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April 28, 2025

VIA EMAIL

The Honorable Bob Ferguson
Governor, State of Washington

Re: Veto Senate Bill 5814 – Extension of Retail Sales Tax to Business Inputs

Dear Governor Ferguson:

On behalf of the Council On State Taxation (COST), we urge you to veto Senate Bill 5814 which extends the Retail Sales Tax to select services that are mostly, if not exclusively, purchased by businesses. This base expansion to business-to-business transactions (business inputs) violates several principles of sound tax policy.

A fair, efficient, and well-designed sales tax should be levied only on final consumption by the ultimate consumer. S.B. 5814 is in direct contravention of an ideal sales tax system as it applies to business inputs, which creates tax pyramiding and a lack of transparency to both consumers and policy makers. This extension of the sales tax exacerbates the pyramiding and the lack of transparency inherent in S.B. 5814. Enactment of such a proposal will significantly impact Washington's economic competitiveness and growth as it will place Washington's businesses at a competitive disadvantage.

About COST

COST is a non-profit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of approximately 500 major corporations engaged in interstate and international business, many of which have significant business activities in Washington. COST's objective is to preserve and promote the equitable and non-discriminatory state and local taxation of multijurisdictional business entities.

COST Opposes Sales Taxes on Business Inputs

The COST Board of Directors has adopted a formal policy position opposing the imposition of sales taxation on business inputs.¹ That policy position provides:

Imposing sales taxes on business inputs violates several tax policy principles and causes significant economic distortions. Taxing business inputs raises production costs and places businesses within a State at a competitive disadvantage to businesses not burdened by such taxes. Taxes on business inputs, including taxes on services purchased by businesses, must be avoided.

Imposing sales tax on business inputs specifically violates the tax policy principles of neutrality, equity, simplicity, and transparency and causes economic distortion. This distortion results primarily from tax pyramiding. Pyramiding occurs when a tax is imposed at multiple levels and thereby imposes a hidden effective tax rate that exceeds the retail sales tax rate. The hidden rate creates a lack of transparency for both the consumer and the legislature. Tax pyramiding forces companies to either pass these increased costs on to consumers or reduce their economic activity in the State to remain competitive with other service providers that do not bear the burden of increased taxes. The economic burden of taxes on business inputs inevitably shifts to consumers through higher prices or to labor in the State through lower wages and fewer jobs. To put it simply, although this tax is a direct tax on businesses, the vast majority of the tax will be passed along to Washington citizens through higher prices and/or stagnating wages.

Tax on Business Inputs Will Undermine Washington’s Competitiveness

With the rapid growth of the computer-related and digital automated services sector in recent decades, it is understandable that a state would want to expand its sales tax base to include these additional service categories. However, the direct tax on business-to-business services in S.B. 5814 will significantly undermine Washington’s economic competitiveness with its neighboring states² and foreign countries whose inputs are exempt from such taxation.³ The passage of S.B. 5814 will significantly increase the share of Washington’s sales tax derived from business inputs which will put businesses selling these services into and out of Washington at a competitive disadvantage compared to businesses entering into these transactions in neighboring states.

The Extension of Business Services Tax Is Administratively Burdensome

The COST Board of Directors has adopted a formal policy statement urging states to impose fair, efficient, and customer-focused tax administration:

¹ See <https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/sales-taxation-of-business-inputs.pdf>.

² Washington derives approximately 37% of its sales tax revenue from the taxation of business inputs. Most of Washington’s neighboring states derive a similar percentage of their sales tax from business inputs: Idaho – 32%, California – 39%. See the COST Sales Tax Scorecard, “The Best and Worst of State Sales Tax Systems” is available at https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/270677_cost_salestaxbk_2022_final.pdf.

³ Almost all other countries impose a value-added tax (VAT) rather than a retail sales tax. A VAT essentially has a business input exemption built into the design of the tax to avoid pyramiding of the tax. Under a VAT, all business inputs are taxed, but a refund or credit is allowed if the next stage of the supply chain is subject to VAT. This method generally ensures that the tax is applied at only one level.

The Extension of Business Services Tax Is Administratively Burdensome

The COST Board of Directors has adopted a formal policy statement urging states to impose fair, efficient, and customer-focused tax administration:

Fair, efficient and customer-focused tax administration is critical to the effectiveness of our voluntary system of tax compliance. A burdensome, unfair, or otherwise biased administrative system negatively impacts tax compliance and hinders economic competitiveness.⁴

The proposed extension of business services taxation in S.B. 5814 violates this policy position because it is a burdensome tax that will require most taxpayers to initiate extensive system changes to collect and remit the proposed tax within the sales tax system. Many of the service providers implicated in S.B. 5814 do not currently collect and remit sales tax on these services and will be required to register for a sales tax account and expend significant IT resources to accommodate the tax.

S.B. 5814 leaves many questions about the administration of the tax unanswered. As just one example, how will the services subject to the tax be sourced – to where the benefit of the service is derived or to where the service is performed? How are these distinctions defined? Numerous additional critical administrative issues with such taxes, including the bundling of goods with services, collection, remittance, and definitions are silent in the bill. Requiring taxpayers to guess which transactions are subject to the tax and how to source them is unconscionable, particularly when taxpayers that fail to collect the proper amount of tax are liable for any taxes they failed to collect.

Conclusion

The extension of the Retail Sales Tax on business-to-business transactions in S.B. 5814 will harm Washington by discouraging business activity in the State, which will negatively impact investment and jobs. Approximately 37% of Washington's current sales tax base consists of business inputs, and taxing additional business inputs will increase that share, thereby directly increasing the costs to conduct business in Washington and reducing the competitiveness of Washington businesses. S.B. 5814 places significant administrative burdens on Washington businesses, many of which do not currently collect and remit sales tax on the services they provide. Although S.B. 5814 purports to impose this tax on businesses, the ultimate incidence of the tax will be borne by Washington citizens and therefore will negatively impact Washingtonians' economic well-being and the State's economic development efforts.

We strongly encourage you to veto S.B. 5814's extension of tax on business inputs.

Respectfully,

Mark B Holmes

Mark B. Holmes

cc: COST Board of Directors
Patrick J. Reynolds, COST President & Executive Director

⁴ See <https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/fair-efficient-and-customer-focused-tax-administration---revised-feb-2024---final.pdf>