Concerns with the 2014 JLARC Tax Preference Performance Review:
International Investment Management Services

JLARC CONCLUSION 1: *Adoption of an economic nexus and apportionment standard has reduced the competitive disadvantage for IIMS businesses located in-state compared to out-of-state.*

- <u>Issue 1:</u> **Most states are moving to an economic nexus standard and revised apportionment standards.** Over 30 states have adopted economic nexus and 20 states have moved to single sales apportionment. Washington's adoption of economic nexus and an apportionment standard is in line with other states and does not reduce the competitive disadvantage of the B&O tax.
- <u>Issue 2:</u> **JLARC improperly assumes that an in-state IIMS business pays the same amount of B&O tax as an out-of-state business.** This assumption is not correct as B&O tax is not only imposed on sales to third parties (clients) but also on intercompany service transactions.
- If a company operates through multiple subsidiaries (which is often the case in the highly-regulated financial services sector), and these subsidiaries are all located in Washington, an in-state company will pay a significant amount of B&O tax on these intercompany service transactions.
- Therefore, in-state and out-of-state IIMS businesses could generate the same amount of revenue from Washington clients, but the in-state IIMS business could pay significantly higher B&O tax based on the level of its intercompany service transactions.
- <u>Issue 3:</u> **JLARC did not compare the actual amount of B&O tax burden for a Washington-headquartered company vs. what the company would pay if headquartered somewhere else.** Many states with a tax on net income are moving to a single sales apportionment. This fact, combined with a business model that often has high revenue and low margins, often results in a significantly lower tax burden for a company headquartered in one of those states compared to the B&O tax the same company would pay if headquartered in Washington, even with the lower IIMS rate.

JLARC CONCLUSION 2: *The growing number of firms claiming the preference includes out-of-state businesses. This is partially due to adoption of economic nexus in 2010.*

- <u>Issue 1:</u> **The chart shown on Exhibit 75 is extremely misleading because it improperly infers that economic nexus caused an increase in the use of the IIMS rate.** However, if the graph is examined carefully, the majority of the increase occurred BEFORE economic nexus was adopted in June 2010. Even after June 2010, compliance with reporting requirements by out-of-state companies across all sectors has been slower than anticipated (based on discussions with the DOR).

JLARC CONCLUSION 3: *JLARC quotes the prime sponsor of the original legislation (who stated that the intent was to ". . . retain the people in this state . . . ") to infer a public policy objective of retaining jobs in Washington state.*

- **Issue 1: Although JLARC correctly infers the original public policy objective was to retain jobs, the report fails to analyze whether that objective was fulfilled.** The report focuses almost exclusively on the competitive disadvantage of companies, and fails to analyze the success of the preference, which has led to the preservation of jobs in Washington.
- A prime example that this public policy is being met is the preservation and expansion of quality jobs at Russell Investments, who was stated as a primary target by the Legislature in policy discussions in 2005:

	12/31/1995	8/12/2014	% Increase
Russell's Washington Employees	796	952	19.60%

JLARC CONCLUSION 4: *JLARC projects IIMS savings of $26.7 million during the 2015-17 biennium.*

- **Issue 1: The fiscal estimate is based on returns filed with the DOR claiming IIMS before the DOR issued its most recent Excise Tax Advisory (ETA), which will significantly reduce the number of eligible businesses and the projected savings.**
- JLARC itself states in their report that the recent growth in the use of the IIMS rate is partially due to businesses that DOR believes may not qualify.[1] The DOR issued an ETA on February 28, 2014 which it believes will eliminate a significant number of companies from qualifying for the lower IIMS rate who currently file under this category. This implies that JLARC's savings estimate is grossly overstated as it includes companies that will no longer be in the IIMS category.

[1] The DOR has stated there were approximately 70 taxpayers either under audit or being held for audit for this issue.