



INCREMENTAL STEPS TOWARD TAX REFORM: DISCUSSION BRIEF #1

Fairer Taxes for Washington: A High Incomes Tax

The problem: Washington suffers from an outmoded and regressive tax structure. State and local taxes fall too heavily on low- and middle-income residents, yet public revenues are not sufficient to finance the improvements needed for world-class education and transportation systems. The national economic downturn compounds these problems by further reducing tax revenue. Without new sources of funds, Washington will be forced to cut essential services and postpone important new investments to improve 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 past votes of the people against a state income tax, most Washington policymakers are hesitant to consider a broad income tax.

A step in the right direction: Rather than cut services or increase rates on existing regressive taxes, Washington could implement a new tax on the highest income state residents. A high incomes tax could raise enough revenue to allow a reduction in regressive sales or property taxes, while still raising new funds to invest in high priority services.

ESTIMATE OF BIENNIAL REVENUE FOR HIGH INCOMES TAX IN WASHINGTON

A Graduated High Incomes Tax Option	Biennial Revenue	% of Households Paying
<ul style="list-style-type: none"> • First \$200,000 of Adjusted Gross Income exempt for joint filers (\$100,000 exempt for individual filers). • 3% rate on income between \$200,000 and \$999,999 • 5% rate on income over \$1 million 	\$2.58 billion	4%

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

Options for Progressive Revenue Reductions	Losses	Net New Revenue
Sales tax reduction from 6.5% to 6.0%	(\$1.3 billion)	\$1.28 billion
Eliminating 50% of state portion of property tax	(\$1.5 billion)	\$1.08 billion

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

Constitutional and Legal Issues: A high incomes tax passed without a constitutional amendment would certainly be challenged in court. Even without the constitutional issue, passing an income tax would likely require a super-majority vote in the state legislature and a ratifying vote of the people.¹ But the right mix of a high incomes tax, reduced general taxes, and dedication of revenues to popular new programs might win the popular vote.

Who would pay: A high incomes 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. Only about 120,000, or 4% of households, have incomes over \$200,000 for couples or \$100,000 for singles, and 3,000, or 0.1% of Washington households, have taxable incomes over \$1 million.²

How it would work: The high incomes tax would be assessed on adjusted gross income as calculated for federal income taxes. Relying on the federal income tax form makes the process streamlined for individuals and keeps much of the cost for enforcement with the federal government. The tax would be 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.

The Department of Revenue would have to establish new systems to collect the state tax. In 2003, state agencies estimated that administration of a state millionaires' tax would cost about \$31 million per biennium, plus about \$30 million in one-time costs to establish the system.³

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

Growing wealth: Since 1979, the wealthy have enjoyed substantial income gains and increasingly pulled away from other Americans. 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%.⁴ In Washington from the late 1990s to 2006, the top fifth gained 11.6% while the bottom fifth lost 4.2% in income, adjusted for inflation.⁵

The wealthiest have also benefited the most from federal tax cuts since 2001. In Washington, 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%.⁶ Meanwhile, public services are suffering from chronic underinvestment.

¹ For a fuller discussion of high incomes tax options and the constitutional and legal issues, see Marilyn P. Watkins, "Fairer Taxes for Washington: Taxing high incomes to reduce regressive taxes and improve public services," April 2008, Economic Opportunity Institute, <http://www.eoionline.org/>.

² In contrast, 80% of state households have annual incomes under \$88,000. 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.

³ Washington Office of Financial Management, Fiscal Note for Senate Bill 5902, March 25, 2003, www.leg.wa.gov.

⁴ 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.

⁵ 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.

⁶ The bottom 60% of households have only gotten about 15% of those tax reductions. On their 2007 federal taxes, the wealthiest 1% of Washington households will save on average \$69,500 in taxes due to reductions enacted since 2001, while the bottom 60% will save on average \$455. Citizens for Tax Justice, "The Bush Tax Cuts: Are Washingtonians Better Off?" October 2006, <http://www.ctj.org/>.