

LITTER TAX COMPLIANCE

Report of the Department of Revenue

*Prepared Pursuant to
Chapter 257, Laws of 1998 (2SHB 3058)*

**Washington State Department of Revenue
William N. Rice, Acting Director**

Analysis by the Research Division

January 2003

February 6, 2003

TO: The Honorable Dino Rossi, Chair
Senate Ways and Means Committee

The Honorable Jeff Gombosky, Chair
House Finance Committee

FROM: William N. Rice, Acting Director

SUBJECT: LITTER TAX COMPLIANCE REPORT

Legislation enacted in 1998 directed the Department to prepare a report on litter tax compliance once every two years. This is the Department's third report on the subject.

The 1998 legislation also changed taxpayer reporting of litter taxes. Beginning in 1999, the tax was reported on each tax return filed by the taxpayer. Previously, litter tax was reported annually while most taxpayers filed tax returns monthly or quarterly. During 1999 the Department of Revenue's Taxpayer Account Administration Division conducted an intensive education effort. Taxpayers from selected industries were contacted and informed of their potential litter tax liability. Any tax return with an error of \$2.50 or more was corrected and a balance due notice was sent, if necessary. This report indicates that the 1998 statutory change and the education effort have continued to have an extremely positive effect on litter tax reporting. While the number of filers remained constant, total collections through voluntary compliance reached an all-time high in 2000 and 2001.

Tables in the study also report the following:

- ◆ Tax reported voluntarily versus tax obtained through enforcement activities,
- ◆ The number of taxpayers and amount of tax paid by major industry, and
- ◆ Total estimated litter tax noncompliance.

We will be distributing copies of the report to the members of your committees and to the Governor and his staff. If you have any questions about the findings, please contact Mary Welsh, Assistant Director of the Research Division at 570-6076.

cc: The Honorable Gary Locke, Governor
Cheryl Strange, Department of Ecology

LITTER TAX COMPLIANCE

The 1998 Legislature established a requirement that a report covering litter tax compliance be prepared beginning in 1999 and in odd-numbered years thereafter (Section 7 of 2SHB 3058, codified in RCW 82.19.010(2)). This report is the Department of Revenue's third submission in response to that requirement.

OVERVIEW OF THE LITTER TAX

The litter tax was adopted in 1971 as part of the Model Litter Control and Recycling Act of 1971. The tax is imposed upon manufacturers, wholesalers, and retailers who sell any item from a list of thirteen categories of products. The categories, as listed in RCW 82.19.020, are:

1. Food for human or pet consumption
2. Groceries
3. Cigarettes and tobacco products
4. Soft drinks and carbonated waters
5. Beer and other malt beverages
6. Wine
7. Newspapers and magazines
8. Household paper and paper products
9. Glass containers
10. Metal containers
11. Plastic or fiber containers made of synthetic material
12. Cleaning agents and toiletries
13. Nondrug drugstore sundry products

Taxpayers compute the amount of tax due by multiplying the gross proceeds of sales of the listed items by the tax rate of fifteen one-thousandths of one percent (0.00015). By comparison, this tax rate is only 3 percent of the typical B&O tax rate (0.484 percent for manufacturing/wholesaling), so the amount of tax liability for many firms is quite low.

The tax receipts are devoted to litter-related programs conducted by the Department of Ecology and other state agencies and for grants to local governments for similar programs (Waste Reduction, Recycling and Litter Control Account per RCW 70.93.180).

The Department of Revenue received many complaints from taxpayers regarding the difficulty of sorting through their inventory and sales data to determine which items are included in the list of thirteen taxable products. Certain businesses were relieved of this task by an administrative rule adopted by the Department pursuant to authority granted in the litter tax statutes. The rule, WAC 458-20-243, allows grocery stores and drug stores to report and pay the litter tax measured by a percentage of total sales (95 and 50 percent, respectively).

TABLE 1 – LITTER TAX COMPLIANCE

Table 1 shows litter tax receipts for Calendar Years 1991–2001. It compares the actual amount of tax reported voluntarily by taxpayers to the amount obtained from Department enforcement activities. Department enforced liability is defined as tax collected through Department enforcement actions or the tax filed on a supplemental return to report the litter tax after the normal due date. Such liability results from assessments (usually in conjunction with a field audit), corrections to the taxpayer’s account (usually by an office audit), tax warrants, or supplemental returns.

Table 1
LITTER TAX COMPLIANCE
Tax Reported Voluntarily vs.
Tax Obtained via Enforcement

Estimates for Calendar Years 1991–2001
Dollars in Thousands

<u>Year</u>	<u>Total Tax</u>	<u>Tax Reported Voluntarily</u>		<u>Tax from Enforcement*</u>	
		<u>Amount</u>	<u>% of Total</u>	<u>Amount</u>	<u>% of Total</u>
1991	\$3,904.0	\$3,104.8	79.5%	\$799.2	20.5%
1992	3,884.9	3,215.4	82.8	669.5	17.2
1993	3,851.3	3,273.3	85.0	578.0	15.0
1994	4,017.9	3,304.5	82.2	713.4	17.8
1995	4,401.1	3,988.6	90.6	412.5	9.4
1996	4,298.6	3,539.0	82.3	759.6	17.7
1997	4,143.2	3,477.2	83.9	666.0	16.1
1998	4,873.1	4,309.9	88.4	563.2	11.6
1999	5,509.1	4,493.4	81.6	1,015.7	18.4
2000	5,730.3	5,598.3	97.7	132.0	2.3
2001	5,785.1	5,733.8	99.1	51.3	0.9

*Enforcement includes audit assessments, correction to account adjustments, warrants, and supplemental returns (due to amnesty program in 1991).

For Calendar 1999, tax from enforcement exceeded \$1 million for the first time. Tax reported voluntarily also reached an all-time high of nearly \$4.5 million. Historically, enforcement activities have accounted for approximately 10 to 20 percent of total litter tax receipts. For 1999, enforcement provided 18.4 percent of total litter receipts. This increase in enforcement resulted from the education effort conducted by the Department's Taxpayer Account Administration Division during 1999.

For Calendar Years 2000 and 2001 total taxes continued to grow and reached \$5.7 million and \$5.8 million, respectively. The split between the amount of taxes collected voluntarily and through enforcement changed drastically. In 2000, taxes reported voluntarily accounted for \$5.6 million or 98 percent of the total \$5.73 million. Enforcement activities accounted for only \$132,000 or 2.3 percent of the total collected. In 2001, taxes collected voluntarily reached \$5.7 million or 99 percent of the total. This change in collection patterns can be attributed directly to the legislative change in reporting frequencies and the Department's education efforts in 1999.

TABLE 2 – LITTER TAX REPORTERS BY YEAR AND INDUSTRY

Table 2 contains a recent history of the number of taxpayers reporting litter tax liability. This table shows the wide range of industries that report the tax, as well as fluctuations in the number of firms that report from year to year. The total number of reporting taxpayers increased dramatically in Calendar 1999. The 20,927 taxpayers reporting litter tax in 1999 constituted a 56 percent increase. Much of this large increase can be attributed to a change in filing requirements adopted by the 1998 Legislature.

The Legislature changed the reporting frequency for litter tax so that it coincided with the taxpayer's reporting frequency for other state excise taxes. This change took effect on January 1, 1999. The 56 percent increase in the number of filers in 1999 indicates that this statutory change had an extremely positive effect on litter tax reporting. The number of taxpayers reporting litter tax has remained relatively constant at 19,661 for Calendar 2000 and at 19,467 for Calendar 2001.

Table 2
LITTER TAX REPORTERS BY YEAR AND INDUSTRY
Includes Voluntary and Involuntary Reporting

Calendar Years 1996-2001

SIC GROUP	INDUSTRY DESCRIPTION	1996	1997	1998	1999	2000	2001
1-14	Agricultural & Fishing	326	293	290	490	452	443
15-17	Construction	124	125	150	662	586	540
20	Food & Kindred Products	243	207	198	235	238	233
24,25	Lumber, Wood Products & Furniture	24	28	20	33	24	22
26	Paper & Allied Products	34	26	32	35	38	38
27	Printing & Publishing	309	257	229	330	282	257
28,29	Chemical & Petroleum Mfg.	15	12	10	17	16	16
31,32	Leather, Stone Products	3	3	2	10	6	7
33,34	Primary & Fabricated Metals	10	13	7	16	17	17
35,36	Industrial & Electrical Machinery	15	16	12	24	19	21
37	Transportation Equipment	6	5	9	27	20	19
39	Misc. Manufacturing Industries	13	14	10	20	18	22
41-47	Transportation	45	53	54	85	75	79
49	Electric, Gas, & Sanitary Services	9	8	7	24	23	24
50	Wholesale Trade Durable Goods	204	192	166	332	251	235
51	Wholesale Trade Nondurable Goods	1,684	1,487	1,417	1,738	1,660	1,655
52	Building Materials & Garden Supplies	154	143	139	200	190	180
53	General Merchandise Stores	141	131	153	190	147	141
54	Food Stores	2,916	2,628	2,503	3,219	2,870	2,922
55	Automotive Dealers & Service Stations	600	584	660	911	1,131	1,082
56	Apparel & Accessory Stores	30	39	40	86	86	84
57	Furniture & Home Furnishings Stores	79	84	72	191	168	147
58	Eating & Drinking Places	4,508	4,232	4,646	7,521	7,162	7,125
59	Miscellaneous Retail	1,829	1,568	1,314	2,128	2,070	2,104
60-67	Finance, Insurance & Real Estate	39	42	38	81	77	78
70	Hotels & Other Lodging Places	126	96	107	175	149	162
72	Personal Services	467	433	364	518	453	450
73	Business Services	257	247	220	479	394	398
75	Auto Repair, Services & Parking	90	110	81	258	230	197
76	Miscellaneous Repair Services	54	58	39	138	113	101
78	Motion Pictures	70	55	54	80	66	67
79	Amusement & Recreation Services	175	142	153	258	232	234
80	Health Services	39	42	44	79	78	90
82	Educational Services	14	14	12	26	21	18
83	Social Services	8	6	5	18	25	22
86	Membership Organizations	71	59	68	120	108	100
87	Engineering & Management Services	52	50	41	80	93	75
89	Services, Not Elsewhere Classified	7	7	3	13	12	10
99	Other and Not Classified	13	6	19	70	54	45
	Nondisclosable	16	22	2	10	7	7
	Total Reporters	14,823	13,539	13,395	20,927	19,661	19,467

TABLE 3 – LITTER TAX LIABILITY BY INDUSTRY

Table 3 gives detailed industry information on litter tax reporters for Calendar Year 2001. It provides a count of litter taxpayers and compares reported litter tax activity by industry groups.

While the majority of litter tax liability is concentrated in a small number of industries, most industries have some activity subject to litter tax. Eating and drinking firms represent the industry with the most litter taxpayers, followed by grocery stores, miscellaneous retail firms, and wholesalers of nondurable goods. Wholesalers of nondurable goods, grocery stores, eating and drinking establishments, and food processing firms paid over 75 percent of the tax.

The average annual litter tax liability for all firms is approximately \$297 per firm. Many firms owe tax based on their selling activities, but the amount of tax owed tends to be small. Only five industries had an average litter tax liability per firm of more than \$1,000. The industry with the highest average litter tax liability per firm was general merchandise stores. Nineteen of the forty industries in Table 3 had an average annual tax of less than \$100.

Table 3
LITTER TAX LIABILITY BY INDUSTRY
Calendar Year 2001

SIC GROUP	INDUSTRY DESCRIPTION	NO. OF LITTER TAX TAXPAYERS	LITTER TAX LIABILITY	AVERAGE
1-14	Agricultural & Fishing	443	\$59,232	\$134
15-17	Construction	540	9,120	17
20	Food & Kindred Products	233	326,737	1,402
24,25	Lumber, Wood Products & Furniture	22	17,797	809
26	Paper & Allied Products	38	88,503	2,329
27	Printing & Publishing	257	132,611	516
28,29	Chemical & Petroleum Mfg.	16	7,449	466
31,32	Leather, Stone Products	7	6,090	870
33,34	Primary & Fabricated Metals	17	20,904	1,230
35,36	Industrial & Electrical Machinery	21	3,578	170
37	Transportation Equipment	19	199	10
39	Misc. Manufacturing Industries	22	3,240	147
41-47	Transportation	79	6,445	82
49	Electric, Gas, & Sanitary Services	24	3,779	157
50	Wholesale Trade Durable Goods	235	86,866	370
51	Wholesale Trade Nondurable Goods	1,655	1,833,958	1,108
52	Building Materials & Garden Supplies	180	15,557	86
53	General Merchandise Stores	141	359,520	2,550
54	Food Stores	2,922	1,620,773	555
55	Automotive Dealers & Service Stations	1,082	119,565	111
56	Apparel & Accessory Stores	84	4,805	57
57	Furniture & Home Furnishings Stores	147	29,424	200
58	Eating & Drinking Places	7,125	548,828	77
59	Miscellaneous Retail	2,104	279,873	133
60-67	Finance, Insurance & Real Estate	78	4,726	61
70	Hotels & Other Lodging Places	162	449	3
72	Personal Services	450	13,285	30
73	Business Services	398	61,102	154
75	Auto Repair, Services & Parking	197	6,544	33
76	Miscellaneous Repair Services	101	1,678	17
78	Motion Pictures	67	-5,509	-82
79	Amusement & Recreation Services	234	12,184	52
80	Health Services	90	3,992	44
82	Educational Services	18	1,053	59
83	Social Services	22	584	27
86	Membership Organizations	100	2,215	22
87	Engineering & Management Services	75	61,640	822
89	Services, Not Elsewhere Classified	10	111	11
99	Other and Not Classified	45	35,864	797
	Nondisclosable	7	334	48
	Total Reporters	19,467	\$5,785,105	\$297

TABLES 4 AND 5 – ESTIMATED LITTER TAX NONCOMPLIANCE

During the 1990s the Department of Revenue developed a methodology for measuring excise tax noncompliance among registered taxpayers. A representative sample of accounts stratified by size and industry was selected annually. Estimates of overall noncompliance were derived from the results of audits of the sample accounts.

The estimate of litter tax noncompliance reported here is based on the same sampling methodology. Audit results for the annual stratified random sample drawn in 2001 were analyzed and statistically projected to Calendar Year 2001. The results analyzed included audits by Taxpayer Account Administration as well as the Audit Division. As litter tax is concentrated in a few major industry sectors, only four industry categories were used. The resulting estimates are reported in Table 4.

Table 4
ESTIMATED NONCOMPLIANCE BY MAJOR INDUSTRY SECTOR
Projected to Calendar Year 2001

<u>Major Industry Sector</u>	<u>Noncompliance Found Through Enforcement</u>	<u>Estimated Undetected Noncompliance</u>	<u>Total Estimated Noncompliance</u>
Manufacturing	\$ (20,367)	\$ (89,921)	\$ (110,288)
Wholesale	\$ 39,022	\$ (76,696)	\$ (37,674)
Retail	\$ 47,374	\$ 114,938	\$ 162,312
All Other	\$ (14,733)	\$ 179,115	\$ 162,382
Total	\$ 51,296	\$ 127,437	\$ 178,733

Enforcement activities found \$51,296 in unreported litter tax for Calendar Year 2001. The amount of undetected litter tax liability was estimated at \$127,437. Estimates of both undetected and total noncompliance were highest for retail and all other sectors.

Several considerations need to be stressed when interpreting these results:

- ◆ These estimates are statistical projections of what could be found if an audit was performed on every single firm currently registered and reporting excise tax to the Department of Revenue. For 2001, that encompassed more than 260,000 firms.
- ◆ The noncompliance estimates are based on multi-year audits performed over a period of several years. The results are based on annualized numbers projected to 2001. This offers no insight into changes in noncompliance over time.

Table 5
TOTAL VOLUNTARY REPORTING AND NONCOMPLIANCE
Projected to Calendar Year 2001

	<u>Amount</u>	<u>% of Total</u>
Tax Reported Voluntarily	\$5,733,809	97.0%
Noncompliance Found Through Enforcement	\$ 51,296	0.8%
Estimated Undetected Noncompliance	\$ 127,437	2.2%
Total Estimated Liability	\$5,912,542	100.0%

As Table 5 indicates, litter tax noncompliance is estimated to be about 3 percent of total liability among registered taxpayers. This is in contrast to the 2001 Litter Tax Study, which found the noncompliance level to be about 40 percent to total liability among registered taxpayers. This improvement in overall litter tax reporting can be attributed to the 1999 legislative changes and the Department's education efforts.