



## \$2 Billion in Progressive Annual Revenue for Washington

Annual State Revenue  
in \$ Millions

<b>Profitable Corporations</b>		<b>\$770 million</b>
<b>Banks and Investments</b>		<b>\$166 million</b>
<ul style="list-style-type: none"> <li>• Increase B&amp;O rate on bank services from 1.8% to 2.5%</li> <li>• Repeal B&amp;O deduction for profits on home mortgages</li> <li>• Sales tax on investment advising, planning, securities trading</li> </ul>	\$68m \$51m \$47m	
<b>Oil refineries</b>		<b>\$276 million</b>
<ul style="list-style-type: none"> <li>• Increase manufacturing and wholesaling rate (0.484% to 1%)</li> <li>• Repeal use tax exemption on extracted fuel</li> </ul>	\$250m \$26m	
<b>High tech</b>		<b>\$111 million</b>
<ul style="list-style-type: none"> <li>• Suspend sales tax deferral on construction</li> <li>• Repeal sales tax exemption on custom software</li> </ul>	\$80m \$31m	
<b>Agribusiness</b>		<b>\$73 million</b>
<ul style="list-style-type: none"> <li>• Repeal B&amp;O exemption for farms with incomes above \$200,000</li> <li>• Repeal sales tax exemption on non-organic sprays and fertilizers</li> </ul>	\$32.7 \$44.6	
<b>Corporate investment income</b> – Limit B&O deduction for investment income of non-financial firms to \$250,000		<b>\$88 million</b>
<b>Corporate and commuter jets</b> – Repeal aircraft fuel tax exemption for commercial airlines and commuter businesses	\$55.2	<b>\$55 million</b>
<b>Update interpretation of Interstate Commerce Clause</b>		<b>\$193 million</b>
<ul style="list-style-type: none"> <li>• Add PUT on instate portion of interstate transportation</li> <li>• Add PUT on through freight and shipments to ports</li> <li>• Add sales tax on items used in interstate commerce</li> </ul>	\$30.6m \$23.7m \$139m	
<b>High income/spending individuals</b>		<b>\$947 million</b>
<ul style="list-style-type: none"> <li>• <b>2% on income over \$1 million</b> for education (SB6482, HB2766)</li> <li>• <b>Capital gains</b> – 5% (exempt \$10,000 singles, \$20,000 couples) (HB2563)</li> <li>• <b>Estate Tax</b> – Increase rates by 50% (on value over \$2 million)</li> <li>• <b>Luxury tax</b> – 10% on motor vehicles, vessels and aircraft valued over \$50,000</li> <li>• <b>Trade-ins</b> – Repeal sales tax exemption</li> <li>• <b>Sales tax</b> - Change sales tax exemption for non-residents to refund (SB6061)</li> </ul>	\$185.6 \$700m \$45m \$70m \$114m \$18m	
<b>Total<sup>1</sup></b>		<b>\$1.9 billion</b>

# Details on Revenue Options

## Banks and Investments

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**Increase B&O rate on bank services from 1.8% to 2.5%** - The B&O (business and occupation) tax is Washington's basic business tax, applied at low rates to a company's total receipts.

**Repeal B&O deduction for profits on home mortgages** – Since 1970, banks and credit agencies have been allowed to deduct interest earned from loans for first mortgages on residential property before calculating their B&O tax – presumably to encourage home purchases. There is no evidence that the tax savings benefits Washington homeowners.<sup>2</sup>

**Sales tax on investment advising, financial planning, securities trading** – Washington's sales tax applies to most goods and blue collar services such as construction and repair, but not to most white collar services. Adding sales tax to these services would have minimal impact on those who invest for the long haul, but will impact those who trade frequently and speculate in financial markets. It will also expand the tax base and make the system slightly less regressive. Because a portion of sales tax goes to local governments, expanding the sales tax base also provides \$14.6 million additional revenue for local governments.

## Oil refineries

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**Increase manufacturing and wholesaling rate (from 0.484% to 1%)** - The B&O tax is Washington's basic business tax. Most activity in Washington's oil refineries is classified as manufacturing or wholesaling, which are both taxed at a rate of 0.484%. The high environmental and health costs of this industry – which are borne by the general public – justify a higher rate.

**Repeal use tax exemption on extracted fuel** – The use tax is a substitute for the sales tax, applied to items used but not purchased in the state. In the 1940s, the legislature clarified that the use tax applied to items produced for commercial or industrial use, but adopted an exemption for extracted fuel that allowed the wood product industry to manufacture fuel for use on-site without paying the use tax. Since that time, five oil refineries have opened in the state (Conoco Phillips, Tesoro, US Oil, Shell, and BP). These profitable multi-national corporations are now the primary beneficiaries of this exemption.<sup>3</sup>

## High tech

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**Suspend sales tax deferral on construction** – Sales tax applies to most construction, but a deferral/exemption for high tech companies was adopted in the early 1990s to encourage their expansion. Computing and other high tech industries are now well established in Washington and will continue to expand here without special incentives. Because a portion of sales tax goes to local governments, eliminating the exemption also provides \$25 million in additional revenue for local governments.

**Repeal sales tax exemption on custom software** – The service of customizing software is fully subject to sales tax in at least 11 states, and more extensively taxed than in Washington in 15 additional states.<sup>4</sup> This would not include “canned” software such as Microsoft products. Because a portion of sales tax goes to local governments, eliminating the exemption also provides \$10 million in additional revenue for local governments.

## Agribusiness

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**Repeal B&O exemption for farms with incomes above \$200,000** - The B&O tax is Washington's basic business tax. Farms have been exempt since the tax was adopted in the 1930s, in the midst of depression. Small family farms would continue to be exempt, but there is little rationale for continuing to exempt large agribusiness.

**Repeal sales tax exemption on non-organic sprays and fertilizers** – Repealing exemption on products not approved by the National Organic Program would encourage farmers to move more quickly to less polluting practices; would also provide revenue for local governments.

## Corporate investment income

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Businesses that receive interest, dividends, and capital gains income but are not engaged in banking or other financial activities as their primary business (generally less than 5% of annual income), may deduct that income when calculating their B&O tax. Most states tax such income through corporate income taxes. Limiting B&O deductions on investment income to \$250,000 for non-financial firms (individuals would continue to be excluded) would protect small firms and incidental investors, while more fairly taxing firms that gain substantial profits through investments.<sup>5</sup>

## Corporate and commuter jets

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Fuel purchased for aircraft owned by private individuals or businesses pay an aircraft fuel tax. Purchases for commercial flights are exempt. Initially the revenue from the tax paid for the upkeep of small, regional airports that did not receive federal funding and were used primarily by private parties. Now the revenue is used more broadly. Many other states tax such fuel.<sup>6</sup>

## Update interpretation of Interstate Commerce Clause

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**PUT on in-state portion of interstate transportation** – The Public Utility Tax (PUT) applies to public and private transportation, communications, water and energy companies instead of the B&O tax. When it was first instituted, lawmakers believed taxing any portion of transportation that crossed the state line would violate the Interstate Commerce Clause of the US Constitution. Subsequent court rulings make clear that the state can tax the portion inside the state and 46 states plus DC already apply such tax. JLARC (Joint Legislative Audit and Review Committee) recommends ending the exemption.<sup>7</sup>

**PUT on through freight and shipments to ports** – Two PUT deductions similar to the one above were enacted in 1937 specifically dealing with goods transported from one part of the state to another for storage or processing, then transported out of state. JLARC also recommends ending it.<sup>8</sup>

**Sales tax on items used in interstate commerce** – Air, rail, and water transportation companies engaged in interstate or foreign commerce are currently exempt from sales tax on fuel and other items. The U.S. Supreme Court has ruled that states may tax such items, and at least 16 do. Jet fuel is the primary potential source of revenue from ending this exemption. Because a portion of sales tax goes to local governments, eliminating the exemption also provides \$43 million in additional revenue to local governments.<sup>9</sup>

## High income/spending individuals

**Income tax over \$1 million** - SB6482 and HB2766 would establish a 2% tax on income over \$1 million, dedicated to K-4 classroom size reduction.

**Capital gains** – 5% excise tax with exemptions of \$10,000 for singles, \$20,000 for couples. With these exemption levels, the vast majority of the tax would be paid by the highest income individuals with large investment portfolios, while most middle and low income people would be exempt. Most states tax capital gains income through a state income tax.<sup>10</sup>

**Estate tax** – Washington’s estate tax applies only to the value of estates over \$2 million, at marginal rates ranging from 10% to 19% for estates worth over \$11 million. This proposal would raise marginal rates to 15% to 28.5%, retaining the \$2 million exemption. About 400 estates out of 49,000 annual deaths in the state pay the tax each year. In 2010, the federal estate tax was decreased by 11% and the threshold for taxation was increased to \$5 million. This proposed increase in the state estate tax will recoup some, but not all, of that decrease in federal revenues, dedicating it for public services in our state. Because estate taxes can be filed up to 9 months after a death, additional revenue might not be realized during the current biennium.

**Luxury tax** – 10% on motor vehicles, vessels and aircraft valued over \$50,000. The average new car in the US is under \$30,000.<sup>11</sup>

**Trade-ins** – When someone trades in a car (or boat or appliance) while purchasing a new one from a dealer, no sales tax is charged on the value of the trade-in. In private party sales of used cars, the purchaser pays sales tax on the purchase price when registering the vehicle. Typically, sellers get a better price by selling a used vehicle themselves, so trading-in is primarily a convenience, and especially benefits those who frequently buy a new car. Eliminating this exemption would primarily affect upper income people. Because a portion of sales tax goes to local governments, eliminating the exemption would provide \$35 million in additional revenue to local governments.

**Sales tax exemption for non residents** – Residents of states and Canadian provinces with sales tax rates under 3% (Oregon, Alaska, Montana, and Alberta) are not required to pay Washington sales tax. Eliminating this exemption would raise \$25 million for the state and an additional \$8 million for local governments. SB6061 would provide for a refund rather than a complete exemption, raising \$18 million for the state and \$7 million for local governments.

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<sup>1</sup> Sources: Washington Department of Revenue and “Revenue Alternatives Reviewed by Governor Gregoire.” Assumes 12 months of collection.

<sup>2</sup> <http://www.leg.wa.gov/JLARC/AuditAndStudyReports/2011/Documents/2011TaxPreferencesPreliminary.pdf# page=89>.

<sup>3</sup> <http://www.leg.wa.gov/JLARC/AuditAndStudyReports/2011/Documents/2011TaxPreferencesPreliminary.pdf# page=63>.

<sup>4</sup> Federation of Tax Administrators, Sales Taxation of Services Survey, 2007, <http://www.taxadmin.org/fta/pub/services/services.html>.

<sup>5</sup> <http://www.leg.wa.gov/JLARC/AuditAndStudyReports/2009/Documents/09-11.pdf# page=53>.

<sup>6</sup> <http://www.leg.wa.gov/JLARC/AuditAndStudyReports/2011/Documents/2011TaxPreferencesPreliminary.pdf# page=23>.

<sup>7</sup> <http://www.leg.wa.gov/JLARC/AuditAndStudyReports/2010/Documents/11-4.pdf# page=15>.

<sup>8</sup> <http://www.leg.wa.gov/JLARC/AuditAndStudyReports/2010/Documents/11-4.pdf# page=49>;

<http://www.leg.wa.gov/JLARC/AuditAndStudyReports/2010/Documents/11-4.pdf# page=61>.

<sup>9</sup> <http://www.leg.wa.gov/JLARC/AuditAndStudyReports/2009/Documents/09-3.pdf# page=201>.

<sup>10</sup> See Budget and Policy Center, “A Capital Reform: Using Capital Gains to Fuel Job Creation and Economic Prosperity in Washington State,” <http://budgetandpolicy.org/reports/a-capital-reform-using-capital-gains-to-fuel-job-creation-and-economic-prosperity-in-washington-state>.

<sup>11</sup> New York Times, <http://www.nytimes.com/2011/05/21/business/21auto.html>.