June 2020

Taxing Employers for Windfall Compensation in the Pandemic

COVID-19 has laid bare two inter-related public policy dilemmas in Washington State:

1. Our tax system fails to generate the revenue needed to fund public services, due to our overdependence on sales taxes, business and occupation taxes (B&O), and property taxes. It is exacerbated by our failure to adequately tax growing areas of our economy and higher-income individuals and businesses. Our state faces a shortfall of at least $7 billion over the next three years.
2. Our regressive tax system encourages the polarization of income to the top group of already privileged employees, while reinforcing wage stagnation for typical workers. Even prior to the recession, middle- and working-class workers found their economic circumstances precarious, with median full-time wages of $54,000 in 2018.[1] Health coverage, higher education, housing, and child care were priced increasingly out of reach.

In this pandemic, inequities have further deepened. Over 1 million Washingtonians have no health insurance.[2] Sixty percent of Washington state households with incomes under $50,000 have lost jobs.[3] More than half of black households in our state have lost employment. In King County, between March 1 and May 16, 29 percent of Black workers filed for unemployment, as did 40 percent of Native Hawaiian/Pacific Islander workers, and 30 percent of American Indian/Alaska Natives.[4]

Between July 2018 and June 2019, Washington State employers awarded compensation in excess of $250,000 to over 65,500 employees (1 percent of total employment in the state). Of these, over 3,000 received more than $1 million, more than 100 received between $5 million and $10 million, and 56 received more than $10 million.[5] Most high-income households have not been materially touched by the pandemic/depression, but are surrounded by lost jobs, lost health coverage, and soon lost homes.

We can rebuild public services for health care, mental health, and education, and begin to adequately fund early learning and care by putting in place an excise tax on employers for their decisions to provide surplus compensation to executive employees.

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[1] Author's calculation from 2018 data on employee compensation by the Employment Security Department. https://esd.wa.gov/labormarketinfo/median-hourly-wages

[2] https://www.ofm.wa.gov/sites/default/files/public/dataresearch/healthcare/healthcoverage/COVID-19_impact_on_uninsured_20200527.pdf

[3] https://www.census.gov/data/tables/2020/demo/hhp3.html

[4] https://www.kingcounty.gov/depts/health/covid-19/data/impacts/unemployment.aspx

[5] All data from Senate Ways and Means Committee calculations of Employment Security Department compensation records.

How This Could Work:

Employers compensating employees in excess of a compensation threshold of, for example, $250,000, would pay a marginal tax on compensation above this level. All employers would be included: corporations, other for-profit businesses, non-profit organizations, universities and colleges, foundations, and public institutions. Washington's Employment Security Department (ESD) maintains a database of employee compensation, so this tax would be relatively easy to track. With immediate implementation revenue collections could begin in Fiscal Year 2021.

Employers that do not compensate above this threshold would be exempt from this tax. If they choose to compensate above this threshold, they will contribute surplus compensation.

Several Models Already Exist:

1. In 2019, Sen. Joe Nguyen introduced this concept with **Senate Bill 6017**. This bill would have established a progressive tax on compensation in excess of $1 million. Employers would pay a 5 percent tax on compensation between $1 million and $5 million, a 7.5 percent tax on compensation between $5 million and $10 million, and a 10 percent tax on compensation exceeding $10 million. If this tax had been in place in Fiscal Year 2019, it would have raised $256 million that fiscal year.

   SB 6017 would have covered about 3,300 employees, the top 0.0006 percent of employees. Average compensation for these employees was over $2 million. Average compensation for the 56 employees compensated over $10 million was $22.7 million.[6]

Compensation from Employer	Number of Employees in Cohort	Total Compensation of Cohort	Revenue from Tax on Excess Compensation	Marginal Tax Rate	Average Compensation Per Employee
$1,000,000 - $4,999,999	3,336	$2,985,824,327	$149,291,216	5.0%	$1,889,604
$5,000,000 - $9,999,999 subset	108	$474,447,407	$35,583,556	7.5%	$8,739,373
$10,000,000 + subset	56	$712,789,776	$71,278,978	10.0%	$22,728,389
Total[7]	**3,336**	**$7,509,061,510**	**$256,153,749**		**$2,250,918**

Source: Data is derived from Senate Ways and Means calculations of Employment Security Department compensation data, for FY 2019.

2. Rep. Frank Chopp is proposing a similar tax to fund the Health Equity and Recovery Trust Fund (HEART). His proposal would levy a 5 percent tax on compensation exceeding $500,000, and 10 percent on compensation over $10 million. This tax would raise about $410 million a year, assessed on employers who together employ 10,000 workers paid in excess of $500,000, or fewer than 0.002 percent of employees in the state.

Threshold for Taxation	Marginal Tax Rate	Wages in Tier	Revenue
$500,000	5%	$6,840,901,824	$342,045,091
$10,000,000	10%	$712,789,776	$71,278,978
		Total Revenue	**$413,324,069**

Source: Data is derived from Senate Ways and Means calculations of Employment Security Department compensation data, for FY 2019.

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[6] Ibid.

[7] The total of total compensation includes the first $1 million of compensation per employee. The total in the total compensation column is, thus, not additive.

3. The Legislature could consider amending SB 6017 with elements from **House Bill 2907**, which sets the threshold for surplus compensation at $150,000. A logical threshold is $137,700 (the ceiling for employers' Social Security FICA and paid family and medical leave taxes). Above this threshold employers receive a 6.35 percent windfall/tax holiday. Rather than leave employers with this windfall, the state could place an excise tax on employers for compensation above this threshold. With the windfall tax on employers for compensation in excess of $137,700 at 3.2 percent, and stepped up for significant increases in compensation, **$1.5 billion in revenue would be generated annually**.

Category	Gross Wages	Average Wages per Cohort	Tax Total	Count	Employer Marginal Tax Rate
$137,700-$250K	$35,148,410,068	$176,583	$247,664,015	199,048	3.2%
$250K-$500K	$17,035,036,114	$326,843	$367,525,057	52,120	4.5%
$500K-$1M	$6,597,630,090	$664,146	$245,294,128	9,934	6.0%
$1M-$5M	$5,665,824,327	$1,698,389	$382,580,682	3,336	10.0%
$5M-$10M	$734,447,407	$6,800,439	$77,210,220	108	15.0%
Over $10M	$1,272,789,776	$22,728,389	$209,469,197	56	20.0%
		Total Revenue	**$1,529,743,299**		

Source: Data is derived from Senate Ways and Means calculations of Employment Security Department compensation data, for FY 2019.

4. Another approach suggested by Senate leadership is to set the threshold for employer taxes on windfall compensation at $250,000. The increment between $250,000 and $500,000 would be taxed at 3 percent. The increment between $500,000 and $1 million would be taxed at 4 percent. The increment in excess of $1 million would be taxed at 5 percent. This would generate about $565 million annually, for employer compensation of 1.2 percent of the most highly compensated employees in the state.

Threshold for Taxation (adjustable)	Marginal Tax Rate	Wages in Tier	Revenue
$250,000	3%	7,363,536,114	$220,906,083
$500,000	4%	3,380,630,090	$135,225,204
Greater than $1,000,000	5%	4,173,061,510	$208,653,075.50
		Total Revenue	**$564,784,363**

Source: Data is derived from Senate Ways and Means calculations of Employment Security Department compensation data, for FY 2019.