Economic Opportunity Institute

Policy Memo

Lost Revenue, Lost Opportunities: Tax Exemptions in Washington State

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SUMMARY

Washington state's tax code includes over 500 tax exemptions, deductions, credits, and other breaks worth an estimated $64.7 billion during the 2003-05 biennium. Some of these tax breaks benefit everyone in the state, while others benefit selected industries or even a single company. Because of federal laws and administrative issues, the Washington Department of Revenue (DOR) estimates that only about one-fifth of that total, or $13.6 billion, could be collected if all of the tax exemptions were repealed.[1]

While the state legislature was grappling with sizable budget deficits and cutting government services in 2002 and 2003, it also granted 43 new tax exemptions, mostly in the form of business incentives. These new tax breaks eliminated $214 million in public revenues for the 2003-05 biennium.[2] In 2004, the legislature added or extended 12 more business tax breaks at a cost to state and local governments of $98 million for the remainder of the current biennium and $291 million for the 2005-07 biennium.[3]

The proliferation and high cost of tax breaks in the face of severe cuts in education, health, and other basic government services have aroused considerable controversy. Budget analysts predict that when Washington's legislators return to Olympia in 2005 they will be forced to grapple with budget shortfalls yet again. Although both common wisdom and the pleadings of corporate lobbyists suggest that tax breaks for businesses are the only way to keep and attract jobs, a recent economic analysis concludes that state economies would grow faster and produce more new jobs if states invested more in transportation, education, and public safety instead of giving more tax cuts.[4]

Evaluating tax breaks side-by-side with the need for lower class size in public schools, children's health programs, access to college, transportation improvements, and other investments in our future has to be part of the solution to Washington's long-term budget problems. This paper provides background information on tax exemptions in Washington state and discusses major issues to consider in moving toward more balanced and fair tax policies.

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Tax Source	Number of Tax Breaks in 2003	State Fiscal Impact 2003-05	Local Fiscal Impact 2003-05	Total Fiscal Impact 2003-05	Amount likely to be collected if repealed (State & Local)
Retail Sales & Use	140	$18.5 billion	$5.3 billion	$23.8 billion	$11.6 billion
Property Tax	101	$6.1 billion	$22.6 billion	$28.7 billion	$6.9 million
State B&O Tax	133	$5.5 billion		$5.5 billion	$1.8 billion
Other Business	39	$1.9 billion		$1.9 billion	$120 million
Other Taxes	90	$4.7 billion	$122 million	$4.8 billion	$52 million
Total	**503**	**$36.7 billion**	**$28 billion**	**$64.7 billion**	**$13.6 billion**

Summary of Washington State Tax Exemptions, 2003

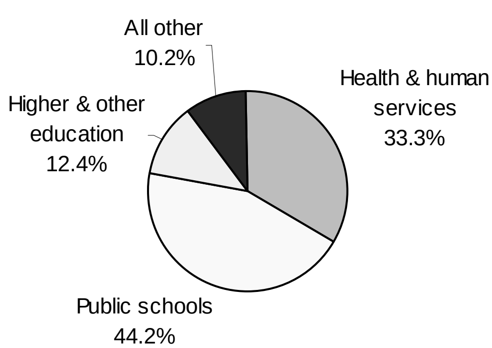
Source: Washington Department of Revenue, "Tax Exemptions 2004"

OVERVIEW OF WASHINGTON'S TAX STRUCTURE

The state's general fund, which totals about $23 billion in the 2003-05 biennium, supports education, social and health services, and other government functions such as courts, state police, and parks. Transportation and capital construction have separate budgets and sources of funding.

Washington's tax structure has remained substantially the same since the 1930s, although the state's economy has changed dramatically.[5] The state relies on three major taxes for the bulk of general fund revenues.

Washington General Fund Spending, FY 2003

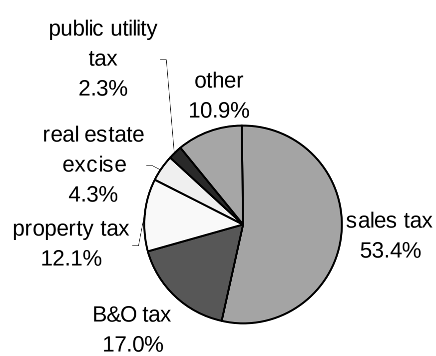


Source: Office of Financial Management, General Fund Expenditures FY 2003

Sales and use tax

The state collects 6.5% on the sale of retail goods and a few services. In 2003, the sales tax provided 53.4% of the state's general fund revenues. Local governments collect additional sales tax ranging from 0.5% to 2.4%, and therefore also lose revenue because of sales tax exemptions.

Sources of Washington State General Fund Revenue, FY 2003



Source: Washington Legislative Evaluation and Accountability Program, 2003 State Budget Notes

Business and occupation tax (B&O)

B&O tax is levied on the gross receipts from business activities. Most firms pay one of three rates: 0.484% for manufacturing and wholesaling, 0.471% for retailing, and 1.5% for services. There are also several special rates for specific activities. B&O taxes accounted for 17% of the general fund in 2003.

Property tax

Local communities receive the majority of property tax revenues to support the services of cities, counties, and a variety of special purpose districts such as fire, hospital, library, and emergency medical. Voter-approved special levies by school districts account for about one-third of total property taxes. The state also collects a regular property tax levy in recognition of the state responsibility to finance public schools. The state levy usually represents slightly less than one-quarter of total property taxes and 12% of state general fund revenues.

Other taxes

Real estate excise, public utility , tobacco, liquor, estate, and other taxes and fees together account for the remaining 17.5% of state general fund revenues.◆

TAX EXEMPTIONS, PREFERENCES, INCENTIVES, OR LOOPHOLES?

Tax exemptions are intended to serve a number of purposes. The 20 exemptions classified as “commerce” in the list below prevent taxing interstate commerce, which would violate the United States Constitution. Most of the 69 exemptions classified as “government” keep one government entity from taxing another. The legislature or the people have enacted other exemptions in an attempt to adapt the tax system to an ever-changing economy or in response to specific economic or social needs, such as agricultural exemptions passed during the depression of the 1930s, the sales tax exemption on food, and the property tax break for low-income seniors and disabled residents.

Washington Tax Exemptions in 2003 by Intended Purpose or Beneficiary

Category	Numberof Exemptions	State and Local Impact, 2003-05	% of Total Fiscal Impact
Intangibles	1	$20.7 billion	32%
Individuals	41	$15.9 billion	24.5%
Services	3	$6.9 billion	10.7%
Agriculture	55	$2.3 billion	3.5%
Business incentive	80	$746 million	1.2%
Other business	75	$2.0 billion	3.0%
Miscellaneous	25	$127 million	0.2%
Tax base	61	$5.9 billion	9.1%
Nonprofits	73	$663 million	1.0%
Government	69	$4.6 billion	7.1%
Commerce	20	$5.0 billion	7.7%
Total	**503**	**$64.7 billion**	**100%**

Source: Washington Department of Revenue, “Tax Exemptions 2004”

Washington Tax Exemptions by Year Adopted

Year Adopted	Number	Fiscal Impact 2003-05
1854-1933	35	$29 billion
1935-1969	112	$25.4 billion
1970-1979	75	$6.2 billion
1980-1989	95	$1.4 billion
1990-1999	112	$1.4 billion
2000-2002	36	$1.3 billion
2003	38	$89.8 million
2004	16*	$108.7 million

* Includes extensions of previously enacted tax breaks.
Sources: Washington Department of Revenue, "Tax Exemptions 2004" and Washington State Legislature Bill Information website

Most of the biggest exemptions in terms of dollar value were adopted early in Washington's history, but the pace at which new exemptions are being adopted has increased since 1970.

Not only is the state legislature adopting exemptions at a faster pace than ever, but the type of exemptions has shifted. In the 1990s, the legislature turned increasingly to a strategy of providing business incentives. Many of these tax breaks are narrowly directed to benefit a single industry or even a single company. Eleven of the business incentives adopted between 1990 and 2003 benefit fewer than three firms each, not counting the package of over $3 billion in tax breaks negotiated in 2003 for the Boeing Company (which potentially also benefit other firms manufacturing aircraft components).[6]◆

Business-Related Tax Exemptions, by Date Adopted

Category	Before 1970	1970-89	1990-99	2000-03	Total
Agriculture	18	18	8	11	55
Business	17	30	22	6	75
Business incentive	6	13	30	31	80
Service	2		1		3
Total	**43**	**61**	**61**	**48**	**213**

Source: Washington Department of Revenue, "Tax Exemptions 2004"

SHOULD EXEMPTIONS BE REPEALED?

Closing tax loopholes has strong popular appeal, but identifying which exemptions to repeal is not easy. Each has its advocates. But there are a number of problems with Washington's heavy reliance on tax exemptions:

- The cumulative fiscal impact of the exemptions is huge. The state needs revenue to provide the basic services that are essential to the education of children and workers, the health of state residents, improving the transportation infrastructure, a high quality of life, and a prosperous economy.
- Tax exemptions that may benefit only a few shift the burden, either by taking money away from vital services or by forcing others to pay higher taxes to compensate for revenue losses.
- Exemptions are adopted piecemeal, often in response to specific industry requests, without being weighed against each other or against needs for public programs.
- Once adopted, exemptions are rarely evaluated or repealed, even though economic pressures and needs change dramatically over time.[7]
- The state is already facing a problem of public revenues growing more slowly than the demand for public services, since our tax system is based on the economy of the 1930s, rather than on the economy of the early 21st century. We collect sales tax on the sale of goods, but not on the growing service sector. We tax real property which produced wealth for farmers and timber companies, but not intangible property, like stocks and bonds, that produces wealth for software and biotech companies. Exemptions shrink the tax base even faster, making this "structural deficit" problem worse.[8]

Each category of tax exemptions raises a different set of issues when considering repeal or reform.

Intangibles

The single largest exemption is the exemption from property tax of intangible personal property, such as money, stocks, trademarks, and franchise agreements. DOR estimates that taxing all intangible property could raise $16 billion in local property taxes and $4.5 billion in state taxes for the biennium. However, while one state, Florida, does directly tax the value of intangible assets (at a very low rate), the mobility of intangible wealth would make it difficult for Washington to collect a property tax on intangibles. [9]

Most states and the federal government *do* successfully collect taxes on the *income* from intangible property. Washington does not because it is one of only seven states without any form of personal income tax. Two states, New Hampshire and Tennessee, do not have a general income tax but do tax the income from dividends and interest.[10] Washington has a history of judicial and voter rejection of income taxes.[11] However, it has been 30 years since the state's voters last considered a personal income tax. Meanwhile, intangible assets have become an increasingly important part of the state's economy. Failure to tax intangible wealth forces the state to collect higher rates on other taxes. If it made sense to tax real property in the 19th century when it was the primary generator of wealth and new economic activity, then it makes sense to tax at least the income from intangible property today.

Clearly it will take more than simply repealing this exemption, but in order to move toward a fair, sustainable, and adequate tax system, Washington needs to add at least some categories of intangible property to the tax base, whether as part of an income tax or as a separate tax.[12]

Individuals

One-fourth of the fiscal impact of exemptions comes from those that primarily benefit individuals. According to DOR, half of the individual exemptions are for taxes that probably could not be collected anyway. Many of those that are collectable have broad support, such as property tax breaks for low-income seniors, or encourage beneficial behavior, such as a sales tax exemption on gun safes. The sales tax exemptions on food and prescription drugs together cost over $1 billion *each year*, but they benefit all state residents and help ease the burden of the regressive sales tax for those who spend most of their income on basic necessities.[13] The exemption of motor vehicle fuel from sales tax costs the general fund $500 million a biennium, but the state levies a gasoline tax instead that generates over $1 billion per biennium for the transportation fund.[14]

Despite their benefits to particular groups, the individual exemptions should be evaluated periodically and prioritized along with other needs of the state. Some that deserve particular scrutiny during tight budget times include the tax exemption for small boats, the sales tax exemptions on academic transcripts and newspapers, and the sales tax exemption for residents of Oregon and low-sales tax states. Together, these four exemptions cost the state over $111 million in the 2003-05 biennium, and cost local governments over $31 million.

Services

The Department of Revenue lists only three exemptions in the services category, but the fiscal impact is huge – a whopping $5.3 billion to the state and $1.6 billion to local governments in the 2003-05 biennium. When the retail sales tax was adopted in 1935, only tangible goods were included. A few services have been added to the sales tax base over the years, mostly blue collar services such as car repair and construction. In 1960, consumers spent roughly the same percentage of their income on durable goods and on services. Today, however, consumers are spending only 27% of their income on goods that are taxable and 60% on untaxed services.[15] This means that revenues to both the state and local governments are falling further and further behind the demand for public services. The 2002 Tax Structure Study Committee headed by Bill Gates, Sr., recommended adding to the sales tax base consumer services, such as movie theaters, sports, beauticians, and cable television, in order to help deal with this structural deficit problem.[16]

Few states have successfully added sales tax to business, professional, or financial services, due in large part to the opposition and strength of organizational lobbies. A sales tax on business and professional services also could disadvantage smaller firms that hire outside lawyers, accountants, and computer consultants, rather than having such services in-house. And since Washington’s B&O tax is on gross receipts, businesses that purchase these services could end up paying additional B&O tax on their sales tax payments.[17] However, there would be ways to mitigate the problems in business taxes, and there is no compelling reason why people should be expected to pay sales tax for an oil change or home remodel, but not for an attorney, an accountant, or an architect. The amount of

Estimated Revenues from Including Services in the Sales Tax Base

	State Revenue		Local Revenue	
Service	**2003-05**	**2005-07**	**2003-05**	**2005-07**
Consumer	$323.4 million	$381 million	$94.5 million	$111.4 million
Business and professional	$2.1 billion	$2.5 billion	$614.4 million	$723.9 million
Customized Software	$42.7 million	$49.4 million	$12.5 million	$14.5 million
Financial	$1.7 billion	$1.9 billion	$500 million	$566 million
Medical	$1.2 billion	$1.3 billion	$337 million	$382 million
Total	**$5.3 billion**	**$6.1 billion**	**$1.6 billion**	**$1.8 billion**

Totals may differ from sum of column due to rounding. Figures include losses from lowering the B&O rate.
Source: Washington Department of Revenue, “Tax Exemptions 2004”

public revenue that could be gained from a sales tax on business and professional services alone would be sufficient to reduce the overall sales tax rate by one cent and still invest an additional $1 billion per biennium in education or other high priority public services. In addition, since higher income people tend to spend more on services, adding sales tax to consumer, business, and professional services would help mitigate the state's regressive tax structure.

As a basic necessity like food, medical services should continue to be exempt from sales tax, especially given the skyrocketing cost of medical care, the difficulty low-income people already have with gaining access to health services, and the high amount the state spends on health care.

Agriculture

Agriculture is a major component of Washington's economy, and has historically been plagued by roller-coaster international markets and prices and unpredictable weather. While these uncertainties have remained constant, agriculture has changed dramatically over the decades. Tax breaks that addressed critical needs of farmers in the 1930s or 1970s may be of much lower priority today. Like other categories of business exemptions, agricultural preferences should include expiration dates and evaluations. Renewals or new tax breaks should be evaluated in the context of the state's budget and be tailored to the current economy and high priority issues, for example, a tax break for farmers who take specific steps to prevent mad cow disease.

Business Preferences and Incentives

Washington has over 160 tax breaks specifically for businesses. Some benefit large numbers of new and expanding companies, such as the small business B&O tax credit that benefits 159,000 firms and the sales tax exemption on new manufacturing machinery and equipment that potentially benefits 15,000 to 16,000 companies.[18] However, many of the tax breaks apply much more narrowly to a type of company or specific firm, such as the Boeing incentives adopted in 2003, or reduced tax rates for aluminum smelters passed in 2004.[19]

Most states offer some business incentives. Advocates for business incentives argue that tax breaks help attract and keep businesses, provide jobs and economic growth, and ultimately pay for themselves by stimulating new tax revenue. However, a new analysis of hundreds of studies of tax incentives and economic development by economist Robert Lynch of Washington University finds that the evidence does not support this contention.[20] The studies Lynch examined differed widely in their conclusions but consistently found that:

- State and local taxation has at most a small effect on business location decisions. Other factors are more important, including the availability of trained workers, quality of public services, proximity to markets, and access to raw materials.
- There is little evidence that tax cuts stimulate the economy or create jobs if they are paid for by reducing public services.
- There is evidence that reductions in public services due to tax cuts cause job loss and slow the economy.

According to Lynch's analysis, those studies that have found a link between tax cuts and economic growth have failed to consider the effects of lost revenue on public services. On the other hand, investment in public services, particularly transportation, public education, and public safety, has been shown to lead to economic growth. Lynch concludes that cutting taxes to provide business incentives is not generally a cost-effective way for states to stimulate the economy or create jobs. By forcing cuts in public services and direct job losses, tax cuts may in fact slow down economic and employment growth. States would generally be better off spending the money directly on jobs, infrastructure development, education, and other key services that benefit all businesses.

While there may indeed be situations where short-term targeted tax relief is a good policy choice, Lynch's findings confirm that heavy reliance on tax-cutting to stimulate economic growth, including through targeted business incentives, is a fatally flawed strategy.◆

TAX EXEMPTIONS AND THE 2004 WASHINGTON LEGISLATURE

In the 1990s the Washington legislature adopted several business incentives with sunset clauses that were set to expire during the 2003-05 biennium. Despite making major cuts in public services in order to balance the budget in 2003, the legislature faced intense lobbying to renew expiring business incentives and also to pass new exemptions.

In the end, the 2004 legislature passed 16 revenue bills, including 12 business tax breaks, that will reduce revenues to the state by $87 million and to local governments by $22 million this biennium. In the 2005-07 biennium, those figures balloon to $266 million in lost state revenues and $57 million lost to local governments. Eighty percent of that price tag comes from renewing three expiring packages of business incentives: high tech research and development incentives costing $67 million in 2003-05 and $215 million in 2005-07; rural development incentives costing $20 million in 2003-05 and $50 million in 2005-07; and credits to encourage rural infrastructure development costing $50,000 in 2003-05 and $200,000 in 2005-07.[21] (See Appendix A.)

The legislature turned down a number of other requests for tax breaks, including:[22]

- a sales tax exemption for physical fitness centers that would have cost $6.3 million in 2005-07;
- a sales tax exemption for call center construction with a $2 million price tag for 2005-07;
- a tax increment financing measure with an estimated cost of $5 million in 2005-07;
- reduced B&O rates for temporary staffing services that would have cost $17.4 million in 2005-07;
- B&O and sales tax incentives for fruit and vegetable processors that would have totaled $22.4 million in 2005-07; and
- a B&O deduction for postage that would have cost $6.7 million in 2005-07.◆

ACCOUNTABILITY FOR BUSINESS TAX BREAKS

Several of the exemption bills passed by the Washington legislature in 2004 require companies to report on their use of the tax breaks and allow public access to some of the information. Over the past 14 years, there has been a national trend toward more accountability for business tax breaks. The number of states with some accountability requirements has increased from only two in 1990 to at least 43. Maine, Minnesota, and Illinois laws go the furthest in applying standards and requiring public disclosure for most economic development subsidies and business tax breaks.[23]

Attempts in Washington to pass universal accountability measures for business tax breaks have failed so far. House Bill 1869, which would have established a citizens commission to regularly review most tax exemptions, passed the House in both 2003 and 2004, but died in the Senate.[24]

The Department of Revenue regularly publishes a report which lists all tax exemptions and their estimated revenue impact, purpose, and beneficiaries. By statute, the report is now issued every four years, most recently in January 2004.[25] The report does not coincide with the state biennial budget cycle. Therefore, when the legislature is crafting the budget and weighing the many competing priorities for public money, it does not have before it the most current information on tax revenues already given up. More importantly, the legislature has established no routine mechanism to assess the effectiveness of those tax expenditures.[26]

House Bill 2654 introduced in 2004 would have required the governor to submit a tax expenditure report detailing all tax preferences every two years along with the proposed budget. This bill also passed the House with strong bipartisan support, but failed in the Senate.[27] At least 37 states have regular reporting on tax breaks, and several states now require tax expenditure analyses as part of their budget process, including Oregon, Idaho, Texas, and Pennsylvania.[28]

If the pattern from recent years continues, the Washington legislature will face intense lobbying from business groups in every session to pass new business tax breaks and renew expiring ones. Before considering these, the legislature needs to take action on three fronts:

1. Incorporate consideration of tax breaks fully into the budget adoption process, so that priorities can be set, competing demands balanced, and the tradeoffs between foregoing revenues and foregoing particular services made clear.
2. Require reporting, public disclosure, and rigorous evaluation for all business tax breaks. The public has a right to know how tax dollars are being spent, and legislators need to know which programs are working as intended and which ones are not.
3. Include sunset dates in all new agricultural and business tax breaks,and implement a system to periodically review, evaluate, and possibly repeal exemptions already on the books.◆

CONCLUSIONS

Some of Washington's more than 500 tax preferences would likely be retained under any system of evaluation and review because they are necessary to comply with federal law, benefit all state residents, or protect particularly vulnerable groups. The surge in new exemptions and tax breaks in the past several decades, however, can be attributed to two main causes:

- Washington's tax structure is 70 years old and no longer fits the economy or the public's need for services.
- Cutting taxes has been widely, if incorrectly, accepted as a way to keep and attract jobs.

When one select group gets a tax break, others want the same benefit. And the more tax breaks are given, the worse the problems with the tax structure become. Either the state is forced to raise everyone else's taxes, setting off a new cycle of companies demanding tax breaks to stay in business and vulnerable groups asking for relief, or the state cuts services, adding to job losses, making the state a less attractive place to do business, and shortchanging children, the elderly, public health, and our future.

Large tax cuts at the federal level since 2001 have produced a dismal record of job loss rather than job growth.[29] The overwhelming weight of evidence suggests that investing in transportation infrastructure, the education of workers and children, public safety, access to health care, and services that provide a high quality of life is the best way to promote and sustain economic growth and vitality. These investments cannot be made without increased tax revenue.

It's time for Washington to break the tax preference cycle.

We need to get serious about a major overhaul of the state's tax system. In 2002, the Washington Tax Structure Study Committee concluded that Washington's taxes were unfair to low and middle-income residents and many businesses and that too much of our tax base depended on shrinking parts of the economy while growing areas were taxed only lightly or not at all.[30] The committee recommended a number of alternatives to make the system more fair, stable, and adequate to the modern economy.

Their recommendations included restructuring businesses taxes, adding a modest income tax, including more services in the sales tax, and reducing other taxes. Implementing major reform will most likely take time. Unfortunately, the governor and legislature immediately shelved the committee report, rather than begin the arduous and politically sensitive process of grappling with its proposals.

Getting control of tax exemptions is an important first step in tax reform. In 2005, the Washington legislature should adopt legislation:

- requiring all businesses that take tax breaks to publicly report the amount claimed and the number and compensation levels of jobs created;
- providing a regular method for the legislature and the public to evaluate the effectiveness of tax exemptions; and
- requiring that tax exemptions be considered and prioritized as part of the budget process.

With these reforms in place, a small number of new tax breaks may still rise to a high priority when stacked against all the needs of the state, but public spending will be far more balanced, and both legislators and the public will have more confidence in the system.◆◆◆

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Notes

Two major sources for this paper were published by the Washington State Department of Revenue and are available on DOR's website at http://www.dor.wa.gov/content/Statistical_Reports/stats_taxanlyz.asp:

Tax Exemptions 2004: A Study of Tax Exemptions, Exclusions, Deductions, Deferrals, Differential Rates and Credits for Major Washington State and Local Taxes, January 2004.

Tax Reference Manual: Information on State and Local Taxes in Washington State, January 2002.

[1] Washington State Department of Revenue, *Tax Exemptions 2004: A Study of Tax Exemptions, Exclusions, Deductions, Deferrals, Differential Rates and Credits for Major Washington State and Local Taxes,* January 2004.

[2] The legislature cut the 2001-03 budget in 2002, and addressed a projected $2.7 billion deficit for the 2003-05 budget in 2003 mostly through program cuts. A summary of the budget adopted in 2003 and the cuts made can be found in Legislative Evaluation & Accountability Program Committee, "2003-05 Omnibus Budget Overview," p. 11-14, http://leap.leg.wa.gov/leap/budget/lbns/2003partii.pdf. Tax expenditures approved in 2003 are listed in DOR, *Tax Exemptions 2004.*

[3] The 12 new business tax breaks were passed in bill numbers HB 2546, HB 2675, SB 6240, HB 1328, HB 2453, HB 2518, HB 2929, HB 2968, HB 3116, HB 3158, SB 6304, and SB 6490. See www.leg.wa.gov.

[4] Robert G. Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development,* Economic Policy Institute, March 2004.

[5] See Jason Smith, "A Concise History of Washington's Tax Structure," Economic Opportunity Institute, August 2002, www.eoionline.org.

[6] In 2003, Governor Locke and legislative leaders negotiated a $3 billion package of incentives for the Boeing company to assemble its proposed 7E7 aircraft in Washington (see, "Efforts to Land the 7E7", http://www.actionwashington.com/efforts/index.htm). The Department of Revenue does not generally make public the estimated impact of exemptions that are used by fewer than 3 companies, and does not include the fiscal impacts for 11 of the business incentives listed in "Tax Exemptions 2004" for this reason. However, fiscal impacts are given for the aerospace-related business incentives adopted in 2003 because they are available to aircraft component manufacturers in addition to Boeing.

[7] Washington Tax Structure Study Committee, "Tax Exemptions," April 18, 2002, http://dor.wa.gov/content/WAtaxstudy/Tax%20Exemptions.pdf.

[8] For discussion of the structural deficit problem, see Marilyn P. Watkins and Jason Smith, "It's Not Just the Recession: The Budget Crisis and Washington State's Structural Deficit," July 2003, http://www.eoionline.org/

Taxes/StructuralDeficit.pdf; Washington Office of Financial Management, "Adequacy of State Revenues," February 2002, http://www.ofm.wa.gov/budget/manage/adequacy/ofm20020208.pdf.

[9] DOR, "Tax Exemptions 2004," p. 39; "Discussion Brief: Intangible Wealth Tax," EOI, September 2002, http://www.eoionline.org/TaxPolicy-IntangibleWealthTax.htm; State of Florida, Department of Revenue, "Florida's Intangible Personal Property Tax," http://www.myflorida.com/dor/taxes/ippt.html.

[10] The states without any personal income tax are Alaska, Florida, Nevada, South Dakota, Texas, Washington, Wyoming. For information on New Hampshire's and Tennessee's interest and dividends tax, see www.revenue.nh.gov; and www.tennesseeanytime.org/etax/whofiles.html.

[11]Washington voters did approve a graduated personal income tax in 1932, but the Supreme Court threw it out. Since then, the voters have rejected 6 proposed constitutional amendments to allow a graduated income tax, most recently in 1973. A corporate income tax was voted down in 1973. See Smith, "A Concise History of Washington's Tax Structure," EOI, August 2002, www.eoionline.org.

[12] See, "Discussion Brief: An Income Tax for Washington State," Economic Opportunity Institute, September, 2002, http://www.eoionline.org/WATaxPolicy-Income.pdf; "Discussion Brief: Intangible Wealth Tax," EOI, September 2002, http://www.eoionline.org/TaxPolicy-IntangibleWealthTax.htm; and Washington Tax Structure Study Committee, "Personal and Corporate Income Taxes," August, 2002, http://dor.wa.gov/content/WAtaxstudy/Personal%20_Corp_Income_Tax_8-9-02.pdf.

[13] Washington's tax structure has been ranked the most regressive in the country by the Institute on Taxation and Economic Policy, "Who Pays: A Distributional Analysis of the Tax Systems in All 50 States," January 2003, http://www.itepnet.org/wp2000/text.pdf.

[14] 2003 Washington State Legislative Budget Notes, Transportation Budget, p. 328, http://leap.leg.wa.gov/leap/budget/lbns/2003toc.asp. The state could collect *both* a sales tax and the gasoline tax on gas sales.

[15] U.S. Bureau of Economic Analysis, Department of Commerce, Personal Consumption Expenditures, http://www.bea.doc.gov/.

[16] Washington Tax Structure Study Committee, Final Report, Introduction and Summary, http://dor.wa.gov/content/WAtaxstudy/Intro&Summary.pdf. See also Watkins and Smith, "It's Not Just the Recession," July 2003, http://www.eoionline.org/Taxes/StructuralDeficit.pdf.

[17] Michael Mazerov, "Expanding State Sales Taxation of Services: Options and Issues," March 24, 2003, Center on Budget and Policy Priorities, http://www.cbpp.org/3-24-03sfp.htm.

[18] DOR, "Tax Exemptions 2004," pp. 136, 192.

[19] SB 6304 passed in 2004 provides a package of tax breaks to aluminum smelters, but the legislature assumed only one smelter in operation in the state. Washington Office of Financial Management, Fiscal Note for 6304, http://www.ofm.wa.gov/fns/LegSearch.asp?BillNumber=6304&SessionNumber=58.

[20] Robert G. Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development,* Economic Policy Institute, March 2004.

[21] See bill analyses and fiscal notes for HB 2546, SB 6240, and HB 2675, www.leg.wa.gov.

[22] See bill analyses and fiscal notes for HB 1357, SB 5219, 5364, 6424, 6665, 6696, www.leg.wa.gov.

[23] At least 11 states now require public disclosure of company specific data for at least some incentives – Minnesota, Maine, Connecticut, North Carolina, Illinois, Louisiana, Ohio, West Virginia, Nebraska, Texas, and Washington. See www.goodjobsfirst.org.

[24] http://www.leg.wa.gov/pub/billinfo/2003-04/House/1850-1874/1869-s_hbr.pdf.

[25] RCW 43.06.4000, http://www.leg.wa.gov/RCW/.

[26] In 1982 the Legislature adopted a requirement (RCW, Chapter 43.136) that all tax preferences be reviewed and either reenacted or repealed. However, the Legislature never followed through with this requirement and repealed the operative section of the program, RCW 43.136.060, in 1993. http://www.leg.wa.gov/RCW/.

[27] H.B. 2654, http://www.leg.wa.gov/wsladm/billinfo/dspBillSummary.cfm?billnumber=2654.

[28] "Tax Expenditure Reports," Good Jobs First, www.goodjobsfirst.org/taxexpend.htm. See also State of Oregon, Tax Expenditure Report, http://www.dor.state.or.us/statistical/ExpR0305/TOCexp.html; State of Idaho, *Idaho's Tax Structure: Exemptions, Credits, Exclusions and Deductions,* http://www2.state.id.us/dfm/2004Idaho/Publications/GFRB/Tax.pdf; State of Pennsylvania, 2004-05 Governor's Executive Budget, Section D, http://www.budget.state.pa.us/budget/lib/budget/2004-2005/exec_budget/005_016_contents.pdf.

[29] See Economic Policy Institute, Job Watch, http://www.jobwatch.org/.

[30] Washington State Tax Structure Committee, Final Report, Introduction and Summary, November 2002, http://www.dor.wa.gov/content/Wataxstudy/Intro&Summary.pdf.

Appendix A

Tax Exemption and Revenue Reduction Bills Passed by Washington Legislature 2004

Bill Number and Description	Comments	State Fiscal Impact in $000s		Local Fiscal Impact in $000s	
		03-05	05-07	03-05	05-07
Extending Expiring Incentives					
2546 extends to 2015 sales tax exemptions for new facilities and B&O tax credits for high tech firms conducting research and development	requires annual reporting, but only amount of credits taken can be public; DOR reports in 2009 and 2013	$52,384	$175,063	$14,346	$39,536
2675 extends electric utility tax credit to 2011; provides incentives to develop infrastructure for job growth in rural areas		$50	$200	0	0
6240 rural and distressed counties incentives – B&O credit for help desks or computer software extended through 2010; sales tax deferral for manufacturing, computer programming, R&D extended to 2010	firms taking deferral must respond to survey that can be public; 21 firms have taken software credit, 17 help desk; 90-160 applicants for sales tax deferral received each year	$15,834	$39,118	$4,420	$10,981
Subtotal expiring incentives		**$68,268**	**$214,381**	**$18,766**	**$50,517**
New Business Tax Breaks					
1328 boarding homes – lowers rates and allows B&O deduction for DSHS payments for Medicaid patients		$3,945	$12,910	0	0
2453 amends B&O exemption on wholesaling of new cars between dealers	conforms law to practice	$3	$8	0	0
2518 gives certain chemical processors that require large amounts of electricity similar Public Utility Tax exemptions as aluminum smelters	includes accountability and public disclosure provisions; 1 known firm would qualify	$325	$650	0	0
2929 American beef ban – exempts portion of income from processing and selling beef from B&O tax for slaughter firms	for those hurt by international bans on American beef due to mad cow disease	$2,188	$3,875	0	0
2968 B&O excise tax deductions for nonprofits receiving government grants for salmon restoration		$370	$840	0	0
3116 B&O and sales tax exemptions extended to blood & tissue banks	reenacts 1995 exemptions invalidated by court	$239	$552	$34	$79

Bill Number and Description	Comments	State Fiscal Impact in $000s		Local Fiscal Impact in $000s	
		03-05	05-07	03-05	05-07
3158 sales tax exemption on computer equipment used by printer or publisher	exemption already exists for manufacturing equipment	$1,370	$3,120	$400	$910
6304 Aluminum smelters - lowers B&O rate and provides property and sales tax credits to aluminum smelters through 2006; lowers B&O rate for those providing electricity to smelters if they pass the savings on to smelters	includes reporting and disclosure provisions; assumes only 1 smelter in operation	$1,714	$3,037	0	0
6490 exempts fuel cells from sales and use tax	promotes alternative fuel	$121	$242	$35	$70
Subtotal new business tax breaks		**$10,275**	**$25,234**	**$469**	**$1,059**
	Other Revenue Measures				
2693 taxation of timber – exempts standing timber on public land sales from property tax, but would phase-in counties getting a share of the timber tax from harvests on public land	simplifies taxes and helps counties hurt by Motor Vehicle Excise Tax losses	$144	$861	$184	gains $251
3036 prohibits expiration dates on gift certificates and stored value cards	unclaimed value had gone to state after expiration	0	$5,480	0	0
6115 use tax exemption for donated amusement and recreation services	lets golf courses continue donating use to high school teams, etc.; has never been collected	$231	$409	$59	$105
6515 changing taxable definitions to partially conform with streamlined sales tax agreement	part of effort to standardize definitions of taxable goods across states, so that states might more easily collect sales tax on internet sales	$7,942	$19,854	$2,321	$5,803
Subtotal other revenue measures		**$8,317**	**$26,604**	**$2,564**	**$2,657**
Total Lost Revenue		**$86,858**	**$266,217**	**$21,797**	**$57,233**

Source: Washington State Legislature Bill Information, www.leg.wa.gov

Appendix B

Washington State Tax Exemptions with Highest Fiscal Impact (with revenue that could be collected if repealed)

Brief Description	Primary Beneficiaries	State Fiscal Impact in $millions		Local Fiscal Impact in $millions	
		FY 2004	FY 2005	FY 2004	FY 2005
Personal & professional services – sales tax exemption	Individuals and businesses that use and provide services	2,478	2,813	724	822
Food and food ingredients – sales tax exemption	Individuals	671	719	196	210
Investments by nonfinancial firms - B&O deduction	Individuals and noncorporate businesses (50%), nonfinancial corporations (30%), pension trusts (20%)	457	479	0	0
Motor vehicle and special fuel subject to fuel tax – sales tax exemption	Individuals and businesses	250	240	73	70
Prescription drugs– sales tax exemption	Individuals, physicians, hospitals	219	235	64	69
Manufacturing machinery – sales tax exemption	15,000 – 16,000 manufacturing firms	149	162	43	47
Real estate excise tax exemptions on gifts, inheritance, divorce transfers, government transfers, etc.	Individuals acquiring real property in specific situations	143	153	51	55
Trade-ins – sales tax exemption	Vehicle and farm implement dealers	125	130	37	38
Labor for local road construction – sales tax exemption	Washington cities and counties	75	79	18	20
Medical devices (insulin, prosthetics, hearing aids, etc.) – sales tax exemption	Individuals	73	78	21	23
Public/nonprofit hospitals; Medicare receipts - B&O deduction	Nonprofit and public hospitals	59	64	0	0
Government grants to nonprofits for health or social welfare programs - B&O deduction	Nonprofit social service organizations and clients	56	58	0	0
Commercial aircraft - Aircraft fuel tax exemption	Commercial airlines and aircraft manufacturers	48	49	0	0

Brief Description	Primary Beneficiaries	State Fiscal Impact in $millions		Local Fiscal Impact in $millions	
		FY 2004	**FY 2005**	**FY 2004**	**FY 2005**
High technology deferral – sales tax deferral/exemption	298 firms over 10 years	48	47	14	14
Local residential & coin-op telephone service – sales tax exemption	Individuals	42	41	12	12
$28,000 minimum for filing a tax return – B&O tax	Small businesses	41	41	0	0
Fertilizer and chemical spray – sales tax exemption	Agricultural producers	39	41	8	9
Interest on real estate loans – B&O deduction	Financial institutions, real estate industry, possibly home buyers (if savings is passed on)	37	38	0	0
Agricultural producers – B&O exemption	10,000-12,000 (out of 30,000) agricultural producers with incomes over small business credit	26	27	0	0
R & D high technology firms – B&O credits	1,311 firms over 10 years	25	24	0	0
Small business credit	159,000 firms	22	22	0	0
Customized computer software – sales tax exemption	Buyers of custom software	21	22	6	6
Total		**$5,104**	**$5,565**	**$1,271**	**$1,397**

Source: Washington Department of Revenue, Tax Exemptions 2004