

An Income Tax for Washington

Questions and Answers

BY MARILYN WATKINS, PH.D.

Washington State has been losing ground on education for 15 years, slipping towards the bottom of national rankings in class size and school funding. Our children, workers, and businesses deserve better. The recession highlights how difficult it is to raise additional revenues to maintain and improve public services, given Washington's outmoded and regressive tax structure. Could now be the time to implement a new tax structure including an income tax in Washington State?

Q. WHY CONSIDER AN INCOME TAX FOR WASHINGTON?

A. With an outmoded public revenue system, Washington cannot provide the foundation of high quality public services state residents and businesses need to thrive in the modern economy. Sales taxes provided 56.5% of Washington's General Fund in 2007-09, and 49% of all state revenue.¹ Washington is one of only seven states with no income tax. On average across the states, individual income taxes contribute about 35% of state revenues, and sales tax just 31.5%.²

Not having an income tax and relying too heavily on sales tax makes Washington's tax structure:

- **Regressive.** Low- and moderate-income residents pay particularly high portions of their income in state and local taxes, while the wealthy do not contribute their fair share.³
- **Inadequate** – with the gap widening. In the 2005-06 school year, Washington ranked 37th among the states in per pupil funding for public schools, and 46th relative to state personal income.⁴ Public revenues in the state grow more slowly than the economy and need for state services, as people spend more of their income on services which are not subject to sales tax.⁵ Income tax revenues, in contrast, tend to grow at the same rate as the economy.
- **Unstable.** While all state budgets have taken a hit in the current recession, Washington's public revenue stream has been particularly devastated by the collapse of consumer spending and the housing market. The more diversified a state's revenue stream, the better able it is to hold up as the economy changes.



**Q. HOW DOES
WASHINGTON'S TAX
STRUCTURE COMPARE
TO OTHER STATES?**

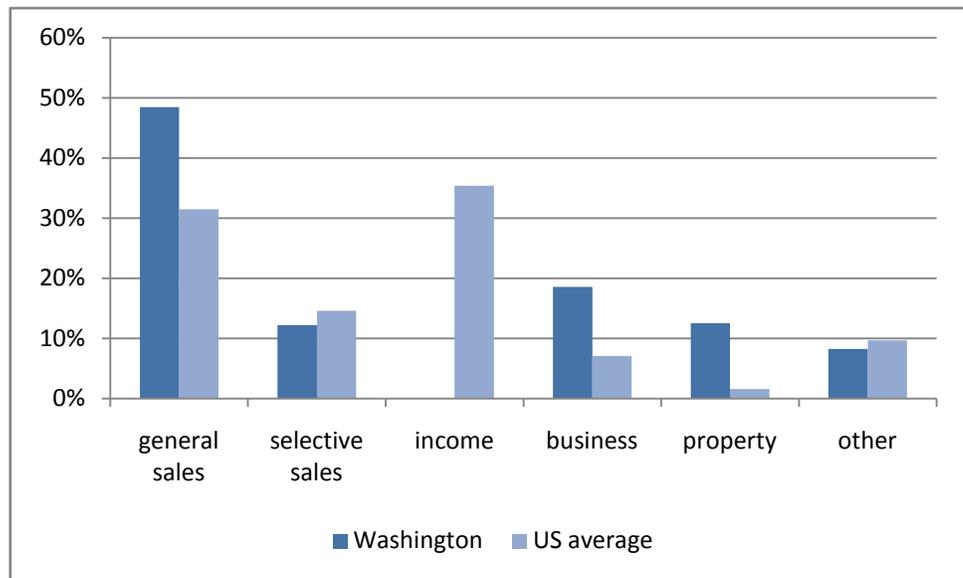
A. Washington relies more heavily on sales and business taxes than most states, because it is one of only seven states without income tax. The **sales tax** rate of 9.5% in effect in parts of King County effective April 1, 2009 makes Washington tied for the 6th highest rate among the states in combined allowable state and local sales taxes.⁶

Washington's main **business tax**, the business and occupation tax (B&O), is levied on a company's gross receipts. Although the rates are low, ranging from 0.138% to 1.5% depending on the type of company, Washington collects proportionately more from the B&O than most states do from the more common corporate income tax.⁷

In total state and local **property taxes**, Washington residents pay a little less than average, but more of the revenue goes to state services than is typical among the states.⁸ While in many states all or almost all of property tax revenues support local services, in Washington about one fourth of property taxes go to the state and then is redistributed to support K-12 education.

PERCENTAGE OF RELIANCE ON MAJOR STATE TAXES

WASHINGTON AND U.S. AVERAGE, FISCAL YEAR 2007



***Selective sales tax** includes gasoline, liquor, cigarettes, etc.; **Business taxes** include B&O, public utility, and other gross receipts taxes, and corporate income taxes; **Other** includes motor vehicle, estate, real estate excise, and other taxes. Sources: Federation of Tax Administrators and Washington Department of Revenue.*

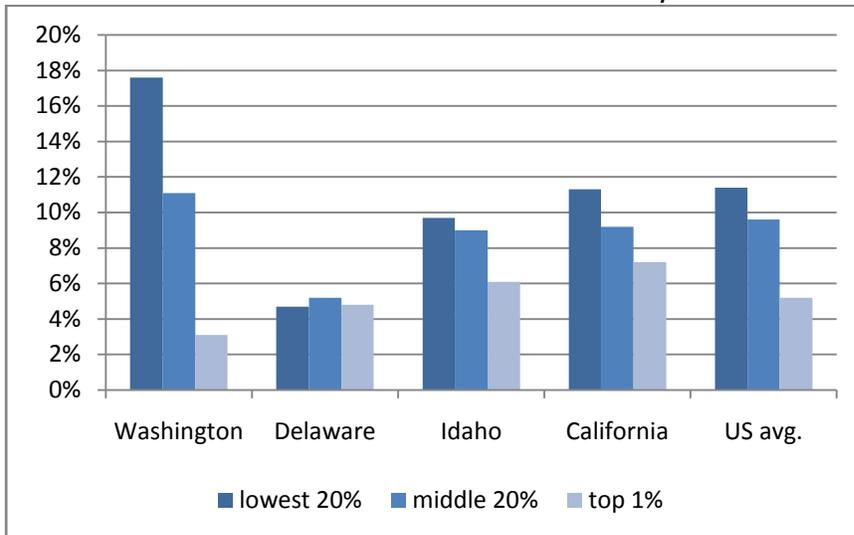
A. Overall, wealthy people in Washington contribute less tax revenue than they would living in another state, while low- and middle-income people pay more.⁹

A District of Columbia study comparing state and local tax payments in the largest city in every state in 2007, found Seattle residents at every income level paid more in sales tax than the median for all included cities. The study found that in property taxes, the lowest income Seattle residents paid at the median level, but for all other income groups, Seattle residents paid less than the median.¹⁰

**Q. HOW MUCH DO
WASHINGTON
RESIDENTS PAY IN
TAXES COMPARED TO
OTHER STATES?**

**PERCENTAGE OF INCOME PAID IN STATE AND LOCAL TAXES
AFTER FEDERAL DEDUCTIONS, BY INCOME**

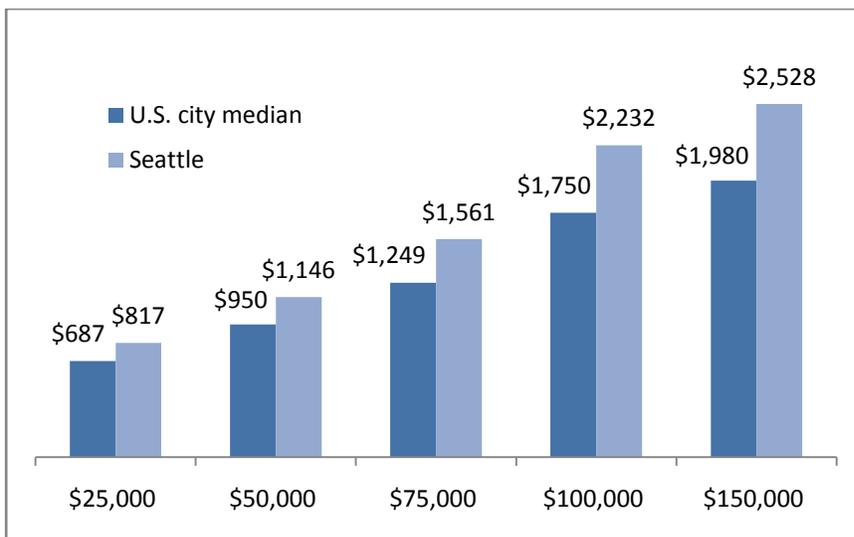
WASHINGTON AND SELECTED OTHER STATES, 2002



Source: *The Institute on Taxation and Economic Policy, Who Pays? 2002.*

SALES TAX PAYMENTS FOR FAMILY OF 3 BY INCOME

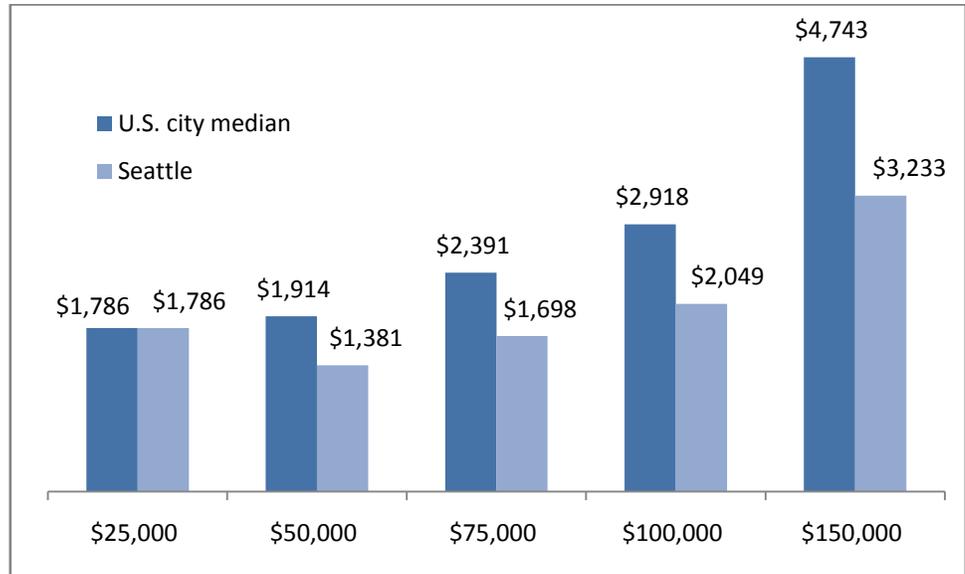
SEATTLE AND MEDIAN FOR LARGEST CITY IN EACH STATE



Source: *Government of District of Columbia, Tax Rates and Tax Burdens*

PROPERTY TAX PAYMENTS FOR FAMILY OF 3 BY INCOME

SEATTLE AND MEDIAN FOR LARGEST CITY IN EACH STATE



Source: Government of District of Columbia, Tax Rates and Tax Burdens

Q. WHAT OTHER STATES DON'T HAVE AN INCOME TAX? WHY IS WASHINGTON WORSE OFF?

A. The other states without an income tax have other major sources of revenue: Alaska, Texas, and Wyoming have oil and mineral revenues; Nevada has gambling, Florida has tourism, and South Dakota applies sales tax to a broad range of services.¹¹

Tennessee and New Hampshire have limited income taxes on unearned income (from interest and dividends) but not on wage and salary income.

Q. WHAT ARE TYPICAL RATES AND EXEMPTION LEVELS FOR STATE INCOME TAXES?

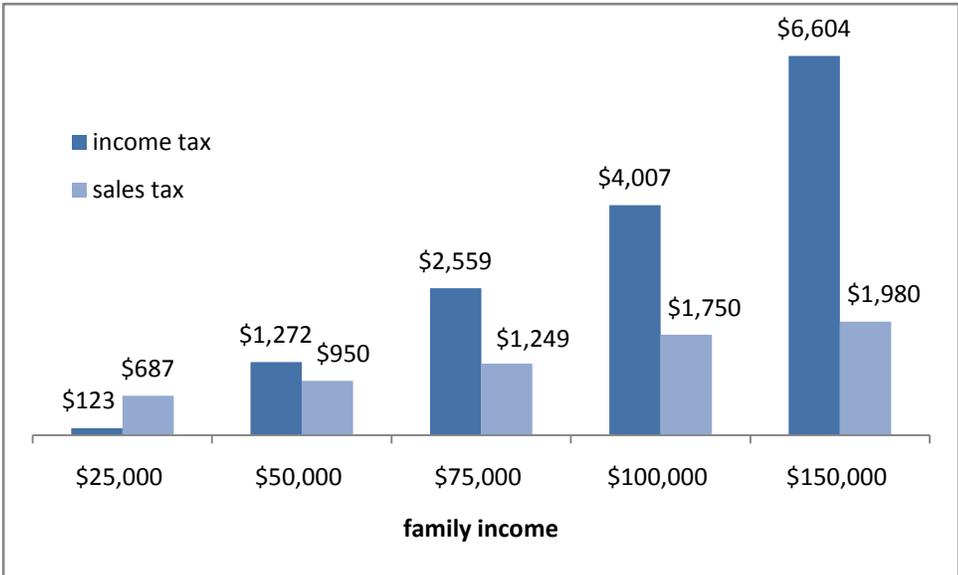
A. Most states have graduated rates and rely largely on federal definitions of taxable income. As of January 2008, top marginal rates ranged from a high of 10.3% on incomes over \$1 million in California to a 3% rate on all incomes in Illinois. The top rates in Washington's nearest neighbors were 9% in Oregon and 7.8% in Idaho. Seven states had flat rates, ranging from Illinois 3% to 5.3% in Massachusetts.

Exemption levels in most states are low enough that most people pay some state income tax. In 2008, Connecticut had by far the highest personal exemption level, with \$12,750 for singles and \$24,500 for couples. Most states had exemption levels in the \$2,000 to \$3,500 range for singles, with double those amounts for couples. For most families, state income tax obligations are lower than the federal income tax.¹²

**Q. HOW MUCH DO
WASHINGTON
RESIDENTS PAY IN
TAXES COMPARED TO
OTHER STATES?**

A. According to the District of Columbia study, the median state tax payments across the U.S. in 2007 were \$1,272 in state income tax and \$950 in sales tax for families of three with annual incomes of \$50,000. Both income and sales taxes payments rise with income. As the following graph illustrates, sales tax payments rise much more slowly, since higher income people tend to spend more on services which often are not taxed and save more of their income. Nationally, families with annual incomes of \$25,000 spend far more on sales tax than on state income tax.¹³

MEDIAN STATE INCOME AND SALES TAX PAYMENTS FOR U.S. FAMILIES OF THREE, BY INCOME, 2007



Source: Government of District of Columbia, Tax Rates and Tax Burdens

**PERCENT OF INCOME PAID IN STATE INCOME AND SALES TAXES FOR U.S. FAMILIES OF THREE
2007, MEDIAN OF ALL STATES**

Income	% of income paid in state income tax	% of income paid in sales tax
\$25,000	0.5%	2.7%
\$75,000	3.4%	1.7%
\$150,000	4.4%	1.3%

Source: Government of District of Columbia, Tax Rates and Tax Burdens

**Q. IS A STATE
INCOME TAX
UNCONSTITUTIONAL?**

A. In 1932, Washington voters approved an initiative establishing a graduated personal and corporate income tax, with 70% of voters supporting the new tax. The State Supreme Court, in a divided five to four decision, ruled that initiative unconstitutional. The court reasoned that income was property and that a graduated tax violated the constitutional provision that taxes be uniform on the same class of property.

Highly respected legal scholars believe that if an income tax measure passed today without a constitutional amendment and was challenged in court, there is a good chance that the Supreme Court would reverse its earlier ruling and allow the tax to stand.¹⁴ Others point to rulings as recent as 1999 that suggest the Court would hold to its earlier position.¹⁵

If income continues to be regarded as property, two other constitutional provisions would apply to an income tax: a constitutional amendment adopted in 1972 limits property tax levies to 1% of the current market value of the property; and exemption levels for personal property are limited to \$15,000 for heads of household.¹⁶

An income tax in Washington could be passed by constitutional amendment, which must pass each chamber of the legislature with a two-thirds majority and be ratified by the people with a simple majority.

An alternative – and more politically feasible – route would be to pass an income tax legislatively, either by initiative or by a majority vote in the legislature and ratifying vote of the people. Such legislation would almost certainly be challenged in court, providing the State Supreme Court with the opportunity to review and possibly reverse the ruling from 75 years ago.

**Q. WOULD
WASHINGTON VOTERS
APPROVE AN INCOME
TAX?**

A. The most likely income tax proposal to appeal to state voters would be an income tax limited to the relatively wealthy, paired with a reduction in the property or sales tax, and dedicated to education or other priority public services.

It has been 36 years since Washington voters have considered an individual income tax. After the 1932 initiative establishing an income tax was thrown out by the court, the legislature established the sales tax and business and occupation tax in 1935. Along with the property tax that had existed since territorial days, these taxes have provided the bulk of state revenues since.

Voters subsequently turned down constitutional amendments on personal income taxes in 1936, 1938, 1942, 1970, and 1973. Separate measures for a corporate income tax were also voted down in 1975 and 1982.

In more recent years, Washington voters have been highly selective in approving or limiting taxes. Voters have approved several limits on property tax, repealed the motor vehicle excise tax, and required super majorities in the legislature or votes of the people for most tax increases. But voters have also approved a cigarette tax hike to fund the Basic Health Plan, an estate tax to fund education, and other school and transportation tax increases.

Endnotes

- ¹ Washington Department of Revenue, *Tax Statistics*, www.dor.wa.gov.
- ² Federation of Tax Administrators, "2007 State Tax Collections by Source," <http://www.taxadmin.org/fta/rate/07taxdis.html>.
- ³ The Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, 2002, January, 2003, <http://www.ctj.org/itep/whopays.htm>; Government of the District of Columbia, *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison 2007*, issued August 2008, http://www.taxadmin.org/fta/rate/DC_Tax_Burden_07.pdf.
- ⁴ U.S. Census Bureau, *Public School Finance*, 2006, issued April 2008, <http://ftp2.census.gov/govs/school/06f33pub.pdf>.
- ⁵ Washington Office of Financial Management, "Adequacy of State Revenues, Presentation to the Washington State Tax Structure Committee", Feb. 8, 2002, <http://www.ofm.wa.gov/fiscal/adequacy/ofm20020208.pdf>; Larry R. Moran and Clinton P. McCully, "Trends in Consumer Spending, 1959-2000," U.S. Bureau of Economic Analysis, 2001, <http://www.bea.gov/scb/pdf/national/nipa/2001/0301pce.pdf>.
- ⁶ As of April 1, 2008, Arkansas (11%), Oklahoma (11%), Oklahoma (10.5%), Louisiana (10.25%), Tennessee (9.75%), Arizona (9.6%), and New York (9.5%) had rates equal to or above Washington's allowable rate. Washington Department of Revenue, "Comparison of State/Local Retail Sales Taxes – 2008", www.dor.wa.gov.
- ⁷ Washington Department of Revenue, *Tax Reference Manual 2007*, p. 103, www.dor.wa.gov.
- ⁸ Washington Senate Ways and Means Committee, "2009 Citizen's Guide to the Budget," <http://www.leg.wa.gov/Senate/Committees/WM/>; Government of the District of Columbia, *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison 2007*, issued August 2008, http://www.taxadmin.org/fta/rate/DC_Tax_Burden_07.pdf.
- ⁹ The Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, 2002, January, 2003, <http://www.ctj.org/itep/whopays.htm>.
- ¹⁰ Government of the District of Columbia, *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison 2007*, issued August 2008, http://www.taxadmin.org/fta/rate/DC_Tax_Burden_07.pdf. Washington Department of Revenue, *Tax Reference Manual 2007*, p. 167 also notes that combined state and local property taxes in Washington are below the national average. www.dor.wa.gov.
- ¹¹ Federation of Tax Administrators, "FTA Taxation of Services - Update 2007," July 2008, <http://www.taxadmin.org/fta/pub/services/btn/0708.html#table>.
- ¹² Federation of Tax Administrators, "State Individual Income Taxes," as of January 1, 2008, www.taxadmin.org.
- ¹³ Government of the District of Columbia, *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison 2007*, issued August 2008, http://www.taxadmin.org/fta/rate/DC_Tax_Burden_07.pdf.
- ¹⁴ Hugh D. Spitzer, "A Washington State Income Tax – Again?" *University of Puget Sound Law Review*, vol. 16, no. 2, 1993.
- ¹⁵ *Harbour Village Apartments v. City of Mukilteo*, 139 Wn.2d 604, 608, 989 P.2d 542 (1999).
- ¹⁶ Washington Department of Revenue, *Tax Reference Manual 2007*, p. 167, www.dor.wa.gov.