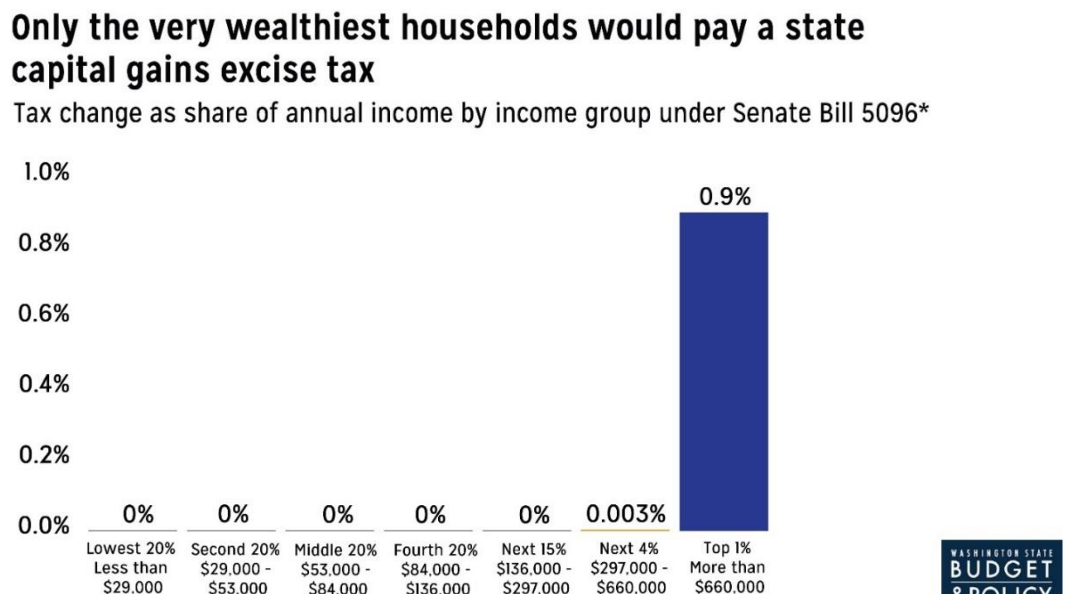
Why <u>now</u> is the time to pass a tax on extraordinary profits

Members of the Washington State Senate have an historic opportunity to create a more just state tax code while bolstering and sustaining our state's fiscal and economic recovery long after federal recovery funds fade away. Senate Bill 5096 would create a new 7% excise tax on extraordinary profits from the sale of financial assets (capital gains) above $250,000 per year. **If approved, this would be the most equitable change to Washington state's upside-down tax code in nearly 90 years. And it would generate over $500 million per year in permanent new resources for child care and investments to help correct the upside-down nature of our tax code. Below are three reasons why Senators should act now and pass SB 5096 off the Senate floor.**

1. Taxing capital gains would begin to address longstanding economic and racial injustices in our state tax code and economy

We have the most upside-down or regressive state and local tax code in the nation, in which the poorest households face average tax rates that are six times higher than the rates paid by those at the very top of the income and wealth ladders. This regressive tax code is especially damaging to Washingtonians who are Black, Indigenous, or people of color, who face considerably higher average tax rates than wealthy white households.

Because financial assets are so heavily concentrated among the very wealthiest households[i] in our state, **SB 5096 would be paid only by those who can afford to pay more for investments in schools and other priorities that benefit us all. As a result, fully 99.8% of the capital gains excise tax would be paid by the richest 1% of Washingtonians, those earning a minimum of $660,000 per year,** according to analysis from the Institute on Taxation and Economic Policy. No households earning less than $297,000 per year would pay any additional taxes under SB 5096.



Source: Institute on Taxation and Economic Policy, microsimulation model, February 2021
*Projected impact of a 7% excise tax on long-term capital gains over $250,000 for single filers; $500,000 for joing filers. Does not include the following exemptions inlcuded in SB5096: all real estate; familiy-owned businesses; livestock; timber; farmland; and depreciable business property.

A small excise tax on high-end capital gains isn't too much to ask of the few, very wealthy households who would pay it. The richest 1% of households in Washington state would see their annual tax bills rise by a mere 0.9% of their annual incomes under SB 5096 (see chart on previous page). That's a very reasonable price to pay for child care, early learning, and other investments needed build a thriving future for all communities in our state. And the surging stock market has meant these households have only seen their wealth and power grow during the current pandemic and recession.

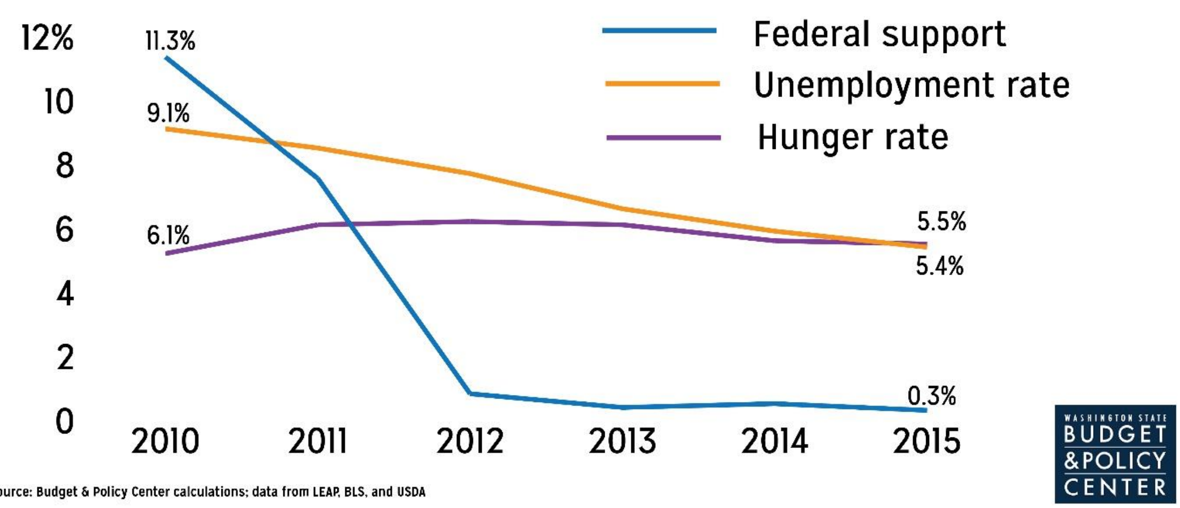
2. The tax revenue will help our state avoid the mistakes of the last recession by providing a permanent replacement for time-limited federal recovery funds.

It's great news that leaders in the United State Congress are working to pass a large economic recovery and pandemic disaster relief package that will include funding to help state and local governments weather the current storm. But those funds won't last forever, and the recession will continue to wreak havoc on our state and local budgets for many years to come.

While the Great Recession nominally ended in early 2009, lawmakers grappled with large budget shortfalls at least through the 2015-17 budget cycle. Federal recovery funding, which helped prevent damaging budget cuts early on, rapidly diminished after 2010, and dried up completely after 2015 (see chart below). Yet the unemployment rate in Washington state didn't return to its pre-recession level until 2017.[ii] Lawmakers made millions of dollars in cuts to public investments like health care during the period when federal funding was drying up and much of the funding that was cut from the state budget during this period was never restored.

Federal recovery aid following recessions is temporary, but the economic pain lingers

American Recovery and Reinvestment Act (ARRA) funding as a share of state-only general fund expenditures, unemployment rate, and the hunger rate in Washington state by year



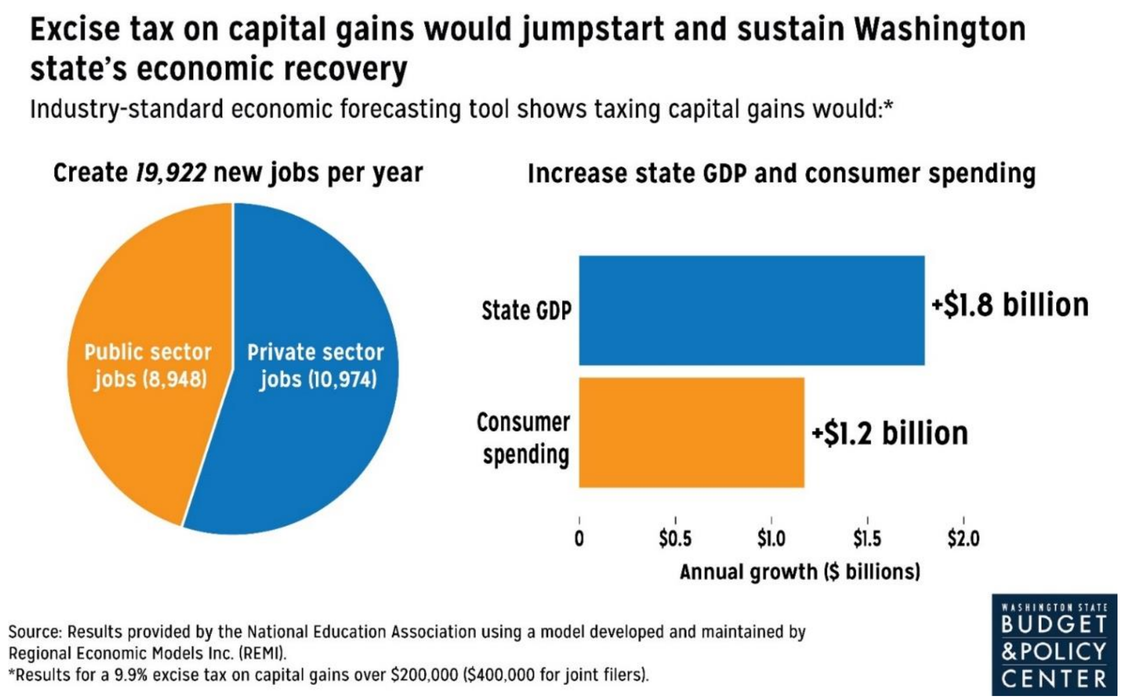
Source: Budget & Policy Center calculations; data from LEAP, BLS, and USDA

Senate Bill 5096 would help ensure lawmakers aren't forced to repeat that economically damaging cycle of cuts and disinvestment in the years ahead. If approved now, capital gains excise tax revenue would begin flowing into state coffers in April 2023 – right as federal recovery act dollars are likely to start phasing down.

3. Taxing capital gains would jumpstart our state economy and create jobs.

During the Great Recession, states that raised taxes on the richest households subsequently saw stronger economic recoveries **compared to those that responded with austerity and regressive tax cuts.**

In accordance with mainstream economic theory, modeling from an industry-standard economic forecasting tool, the REMI economic model, shows SB 5096 would be unambiguously good for our state economy. **As the chart below shows, a tax on high-end capital gains would create nearly 20,000 new jobs per year in Washington state, more than half in the private sector. Investments enabled by the tax would also increase state gross domestic product (GDP) by nearly $2 billion per year. And consumer spending at local small businesses would increase by $1.2 billion per year.**



Opponents' claims don't stand up to scrutiny

Those who are opposed to higher taxes on the rich and powerful for any reason make several false or misleading claims to stop lawmakers from enacting SB 5096. Proposals for an excise tax on capital gains have been introduced and discussed for eight years, have been thoroughly vetted through many public hearings and dozens of opportunities for stakeholder input, and legislators have already made reasonable amendments to address concerns.

Opponents frequently cite fluctuations in the stock market as a reason to oppose a state excise tax on capital gains. As we've written, this argument is greatly overblown since **taxing capital gains would have only a small impact on the overall volatility of Washington state's tax system. And SB 5096 is smartly crafted to fully address the issue of revenue volatility by dedicating capital gains tax revenue above $350 million per year into a separate "taxpayer relief account."**

Moreover, opponents completely ignore the fact that the stock market recovers more rapidly following an economic downturn than any other part of the economy. Since March 2020, the Dow Jones Industrial Average has grown 69%[iii]. By contrast, employment, consumer spending, and GDP all remain painfully depressed, as a result of the recession and pandemic. **Enacting SB 5096 will allow us to tap a rapidly growing resource – one that is heavily concentrated among those at the very top – to fuel a broader recovery for all communities in Washington state.**

Opponents also claim the tax will be struck down by the State Supreme Court. In reality, SB 5096 is very likely to upheld as a legal excise tax applied to profits from the sale of high-end financial assets. **Lawmakers, prominent state constitutional scholars, and public finance attorneys have carefully crafted this measure to ensure it conforms with Washington state law.** Similar taxes, such as the Real Estate Excise Tax, have been upheld by the Court multiple times.

Finally, opponents claim that SB 5096 would induce wealthy Washingtonians to leave Washington state. But the notion that millionaires move from one state to another to avoid paying their fair share in taxes has been heavily studied and thoroughly debunked. In fact, research shows that people of all income levels who move from one state to another desire high-quality schools, good parks, affordable housing, natural beauty, modern transportation infrastructure, and other public amenities – all things that taxes support. This claim is especially absurd in the context of SB 5096. As shown above, the few, very wealthy households who would pay any additional taxes under SB 5096 would see their annual Washington state tax bills rise by only 0.9% of their annual income – an amount only their accountants would notice. And the effective state and local tax rate among the richest 1% of households would still be among the lowest in the nation.

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[i] As of 2018, households earning a *minimum* of $1 million per year claimed nearly three-fifths of all capital gains generated in Washington state, according to data from the IRS.

[ii] Budget & Policy Center calculations; seasonally adjusted unemployment data from the Bureau of Labor Statistics. The unemployment rate in Washington state averaged 4.7% in 2007; it didn't return to that rate until 2017.

[iii] Budget & Policy Center calculations; historical price data from the Dow Jones Industrial Average, adjusted daily close, March 23, 2020 through February 19, 2021.

The Washington State Budget & Policy Center is a research and policy organization that works to advance the economic well-being of all Washingtonians.

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