

## REVENUE OPTIONS (February 12, 2010)

The list below presents a set of positive choices to help lawmakers deal with the continued impact of the national economic recession on the fiscal 2011 budget without again resorting to cuts in health care, environmental protections, education and other essential state services. Though there are many other revenue options that can and should be considered, these options are offered as a starting point. The options take into account sufficiency, fairness and consistency, and the benefits of incorporating non-essential or harmful goods or services into the revenue base.

PROPOSED CHANGES	FY2011 Revenue (\$ millions)
<b>Sales tax base expansions</b>	
Modernize the sales tax to include consumer services <sup>1,2</sup> . . . . .	118
Repeal the exemption for custom software . . . . .	70
Extend the sales tax to purchases of candy, gum, and bakery products sold on-site . . . . .	44
Repeal the exemption for nonorganic fertilizer, spray, and washes . . . . .	35
Repeal the exemption for non-Washington residents (HB 3176). . . . .	33
Repeal the exemption for out-of-state coal (HB 3077 / SB 6573) <sup>b</sup> . . . . .	4
Subtotal	304
<b>Other taxes</b>	
Enact a new tax on sugar-sweetened beverages of 1 cent per oz. at wholesale <sup>c</sup> . . . . .	315 <sup>3</sup>
Increase the Hazardous Substance Tax to 2.0 from 0.7 percent(HB 3181 / SB 6851) <sup>d</sup> . . . . .	225
Enact a new tax on bottled water of 1 cent per oz. at wholesale . . . . .	135
Increase the B&O tax rate on business services to 2.0 from 1.5 percent <sup>e</sup> . . . . .	130
Repeal the Dot Foods B&O exemption (HB 3176 & Governor's proposal) . . . . .	95
Increase the cigarette tax to \$3.025 from \$2.025 per pack (HB 2493 / SB 6443) . . . . .	85
Economic Nexus (both HB 3176 & Governor's proposal) . . . . .	73
Repeal of first mortgage deduction (HB 3176) . . . . .	62
Other actions included in HB 3176 or Governor's proposal . . . . .	25
Increase the other tobacco products tax (HB 2493 / SB 6443) . . . . .	10
Subtotal	1,155
<b>The Working Families Tax Rebate (10 percent of the federal EITC)</b>	
Subtotal	-78
<b>Temporarily (3-years) increase the sales tax rate to 7.5 from 6.5 percent</b>	
Subtotal	1,031

1. Revenue estimates include a reduction in the B&O tax rate to the rate applied to retail sales businesses. Some consumer services are also purchased by businesses.

2. Services include: Satellite and cable TV services; personal care services (hair, nail, skin, massage, and other services); travel agent commissions and other travel arrangement services; investment advice; admissions (movie theaters, race tracks, sporting events, and others); instructional lessons (sports); and tax preparation services.

3. Extending the tax to include diet beverages would generate an additional \$160 million per year in new revenue.

All revenue estimates are from the Department of Revenue except: <sup>a</sup>Joint Legislative Audit and Review Committee (JLARC), Tax Preference Reviews, various years; <sup>b</sup>Fiscal note for SB6573; <sup>c</sup>Childhood Obesity Prevention Coalition; <sup>d</sup>Washington Toxics Coalition; <sup>e</sup>BPC calculations of data from DOR.



## **Sales tax base expansions**

### **Modernizing the Sales Tax to include consumer services**

The economy has changed since the sales tax was first enacted in 1935. Consumers now spend a larger portion of their incomes on services than on goods. But the sales tax has not kept pace with these changes in consumer behavior. Along with generating about \$118 million in new resources, extending the sales tax to consumer services would bring the tax more in line with the modern economy. This action would also ensure that consumers are treated more equitably under the sales tax, regardless of their purchasing preferences. Below is a list of eight currently untaxed consumer services along with the amount of revenue that would be generated in FY2011 if they were added to the tax base.

- 1) Satellite and cable TV services (\$34 million)
- 2) Personal care services – i.e. hair, nail, skin, massage, and other services (\$20 million)
- 3) Travel agent commissions (\$20 million)
- 4) Investment advice (\$19 million)
- 5) Admissions – i.e. movie theaters, racetracks, sporting events, etc. (\$17 million)
- 6) Instructional lessons – i.e. sports (\$4 million)
- 7) Tax preparation services (\$3 million)
- 8) Travel arrangement and reservation services, and fees related to non-sporting events (\$2 million)

### **Repealing the exemption for custom software**

Custom software is currently exempt for the sales tax, costing the state about \$70 million per year in foregone revenue.

### **Extend the sales tax to include candy, gum, and bakery products**

Currently, these products are exempt from the sales tax, costing the state \$40 million per year in foregone tax revenue. Given the economic problems we face, Washington cannot afford to subsidize unhealthy products like candy and doughnuts.

### **Extend the sales tax to non-organic fertilizer**

Fertilizer is currently exempt from the sales tax base, costing the state more than \$40 million per year in foregone revenues. Under this proposal, organic fertilizer would remain exempt.

### **Repeal the exemption for non-Washington residents (HB 3176)**

Currently, out-of-state shoppers from Oregon, some Canadian provinces, and other states that have a sales tax rate of less than 3 percent are not required to pay the sales tax on purchases made while in Washington. This costs the state about \$33 million per year. It is important to note that nonresident shoppers benefit from Washington State public services, including police and fire protection while they are in Washington, but under current law they do not contribute to the cost of maintaining these services.

### **Repeal the exemption for out-of-state coal (HB 3077 / SB 6573)**

Extending the sales tax to include coal used at coal-fired thermal electric generation facilities would generate about \$4 million each year in new tax revenues.

## **Other taxes**

### **Increase taxes on soft drinks**

Establishing a new tax of \$0.01 (one cent) per ounce on sugar-sweetened beverages would generate over \$300 million in new resources each year. Such a tax would help fight the growing obesity epidemic by providing consumers with an incentive to make healthier purchasing choices. Policymakers could also choose to extend the tax to include diet soft drinks, which would generate an additional \$160 million annually. Alternatively, policymakers could choose to increase the pop Syrup Tax to \$2 from \$1 per gallon at wholesale, eliminate the B&O Syrup Tax credit, and establish a tax on canned soft drinks of \$0.05 per 12 ounces at wholesale. This approach would generate over \$100 million in new revenues this year.

### **Increase the Hazardous Substance Tax (HB 3181 / SB 6851)**

Revenues from the Hazardous Substance Tax, which is levied on wholesalers of hazardous substances, currently fund efforts to clean up areas contaminated by toxic substances. Increasing this tax to 2.0 from 0.7 percent would allow our state to maintain current cleanup efforts while providing additional resources for other important services like health care and education. This would also allow the state to invest in additional environmental protection measures in the future.

### **Enact a new excise tax on bottled water**

Under the multistate Streamlined Sales and Use Tax Agreement (SSUTA), Washington cannot levy a sales tax on environmentally-damaging bottled water. Enacting a new tax of one cent per ounce on bottled water (sold by wholesalers) would not violate this agreement, however. Such a tax would generate a substantial amount of new revenues (\$135 million in FY11) needed to maintain core public services.

### **Repeal the Dot Foods exemption (Governor's proposal & HB 3176)**

A recent Washington State Supreme Court decision greatly expanded a B&O exemption that was originally intended to apply only to door-to-door sales companies (Avon, Mary Kay, etc). Both HB 3176 and the Governor's proposal include provisions to repeal this exemption, which would save the state about \$95 million in FY2011.

### **Increase the B&O tax rate on business services**

Increasing the Business and Occupation (B&O) tax on business services – legal services, accountants, architectural services, and others – would generate about \$130 million in new tax revenues each year.

### **Increase the cigarette tax (HB 2493 / SB 6443)**

Raising the tax on cigarettes to \$3.025 from \$2.025 per pack would raise about \$85 million in new revenue this year.

### **Economic Nexus (both HB 3176 & Governor's Proposal)**

Under current law, many companies are not required to pay Washington's B&O tax even though they do a significant amount of business in the state. Economic nexus would provide a more reasonable standard of determining which businesses operating in Washington are liable for B&O taxes. Adopting economic nexus would generate about \$73 million in the current fiscal year.

### **Repeal the B&O deduction on first home mortgages (HB 3176)**

The B&O deduction on interest from first home mortgages was originally intended to help a major bank headquartered in Washington compete with other national banks. There are no longer any major banks headquartered in Washington and the vast majority of mortgages are originated by out-of-state banks or sold to out-of-state banks. The deduction no longer makes sense. Modifications to this deduction protect community banks and allow them to compete with national banks that received federal bailout funds. HB 3176 would repeal the deduction, but would exempt the first \$35 million of interest from loans from taxation.

### **Other actions included in HB 3176 or the Governor's Proposals**

A number of smaller tax actions are included in HB 3176 and in Governor Gregoire's revenue proposal.

Smaller measures found only in HB 3176 include:

- 1) Extending to real estate excise tax (REET) to banks that sell foreclosed homes (\$5.5 million);
- 2) Holding business owners liable for delinquent B&O taxes (\$4.5 million);
- 3) Extending the public utility tax (PUT) to out-of-state trucking companies that use Washington roads (\$6 million)
- 4) Changing the aircraft excise tax to an ad valorem (value-based) tax of 0.5 percent – the same rate applied to private boats and other watercraft (\$4.5 million);

Smaller measures found in both HB 3176 and the Governor's proposal include:

- 1) Imposing greater restrictions on tax avoidance (\$12 million);
- 2) Repealing the B&O exemption on salaries paid to members of corporate boards (\$2.1 million);
- 3) Limiting favorable B&O tax treatment for processing certain meats, fruits, and vegetables (\$4.1 million);
- 4) Repealing the sales tax exemption on bullion (\$1.9 million); and
- 5) Suspending the sales tax exemption for cattle operations in livestock nutrient management (\$0.119 million).

Governor Gregoire's proposal also includes several small tax cuts, totaling about \$15 million in FY2011.

### **Increase the other tobacco products tax (HB 2493 / SB 6443)**

Raising the tax on other tobacco products to 95 percent of the wholesale price for most tobacco products other than cigarettes, increasing the cap on cigar taxes, and changing the basis for taxing "moist snuff", would generate an additional \$10 million in new resources in the current fiscal year.

### **Temporary (3-year) sales tax increase**

Increasing the sales tax by would be the simplest and most straightforward way to prevent damaging budget cuts. A sales tax increase could be implemented quickly and would be simple for the state to administer and for businesses to comply with. Every one-tenth of one percentage-point (0.1 percent) increase in the sales tax rate would generate about \$100 million in new resources. Temporarily increasing the sales tax by a full percentage-point to 7.5 from 6.5 percent would generate over \$1 billion each year in new revenues.

### **The Working Families Tax Rebate**

Full funding for the Working Families Tax Rebate (WFTR) can be included in any revenue package. At a cost of \$77 million per year, the WFTR is an important tool because it would reduce costs for lower- and moderate- income working families.