CHAPTER TWO
REFORMING TAXATION

1. Policy Recommendation: Make taxes in Washington more fair and less regressive by enacting tax relief

Elected officials in Washington often make earnest statements about social justice and income inequality, but at the same time they seem entirely insensitive to the heavy tax burden they place on citizens. The people of Washington pay over 50 different kinds of taxes at the state and local level.[1] The biggest taxes are regressive – the sales tax, the property tax and the Business and Occupation tax. One tax in particular, the Motor Vehicle Excise Tax (MVET) is seen as unfair, because officials impose the tax on the inflated value of vehicles.

MVET viewed as unfair

The Motor Vehicle Excise Tax (MVET) is imposed by state lawmakers and some local governments, such as Sound Transit. It is a yearly tax based on the estimated value of trailers and motor vehicles.

Many families pay the MVET many times in one year, because officials apply it to a wide range of vehicles, including cars, trucks, motorcycles, motor homes and trailers. Some working families pay the tax on as many as five or six different vehicles and trailers each year, resulting in hundreds of dollars in cost per family.

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1 "The Tax Reference Manual, Information on State and Local Taxes in Washington State," by Kathy Oline, Assistant Director, compiled by Don Taylor, Research Division, Washington State Department of Revenue, January 2010, at http://dor.wa.gov/docs/reports/2010/Tax_Reference_2010/TRM%202010%20-%20Entire%20Document.pdf.

In addition to the high tax burden imposed on families, the MVET is seen as unfair because of the controversial method officials use to set a vehicle's value. Officials use an inflated depreciation schedule, instead of true market value, to decide the tax burden they impose on vehicle owners. This results in the overvaluing of most vehicles for tax purposes.

Regressive sales taxes fall hardest on the poor

In addition to the MVET, state and local officials impose a high sales tax on residents. The total rate on consumer purchases, except food and medicine, often exceeds nine percent and is one of the highest sales tax rates in the country. Many lawmakers want to extend this tax to services as well, representing a massive tax increase across the economy.

In heavily-populated King County, officials impose the highest sales tax rate in the state, making it harder to find work and earn a living in otherwise prosperous urban communities.

Increasing regressive taxation assigns a larger share of the tax burden to low-income citizens. As a person's income decreases, the proportion spent on essential living expenses, including taxes, increases. By imposing a high sales tax rate, public officials force poor Washingtonians to devote an ever-larger share of their income to funding government agencies and subsidizing public services, compared to high-income citizens.

Providing property tax relief

The same is true of the property tax. As lawmakers and local officials increase total property collections, they increase the amount each property owner must pay. In addition, local officials often ask voters for special levies, saying tax increases are needed to pay for essential public services, even when regular property tax revenue is already increasing. When levies are framed as preventing cuts in schools, parks and medical services people feel pressured to vote “yes,” despite the higher cost.

The result is a rising financial burden that falls hardest on people living on fixed incomes, the elderly, the disabled and the unemployed. Public officials should manage the normal increases in regular tax collections responsibly, or use it to provide tax relief, rather than seeking more money by increasing the financial burden they place on the most vulnerable people in the community.

Work with public-sector unions to reduce costs

Regressive taxation falls disproportionately on working families. When public officials maintain a high tax burden, they reduce take-home pay, make income inequality worse, and in general make life harder for middle- and low-income families. The high taxes public officials impose increase the cost of housing, making it harder for young people to buy a first home, and for older people living on fixed incomes to stay in their homes.

Instead of seeking to increase regressive taxes, state and local officials should work to improve their management of the current rise in tax revenue. They should seek to open a dialogue with executives at public-sector unions as a way to preserve cost-effective services for the public.

Enacting tax relief would make Washington’s tax system more fair and less regressive, while preserving stable and moderate yearly tax revenue, based on natural growth of the economy, to fund vital public services.

2. Policy Recommendation: Adopt a constitutional amendment requiring a supermajority vote to raise taxes

In February 2013, the state supreme court overturned the voter-approved requirement that proposed tax increases must receive a supermajority vote of the legislature, or voter approval, to be enacted. When the supreme court strikes down a law passed by the people, the legislature often seeks to implement what the people want. Recent examples include Initiative 695, to reduce car tab costs, and Initiative 747, to limit yearly property tax increases. In both cases, after the courts ruled against popular ballot initiatives, lawmakers enacted bills that carried out the will of the voters.

Ballot measures to limit tax increases consistently receive strong voter support. Approval of Initiative 1366 in 2015 represented the sixth time since 1993 that voters have approved the policy of requiring a supermajority vote in the legislature to pass tax increases. Voters passed similar measures in 1993, 1998, 2007, 2010 and 2012. In addition, in 1979 voters approved a revenue limit which required a supermajority vote of lawmakers to exceed the limit (Initiative 62).

Supermajority vote requirements are common

Requiring a supermajority vote in the legislature to increase taxes is not unique to Washington. Seventeen states have some form of supermajority vote requirement for tax increases. Supermajority requirements are common in provisions of Washington's own constitution.

There are currently more than 20 supermajority vote requirements in the state's constitution. Several of these provisions have been part of the Washington constitution since statehood. The most recent one was added by lawmakers and confirmed by voters in 2007.

A supermajority vote requirement is not undemocratic

Since supermajority vote restrictions are a common way for the people to place limits on government power, lawmakers should send voters a proposed constitutional amendment to require a supermajority vote in the legislature to raise taxes. Such a proposal would not be undemocratic. Instead, it would be consistent with existing constitutional precedents for requiring higher vote thresholds for certain government actions.

A statewide poll in 2016 found that 65 percent of voters want lawmakers to send them a constitutional amendment requiring a supermajority vote to raise taxes.[2] Voters and lawmakers clearly want reasonable limits on raising taxes. Passage of a constitutional amendment would set this popular commonsense policy in place and decide the matter once and for all, without further interference by the courts.

2 "New Poll: Lawmakers should act on supermajority for taxes amendment," by Lisa Shin, Press Release, Washington Policy Center, January 5, 2016, at http://www.washingtonpolicy.org/publications/detail/new-poll-lawmakers-should-act-on-supermajority-for-taxes-amendment.

3. Policy Recommendation: Do not impose a state income tax

Washington is one of only seven states that does not tax citizens' incomes (two other states do not tax general income but have taxes on interest). Doing so would fundamentally alter the state's tax structure, changing it from one that mainly taxes consumption to one that also taxes people's work and productivity.

Each of the 50 states levies a different combination of taxes on the people who live, do business or travel within its borders. These different types and levels of taxation have a profound impact on the actions of residents and business owners, and high taxation can significantly impede economic growth. More than any other type of tax, an income tax can stifle a state's economic growth, create instability in public revenues and limit people's take-home income.

An income tax is considered unfair and unconstitutional

Since 1930, the Washington state supreme court has issued numerous opinions interpreting Article 7, Sections 1 and 2 of the state constitution to require taxation of property, which includes income, to be uniform and limited to a rate of one percent. While there is no ban on a uniform income tax of one percent, 80 years of legal precedents show that a progressive or targeted income tax that treats people with different income levels differently is considered unfair and unconstitutional in Washington.

Officials at the state Department of Revenue agree that Washington has a ban on a graduated income tax, but they are not certain the "current court," as they put it, would follow 80 years of precedent and hold a graduated income tax bill unconstitutional.[3]

A state income tax is unpopular

3 E-mail to the author from Kim Schmanke, Communications Director, Washington State Department of Revenue, September 24, 2015, copy available on request.

There is a serious problem when the state's tax enforcement agency is not sure whether the courts would be bound by eight decades of case law. Lawmakers should send voters a crystal clear constitutional amendment banning income taxes in Washington. Judging from past elections, the people oppose a state income tax in Washington and a proposed ban would probably pass.

Here is the record of popular opposition to measures proposing a state income tax:

- 1934 – House Joint Resolution 12........ defeated 43% to 57%
- 1936 – Senate Joint Resolution 7 .... defeated 22% to 78%
- 1938 – Senate Joint Resolution 5 .... defeated 33% to 67%
- 1942 – Constitutional Amendment ...... defeated 34% to 66%
- 1944 – Initiative 158 .... defeated 30% to 70%
- 1973 – House Joint Resolution 37 .... defeated 23% to 77%
- 1975 – Initiative 314 .... defeated 33% to 67%
- 1982 – Initiative 435 .... defeated 34% to 66%
- 2010 – Initiative 1098 .... defeated 36% to 64%

In Tennessee, lawmakers wanted to make sure citizens would be assured that imposition of a state income tax was not just one legislative session away. They asked voters to approve a constitutional amendment banning income taxes. As the sponsor of the Tennessee income tax ban explained:

> "This is going to help us bring in jobs to Tennessee. We can say not only do we not have an income tax, but we'll never have an income tax."[4]

In 2014, Tennessee voters passed the proposal with 66 percent of the vote and the state's constitutional ban on a state income tax went into effect.

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4 "Senate OKs measure to ban Tenn. income tax," by Lucas Johnson II, *Business Week*, March 9, 2011.

As in Tennessee, lawmakers in Washington should let the people act on a constitutional amendment making our state's ban on an income tax clear, while protecting it from being overturned by a surprise court ruling in which judges ignore past legal precedents.

4. Policy Recommendation: Stop unfair retroactive tax increases

Officials at the Department of Revenue report that in recent years lawmakers have imposed several retroactive tax increases. These include SB 6096 (passed in 2009), 2ESSB 6143 (passed in 2010) and EHB 2075 (passed in 2013).[5] These laws required citizens to pay taxes on transactions and economic activity that had already occurred.

Most people consider this practice unfair, for the obvious reason that lawmakers change the taxation rules after people have already engaged in taxable activity. As the Council on State Taxation describes it:

> "Taxpayers make significant financial decisions based on the current tax laws; those decisions must not be undermined by legislation imposing new or increased tax liabilities after the fact."[6]

Unfairly changing the rules of the game

Put in simple terms, it is not fair for lawmakers to change the rules after the game has already been played. It is an obvious case of public officials using state power to pick winners and losers, and in this case taxpayers are always the losers.

The principle of tax fairness is recognized across the country. Several states prohibit retroactive laws and tax increases. Examples include Texas, Georgia and Ohio.[7] A typical example of this policy

5 E-mail to the author from Kim Schmanke, Communications Director, Washington State Department of Revenue, February 29, 2016, copy available on request.
6 "Retroactive Tax Legislation – Policy Position," Council on State Taxation, at http://www.cost.org/uploadedFiles/About_COST/Policy_Statement/RetroactiveTaxLegislation.pdf.
7 E-mail to the author from Kae Warnock, Policy Specialist, National Conference of State Legislatures, March 17, 2016, copy available on request.

is a provision of the constitution of Ohio:

> "The general assembly shall have no power to pass retroactive laws, or laws impairing the obligation of contracts... (Article 2, Section 28).

In Washington state, Article 1, Section 23 of the constitution prohibits ex post facto laws – that is, laws that change the legal consequences of something citizens have already done. Even so, justices on the state supreme court have recently upheld enforcement of retroactive tax increases.[8]

Protecting working families

Since people in Washington cannot depend on the supreme court to protect them against retroactive tax laws, lawmakers should stop the practice of passing such laws in the first place. Ending retroactive taxes would protect working families and business owners from being faced with tax burdens they did not expect. It would also make Washington's workplaces and business climate more fair, since people would be taxed only on what they do in the future, not on decisions they have made in the past.

8 "DOT Foods v. Washington Department of Revenue," Case No. 92398-1, Washington State Supreme Court, March 17, 2016, at http://www.courts.wa.gov/opinions/pdf/923981.pdf; and "Estate of Hambleton consolidated with Estate of Macbride v. Washington Department of Revenue, Case No. 89419-1 consolidated with No. 89500-7, Washington State Supreme Court, October 2, 2014, at http://www.courts.wa.gov/opinions/pdf/894191.pdf.

5. Policy Recommendation: Do not impose a state capital gains income tax

Some politicians have called for imposing a state capital gains income tax on the people of Washington state. The volatile history of capital gains income taxes in other states, however, shows this form of taxation does not provide a fiscally sound and secure way of financing ongoing government services.

For example, analysts at the California's Legislative Budget Office (LAO) report:

> "Probably the single most direct way to limit the state's exposure to the kind of extreme revenue volatility experienced in the past decade would be to reduce its dependence on the source of income that produced the greatest portion of this revenue volatility – namely, capital gains and perhaps stock options."[9]

Researchers at Standard and Poor's found that, "State tax revenue trends have also become more volatile as progressive tax states have come to rely more heavily on capital gains from top earners."[10]

Capital gains taxes are unstable

Similarly, analysts at the Washington state Department of Revenue (DOR) found that:

> "Capital gains are extremely volatile from year to year. Revenue from this proposal will depend entirely on fluctuations in the financial markets and can be expected to

9 "Revenue Volatility in California," by Elizabeth G. Hill, Legislative Analyst, California Legislative Analyst's Office, January 2005, at http://www.lao.ca.gov/2005/rev_vol/rev_volatility_012005.pdf.
10 "Income Inequality Weighs On State Tax Revenues," S&P Capital IQ, Global Credit Portal, Standard and Poor's, September 15, 2014.

> vary greatly from the amounts presented here."[11]

Supporters of a capital gains taxes call it an "excise tax" for the "privilege of selling or exchanging long-term capital assets," but it is actually a tax on income. None of the states that do not have an income tax have a capital gains tax. This is likely because capital gains are considered income, and that taxing capital gains is the same as taxing income.

Officials point to the benefit of no state capital gains income tax

Washington officials recognize the public benefit of not taxing capital gains. The state Department of Commerce noted that in Washington:

> "We offer businesses some competitive advantages found in few other states. These include no taxes on capital gains or personal or corporate income. We also offer industry-specific tax breaks to spur innovation and growth whenever possible."[12]

The experience of other states shows that capital gains tax revenue is highly volatile. If enacted in Washington, a capital gains income tax law would certainly face legal challenges for being an unconstitutional tax on income.

For these reasons lawmakers should maintain Washington's competitive advantage and not adopt a highly volatile, and likely unconstitutional, capital gains income tax.

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11 "Fiscal Note for HB 2563: Establishing a state tax on capital gains," Washington State Legislature, February 2, 2012.

12 "Choose Washington – Pro-Business," Washington State Department of Commerce, February 8, 2015 at https://web.archive.org/web/20121213195601/http://choosewashingtonstate.com/why-washington/our-strengths/pro-business/.

6. Policy Recommendation: Create a tax transparency website like the fiscal.wa.gov site

There are approximately 1,800 taxing districts in the state whose officials impose various taxes on Washingtonians.[13] There is no single resource, however, to help individuals and businesses learn which taxing districts and rates they are subject to, and how much officials in each taxing district add to their total tax burden. A typical home, for example, can be located in as many as ten different taxing districts.

To help improve the transparency of state and local taxation, state leaders should create an online searchable database of all tax districts and tax rates in the state. The database could be modeled after the state's high-quality budget transparency website: fiscal.wa.gov. If enacted by state officials, this recommendation would set up an online database where citizens could find their state and local tax rates (such as property and sales taxes) by entering a zip code, street address, or by clicking on a map showing individual taxing district boundaries.

Enhancing trust in government

An online calculator would be provided for educational purposes, to allow individuals and business owners to estimate their total tax burden and which officials are responsible for imposing it on them. To facilitate the creation and maintenance of a searchable database, taxing districts would report their tax rates to the state annually, and would report any changes within 30 days of imposing the rate changes.

A bill was introduced in 2009 to create a tax transparency

13 "Tax transparency bill introduced," by Jason Mercier, blog post, Washington Policy Center, February 26, 2009 at http://www.washingtonpolicy.org/publications/detail/tax-transparency-bill-introduced.

website, but the legislature took no further action on it.[14]

Increasing the ease of public access to state and local tax rates would enhance trust in government and increase the public's understanding of the cost of government services. Improved transparency would also facilitate meaningful tax competition among taxing districts, because taxpayers could compare different tax burdens based on where they decide to live or locate their businesses.

Additional Resources

"SJR 8208 and SJR 8209, to amend the state constitution to require a two-thirds vote in the legislature to raise taxes," Legislative Memo, Washington Policy Center, January 2016

"Proposed capital gains tax is likely an unconstitutional income tax and would be an unreliable revenue source," Legislative Memo, Washington Policy Center, March 2015

"History of Washington state tax ballot measures since 1932," Legislative Memo, Washington Policy Center, January 2012

"Tax transparency bill introduced," blog post by Jason Mercier, Washington Policy Center, February 2009

"Sound tax policy vs. retroactivity," by J.D. Foster, PhD, Tax Foundation, July 1997

14 "SB 6105: Concerning transparency in state and local taxation," Washington State Legislature, February 26, 2009 at http://apps.leg.wa.gov/billinfo/summary.aspx?bill=6105&year=2009.

THE POLICY EXPERTS

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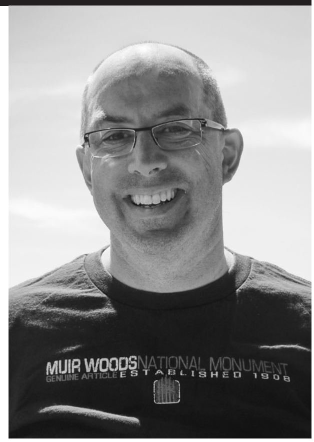

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