



## Exemptions to Ax – Sins to Tax

\$1.8 billion in new revenue to stimulate Washington's economy and remodel its tax structure<sup>1</sup>

	FY2011 State Revenue (in millions)	FY 2011 Local Revenue (in millions)
<b>Repeal Business Exemptions</b>		
<i>Sales tax on security brokers</i>	\$45.6	\$14.1
<i>Sales tax on items used in interstate commerce (taxed in 16+ states)<sup>3</sup></i>	\$176	\$53
<i>Sales tax on out-of-state coal<sup>7</sup></i>	\$10.9	\$2.4
<i>B&amp;O deduction for investment earnings of nonfinancial firms<sup>3</sup></i>	\$211.4	
<i>B&amp;O deduction for interest on residential property first mortgage loans</i>	\$84.5	
<i>B&amp;O deduction for tuition &amp; fees of private educational institutions<sup>3</sup></i>	\$20.5	
<i>Special Public Utilities Tax rate for urban transportation and small vessels<sup>3</sup></i>	\$9	
<i>Governor's proposal (excluding HomeStreet fix)<sup>5</sup></i>	\$92.9	
<i>Additional tax preferences analyzed by JLARC 2009<sup>3</sup></i>	\$15.9	
<b>Subtotal</b>	<b>\$666.72</b>	<b>\$69.50</b>
<b>Other Business Tax Changes</b>		
<i>Increase Hazardous Substance Tax from 0.7% to 2% of wholesale value<sup>8</sup></i>	\$225	
<i>Hospital safety net assessment<sup>9</sup></i>	\$231.8	
<b>Subtotal</b>	<b>\$456.80</b>	
<b>Individual Taxes</b>		
<i>Sales tax on candy and gum</i>	\$28	\$8.6
<i>Sales tax on bakery products sold on-site</i>	\$15.9	\$4.9
<i>Sales tax on cosmetic surgery</i>	\$6.6	\$2.0
<i>Raise general aviation excise tax to level of personal property tax<sup>3</sup></i>	\$10.8	
<i>Double estate tax rates starting in April 2010</i>	\$65.8	
<i>New 1 cent per oz. on sweetened beverages, including diet (wholesale)<sup>12</sup></i>	\$419.6	
<i>New 1 cent per oz. on bottled water (wholesale)</i>	\$134.7	
<i>Cigarette tax from \$2.025 to \$2.275</i>	\$24.7	
<i>Increase tobacco products excise tax</i>	\$8	
<b>Subtotal</b>	<b>\$714.10</b>	<b>\$15.50</b>
<b>TOTAL (BUSINESS AND INDIVIDUAL)</b>	<b>\$1,837.62</b>	<b>\$85</b>

## Additional Options for New Revenue

	FY2011 State Revenue (in millions)	FY 2011 Local Revenue (in millions)
<b>Repeal Business Exemptions</b>		
<i>HomeStreet court case, restore to DOR position<sup>5</sup> (if B&amp;O deduction on interest from first mortgage loans is not repealed)</i>	\$8.6	
<i>Pop syrup B&amp;O credit and increase syrup tax from \$1 to \$2 (paired with 5 cent per 12 oz canned soft drink tax if sweetened beverage tax is not enacted)</i>	\$15.4	
<i>Sales tax on non-organic fertilizer (not approved by the National Organic Program)</i>	\$35.0	\$10.8
<i>Sales tax on custom software (taxed in 11+ state)</i>	\$70.1	\$21.7
<i>Limit sales tax deferral on high tech construction to \$1 million<sup>4</sup></i>	\$50	\$15.5
<i>Sales tax on detective &amp; security services<sup>2</sup> (taxed in 14 states)</i>	\$62.5	\$19.3
<i>Sales tax on janitorial services (taxed in 17 states)</i>	\$33	\$15
<b>Other Business Tax Changes</b>		
<i>Temporary B&amp;O increase on business and financial services from 1.5% to 2%, with new sales tax on custom software, detective &amp; security, and security brokers</i>	\$68	
<i>Temporary B&amp;O increase on business and financial services from 1.5% to 2%, with continuation of no sales tax on custom software, detective &amp; security, and security brokers</i>	\$84.3	
<i>Public utility tax rate increase 10%</i>	\$50.7	
<b>Individual taxes</b>		
<i>Sales tax on consumer services</i>	\$99.6	\$30.8
<i>Sales tax on trade-ins of boats, motor homes, appliances</i>	\$3.8	\$1.1
<i>Real estate excise tax increase 1.28% to 1.6%</i>	\$122.7	
<i>New 5 cents per 12 oz. container soft drinks (wholesale - paired with pop syrup tax if sweetened beverage tax is not enacted)</i>	\$93.6	
<i>Cigarette tax from \$2.025 to \$3.025<sup>6</sup></i>	\$88.8	
<i>Disposable cup tax of 5 cents per disposable coffee cup<sup>11</sup></i>	\$20.8	

**Sources:**

<sup>1</sup> Unless otherwise cited, Department of Revenue, "Estimated Impact of Revenue Alternatives," November 30, 2009

<sup>2</sup> Based on DOR November 2008 estimate

<sup>3</sup> Joint Legislative Audit & Review Committee, Tax Preference Performance Reviews

<sup>4</sup> EOI estimate based on 2006 DOR survey; <sup>5</sup> Governor Gregoire's proposal, DOR, January 4, 2010

<sup>6</sup> Fiscal Note on HB 2493; <sup>7</sup> Fiscal note SB6573;

<sup>8</sup> Washington Toxics Coalition; <sup>9</sup> Washington State Hospital Association

<sup>10</sup> <http://www.courts.wa.gov/content/Briefs/Ao8/805440%20supp%20br%20of%20petitioners.pdf>

<sup>11</sup> DOR estimate, assuming July 1, 2010 implementation

<sup>12</sup> <http://www.yaleruddcenter.org/sodatatax.aspx>

## **New Revenues Explained: \$1.8 billion priority list**

### **REPEAL BUSINESS EXEMPTIONS (REVENUE IN MILLIONS):**

**Sales tax on security brokers** – Washington relies heavily on sales tax, but the percentage of the state economy covered by sales tax has been shrinking. Expanding the sales tax base to reflect the modern economy will strengthen our long term ability to fund services, and provide revenue to local as well as state governments. A sales tax on security brokers will have minimal impact on those who invest for the long haul, but will impact those who trade frequently in speculative transactions. State revenue: \$45.6. Local revenue: \$14.1.

**Sales tax on items used in interstate commerce** (taxed in 16+ states)<sup>3</sup> – Air, rail, and water transportation companies engaged in interstate or foreign commerce are exempt from sales tax on fuel and other items. U.S. Supreme Court has ruled that states may tax such items, and many do. JLARC review in 2008 found no clear purpose for the exemption. The estimate here is for jet fuel, the largest component of this category, so revenues may be larger. State revenue: \$176. Local revenue: \$53

**Sales tax on out-of-state coal**<sup>7</sup> – Coal burned by a Centralia power plant was exempted from sales tax when 70% was purchased locally, to help preserve jobs. Now coal is imported and the plant is a top producer of greenhouse emissions. SB 6573 sponsored by Sen. Oemig would repeal. State revenue: \$10.9. Local revenue: \$2.4

**B&O deduction for investment earnings of nonfinancial firms (individual exemption continues)**<sup>3</sup> – Businesses that receive interest, dividends, and capital gains income but are not engaged in banking or other financial activities as their primary business (generally less than 5% of annual income), may deduct that income when calculating their B&O tax. Most states tax such income through corporate income taxes. JLARC review said a complete exemption could be held to apply to individuals not otherwise engaged in business who have investment holdings generating more than the \$28,000 minimum for filing a B&O return – this revenue estimate continues exemption for individuals. \$211.4

**B&O deduction for interest earned on residential property first mortgage loans** – Since 1970, credit agencies can deduct interest earned from loans for first mortgages on residential property – presumably to encourage home purchases. No evidence that the tax savings is passed on to consumers. A HomeStreet “fix” is not required if the 1<sup>st</sup> mortgage deduction is repealed. HomeStreet, a mortgage company, was ordered by DOR to pay B&O tax on investment income derived from residential mortgages. The company paid, then sued for reimbursement, claiming the first mortgage exemption (described above). Trial and Appeal courts ruled for DOR but the state Supreme Court reversed.<sup>10</sup> \$84.5

**B&O deduction for tuition & fees of private educational institutions**<sup>3</sup> – Applies to private and parochial schools approved by State Board of Ed, accredited degree-granting colleges, private kindergartens and other institutions. \$20.5

**Special Public Utilities Tax rate for urban transportation and small vessels** (raise from 0.642 to 1.926)<sup>3</sup> – The PUT is in lieu of the B&O. A preferential rate for urban transportation was adopted when street cars and interurban railways were financially distressed. Private street cars and interurbans have been replaced with public transit. Primary beneficiaries now are freight companies, taxis, limos, messenger services, etc. Other states do not distinguish between urban and other transportation services. \$9

**Governor's proposal:** (totals \$92.9 million without HomeStreet fix, which is taken care of by eliminating 1<sup>st</sup> mortgage B&O deduction)

- **B&O exemption for out-of-state businesses with "economic nexus"** (Governor request)<sup>5</sup> - We now tax companies with a physical presence in the state – this would broaden to include those with a significant economic presence. \$73.1
- **Loopholes and tax avoidance** - Imposes use tax on tangible personal property acquired through a series of transactions designed to avoid tax, and clarifies who is responsible for paying Real Estate Excise Tax in certain circumstances. \$11.6
- **Limit B&O preference for processing meat, fruit & vegetables.** \$4.1
- **Clarify taxation of corporate board of directors' fees.** \$2.1
- **Sales tax and B&O exemptions on bullion** – Sales of precious metals and bullion have been exempt from B&O since 1985, because sellers argued they were in competition with other states. Streamlined Sales Tax Agreement makes tax avoidance by purchasing elsewhere less likely now. \$1.9
- **Sales tax for cattle operations in livestock nutrient management** – Livestock feeding operations are regulated by state and federal governments to prevent water and other pollution. Tax exemption passed after changes in those laws. Farmers have had adequate time to transition. \$0.12

**Additional tax preferences analyzed by JLARC:**<sup>3</sup> \$15.9

- **Fraternal benefit societies insurance premium tax exemption** - In contrast to 1891 when adopted, these now act like insurance companies and should be taxed as such.
- **Sales tax on farm equipment alternatives to field burning** - Passed to aid transition to less polluting practices. Farmers have had 11 years to make transition.
- **Ocean marine insurance rate preference and deduction** - For decades, marine insurance losses were highly volatile, but for the last decade, loss rate has been similar to all insurance.
- **B&O credit on hospital lift equipment** - Credit was passed in 2006 to give hospitals incentives to quickly purchase patient lift equipment in order to reduce injuries to nurses and patients. Credit was intended to expire Dec. 2010.
- **Rural county software development and help desk** – Tax credits passed in 1999 to expand jobs and raise incomes in rural areas. Set to expire in 2011. Only 39 jobs created. Half the claimants of high tech credit are sole proprietors with no employees. The disparity between urban and rural wages has not changed. JLARC recommends letting them expire.
- **Rural electric utility contributions** – Since 1999 rural utility companies have been able to take a PUT credit equal to half their contributions to a rural economic development revolving fund. Credit expires in 2011. According to JLARC review, there is no evidence of economic development resulting from the credit.
- **B&O exemption for non-profit kidney dialysis, hospice, and nursing homes** – According to JLARC review, hospitals were originally exempted from B&O, and the legislature gradually expanded the exemption to include non-profit clinics performing services traditionally performed by

hospitals. Since 1993, hospitals have paid B&O in order to help finance health care, making the reason for continuing the exemption on clinics unclear.

- **Gas tax deduction for handling losses** – When licensees remove motor vehicle fuel from the terminal, they may deduct 31 gallons per 10,000 from the motor vehicle fuel tax to account for handling losses, in a tax break dating back to the 1930s. Fuel evaporation and spillage both cause pollution and have been minimized in current technology. JLARC recommends terminating.
- **Non-profit horse racing B&O exemption** – Non-profit horse racing is also exempt from the pari-mutuel tax, so applying B&O would not result in double taxation.

#### **OTHER BUSINESS TAX CHANGES (REVENUE IN MILLIONS):**

**Increase Hazardous Substance Tax from 0.7% to 2% of wholesale value**<sup>8</sup> - Applies to first possession of petroleum, pesticides, and certain chemicals – over 8,000 substances which Department of Ecology has determined to cause a threat to human health or the environment. Receipts are currently dedicated to cleanup of hazardous waste sites and grants to local governments for hazardous waste programs. Passed by initiative in 1989. \$225

**Hospital safety net assessment**<sup>9</sup> - Proposed by the Washington State Hospital Association to leverage additional Medicaid reimbursements from the federal government, as in 25+ other states. \$231.8

#### **INDIVIDUAL TAXES (REVENUE IN MILLIONS):**

**Sales taxes on consumer products** - Washington relies heavily on sales tax, but the percentage of the state economy covered by sales tax has been shrinking. Expanding the sales tax base to reflect the modern economy will strengthen our long term ability to fund services, and provide revenue to local as well as state governments.

- **Candy and gum** – Allowed and clearly defined under the Streamlined Sales Tax Agreement. State revenue: \$28. Local revenue: \$8.6.
- **Bakery products sold on-site** - State revenue: \$15.9. Local revenue: \$4.9
- **Cosmetic surgery** - State revenue:\$6.6. Local revenue: \$2.0

**Raise general aviation excise tax to level of personal property tax**<sup>3</sup> – In 1949 the legislature simultaneously enacted an aviation excise tax and exempted aircraft subject to it from personal property tax. 75% of owners paying the tax are individuals and most of the rest are corporations. The excise tax does **not** apply to commercial aircraft or those owned by the manufacturer for testing or training. \$10.8

**Double estate tax rates starting in April 2010** - The estate tax is one of the few truly progressive taxes Washington has. Our present tax was upheld by voters in 2006. It exempts the first \$2 million of property and farm property. Rates start at 10% and rise to 19% over \$11 million. The federal estate tax expired on January 1, 2010. \$65.8

**New 1 cent per oz. on sweetened beverages (wholesale)**<sup>12</sup> – Includes soda, sweetened teas, power drinks, etc. both regular and diet that meet the Streamlined Sales Tax Agreement definition of soft

drinks. Fruit beverages and those containing milk or milk substitutes are excluded. \$419.6 (DOR estimate \$258.5)

**New 1 cent per oz. on bottled water (wholesale)** – The Streamlined Sales Tax Agreement currently classifies water as food, so a sales tax could not be applied without appealing for a reclassification to the SST Governing Board. However, a wholesale tax is allowed. \$134.7

**Cigarette tax from \$2.025 to \$2.275** \$24.7

**Increase tobacco products excise tax** – Applies to the first handling or sale of cigars, pipe or chewing tobacco, and other tobacco products except cigarettes. \$8

## **New Revenues Explained: Additional options for new revenue**

### **REPEAL BUSINESS EXEMPTIONS (REVENUE IN MILLIONS):**

**HomeStreet court case, restore to DOR position<sup>5</sup>** - A HomeStreet “fix” is not required if the 1<sup>st</sup> mortgage deduction is repealed. HomeStreet, a mortgage company, was ordered by DOR to pay B&O tax on investment income derived from residential mortgages. The company paid, then sued for reimbursement, claiming the first mortgage exemption (described above). Trial and Appeal courts ruled for DOR but the state Supreme Court reversed.<sup>10</sup> \$8.6

**Pop syrup B&O credit and increase syrup tax from \$1 to \$2** -Pop syrup used in fountain drinks in fast food restaurants and other locations has been taxed since 1989, with income going to violence reduction. A B&O credit to off-set the wholesale tax was added in 2006. Could be paired with new tax on canned soft drinks if new wholesale tax on sweetened beverages is not adopted. \$15.4

**Sales tax base expansion** - Washington relies heavily on sales tax, but the percentage of the state economy covered by sales tax has been shrinking. Expanding the sales tax base to better reflect the modern economy will strengthen our long term ability to fund services, and provide revenue to local as well as state governments.

- **Sales tax on non-organic fertilizer** (not approved by the National Organic Program) – Would encourage farmers to move more quickly to less polluting practices. State revenue: \$35.0. Local revenue: \$10.8
- **Sales tax on custom software** (taxed in 11+ state) – Would not include “canned” software such as Microsoft products. State revenue: \$70.1. Local revenue: \$21.7
- **Limit sales tax deferral on high tech construction to \$1 million<sup>4</sup>** – Most users of the deferral claim less than \$1 million annually. Historically, a handful of very large corporations claim up to \$5 million and one claims up to \$30 million annually. State revenue: \$50. Local revenue: \$15.5
- **Sales tax on detective & security services<sup>2</sup> (taxed in 14 states)** State revenue: \$62.5. Local revenue: \$19.3
- **Sales tax on janitorial services (taxed in 17 states)** State revenue: \$33. Local revenue: \$15

### **OTHER BUSINESS TAX CHANGES:**

**Temporary B&O increase on business and financial services** from 1.5% to 2% (\$84.3 if no sales tax on custom software, detective & security, and security brokers) \$68

**Public utility tax rate increase of 10%** - PUT is in lieu of B&O tax for utilities. \$50.7

**INDIVIDUAL TAXES (REVENUE IN MILLIONS):**

**Sales tax on consumer services** – Including barbers and hair salons, veterinarians, recreation, and other services. State revenue: \$99.6. Local revenue: \$30.8

**Sales tax on trade-ins** of boats, motor homes, appliances. State revenue: \$3.8. Local revenue: \$1.1

**Real estate excise tax increase 1.28% to 1.6%** - In most cases, the tax is paid by the seller of the property. \$122.7

**New 5 cents per 12 oz. can soft drinks (wholesale)** – Canned soft drinks were taxed at wholesale along with pop syrup from 1989 to 1995. Could be combined with pop syrup tax above if 1 cent per oz. sweetened beverage tax is not adopted. \$93.6

**Cigarette tax** from \$2.025 to \$3.025.<sup>6</sup> \$88.8

**Disposable cup tax of 5 cents per disposable coffee cup**<sup>11</sup> – Applied on use for ready-to-go coffee, beginning June 1, 2010. Could be at retail or wholesale. \$20.8

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**Sources:**

<sup>1</sup> Unless otherwise cited, Department of Revenue, "Estimated Impact of Revenue Alternatives," November 30, 2009;

<sup>2</sup> Based on DOR November 2008 estimate

<sup>3</sup> Joint Legislative Audit & Review Committee, Tax Preference Performance Reviews

<sup>4</sup> EOI estimate based on 2006 DOR survey

<sup>5</sup> Governor Gregoire's proposal, DOR, January 4, 2010

<sup>6</sup> Fiscal Note on HB 2493

<sup>7</sup> Fiscal note SB6573

<sup>8</sup> Washington Toxics Coalition

<sup>9</sup> Washington State Hospital Association

<sup>10</sup> <http://www.courts.wa.gov/content/Briefs/A08/805440%20supp%20br%20of%20petitioners.pdf>

<sup>11</sup> DOR estimate, assuming July 1, 2010 implementation

<sup>12</sup> Childhood Obesity Prevention Coalition (their estimate is for sugar sweetened only)