Fairer Taxes for Washington

BLUEPRINT for change

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Taxing high incomes to reduce regressive taxes and improve public services

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Washington State's seventy year-old tax structure is built on an ever-shrinking base, and taxes fall most heavily on those least able to afford them. This discussion brief outlines options for a limited tax on the highest income households, coupled with a reduction in sales or property tax. The result would be a fairer tax system that keeps pace with economic growth and provides the revenues for high-priority public investments in education and infrastructure that are necessary for shared prosperity.

Key Findings

Our state's existing tax system is outdated and unfair.

- Washington's tax system falls most heavily on low- and moderate-income residents and smaller businesses, while the state's wealthiest residents pay relatively little for public services.
- By failing to capture revenue from a changing economy, we are starving our state of needed investments in education, transportation, and health.

A tax on high incomes will raise revenue that grows with our economy.

- A tax on incomes over $200,000 would fall on the top 4% of households. It would raise $2 billion per biennium at 3%, and $3.4 billion at 5%.
- A "millionaires" tax would be paid by 0.1% of households. It would raise $780 million per biennium at 3%, and $1.3 billion at 5%.
- A tax on interest, dividend, and capital gains income with middle class and senior exclusions would raise up to $1.9 billion.

New progressive taxes *paired with* reductions in regressive taxes will reduce inequities in our state's tax structure.

- Pairing new progressive taxes with reductions in regressive taxes could net $400-$760 million each biennium.
- Lowering the state portion of the sales tax from 6.5% to 6% would cost $1.3 billion a biennium and save the typical Washington family $60 per year.
- Cutting the state portion of the property tax in half would cost $1.5 billion a biennium and save the average homeowner $330 annually.

Economic Opportunity Institute

Introduction and Summary

Washington is a wonderful place to live and do business, but we can do better. We need a renewed commitment to upgrading public schools, expanding investment in early learning and higher education, modernizing the transportation infrastructure, and broadening access to health care. These public investments in the common good will provide the basic foundations for healthy families, profitable businesses, a clean environment, and economic opportunity that is available to all.

PUBLIC INVESTMENT IN THE COMMON GOOD SPURS ECONOMIC GROWTH AND OPPORTUNITY

How do we pay for these investments in our common future? In 2006 and 2007 the state economy grew rapidly, and tax revenues rose as well. However, economic growth is slowing, and in the next few years demands for existing state services will likely exceed public income, even without the improvements and expansions we need. In recent elections, voters have been willing to increase taxes for priority investments when accompanied by high levels of accountability, but have shown uneasiness with raising taxes generally.

Washington's seventy year-old tax structure has become a hindrance to keeping Washington among the best states in which to live, work, and do business. The bulk of our existing taxes are highly regressive, falling unfairly on lower income households and new businesses. In fact, Washington has the most regressive tax structure of any state.[1]

The tax base is also shrinking relative to the state's economy, because taxes are concentrated on parts of the economy that were important in the 1930s (such as land and purchases of goods), and leave key components of the modern economy untouched (such as investment wealth and purchases of services).[2] Simply raising existing rates to fund new services only makes these problems with the tax structure worse and fuels voter discontent.

IMPROVED PUBLIC SERVICES SHOULD BE FINANCED BY PROGRESSIVE REVENUES THAT GROW WITH OUR ECONOMY

To finance new investments in education, health, and transportation, Washington's legislature should give priority to revenues that:

1. **Are progressive** – that will be paid primarily by those with the greatest ability to pay; and

2. **Expand the tax base** – so that public revenue growth keeps pace with growth in the state economy and the demand for public services.

Other states have achieved more progressive and flexible tax structures by including a broad-based income tax in their mix of public revenues. However, because of a state Supreme Court decision dating back to the 1930s and several votes of the people against a state income tax during the mid-20th century, most Washington policymakers are hesitant to consider a broad income tax.

A more limited tax targeted to the highest income households may be more palatable both to policymakers and state voters as a way to finance high priority public investments. This discussion brief sketches out possibilities for two types of limited income tax:

- A tax on all types of income limited to the highest income households. A "millionaires" tax would raise $260 million to $1.3 billion per biennium in new revenues; a tax on incomes over $200,000 would raise $686 million to $3.4 billion.[3]
- A tax on *unearned* income (interest, dividends, and capital gains) would raise between $466 million and $2.3 billion per biennium.

TAXING HIGH INCOMES COULD RAISE $260 MILLION TO $3.4 BILLION PER BIENNIUM

Both of these approaches would either require a constitutional amendment, or if passed without, could be expected to spark a challenge to the Supreme Court.

Either of these options could also be paired with a reduction in the sales or property tax. Such pairings would reduce the share of taxes paid by low and moderate-income state residents and most businesses.

ESTIMATES OF REVENUES FOR TAX ON HIGH-INCOME HOUSEHOLDS IN WASHINGTON

New revenue options	% of all households paying	Biennial revenue gains (in millions)
Millionaire's tax (on income over $1 million)	**0.1%**	
1% rate		**$260**
3% rate		**$780**
5% rate		**$1,300**
High-income tax (on adjusted gross income over $200,000 for joint returns, over $100,000 for individual returns)	**4%**	
1% rate		**$686**
3% rate		**$2,060**
5% rate		**$3,434**
Unearned income tax (on interest, dividends, & capital gains; exemption of $10,000 joint/$5,000 single)	**10%**	
1% rate		**$466**
3% rate		**$1,398**
5% rate		**$2,330**
5% rate with seniors exempt	**6%**	**$1,908**

Source: Institute on Taxation and Economic Policy estimates based on 2006 income levels for Washington taxpayers.

Progressive revenue reductions	Biennial revenue losses (in millions)
State sales tax reduction from 6.5% to 6.0%	**($1,300)**
Eliminating 50% of state portion of property tax	**($1,504)**

Source: Washington State Economic and Revenue Forecast Council, November 2007.

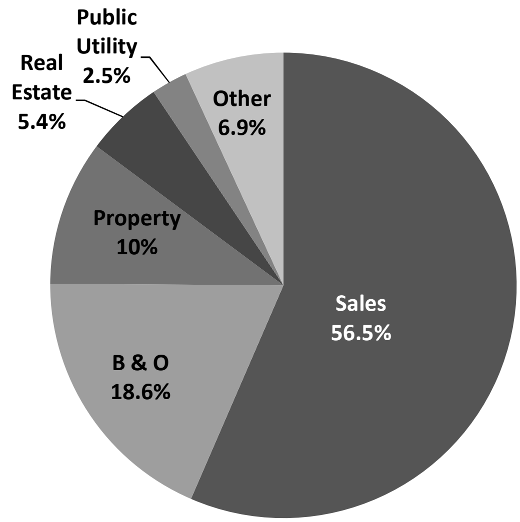
Washington's Existing Tax Structure

The basic framework of Washington's tax structure was established in the 1930s. The state's General Fund relies on three major sources of revenue: sales, business (B&O), and property taxes. Other sources of revenue for the General Fund include real estate, public utility, estate, tobacco, liquor, and a variety of smaller taxes and fees.[4]

THE UNDERLYING FRAMEWORK OF WASHINGTON'S TAX SYSTEM HASN'T CHANGED SINCE THE 1930'S

SOURCES OF REVENUE FOR WASHINGTON'S GENERAL FUND, 2007-09

($30 BILLION TOTAL)



Source: Washington State Economic and Revenue Forecast Council, November 2007.

The retail sales and use tax contributes over half of the General Fund – $17 billion in the 2007-2009 budget. The state collects 6.5% on the sale of most goods and some services, such as construction and car repair. Local governments collect an additional 0.5% to 2.4% sales tax. Sales tax has grown from 51% of the 2005-07 General Fund to 56.5% of projected revenues in 2007-09.

RETAIL SALES AND USE TAX ACCOUNTS FOR OVER HALF OF THE STATE'S GENERAL FUND REVENUE

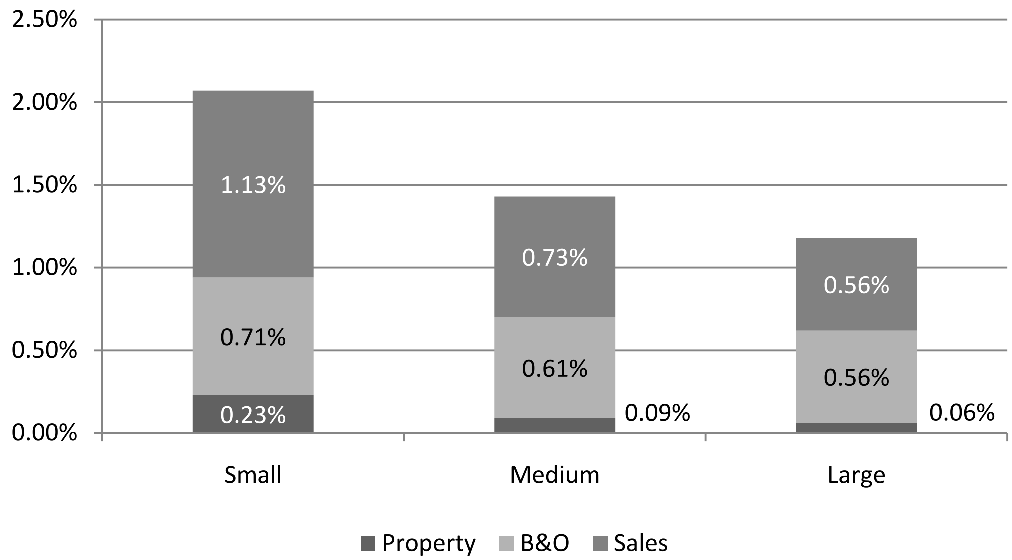
Property taxes contribute $3 billion to the state General Fund. The state portion of the property tax supports public schools, and represents about one quarter of the total property tax paid by Washington residents. The rest stays in local communities to fund city and county services, fire districts, libraries, local school bonds, and the like.

The business and occupation (B&O) tax adds $5.6 billion to the 2007-09 budget. It is levied on a business's gross receipts without allowing deductions for costs. B&O rates vary by type of business. Although rates are quite low – 1.5% on services not subject to sales tax and less than 0.5% on most other businesses – the gross receipts tax can be particularly hard on low-profit-margin companies, such as those in retail, and on start-up or expanding firms that frequently earn no profits.

Gross receipts taxes can also be more readily passed directly on to consumers than the corporate income tax that most other states have. Businesses pay sales tax on goods they purchase for company use and property tax in addition to B&O tax. In fact, small- and medium-size firms in Washington pay more in sales tax than in B&O tax on average.[5]

STATE TAXES PAID BY WASHINGTON BUSINESSES

(AS A PERCENTAGE OF GROSS INCOME, BY FIRM SIZE)



Source: Washington Department of Revenue, 2002 data.

Comparison with Other States

In contrast to Washington, all but six other states include a tax on personal income in their array of revenues. On average in other states, individual income taxes contribute about one third of General Fund revenues.[6] Without an income tax, Washington necessarily relies more heavily on sales and business taxes. Washington has the 10th highest combined total state and local sales tax rate among the states.[7]

WASHINGTON IS ONE OF ONLY SEVEN STATES WITHOUT AN INCOME TAX

The major business tax in most other states is a tax on corporate profits. On average across the states, corporate income taxes represent 6% of state General Fund revenues. In Washington, the B&O tax contributes 18.5%.[8]

State and local government reliance on the property tax is slightly below average in Washington compared to other states.[9]

Problems with Washington's Tax Structure

Washington's tax structure relies too heavily on sales tax and for the most part fails to tap the vast and growing wealth of our state's most affluent residents. Our tax system is a barrier to expanding investments in education, public health, and infrastructure because:

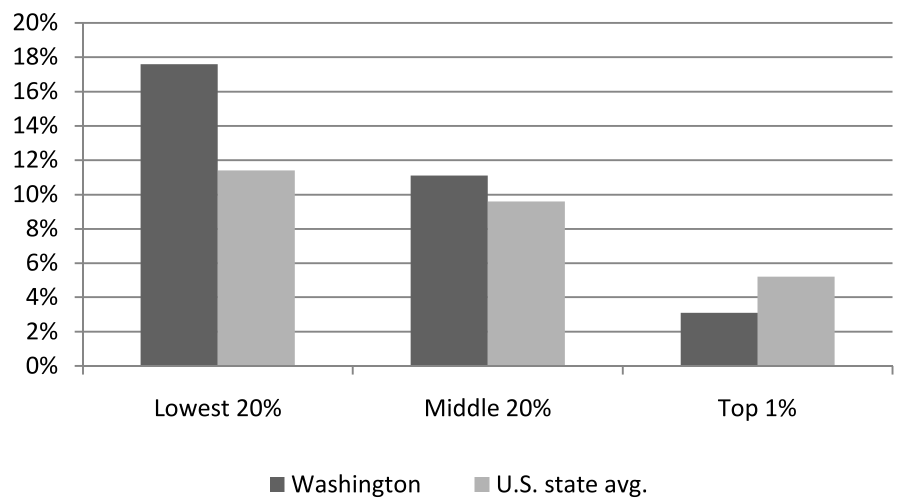
WASHINGTON'S TAX STRUCTURE STARVES EDUCATION, PUBLIC HEALTH, AND TRANSPORTATION OF NEEDED INVESTMENT

- **It creates a structural deficit.** The sales tax base is growing more slowly than demand for state investments and the economy overall. Historically, sales taxes have been applied to goods and not to services. However, personal spending on services is steadily growing, and spending on goods is falling as a percentage of personal consumption. Goods and services subject to Washington sales tax represented 32% of total consumer spending in 1959, but only 26% in 2000.[10] Goods sold over the internet and via catalogue also often escape sales tax. (Although the recently adopted "streamlined sales tax agreement" may help states collect sales tax on a greater percentage of these sales.)[11]
- **It is regressive.** Sales, property, and indirectly, B&O taxes fall more heavily on low income people who must spend most of their income, than on high income people who spend more on untaxed services and save a portion of income. In fact, Washington has the most regressive tax system of any state.[12]

WASHINGTON'S TAXES FALL MOST HEAVILY ON THOSE LEAST ABLE TO PAY

PERCENT OF INCOME PAID IN STATE AND LOCAL TAXES*

(WASHINGTON AND U.S. STATE AVERAGE, 2002)



**Data for non-elderly taxpayers with offset for federal deduction*
Source: Institute on Taxation and Economic Policy, Who Pays? A Distributional Analysis of the Tax Systems in All 50 States, 2002.

Advantages of Personal Income Taxes

The personal income tax has a number of advantages:

- It can be fairer than consumption taxes, based on a person's ability to pay.
- It is a robust source of revenue that tends to grow at the same rate as the overall economy.
- It can be progressive, with higher rates on the highest-income households.
- It provides an easy way to tax intangible wealth from stocks, bonds, and capital gains – important parts of the modern economy.
- The federal government provides the basic mechanism for the administration and enforcement of an income tax through the federal income tax system.
- It provides a mechanism for rebates or credits in support of social policies (such as to low-income families, to support quality preschool, or promote energy conservation).

AN INCOME TAX IS MORE FAIR THAN CONSUMPTION TAXES AND PROVIDES REVENUES THAT GROW WITH THE ECONOMY

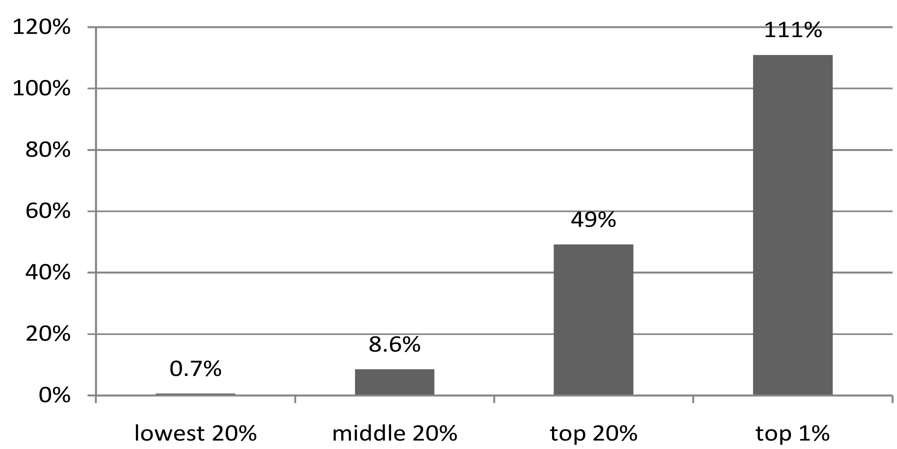
Washington's tax structure is currently unfairly skewed to favor the well-to-do. Rapid income growth and falling federal taxes further strengthen the case that the state's wealthiest families should pay more to finance high priority public services.

Since 1979, the wealthy have enjoyed substantial income gains and increasingly pulled away from other Americans. The wealthiest families experienced the biggest gains. Between 1979 and 2003, the incomes of the wealthiest 1% rose by 111% above inflation. Incomes for the entire top 20% rose by 49% over the same period, while incomes of the middle fifth inched up only 8.6% and the lowest-income group experienced no perceptible gain.[13] In Washington State between the late 1990s and 2006, the top fifth gained 11.6% while the bottom fifth lost 4.2%.[14]

WASHINGTON'S WEALTHY ARE IN A POSITION TO PAY MORE TO FINANCE PUBLIC INVESTMENTS

INFLATION-ADJUSTED INCOME GROWTH FOR U.S. HOUSEHOLDS

(BY INCOME GROUP, 1979-2003)



Source: Economic Policy Institute, State of Working America, 2006/2007.

The wealthiest families have also benefited the most from federal tax cuts since 2001. According to an analysis by Citizens for Tax Justice, in Washington State over one third of federal tax cuts since 2001 have gone to the top 1% of households, and nearly three-fourths have gone to the top 20%. The bottom 60% of households received only about 15% of those tax reductions. On their 2007 federal taxes, the wealthiest 1% of Washington households will each save on average an estimated $69,500 in taxes due to reductions enacted since 2001, while the bottom 60% will save $455 on average.[15]

Constitutional and Legal Issues

Since the 1930s, efforts to reform Washington's tax structure to include an income tax have had to contend with a State Supreme Court ruling designating income as property. Washington's constitution requires that property taxes be uniform on a particular class of property, regular levy rates not exceed 1%, and exemptions for personal property not exceed $15,000 per head of household. A state income tax that does not meet these restrictions requires either a constitutional amendment or a reversal of the court decision.

TO IMPLEMENT A TAX ON HIGH INCOMES, A 1930'S STATE SUPREME COURT DECISION WILL NEED TO BE ADDRESSED

Several proposals to amend the constitution and adopt a general personal income tax have been approved by the necessary two-thirds majorities of both chambers of the legislature, only to be defeated by votes of the people. The most recent attempt was in 1973. Some legal scholars believe that if an income tax measure passed today without a constitutional amendment and was challenged in court, there is a good chance that the Supreme Court would reverse its earlier ruling and allow the tax to stand.[16] Others point to rulings as recent as 1999 that suggest the Court would hold to its earlier position.[17]

Even without the constitutional issue, passing an income tax of any kind would likely require a super-majority vote in the state legislature and a ratifying vote of the people. Initiative 601, passed in 1993, requires a two-thirds vote of both chambers in the state legislature to raise taxes and establishes a spending limit for the state. While the initiative has been amended a number of times and the super-majority provision was temporarily suspended in 2002 and 2005, 601's restrictions remain largely in effect.[18] Initiative 960, passed in November 2007, further limits the legislature's ability to raise funds without a vote of the people. The constitutionality of I-960 has not yet been determined.

Another route to passing a limited income tax is by initiative, with the understanding that after passage the new tax would be subject to constitutional review. Initiative campaigns are expensive, but the people have shown a willingness to make policy advances the legislature is reluctant to enact. Two examples are the minimum wage initiative of 1998 and the initiative to increase funding of the Basic Health Plan by raising tobacco taxes in 2001.

One possible scenario would be to introduce an initiative which institutes a new tax, reduces the sales or property tax, and dedicates remaining new revenues to a popular service such as K-12 education, universal preschool, or children's health. If such an initiative passed, it is nearly certain its constitutionality would be challenged. This would give the State Supreme Court an opportunity to reconsider and possibly reverse its previous ruling that income is property.

Even if the court ruled the new tax unconstitutional, a vote of the people might convince the legislature to launch a constitutional change that would ultimately allow the new tax to stand. Either outcome would simplify future efforts to overhaul Washington's tax structure.

Progressive Revenue Options

Politically it may not be easy to raise new public revenue, but Washington cannot long afford to forego expanded investments in education, health, and transportation. In considering funding for these investments in our common future, we should give priority to revenues that improve our current tax structure, rather than exacerbate problems of unfairness and a declining tax base. This section lays out three options for highly progressive new revenues and two options for reducing regressive taxes.

Progressive new revenues:

- Millionaire's tax (on incomes over $1,000,000)
- High income tax (on joint incomes over $200,000, single incomes over $100,000)
- Unearned income tax (on interest, dividends, and capital gains)

Reductions in regressive taxes:

- Sales tax
- Property tax

ONLY 4% OR LESS OF WASHINGTON HOUSEHOLDS WOULD PAY A TAX ON HIGH INCOMES

Millionaire's Tax and High Income Tax

These two taxes share many features. They have the advantages of being highly progressive and expanding the tax base to a source of revenue that has been growing faster than the general economy for the past few decades. The tax would be paid by the small fraction of state residents who are currently contributing the smallest percentage of their income to state and local services.

Estimates in this brief assume state income tax would be assessed on adjusted gross income as calculated on the federal income tax return. The tax would be marginal, that is, assessed only on the portion of income above the taxable level. Payers of the new tax would be able to deduct the state income tax from their federal income taxes, offsetting part of the cost to them.

Revenues and Impacts of High Income and Millionaires' Taxes on Washington Households (Based on 2006 Incomes)

2006 Income group	Lowest 80%	Next 15%	Next 4%	Top 1%	% of all house-holds paying	Biennial revenue gains in millions
Income range	**$0-88,000**	**$88,000-$172,000**	**$172,000-$437,000**	**$437,000 +**		
Average income in range	**$38,000**	**$118,000**	**$257,000**	**$1,550,000**		
Tax on incomes over $100,000 single filers/$200,000 joint filers						
% paying tax	*0*	*7%*	*62%*	*100%*	**4%**	
Average $ tax change at 3%	*0*	*$49*	*$1,404*	*$29,592*		**$2,060**
% of income	*0*	*0.04%*	*0.5%*	*1.9%*		
Average $ tax change at 5%	*0*	*$81*	*$2,339*	*$49,319*		**$3,434**
% of income	*0*	*0.07%*	*0.9%*	*3.2%*		
Tax on incomes over $1 million						
% paying tax	*0*	*0*	*0*	*12%*	**0.1%**	
Average $ tax change at 3%	*0*	*0*	*0*	*$13,622*		**$780**
% of income	*0*	*0*	*0*	*0.9%*		
Average $ tax change at 5%	*0*	*0*	*0*	*$22,704*		**$1,300**
% of income	*0*	*0*	*0*	*1.5%*		

Source: Institute on Taxation and Economic Policy based on 2006 income levels for Washington households.

Only about 3,000 households, or 0.1% of Washington households, have taxable incomes over $1 million. About 120,000, or 4% of households, have incomes over $200,000 for couples or $100,000 for singles. In contrast, 80% of state households have annual incomes under $88,000.[19]

Example I – High income tax assessed at the 3% rate

Mr. Smith earned $150,000, Mrs. Smith earned $75,000, and they had interest, dividend, and capital gains income on non-retirement savings of $25,000, giving them a gross income of $250,000. They would pay a state income tax of 3% on $50,000, or $1,500. They would then be able to deduct that $1,500 from their federal taxable income, lowering their federal tax bill by 29% of that amount, or $435.[20] Washington State would gain $1,500 in revenue, at a cost to the Smith's of $1,065 - 0.4% of their income.

Example II – Millionaires' tax assessed at the 3% rate

Will, an attorney, and Belinda, an heiress, have salary income of $230,000 and investment income of $1.4 million, for an adjusted gross income of $1.63 million. They would pay a state tax of 3% on $630,000, or $18,900. Their federal income tax bill would be reduced by 35% of that amount, or $6,615.[21] *Washington would gain $18,900 in revenue at a cost to Will and Belinda of $12,285 – 0.75% of their income.*

WEALTHY RESIDENTS COULD DEDUCT A STATE INCOME TAX WHEN CALCULATING FEDERAL TAXES

Washington could rely on the federal income tax form for calculating adjusted gross income, as most states do, and thus have a simple form for calculating the state tax. This approach makes the process streamlined for individuals and keeps much of the cost for auditing and enforcement with the federal government. The Department of Revenue (DOR) would have to establish new systems to collect the tax. In 2003, DOR estimated that the administration of a state millionaires' tax, including a system for withholding, would cost about $31 million per biennium. One-time costs to establish the system would be about $30 million.[22]

High incomes, and thus revenues from a high income tax, can rise and fall with the stock market and the general economy. However, the effects of this volatility could easily be minimized, for example by spending the funds based on a rolling three year average.

Unearned Income Tax

Most states and the federal government tax income from interest, dividend, and capital gains through an income tax, with top tax brackets for state income taxes ranging from 3% to 9.5%.[23] Two states, Tennessee and New Hampshire, currently tax interest and dividend income but not earned income. Tennessee's rate is 6% with a $2,500 exemption for joint filers, $1,250 for single.[24] New Hampshire's rate is 5% on income over $4,800 for joint filers.[25] Both states have higher exemptions for seniors.

ONLY SIX OTHER STATES DO NOT TAX UNEARNED INCOME

The tax contemplated here for Washington would be assessed on income reported under the categories of taxable interest, dividends, and net capital gains as part of adjusted gross income for federal income tax purposes. Income earned on retirement and educational savings that is not counted as income for federal tax purposes would be excluded from the tax, as would payouts from pensions and IRAs.

With exemptions set at $10,000 for couples and $5,000 for single filers, most lower-income and middle class Washington residents would not pay the tax. On the other hand, most state residents with incomes in the top 5% of households have substantial unearned income that would be subject to the tax. Altogether, 10% of all state households and 26% of senior households would pay some new tax, if seniors had the same exemption levels as the general population. Seniors could also be completely exempted from the tax. At the 5% rate, a senior exclusion would reduce biennial revenues from $2.3 billion to $1.9 billion.

Revenues and Impact of Unearned Income Tax on Washington Households

(WITH $5,000 SINGLE/$10,000 JOINT EXCLUSION BASED ON 2006 INCOMES)

Income group	**Lowest 20%**	**Middle 20%**	**Top 80^{th} – 95^{th} percentile**	**Top 95^{th} -99^{th} percentile**	**Top 1%**	**% of all house-holds paying**	**Biennial revenue gains in millions**
Average income 2006	$12,000	$44,000	$118,000	$257,000	$1,550,000		
3% tax on interest, dividends, and capital gains							
Average tax change	*$1*	*$23*	*$114*	*$955*	*$17,628*		**$1.4 billion**
Share of income	*0%*	*0.05%*	*0.1%*	*0.4%*	*1.1%*		
% paying tax	*1%*	*7%*	*16%*	*49%*	*92%*	**10%**	
Seniors avg. tax change	*$4*	*$44*	*$290*	*$2,160*	*$18,538*	**26%**	
5% tax on interest, dividends, and capital gains							
Average tax change	*$2*	*$38*	*$189*	*$1,592*	*$29,380*		**$2.3 billion**
Share of income	*0%*	*0.09%*	*0.2%*	*0.6%*	*2%*		
% paying tax	*1%*	*7%*	*16%*	*49%*	*92%*	**10%**	
Seniors avg. tax change	*$6*	*$74*	*$484*	*$3,600*	*$30,896*	**26%**	
5% tax on interest, dividends, and capital gains, all seniors exempt							
Average tax change	*$1*	*$26*	*$122*	*$951*	*$26,701*		**$1.9 billion**
Share of income	*0%*	*0.06%*	*0.1%*	*0.4%*	*1.7%*		
% paying tax	*0%*	*4%*	*11%*	*34%*	*83%*	**6%**	

Source: Institute on Taxation and Economic Policy based on 2006 income levels for Washington taxpayers

Example I

Dr. and Mrs. Pratt have $20,467 in interest income, $37,895 in dividends, and $197,264 in capital gains (earnings on their IRAs and 529 college savings accounts for their children are not counted as income). Their total unearned income for tax purposes is $255,626, of which $10,000 is exempt from state taxation. At 3%, their tax on $245,626 is $7,369. The Pratts deduct their state unearned income tax from their federal taxable income, saving 23% of the state tax total, or $1,695 on their federal income tax bill.

Example II

Mr. and Mrs. Jones have $80,000 in combined salary income, $1,935 in interest income, $2,000 in dividend income, and no capital gains income. Their total unearned income is $3,935, below the $10,000 exemption for a couple. They would owe no state unearned income tax.

Example III

Mrs. Bates, an elderly widow, has $12,000 in Social Security income, $8,000 from her late husband's pension, and another $6,000 in annual income from general savings and investments. She would owe 3% state tax on $1,000 ($6,000 - $5,000 exemption), or $30.

Revenues from this tax would vary with the stock market and business cycles, but in the long run would grow with the economy.

Pairing New Progressive Taxes with Reductions in Regressive Taxes

PAIRING NEW PROGRESSIVE TAXES WITH REDUCTIONS IN REGRESSIVE TAXES WOULD MAKE WASHINGTON'S TAX SYSTEM FAIRER AND STRONGER

The sales tax is Washington's most regressive tax, and is also the largest tax paid by most small- and medium-sized businesses in the state. Using a portion of new revenue to reduce the sales tax rate would be the most effective way to reduce inequities in the state's tax structure. On the other hand, the property tax is more visible and has been a target of voter anger. Therefore, reducing the state portion of the property tax might be more attractive politically.

SELECTED OPTIONS PAIRING NEW REVENUES AND TAX REDUCTIONS

Option	Biennial revenue gain	Biennial revenue loss	Biennial net balance
3% tax on incomes over $100,000/$200,000 + reduction in sales tax from 6.5% to 6%	**$2,060 million**	**($1,300 million)**	**$760 million**
3% tax on incomes over $100,000/$200,000 + reduction in state property tax by 50%	**$2,060 million**	**($1,504 million)**	**$556 million**
5% millionaires tax + reduction in state property tax by 25%	**$1,300 million**	**($752 million)**	**$548 million**
5% unearned income tax with senior exemption + reduction in sales tax from 6.5% to 6%	**$1,900 million**	**($1,300 million)**	**$600 million**
5% unearned income tax with senior exemption + reduction in state property tax by 50%	**$1,900 million**	**($1,504 million)**	**$400 million**

Lowering the state portion of the sales tax from 6.5% to 6% would save the typical median-income Washington family of three about $60 per year.[26] The state would lose $650 million annually in General Fund revenue. Cutting the state portion of the property tax in half would save the average Washington homeowner $330 annually at 2006 rates.[27] The state would lose $750 million in annual General Fund revenues.

Conclusion

PROGRESSIVE TAXES SET THE STAGE FOR A FUTURE IN WHICH ALL CAN PROSPER

For far too long, Washington's outmoded tax structure has stymied investments in programs and services that our state needs to ensure a vibrant economy and broadly shared prosperity. Policymakers have been reluctant to propose the kind of comprehensive tax reform we need to provide a system that is fair, adequate to fund the services we need, and grows with the economy.

This paper outlines incremental steps towards reform that expand the tax base to a growing part of the economy, while providing for both new revenues for high priority services and reductions in regressive and unpopular taxes. These reforms set the stage for each of us to pursue economic opportunity and build a future in which all can prosper.

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1 The Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States, 2002*, January, 2003, http://www.ctj.org/itep/whopays.htm.

2 Washington Office of Financial Management, "Adequacy of State Revenues, Presentation to the Washington State Tax Structure Committee", Feb. 8, 2002,http://www.ofm.wa.gov/fiscal/adequacy/ofm20020208.pdf; Washington Senate Ways & Means Staff, "GF-S Budget Update and Outlook," September 27, 2007, http://www.leg.wa.gov/documents/Senate/SCS/WM/SwmWebsite/Presentations/2007/GFSBudgetOutlook.pdf.

3 Institute on Taxation and Economic Policy estimates based on 2006 income levels for Washington taxpayers, December 2007.

4 Washington State Economic and Revenue Forecast Council, "Washington Economic and Revenue Forecast," September 2007, http://www.erfc.wa.gov/pubs/sep07pub.pdf. Washington also has separate budgets for transportation (funded largely by the gas tax) and capital construction. General information on Washington's taxes can be found in Washington State Department of Revenue, *Tax Reference Manual 2007*, January 2007, http://dor.wa.gov/.

5 Small firms in this analysis have less than $5 million in annual gross income, medium size firms have $5 to $25 million. Department of Revenue, "Incidence of Washington Taxes," presentation to the House Finance Committee, February 15, 2005. These numbers are for established firms.

6 The other states without an income tax are Alaska, Florida, Nevada, South Dakota, Texas, and Wyoming. Tennessee and New Hampshire have a limited income tax on unearned income (from interest and dividends) but not wage and salary income. Federation of Tax Administrators, "2004 State Tax Collections by Source," http://www.taxadmin.org/fta/rate/04taxdis.html.

7 Arkansas (11%), Oklahoma (10.5%), Louisiana (10.25%), Tennessee (9.75%), Arizona (9.6%), New York (9.5%), Illinois (9.25%), Missouri (9.1%), and Alabama (9%) have rates above Washington's 8.9% allowable rate. Washington Department of Revenue, "Comparison of State/Local Retail Sales Taxes – 2007", www.dor.wa.gov.

8 Delaware, Texas, and Ohio also have gross receipts taxes. Corporate income tax receipts have been falling in recent years, leading more states to consider a gross receipts tax. Institute on Taxation and Economic Policy, "Broad-Based Gross Receipts Taxes: A Worthwhile Alternative?"

2007, www.itepnet.org; Federation of Tax Administrators, "2006 State Tax Collection by Source," http://www.taxadmin.org/fta/rate/06taxdis.html; Washington Department of Revenue, Tax Statistics 2006, www.dor.wa.gov.

9 Washington Department of Revenue, *Tax Reference Manual*, 2007, p. 10, www.dor.gov.

10 Author's calculation from U.S. averages in: Larry R. Moran and Clinton P. McCully, "Trends in Consumer Spending, 1959-2000," U.S. Bureau of Economic Analysis, 2001, http://www.bea.gov/scb/pdf/national/nipa/2001/0301pce.pdf.

11 National Governors' Association, Policy Position EC-12, Streamlining State Sales Tax Systems, March 3, 2007, www.nga.org.

12 Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, 2002, www.itepnet.org.

13 Lawrence Mishel, Jared Bernstein, Sylvia Allegretto, *The State of Working America, 2006/2007.* An Economic Policy Institute book. Ithaca, NY: ILR Press, an imprint of Cornell University Press, 2007. p. 65.

14 Data comparisons are for the years 1998-2000 and 2004-2006. Center on Budget and Policy Priorities and Economic Policy Institute, "Pulling Apart: A State-by-State Analysis of Income Trends," 2008 edition, www.epi.org.

15 Citizens for Tax Justice, "The Bush Tax Cuts: Are Washingtonians Better Off?" October 2006, http://www.ctj.org/pdf/bushtaxcutswa.pdf.

16 Hugh D. Spitzer, "A Washington State Income Tax – Again?" *University of Puget Sound Law Review*, vol. 16, no. 2, 1993. A 1% tax on the category of interest, dividend, and capital gains income without a constitutional amendment might withstand a court challenge even if the Supreme Court did not reverse earlier rulings. On the other hand, the court might strike it down for not being uniform on all income. Rates higher than 1% would certainly require either a constitutional change or a new court ruling.

17 Harbour Village Apartments v. City of Mukilteo, 139 Wn.2d 604, 608, 989 P.2d 542 (1999).

18 Washington Expenditure Limit Committee, "Chronology of Initiative 601 Amendments," http://www.elc.wa.gov/sub/chronology.pdf.

19 Institute on Taxation and Economic Policy based on 2006 income levels for Washington taxpayers, December 2007. See also Internal Revenue Service, "Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2005," www.irs.gov.

20 Average percentage savings on federal income taxes for each of these examples were provided by the Institute on Taxation and Economic Policy.

21 Average percentage savings on federal income taxes for each of these examples were provided by the Institute on Taxation and Economic Policy.

22 Washington Office of Financial Management, Fiscal Note for Senate Bill 5902, March 25, 2003, www.leg.wa.gov.

23 Federation of Tax Administrators, "State Individual Income Taxes, as of January 1, 2007" http://www.taxadmin.org/fta/rate/ind_inc.html.

24 Tennessee Department of Revenue, "Individual Income Tax at a Glance," viewed November 20, 2007, http://www.tennessee.gov/revenue/tntaxes/indinc.htm.

25 New Hampshire Department of Revenue, "Frequently Asked Questions, Interest and Dividends Tax," viewed November 20, 2007, http://www.nh.gov/revenue/faq/gti-rev.htm#Interest_Dividends.

26 Based on allowable sales tax deduction for Washington family of 3 with income between $40,000 and $50,000, Internal Revenue Service, Instructions Schedules A & B Form 1040, 2007, "2007 Optional State and Certain Local Sales Tax Tables," p. A-12, www.irs.gov.

27 Based on average assessed value of single family residences in Washington in 2006 ($235,000) and average levy rate in 2006 ($11.32 per $1,000 in value). Washington Department of Revenue, *Property Tax Statistics 2007*, September 2007, Tables 22 and 28, www.dor.wa.gov.

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About Us

The Economic Opportunity Institute (EOI) is a nonpartisan, non-profit public policy organization founded in 1998 and based in Seattle, Washington. Our mission is to forge realistic public policies that promote long-term economic security and opportunity for Washington's middle-class and low-income workers and families, ensuring the benefits of prosperity are broadly available to all those who contribute to it. We utilize research, education and advocacy to shape public debate and advance new policy ideas that support high-quality education, modern work-life standards, retirement security, and shared investments in our common future.

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