Improving Washington's unfair and outdated tax system

Washington has a structural budget problem — a problem largely the result of an unfair, antiquated and inefficient revenue and tax system. The fact is state revenue collections no longer keep pace with the growth of our economy or with increasing demands for services. And our tax system places a disproportionately higher burden on low- and middle-income households.

In 1990, State General Fund revenue collections equaled about 7 percent of total personal income in Washington. But General Fund revenue collections as a share of the overall economy have been declining steadily for the past 25 years and now equal less than 5 percent of personal income — a nearly 30 percent drop.

During that same period, tax collections in Washington have also declined dramatically in comparison to other states. In 1995, Washington ranked 11th among all states in terms of state and local tax collections as a share of personal income — well above the U.S. average. By 2011, Washington's ranking had fallen to 35th and well below the U.S. average.

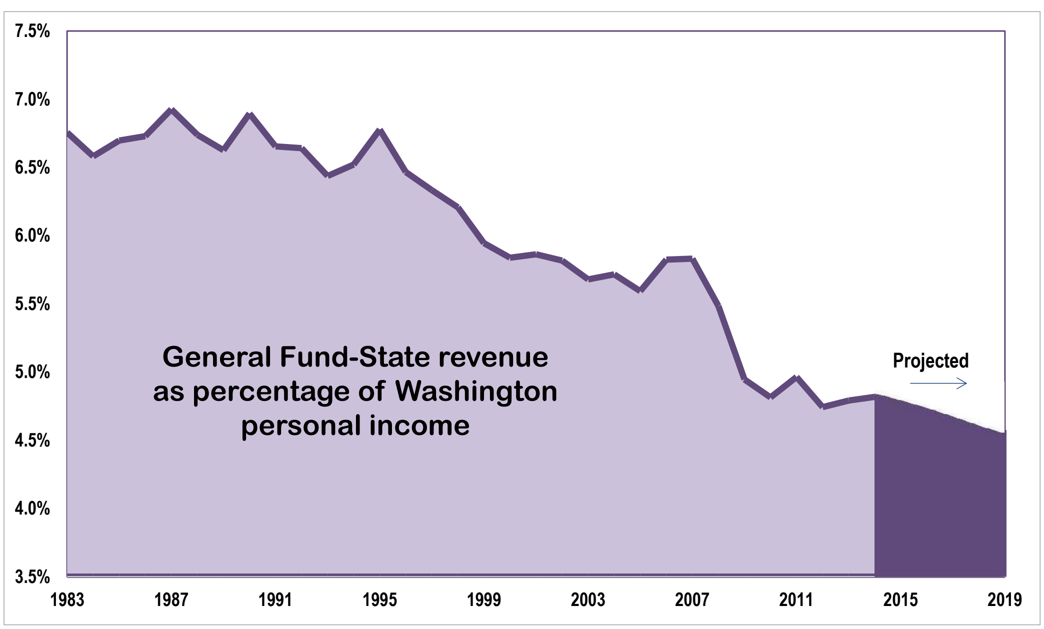
To put that in perspective: If Washington tax collections were merely at the U.S. average, we would be generating about $2.8 billion more a year in state and local revenue.

Besides failing to keep pace with the economy, Washington's tax system is unfair. People at the lower end of the income scale pay a much larger share of their earnings in taxes than do the very richest.

With income inequality at historically high levels, our state's unfair tax system hits the middle class and working poor especially hard.

In fact, Washington's state and local tax system is the most regressive in the nation, according to a **2013 study by the Institute on Taxation & Economic Policy.** The study found that non-elderly residents with the lowest incomes paid 16.9 percent of their incomes in taxes, while those with the highest incomes paid less than 2.8 percent in taxes. In other words, our poorest residents are paying six times as much of their income in taxes as do the wealthiest.

Over the past 25 years, state revenue collections as a share of the economy have fallen by nearly 30 percent.



The disconnect between Washington's tax system and the growth of our overall economy and demand for services is the result of a variety of factors:

- Over the past century, the state has enacted more than 600 tax breaks worth billions of dollars. Many of these are well-targeted and effective at improving the state economy and providing family-wage jobs. But the Legislature has been unable to close tax breaks that are outdated or no longer serve their original purpose.
- Voter-approved measures sharply reduced property tax growth and transportation revenues.
- Consumers are doing more of their shopping online, and because many out-of-state businesses don't collect sales tax, our state loses hundreds of millions of dollars each year.
- During the past half century, there has been a dramatic shift in consumer spending from commodities to services. In general, we do not tax services to the extent that we tax commodities.

Proposed revenue changes to meet highest-priority needs

Governor Inslee's proposed budget includes tax and revenue changes (see table) that will raise a total of about $1.4 billion during the next biennium. Besides helping to address a large budget shortfall, the Governor's plan will make Washington's tax system fairer and better at keeping pace with the state's economy.

The Governor proposes a **new capital gains tax** on the sale of stocks, bonds and other assets to increase the share of state taxes paid by our state's wealthiest taxpayers. The state would apply a 7 percent tax to capital gains earnings above $25,000 for individuals and $50,000 for joint filers, starting in the second year of the biennium. At those earnings thresholds, only a tiny fraction of the state's taxpayers would be affected.

After exemptions are provided to remove any capital gains tax on retirement accounts, homes, farms and forestry, the proposal will raise an estimated $798 million in fiscal year 2017. Earned income from salaries and wages are not capital gains and would not be taxed at all.

Washington is one of just nine states that does not tax capital gains. A 7 percent tax would put the state's rate below Idaho, and considerably below Oregon (9.9 percent) and California (13.3 percent).

The Governor's plan also would:

- Increase the state **cigarette tax** by 50 cents per pack and start taxing **e-cigarettes and vapor product**s, which together will raise about $56 million.
- Repeal five tax breaks (see table), which will raise about $282 million during the biennium.
- Include **$380 million in new revenue** that will be generated by the Governor's market-based carbon pollution reduction plan.

The Governor also proposes several tax decreases (see table) to help spur growth and create jobs in key sectors of the state's economy. For example, his plan restores and reforms two tax incentive programs that encourage high-tech research and development (R&D) spending in advanced computing, advanced materials, biotechnology, electronic device technology and environmental technology. The R&D tax credit program is available to all qualifying businesses with a cap of $500,000 per year, per taxpayer. The R&D tax deferral program is available to all qualifying businesses with a cap of one project, per taxpayer, per year, up to $1 million.

The Governor's plan also calls for lowering taxes for carbon fiber manufacturing and extending tax exemptions related to food processing and production of alternative fuels — growth sectors that are important to Washington's economic future.

Operating Budget Revenue Plan	2015–17
Increases – click title for more detail	**$ in Millions**
7.0% capital gains tax on individuals	$798
Carbon Pollution Accountability Act revenue to GF-S	379
Increase cigarette tax by 50¢ per pac	38
Excise tax on e-cigarettes and vapor products	18
Repeal sales tax exemption for trade-ins valued over $10,000	105
Repeal use tax exemption for extracted fuel, except hog fuel	51
Refund state portion of sales tax to nonresidents	52
Repeal sales tax exemption on bottled water	44
Repeal preferential B&O tax rate for royalties	30
Total	**$1,515**
Decreases – click title for more detail	
Extend high-tech R&D B&O tax credit	($51)
Extend and modify high-tech R&D sales/use tax deferral program	(15)
B&O tax credit for advanced composite manufacturing/wholesaling	(4)
Extend agricultural processor tax exemptions	(15)
Extend commute trip reduction tax credit	(4)
Extend biodiesel, ethanol and biomass tax incentives	(2)
Extend exemption for energy conservation payments from BPA	(1)
Simplify the taxation of amusement, recreation and physical fitness services	(2)
Total	**($94)**
Net New Revenue to General Fund	**$1,421**