

## Key Findings

1. I-1107 would repeal the new excise tax on carbonated beverages (soda), sales tax on bottled water, sales tax on candy, and increased B&O taxes for certain food processors.
2. The legislature voted on the 112-page tax bill (SB 6143) on the same day the final details were made available to the public, leaving no time for public comment or input.
3. State and local taxpayers would see an estimated \$435 million in savings over the next five years if voters approve I-1107, and the state would see at least a \$55 million reduction in available revenue for the current budget and a \$218 million reduction for the 2011-13 budget.
4. Passage of I-1107 will signal the public does not want lawmakers to rely on new revenues to solve the state's ongoing fiscal crisis.
5. The failure of I-1107 will indicate the public accepts the new level of taxation and the legislative budget priorities that go with it.

## Citizens' Guide to Initiative 1107

### *To Repeal Tax Increases on Food and Beverages*

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### Introduction

In November the people of Washington will vote on Initiative 1107. The measure would repeal four of the tax increases enacted earlier this year by the legislature and signed by Governor Gregoire.<sup>1</sup> If passed in November, Initiative 1107 would repeal the following taxes:

- Excise tax on carbonated beverages (soda);
- Sales tax on bottled water;
- Sales tax on candy; and
- Increased Business and Occupation (B&O) taxes for certain food processors (narrowing of a preferential rate).

The tax on carbonated beverages (soda) is two cents per twelve ounce serving, and is scheduled to expire on June 30, 2013. The sales tax on bottled water is scheduled to expire on June 30, 2013, but could be made permanent if Referendum 52 (approving bonds for energy efficient projects) passes this November.

Passage of these tax increases was facilitated when lawmakers voted in February to suspend the state's two-third vote requirement to raise taxes.<sup>2</sup> This allowed the taxes on food and beverages to be adopted by a simple majority vote in the legislature and then sent to the Governor.

The new taxes were adopted by a vote of 52-44 in the House and 25-21 in the Senate.<sup>3</sup> These vote totals are far short of what would have been required had the two-thirds vote requirement remained in place.

If adopted by voters, Initiative 1107 would take effect on December 2, 2010, at which time these tax increases would be repealed. This paper reviews the way the legislature enacted the food and beverage tax increases, how the new taxes are being applied to different products, and the effect the initiative would have on taxpayer savings and the state budget if it is passed by voters.

<sup>1</sup> SB 6143, "Relating to revenue and taxation," passed April 12, 2010, WashingtonVotes.org, at [www.washingtonvotes.org/Legislation.aspx?ID=92888](http://www.washingtonvotes.org/Legislation.aspx?ID=92888)

<sup>2</sup> SB 6130, "Relating to fiscal matters," passed on February 22, 2010, WashingtonVotes.org, at [www.washingtonvotes.org/Legislation.aspx?ID=92872](http://www.washingtonvotes.org/Legislation.aspx?ID=92872)

<sup>3</sup> "Report on 2010 Tax Increases in Washington State," Washington Policy Center, July 15, 2010, at [http://www.washingtonpolicy.org/sites/default/files/2010GuideToTaxIncreases\\_0.pdf](http://www.washingtonpolicy.org/sites/default/files/2010GuideToTaxIncreases_0.pdf)

## Summary of Initiative 1107

The official ballot measure summary for Initiative 1107 reads:

“This measure would reverse certain 2010 amendments to state tax laws, thereby: ending the sales tax on candy and the temporary sales tax on some bottled water; and ending temporary excise taxes on the activity of selling certain carbonated beverages, not including alcoholic beverages or carbonated bottled water. It would also reinstate a reduced business and occupation tax rate for processors of certain foods.”<sup>4</sup>

The intent section of Initiative 1107 explains the reasoning behind the policy changes proposed by the measure.<sup>5</sup> Initiative supporters say:

- “The process the legislature used to increase taxes on food and beverages did not provide adequate public input or scrutiny of the proposed tax increases.”
- “The legislature’s tax increases on food and beverages arbitrarily and unfairly impose higher taxes on some food items and beverages, but not on others that are essentially the same.”
- “Taxes on food and beverages hurt all Washington consumers, and especially lower- and middle-income consumers who can least afford it.”
- “The legislature’s new tax increases come at a time when Washington residents and businesses already face an economic crisis.”

The intent section concludes with, “For these reasons, the people repeal the food and beverage taxes imposed by the 2010 legislature.”

## Level of Tax Relief and Impact on State Budget

Official estimates show state and local taxpayers would see an estimated \$435 million in savings over the next five years if Initiative 1107 is approved.<sup>6</sup> The state would see at least a \$55 million reduction in available revenue for the current budget and a \$218 million reduction for the 2011-13 budget.

The Office of Financial Management projects a \$3 billion gap for the 2011-13 budget.<sup>7</sup> Describing her plan to address this shortfall, Governor Gregoire said:

“By necessity, government must be smaller. We must make a dramatic shift in what can be expected of state government. Essential services for those most in need must continue, but it must be done as efficiently as possible. As we put together a budget that reflects our values, we will demand performance out of every program. The recovery will be long and bumpy, but we will survive this crisis and we will emerge stronger.”<sup>8</sup>

<sup>4</sup> “Proposed Initiatives to the People – 2010,” Office of the Secretary of State, at <http://www.sos.wa.gov/elections/initiatives/people.aspx>

<sup>5</sup> “Initiative Measure No. 1107,” Office of the Secretary of State, at <http://www.sos.wa.gov/elections/initiatives/text/i1107.pdf>

<sup>6</sup> “Fiscal Impact for Initiative 1107,” Office of Financial Management (OFM), at <http://www.ofm.wa.gov/initiatives/2010/1107.pdf>

<sup>7</sup> “Six-Year Outlook,” Office of Financial Management, at <http://www.ofm.wa.gov/budget/info/June2010Six-YearOutlook.pdf>

<sup>8</sup> “Gov. Gregoire announces next steps for state budget,” Office of the Governor, August 12, 2010, at <http://governor.wa.gov/news/news-view.asp?pressRelease=1557&newsType=1>

## Passage of New Tax Affected by Poor Transparency and Little Public Comment

The text of Initiative 1107 notes there was little transparency or opportunity for public debate on the taxes passed by the legislature earlier this year. The 112-page tax bill (SB 6143) was voted on by the legislature the same day the final details were made available to the public, leaving no time for public comment or input.

Here is how *Spokesman Review* capitol bureau reporter Jim Camden described the situation in the legislature when the tax bill passed:

“The public was a loser, at least the public that wanted to weigh in on the final tax package that appeared on the last day of the special session. After spending much of the previous 28 days in backroom discussions about what mix of tax hikes was acceptable to a bare minimum in the House and Senate, Democratic tax leaders rather imperiously released a take it or leave it plan in a ‘conference’ committee and insisted there was really no need to hold public hearings because everything had been discussed in one form or another at some point or another. No real reason to wait a full day before voting; not like anyone really needs to read it, let alone study it line by line.”<sup>9</sup>

This lack of transparency directly contributed to subsequent problems with implementing the tax on soda bottlers, and is one of the primary motivations behind Initiative 1107’s repeal effort.

## Soda Tax Errors Led To Veto Request

By not providing adequate time for public debate on the soda tax increase, lawmakers enacted the new tax without understanding its implications on Washington’s soda bottling industry. The legislature thought it was providing the bottling industry an exemption on the first \$10 million in sales. The problem for small bottlers, however, is they now primarily band together and act mainly as distributors, which means many of them will not qualify for the exemption . This oversight led Speaker of the House Frank Chopp to ask the governor to correct the legislature’s mistake and use her line-item veto authority to strike the soda tax from the bill. The Governor did not grant the Speaker’s veto request and the tax was enacted into law.

*Washington State Wire* reporter Erik Smith described the mix-up this way:

“Here’s what happens when you pass a soda-pop tax increase and you don’t bother with a hearing. You get a great big sticky mess. As part of their \$794 million budget-balancing tax package this year, lawmakers decided to increase the tax on soda pop by two cents a can. And when small bottlers across the state said it was a tax they couldn’t bear, lawmakers said no problem – they’d give them an exemption.

Trouble is, the Legislature didn’t understand how the industry worked. Now bottlers are foaming. They say they’re stuck with a tax break that won’t work and a tax increase that will cut deeply into their business. Lawmakers say they’re sorry, they didn’t mean it that way – and maybe they’ll fix it next year.”<sup>10</sup>

<sup>9</sup> “Looking Back,” by Jim Camden, *The Spokesman Review*, April 18, 2010 at <http://www.spokesman.com/blogs/spincontrol/2010/apr/18/wa-lege-specsess-looking-back/>

<sup>10</sup> “Soda-Pop Industry Shaken by Tax Hike,” by Erik Smith, *Washington State Wire*, April 23, 2010 at [http://www.washingtonstatewire.com/home/2500-soda\\_pop\\_industry\\_shaken\\_by\\_tax\\_hike.htm](http://www.washingtonstatewire.com/home/2500-soda_pop_industry_shaken_by_tax_hike.htm)

The soda tax was designed to stay in place at least three years; it is not scheduled to expire until June 30, 2013. Initiative 1107's repeal of the soda tax would implement the Speaker's veto request, and would save taxpayers \$109.1 million over five years.<sup>11</sup>

## Confusion over the Tax on Candy

While lawmakers were confused about the impact of their soda-tax increase, businesses and consumers are equally frustrated with the application of the new sales tax on candy.

When drafting the bill section that would extend the state sales tax to candy, lawmakers used the National Streamlined Sales Tax definition of "candy" to guide retailers about when the sales tax should be applied.

Section 901 of SB 6143 reads:

"'Candy' means a preparation of sugar, honey, or other natural or artificial sweeteners in combination with chocolate, fruits, nuts, or other ingredients or flavorings in the form of bars, drops, or pieces. 'Candy' does not include any preparation containing flour and does not require refrigeration."

To help business owners decipher which candies are subject to the new sales tax, the Department of Revenue (DOR) created a list of which sweetened products are taxable and which are exempt.<sup>12</sup>

As of August 26, 2010, DOR lists nearly 1,300 candies that are exempt and more than 11,300 products that are taxable. Following are examples of similar candy products that are taxable and exempt from tax:<sup>13</sup>

- Sweetened chocolate is taxable, but unsweetened chocolate is exempt.
- Marshmallow pieces are taxable, but marshmallow cream is exempt.
- Sweetened popped popcorn (caramel or kettle) is taxable, but unpopped popcorn sold with a packaged sweetener is exempt.
- Sweetened fruit roll ups are taxable, but unsweetened fruit roll ups are exempt.
- Brach's Chocolate Covered Raisins are taxable, but Brach's Chocolate Malted Milk Balls are exempt.
- Hershey's Reese's Peanut Butter Cup is taxable, but Hershey's Kit Kat bar is exempt.
- Mars Snickers bar is taxable, but Mars Twix bar is exempt.

These fine distinctions in the regulations have led to considerable confusion for merchants and consumers, and has resulted in customers paying sales tax on items on which no tax is owed. According to a KOMO TV News investigation:

"Stores have more to sort through since the state's candy tax took effect. Yet many merchants are overlooking the differences that make some treats taxable, and others tax-exempt. Candy made with flour is tax free, while

<sup>11</sup> "Fiscal Impact for Initiative 1107," Office of Financial Management (OFM), at <http://www.ofm.wa.gov/initiatives/2010/1107.pdf>

<sup>12</sup> "Things to know about our candy list," Find Taxes and Rates, Washington Department of Revenue at <http://dor.wa.gov/Content/FindTaxesAndRates/RetailSalesTax/Candy/Disclaimer.aspx>

<sup>13</sup> "Candy products by category," Find Taxes and Rates, Washington Department of Revenue at <http://dor.wa.gov/Content/FindTaxesAndRates/RetailSalesTax/Candy/CandyProducts.aspx>

those without are now subject to the sales tax. But our investigation found some stores ring up the 9.5% tax regardless . . . We checked, and found it's completely legal to overtax the consumer.”

‘If a retailer collects too much tax, there’s really no law against that,’ said Mike Gowrylow with the state Department of Revenue. ‘The statute is silent on it, as long as they remit that tax.’ In other words, businesses can collect tax on exempt candies and it is up to customers to catch the mistake.”<sup>14</sup>

With the need to distinguish between nearly 1,300 exempt candies and more than 11,300 similar items that are taxable, it is likely some retailers are routinely overcharging for sales tax because of the confusing nature of the new tax on candy.

The extension of sales tax to candy is a permanent tax increase and not scheduled to expire. Initiative 1107’s repeal of the sales tax on candy would save taxpayers \$195.2 million over five years.<sup>15</sup>

### **Repealing the Canned Chili Tax**

In 2005, the state Supreme Court ruled that the Department of Revenue (DOR) was too narrowly applying a reduced Business and Occupation (B&O) tax rate for businesses that process perishable meat products.<sup>16</sup>

As a result of this ruling, food processors that made products, such as canned chili, TV dinners, soups or canned spaghetti with meatballs, qualified for a reduced B&O tax rate of 0.138% instead of 0.484%.<sup>17</sup>

According to the House Democrats’ summary of their 2010 tax package, the Court’s ruling on the preferred tax rate exceeded the original intent of the legislature. The summary says:

“Current law provides a preferential tax rate for processing or wholesaling perishable meat products. In *Agrilink Foods, Inc. v. Dep’t of Revenue* the Supreme Court expanded the exemption to nonperishable finished products, such as chili and soup.

This ruling expanded the existing preference well beyond the legislature’s original intent and could potentially expand the original legislative intent for a similar exemption for processing perishable fruits and vegetables.”<sup>18</sup>

When asked why the legislature waited five years to respond to this Court ruling, the Department of Revenue said:

“In fact, the legislature considered changing the pertinent statutes both the year before and the year after the *Agrilink* decision. However, the change was characterized in the press as a tax increase on foods that were disproportionately purchased by persons with lower incomes. Interest in making the changes waned until this year when the legislature took a fresh

<sup>14</sup> “Investigation finds some tax-exempt candy still being taxed,” by Joel Moreno and KOMO News staff, August 20, 2010, at <http://www.komonews.com/news/problemsolvers/101213034.html>

<sup>15</sup> “Fiscal Impact for Initiative 1107,” Office of Financial Management (OFM), at <http://www.ofm.wa.gov/initiatives/2010/1107.pdf>

<sup>16</sup> *Agrilink Foods, Inc. v. State of Washington*, No. 74478-5, 2005, at <http://caselaw.findlaw.com/wa-supreme-court/1077220.html>

<sup>17</sup> E-mail communication with Mr. Gary Grossman, Washington Department of Revenue, August 23, 2010, copy available on request.

<sup>18</sup> “Details of House Revenue Package,” by Representative Ross Hunter, Washington State Legislature, March 1, 2010, at [http://housedemocrats.wa.gov/HouseRevenueProposal\\_Detail.pdf](http://housedemocrats.wa.gov/HouseRevenueProposal_Detail.pdf)



look at reestablishing the original legislative intent. The issue of who was impacted [by the tax increase] was not raised.”<sup>19</sup>

Whether or not the products now taxed at a higher B&O rate are more likely to be purchased by low-income people, the fact remains that some food processors will now face a higher B&O tax rate on the food they produce. Initiative 1107 would repeal the legislature’s narrowing of the tax exemption and return the tax for these processed food products to 0.138%.

The new definition of who qualifies for a preferred food processor B&O rate is a permanent change and not scheduled to expire. Initiative 1107’s repeal of the higher tax rate for some food processors would save them and their customers \$18.8 million over five years.<sup>20</sup>

## Repealing the Bottled Water Tax

The new tax on bottled water is scheduled to expire on June 30, 2013, but the tax might be made permanent if Referendum 52 is adopted by voters in November. Referendum 52 would authorize the sale of more than \$500 million in general obligation bonds in excess of the state’s constitutional debt limit to pay for various public construction projects. The measure would repeal the 2013 expiration of the bottled water tax (making it permanent) and use the revenue to pay off construction bonds.

If, however, Initiative 1107 also passes, the bottled water tax would be repealed immediately. The text of the initiative, in section 503, makes it clear that the tax will be repealed even if Referendum 52 is adopted.

Initiative 1107’s repeal of the new bottled water tax would save taxpayers \$121.3 million over five years.<sup>21</sup>

## Conclusion

There are a number of factors for voters to consider when voting on Initiative 1107. First, passage of the initiative would reduce the tax burden in Washington by an estimated \$435 million over five years. The second consideration is the estimated \$55 million reduction in available revenue for the current budget, and a \$218 million reduction for the 2011-13 budget, at a time when state officials are expecting another budget shortfall. Third is how the legislature enacted these tax increases with little transparency and minimal public comment, and whether the lack of openness should invalidate the legislature’s decision to increase the tax burden they place on citizens.

Whatever decision voters make, it will be seen as the public’s judgment on the tax increase decisions made by lawmakers in their effort to pass a balanced budget. The failure of Initiative 1107 will indicate the public accepts the new level of taxation and the legislative budget priorities that go with it. Passage of Initiative 1107, and the repeal of the latest tax increases, will signal the public does not want Olympia to rely on new revenues to solve the state’s ongoing fiscal crisis; that voters want lawmakers to control and reform state spending in order to end Washington’s recurring budget deficits.

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<sup>19</sup> E-mail communication with Mr. Gary Grossman, Washington Department of Revenue, August 26, 2010, copy available on request.

<sup>20</sup> “Fiscal Impact for Initiative 1107,” Office of Financial Management (OFM), at <http://www.ofm.wa.gov/initiatives/2010/1107.pdf>

<sup>21</sup> “Fiscal Impact for Initiative 1107,” Office of Financial Management (OFM), at <http://www.ofm.wa.gov/initiatives/2010/1107.pdf>