THE PROGRESS INDEX

MEASURING SHARED PROSPERITY IN WASHINGTON STATE

REVENUE

WASHINGTON STATE BUDGET & POLICY CENTER
SOUND RESEARCH. BOLD SOLUTIONS.

REVENUE

Washington state should have a stable, dependable, and equitable tax system that ensures there are adequate resources to invest in equal opportunities for our children, families, businesses, and communities.

REVENUE SNAPSHOT

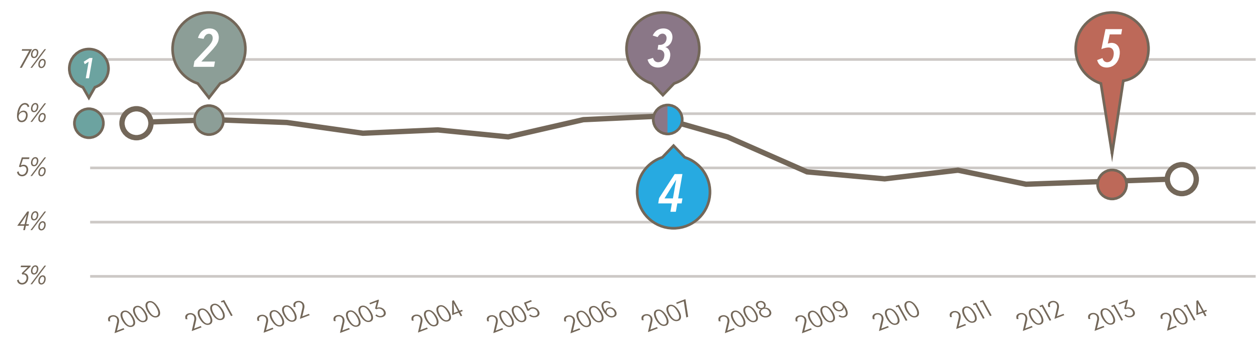
TRENDS IN REVENUE

Washington state's upside-down revenue system – in which low- and middle-income families pay seven times more taxes as a proportion of their income than the wealthiest families – is fundamentally broken. Furthermore, despite an improving economy, tax revenues have fallen behind ***(Figure 26)***. As a result, schools, public health services, environmental protections, and services that support children and families have been sharply cut in recent years.

FIGURE 26:

WASHINGTON STATE'S TAX SYSTEM IS NOT DEPENDABLE IN THE LONG RUN

Near General Fund tax revenues as a share of total state personal income, WA, 2000-2014

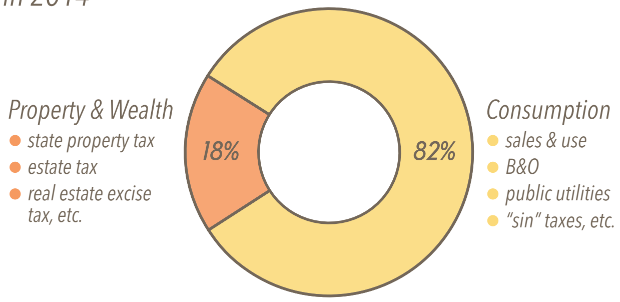


BUDGET MILESTONES

1. *1999: Voters approve Initiative 695, which replaces the state motor vehicle excise tax with a flat, $30 annual fee on each vehicle. The change eliminates nearly $1 billion per year in tax resources for schools, health care, safe communities, and other important priorities.*
2. *2001: Voters approve I-747, which limits the annual growth of property tax revenues to 1 percent or the rate of inflation (whichever is smaller). The limit is arbitrarily low and doesn't allow schools to keep up with the actual costs of things such as paying teacher salaries and educating children with special needs.*
3. *2007: A new process is set up to conduct regular performance evaluations of most state tax breaks, bringing greater transparency and accountability to the system.*
4. *2007: A rainy day fund is created, bringing greater stability to our revenue system by requiring policymakers to set a small portion of revenues aside each year during good economic times.*
5. *2013: Policymakers pass a law requiring all new tax breaks to include a specific public purpose, an expiration date, and a set of measurements for evaluating whether the tax breaks are serving their intended purpose.*

Source: Budget & Policy Center analysis; data from ERFC and BEA

FIGURE 27:
WASHINGTON STATE MOSTLY TAXES CONSUMPTION
State taxes collected by the Department of Revenue in 2014



Source: Budget & Policy Center calculations; data from DOR

HOW WE TAX

Our state's tax system has changed little since it was created in the mid-1930s. Today ***(Figure 27)***:

- Most general state tax revenues (82 percent) come from taxes on consumption or on the purchases of goods and services by consumers and businesses. Consumption taxes include the retail sales and use tax; the Business & Occupation (B&O) tax; public utilities taxes (for water, electricity, natural gas, and waste-management services); and various "sin" taxes, such as the cigarette tax and taxes on alcohol and marijuana.
- A much smaller amount of revenue (18 percent) is collected from taxes on property and wealth.

HOW WASHINGTON STATE'S TAX SYSTEM IS PERFORMING

The slow recovery of state tax revenues following the Great Recession is a direct consequence of an upside-down, 1930s-era tax system that doesn't allow for a healthy, growing revenue system ***(Box 4)***. Our ability to make progress is strongly dependent on whether we fix our broken revenue system. Below is a summary of how Washington state's tax system performs against the principles of a high-quality revenue system, and solutions for how to fix it.

BOX 4:
PRINCIPLES OF A HIGH-QUALITY REVENUE SYSTEM: KEY INDICATORS OF PROGRESS

Equitable	*State and local taxes should not take a disproportionately large bite out of lower- and middle-income families' budgets.*
Stable and dependable	*The tax system should provide enough resources to keep up investments in important public services through good and bad economic times.*
Simple and transparent	*Paying taxes should be simple enough that people and businesses can easily determine how to pay their taxes and calculate exactly how much they actually pay each year.*
Evenhanded for business	*A tax system should treat all businesses equitably, and not favor one industry or activity over another, without a sound justification.*

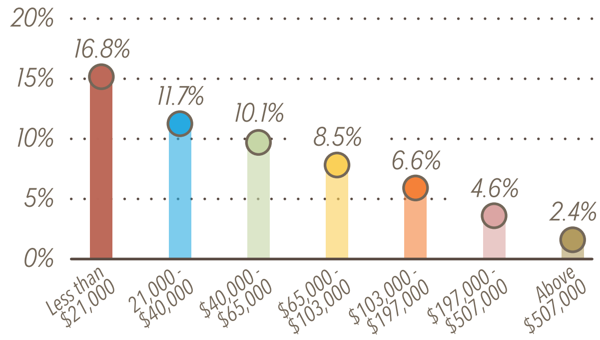
IS WASHINGTON STATE'S TAX SYSTEM EQUITABLE?

Lower- and middle-income families should not have significantly higher state and local tax rates than high-income families. Those who have benefited most from the economic growth in the last few decades can afford to pay higher taxes to ensure schools, health care, child care, and other growth-promoting investments are available to future generations of Washingtonians.

In Washington state, we have the most upside-down tax system in the nation. Poor and middle-class families pay the largest share of their income in taxes (16.8 percent), while the richest 1 percent pay the least (2.4 percent) ***(Figure 28)***. People of color are the hardest hit by our revenue system, as they face greater barriers to economic opportunities and often have lower incomes than their white peers ***(Figure 29)***.

FIGURE 28:
WASHINGTON STATE'S TAX SYSTEM IS UPSIDE DOWN

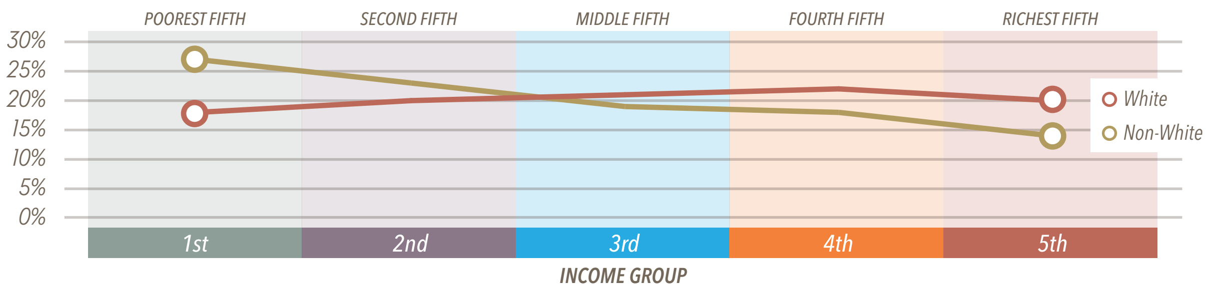
Washington state and local taxes as a share of family income by income group, 2015



Source: Institute of Taxation and Economic Policy

FIGURE 29:
PEOPLE OF COLOR ARE MORE LIKELY TO BE AMONG THE HIGHEST-TAXED/LOWEST-INCOME FIFTH OF WASHINGTONIANS

Share of race/ethnic group by household income, poorest fifth to richest fifth of Washingtonians



INCOME GROUP	White*	Black*	American Indian Alaska Native*	Chinese*	Japanese*	Other Asian Pacific Islander	Other*	Multiracial*	Latino
1st	18%	35%	34%	17%	18%	16%	17%	22%	32%
2nd	20%	24%	24%	13%	16%	17%	26%	21%	27%
3rd	21%	16%	18%	17%	18%	21%	21%	19%	20%
4th	22%	16%	14%	22%	24%	23%	23%	21%	14%
5th	20%	9%	10%	30%	25%	23%	13%	18%	7%

B&PC analysis of IPUMS data, 2012 ACS 5-year estimates. *Non-Hispanic

Note about data: Disaggregated data is presented to provide a preliminary understanding of disparities by race and ethnicity. On its own, this data tells a limited story about the population it represents. We encourage users of this data to engage with communities of color to develop a more accurate and meaningful understanding than the data allow.

IS THE STATE TAX SYSTEM DEPENDABLE AND STABLE?

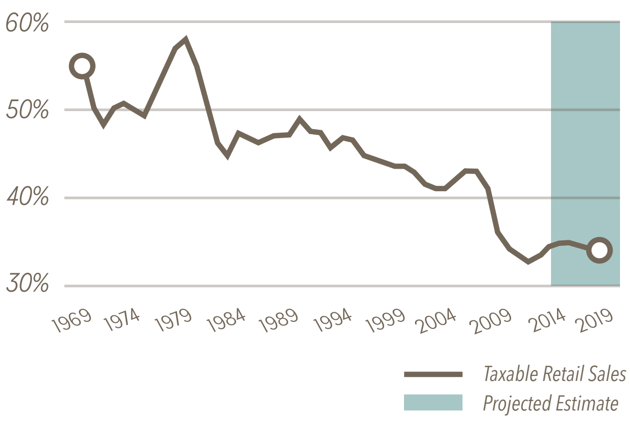
The tax system should provide enough resources to keep up the state's investments through good and bad economic times. As the economy grows and changes, so must investments that support safe, healthy communities and a modern, well-educated, and competitive workforce. A modern state tax system would enable us to reliably fund these investments in the long run. But Washington state's tax system has been falling behind the changing economy for decades. Between 2000 and 2014, tax revenues as a share of state personal income declined by 20 percent (***Table 19***).

The retail sales tax, Washington state's largest source of revenue, is primarily responsible for this long-term decline in revenues relative to the economy. In 1935, the year the sales tax was created, the economy looked much different than it does today. Back then, consumers spent most of their incomes on tangible goods, such as household items and tools. Today, consumers spend most of their incomes on services that are not covered by the sales tax, such as health care, financial advice, and satellite TV. In addition, consumers now purchase many goods from out-of-state via the internet, but the state is barred by federal law from requiring sellers to collect sales tax on many internet transactions.

The consequences of this shift in our economy are dramatic (***Figure 30***). In 1969, the products subject to the state sales tax amounted to 55 percent of Washington state's total economy; today, they amount to only 36 percent and will continue to decline, making the tax system even less dependable in the long run.

Short-term stability is also essential to a healthy revenue system, so that investments in our state can be sustained during economic downturns and other emergencies. "Rainy day funds," also called budget reserves, are the primary tool states use to ensure revenues remain stable during economic downturns. These funds allow policymakers to save a portion of revenues generated during good economic times, which can be drawn down when the economy falters to help maintain funding for schools, public safety, and other essential investments.

FIGURE 30:
THE SALES TAX CAPTURES A SHRINKING SHARE OF THE ECONOMY
Taxable retail sales as a share of total personal income in Washington state, 1969-2019



Source: Economic and Revenue Forecast Council

Washington state made progress on improving revenue stability when policymakers and voters added a rainy day fund requirement to the state constitution in 2007, and again in 2011 by deciding to dedicate additional resources to the fund during times of extraordinarily strong revenue growth. However, our rainy day fund is not sufficient. Total state budget reserves (including rainy day funds) should grow to at least 15 percent of a state's annual general operating budget to be prepared for a recession, according to the Center on Budget and Policy Priorities.[51]

Although budget reserves rise and fall along with economic conditions, reserves in Washington state have not reached this critical 15 percent threshold since 2000. In fact, they have diminished over the past decade (***Table 19***). Just before the 2001 recession caused by the dot-com bust, total reserves reached 12.1 percent of the operating budget; in 2008, just before the onset of the Great Recession, reserves amounted to only 7.5 percent of the state budget. By 2019, Washington state's total reserves are projected to be only 8 percent of the annual state budget.[52]

TABLE 19:

DEPENDABILITY AND STABILITY OF TAX SYSTEM: KEY INDICATORS OF PROGRESS[53]

				ARE WE MAKING PROGRESS?
State tax collections as a share of the state economy (total personal income)	5.8% (2000)	5.6% (2008)	5.0% (2014)	✗
Budget reserves as a share of the state operating budget	12.1% (2000)	7.5% (2008)	*	– ✓

*Data not available or not comparable to subsequent years

IS THE STATE TAX SYSTEM SIMPLE AND TRANSPARENT?

Given that there's no personal income tax, the tax system in Washington state is quite simple for most individuals. Businesses also give the process of filing taxes in Washington state high marks for simplicity *(Table 20)*. That's because compliance with Washington's business and occupation (B&O) tax generally doesn't require businesses to perform complex calculations to determine their net profits (or the share of those profits that occurred in Washington state).

But when it comes to taxpayers' understanding of how much they pay, Washington state's tax system is lacking. The final price of a good or service paid by a consumer in Washington state can include multiple hidden layers of taxation.[54] For example, although cash register receipts show sales taxes directly paid by consumers, they do not reflect the sales taxes and B&O taxes previously paid by manufacturers, wholesalers, and retailers that are built into the final price of a good or service sold in Washington state. As a result, it is impossible for individuals to accurately determine how much they actually pay in state and local taxes each year.

Transparency is further undermined by the growing number of special-interest tax breaks in Washington state. As of 2014, there were 655 tax breaks on the books – 223 more than in 2000 *(Table 20)*. This amounts to billions of dollars in hidden spending every year. That's because, like budgeted investments in education and other priorities, tax breaks are often enacted to advance specific public goals, such as creating jobs or increasing business investment in a particular industry. Unlike budgeted expenditures, however, tax breaks are not routinely reviewed by lawmakers during the biennial budget development process. As a result, they can remain in place for years or decades without having their costs or benefits balanced against competing priorities.

Tax break transparency was improved in 2007 when policymakers established a process to evaluate the performance of most breaks at least once every 10 years. In 2012, the Legislature passed a law requiring all new tax breaks to include an expiration date, specific and measurable goals, and other provisions designed to improve transparency and accountability.

TABLE 20:

SIMPLICITY & TRANSPARENCY OF OUR TAX SYSTEM: KEY INDICATORS OF PROGRESS[55]

				ARE WE MAKING PROGRESS?
Share of business taxpayers surveyed who agree with the statement that "tax forms and instructions are easy to understand."	*	71% (2007)	85% (2014)	✓
Number of special-interest tax breaks	443 (2000)	574 (2007)	655 (2014)	✗

*Data not available or not comparable to subsequent years

IS THE TAX SYSTEM EVENHANDED FOR BUSINESS?

Washington state taxes small businesses much more heavily than it taxes medium and large businesses. B&O taxes among small businesses – those with $5 million or less in gross receipts each year – average 1.7 percent of gross income. Large businesses on the other hand, which are those with more than $25 million in gross receipts each year, have average B&O taxes of less than 1 percent of gross income. Furthermore, service-related businesses, such as hairdressers, accountants, and janitors, are taxed more heavily than manufacturers or shipping companies ***(Table 21)***.

TABLE 21:

EVENHANDEDNESS OF TAX SYSTEM: KEY INDICATORS OF PROGRESS[56]

			ARE WE MAKING PROGRESS?
Taxes as a share of Gross Business Income *By industry type:*	**Manufacturing**	**0.28%**	
	Computer programming	**2.01%**	
	Trade	**0.81%**	
	Services	**2.03%**	
Taxes as a share of Gross Business Income *By industry size:*	**Small** *(gross receipts < $5 million)*	**1.7%**	
	Medium *(gross receipts $5-$25 million)*	**1.2%**	
	Large *(gross receipts > $25 million)*	**0.95%**	

**Data not available or not comparable to subsequent years*

LOOKING AHEAD

HOW WASHINGTON CAN MAKE PROGRESS ON REVENUE

- Expand the sales tax to include more services, which would better reflect today's purchasing patterns and generate at least $100 million per year in additional revenue.
- Tax profits from the sale of corporate stock and other high-end financial assets to generate roughly $800 million per year in new resources. Because the tax would be paid almost exclusively by the very richest Washingtonians, it would begin to make our tax system more equitable for all income groups while fighting the rise of income inequality.
- Fund the Working Families Tax Rebate (WFTR) to reduce taxes for more than 400,000 hardworking families with lower incomes across Washington state. The WFTR would help bring more balance to the tax system based on income and ability to pay, while combating rising income inequality.
- Improve public understanding of tax breaks and accountability by: requiring tax break recipients to meet minimum standards for job creation and other benchmarks; having major corporations publicly disclose how much they claim in state tax breaks each year; and setting expiration dates for all major tax break programs.
- Create a more adequate and equitable property tax by reducing taxes on middle-class and lower-income homeowners and renters, and eliminating the law that severely restricts the growth of property tax revenues from one year to the next.