee proposes charging these maintenance level increases entirely to the WEIA. By charging all the caseload changes to the WEIA, the governor's proposal creates a shortfall in the account in 2019–21. The supplemental proposal would then appropriate $27.8 million from the general fund–state to the WEIA to cover the shortfall (WRC 2020).

The Legislature may choose to fund the increased caseload with non-WEIA funds; if it does so, there would be no WEIA shortfall in 2019–21 (unless the Legislature adopts ESSB 6492). If the Legislature chooses to fund the caseload increase entirely from the WEIA and it enacts ESSB 6492, there would be shortfalls of $52.3 million in 2019–21 and $70.8 million in 2021–23 that would need to be backfilled, as shown in table 3.

Table 3: WEIA Balance Sheet Including Nov. Caseload Changes and ESSB 6492 (Dollars in Millions)

	2019-21	*2021-23*
Beginning Balance	-	(52)
Revenue		
E2SHB 2158	380	393
ESSB 6492	**(30)**	**234**
Total Revenue	*350*	*627*
Total Resources	*350*	*575*
Spending		
Washington College Grant	160	250
Nov. Caseload Changes	**28**	**89**
Foundational Support (Compensation and Central Services)	66	72
Capacity in High Demand Programs at Four-Year Institutions	17	22
Student Support Services at Four-Year Institutions	2	2
WSU Medical School Completion and Expansion	14	23
Nurse Educator and Faculty Salary Increase at CTCs	61	81
Guided Pathways	32	76
Career Connected Learning	11	13
Working Connections Child Care	4	16
Other	6	3
Total Spending	*403*	*646*
Ending Fund Balance	(52)	(71)

WEIA and the Four-Year Balanced Budget Requirement

WEIA appropriations fund education programs that would typically be funded from the general fund–state, education legacy trust account, or the opportunity pathways account. These three accounts are collectively subject to the four-year balanced budget requirement (WRC 2019a). Given the high degree of correlation between these programs and funds, we believe the WEIA should be included in the group of funds required to balance over four years.

In a step in that direction, in June 2019, the Economic and Revenue Forecast Council decided to forecast WEIA revenues as part of the regular revenue forecasts, though the WEIA forecast will be kept separate from the NGFO forecast.

Three bills have been introduced this year that would include the WEIA in the four-year balanced budget requirement: SB 6660, SB 6198, and HB 2857. (HB 2857 would require the WEIA to balance over four years separately from the other funds subject to the outlook.)

Comment

ESSB 6492 would ease the administration of the higher tax rates, in part by not limiting them to 43 sectors. It would increase WEIA revenues over four years by more than originally expected under HB 2158. Although it would reduce revenues in 2019–21 and thereby leave a shortfall in the biennium, estimated 2021–23 revenues under the bill would cover that and still leave a surplus over four years.

But that assumes that the Legislature will decide not to charge the caseload increases entirely to the WEIA. WEIA tax rates should not be increased every time there is a caseload increase. The college grant is mainly funded by non-WEIA sources; increased caseloads could be funded by non-WEIA sources too.

Finally, adding the WEIA to the four-year balanced budget requirement would help to improve budget transparency. Like the WEIA, the education legacy trust account and opportunity pathways account are dedicated to education—and they are included in the balanced budget requirement. Furthermore, this episode nicely illustrates the benefit of including the WEIA: If it were subject to the requirement, expenditures would have to be balanced against expected revenues over a longer term, making shortfalls less likely.

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Washington Research Council
(206) 467-7088
researchcouncil.org