

WASHINGTON

Tax System Due for Reform, Policy Groups Say

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The findings of a February 16 Department of Revenue analysis of state and local tax exemptions in Washington are evidence that the state's tax system is due for reform, according to some policy groups.

The report, released every four years, examined 694 tax breaks for individuals and businesses. According to the report, those tax breaks are projected to save taxpayers \$105.9 billion during the fiscal biennium ending in 2017, including \$50.4 billion in state taxes. Roughly a third of the total is from retail sales and use tax exemptions. Exemptions from the business and occupation (B&O) tax and property tax also form a large percentage of those taxpayer savings.

As used in the study, the term "tax exemption" encompasses various preferences, including exclusions, deductions, credits, deferrals, preferential tax rates, and exemptions.

The analysis shows that more exemptions — 233 — benefit businesses than any other group in the state, with 64 of them for agricultural businesses. There are 91 exemptions for nonprofits, 82 for government entities, 53 for individuals, and 77 miscellaneous exemptions that benefit various groups, including businesses. Also, 73 exemptions are for activities "purposefully excluded in the original tax base," such as employee wages, which aren't subject to the B&O tax. And 21 exemptions were enacted to avoid violating the federal commerce clause.

Many exemptions are recent. According to the report, 340 have been passed since 1990, including 32 in 2003 alone.

Kriss Sjoblom with the business-backed Washington Research Council said the state relies on high sales and B&O tax rates to compensate for its lack of income tax, which creates pressure for numerous exemptions.

"The impact on business . . . is much higher," he said. Sales tax is "much less of a problem when you're charging a 4 percent rate [rather] than a 9 percent rate."

Paul Guppy of the Washington Policy Center said the cost of regulations also pushes businesses to seek tax exemptions.

"The affected industry usually argues on the basis of fairness," Guppy said, citing as example, "We shouldn't pay a tax on chicken health inspections; the government forces us to do that, [but] our competitors don't pay that in other states."

Sjoblom argued that the number of exemptions is somewhat misleading because the state's lack of income tax means it has to compensate for exemptions already built into the federal income tax many states use as a base for their

own. Many more recent exemptions are relatively small in terms of individual value, he said.

Guppy argued that the complexity of the state's tax code is evidence that Washington may be due for reforms. "Tax relief is spotty and piecemeal," he said. "Like a lot of states, we had a big overhaul of our tax system in the 1930s. . . . We have had no tax reform in a meaningful way since then. We have never done what the federal government did in 1986 . . . which was close loopholes."

The state's numerous exemptions harm transparency, according to Andy Nicholas of the Washington State Budget and Policy Center. The exemptions seek to attract and retain businesses by robbing the state of revenue to invest in education and the infrastructure that could bolster its economic competitiveness, he added.

"It shows what I would call a misguided approach to economic development," Nicholas said. "We'll do a one-time thing here, a one-time thing there."

Nicholas said most tax breaks flow to organized industries because they're better represented in the state capitol.

"Small businesses pay taxes on their inputs, but the biggest industries have carveouts," he said. "Aerospace, technology, agriculture . . . have effectively written themselves out of Washington tax law."

All three commentators said large-scale tax reform is politically unpopular. Guppy noted that Washingtonians previously opposed income taxes, while Nicholas said business interests with preferable tax rates don't want to risk change.

However, Nicholas said that given a state supreme court ruling that Washington has to substantially increase funding for education, the tax reform issue is likely to stay topical. Last year's ruling inspired Democratic Gov. Jay Inslee's efforts to create a capital gains tax before he switched to a plan to roll back exemptions, and State Treasurer James McIntire (D) also put forth a proposal to create an income tax. (Prior coverage: *State Tax Notes*, June 29, 2015, p. 988.) ☆