

Appendix E: Recommendations of Previous Tax Study Groups

Previous Tax Studies

As far back as the 1920s, special tax study groups have met to examine Washington's tax structure. A recommendation of the 1921 Tax Investigation Commission resulted in establishment of the State Tax Commission (predecessor to the Department of Revenue). It also called for improvements in state budgeting, changes to property and inheritance tax laws, a constitutional amendment to allow a flat tax on intangibles and repeal of the poll tax. In 1929 another Tax Investigation Commission formulated a tax proposal which included a graduated personal income tax and a corporate net income tax.

This short paper looks at “modern” efforts to review the tax system during the past 45 years. Six different groups have met and formulated recommendations, ranging from administrative changes for the tax administering agency to major tax reform proposals featuring a state income tax. Only the principal recommendations of these groups are included here. Those items which were subsequently enacted, at least partially, are indicated with an asterisk.

1957 Tax Advisory Council (TAC)

Background:

Appointed by Governor Rosellini pursuant to Chapter 43.38 RCW which was adopted in 1957 to facilitate such a tax study (this statute was repealed in 1999). The 15-member group and its eight subcommittees met from May 1957 through September 1958 to address a projected shortfall in state revenues.

Recommendations:

FISCAL ADMINISTRATION:

- Better coordination among the tax-collecting agencies of the state.
- Improved personnel administration within the Tax Commission.*
- Improved audit program within the Tax Commission including a taxpayer information program.*
- Consolidation of the property tax functions within the Tax Commission.*

- Abolishment of the State Board of Equalization.*
- Establishment of a merit system for state employment.*
- Improved state program and budgetary management, including performance budgeting.*
- Improved cash management within the State Treasury.*
- Creation of a separate Council to study state expenditures.*
- Greater flexibility for local government finance and increasing local fiscal capacity.*

TAX CHANGES:

- Rehabilitation of the property tax to improve uniformity of tax burdens and make revenues more responsive to the needs of local governments.*
- Extension of sales tax to most personal and business services.
- Extension of B&O tax to agriculture and rental of real estate.
- Increase in the state sales tax rate from 3.33 percent to 4 percent.*

Outcome:

Recommendations in the area of fiscal management led toward improvements in state budgeting and expenditure controls. For example, an expenditure advisory council was created and issued a comprehensive report in 1960. The state's first performance budget can be traced to the TAC recommendation. In 1959, the Legislature extended the B&O tax to the rental of real estate, as proposed by the TAC; however, this was overturned by the State Supreme Court. Further, in 1959 the Legislature increased the rate of the sales tax from 3.33 percent to 4 percent as recommended by the Council and began a series of base extensions to various selected services (although not to all services as proposed by the Council).

1966 Tax Advisory Council

Background:

Appointed by Governor Evans pursuant to Chapter 43.38 RCW. The 15-member group met from December 1965 through December 1966.

Recommendations:

INCOME AND EXCISE TAXES:

- Single rate personal and corporate net income tax.
- B&O tax reduced from 0.44 percent to 0.20 percent.
- B&O tax modified with the addition of a formula that considers the firm's profit.
- Sales tax rate reduced from 4.5 percent to 3.5 percent.
- Sales tax exemptions for food and prescription drugs.*
- The two mill state property tax levy returned to local government.

- Excess revenue produced by the income tax to be devoted to reducing special school levies.
- Repeal of the 1965 manufacturer's tax credit.*
- B&O minimum increased to \$10,000.*
- B&O tax extended to agricultural production.
- B&O tax extended to radio and TV broadcasting.*
- Repeal B&O deduction for processing horticultural products.
- Review of the differential public utility tax rates.

PROPERTY TAXES:

- Constitutional amendment to reduce the assessment level from 50 percent to 25 percent of true and fair value and to increase the limit on regular levies from 40 mills to 50 mills (effective rate of 1.25 percent).
- Special levies to be allowed for two years and subject to approval by simple majority.
- State to improve the uniformity of assessments and have the power to equalize property valuations among counties.*
- State to assume greater responsibility for financing basic education.*
- The 1965 property tax “freeze” law to be modified.

TAX ADMINISTRATION:

- Establishment of a Department of Revenue with a single Director to replace the three-member Tax Commission.*
- Establishment of a State Board of Tax Appeals to hear taxpayer appeals.*
- Establishment of a Tax Court to consider tax-related litigation.
- Establishment of local tax appeals boards to replace county boards of equalization.
- Calculation of a single property assessment ratio for each county with publication of the results.
- Notice to property owners of any increase in assessed values in excess of \$200.*
- Adoption of a constitutional amendment permitting current use assessment of open space, farm and timber lands.*
- A variety of miscellaneous property and excise tax recommendations.
- Creation of a permanent tax study body to report to the Governor.

Outcome:

Several of the administrative recommendations were adopted by the 1967 Legislature, including establishment of the Department of Revenue and the Board of Tax Appeals. None of the proposals involving major tax changes were enacted and nothing was submitted to the voters, except the proposal allowing current use assessment which was adopted as the 53rd Amendment in 1968.

1968 Tax Advisory Council

Background:

Appointed by Governor Evans pursuant to Chapter 43.38 RCW to continue the study begun by the 1966 Council. Most of the same 15 members from the 1966 group returned to review their earlier recommendations and formulate several new proposals. The group met from July 1967 through December 1968.

Recommendations:

Most of the 1966 recommendations were continued. One major change was to allow the single rate income tax to apply different rates to individuals and corporations. Another was to call for the total repeal of the B&O tax. Instead of outright exemption of food products from sales tax, the 1968 Council recommended a credit against the income tax equivalent to the average sales tax expenditure on food. The property tax limit was lowered to 40 mills at 25 percent assessment level (effective rate of 1 percent). Finally, the degree of reduction in the state sales tax was not specified, except the Council did state that the sales tax rate should not exceed the rate of the personal income tax.

Outcome:

The Council did not formulate a specific tax package complete with proposed tax rates. However, the 1969 Legislature, acting upon the Council's general recommendations, did develop legislation for submission to the voters. House Joint Resolution (HJR) 42 and the implementing bill, Substitute House Bill (SHB) 582, contained the following major provisions:

- Personal income tax, 3.5 percent single rate tax on adjusted gross income (AGI) less \$1,000 personal exemptions.
- Corporate net income tax of 3.5 percent.
- Per capita credit (or refund) of \$15 offsetting sales tax on food.
- Sales tax exemption for prescription drugs.
- Reduction in state sales tax rate to 3.5 percent.
- B&O tax rates reduced by 50 percent.

HJR 42 was defeated at the November 1970 election by more than a two to one margin (309,882, yes; 672,446, no).

1971 Committee for New Tax Policy

Background:

In the wake of the failure of HJR 42, Governor Evans appointed a large, 73-member citizens' group to consider the future of tax reform in Washington and develop a

proposal for the 1972 Legislature. The Committee met from October to December 1971 and held a series of public meetings throughout the state.

Recommendations:

- Eliminate special maintenance and operation (M&O) school levies.* (significant reduction later achieved)
- Exempt food and prescription drugs from sales tax.*
- Eliminate property tax on business inventories.*
- Reduce major B&O tax rates from 0.44 percent to 0.25 percent.
- Impose personal income tax with graduated rates from 2 percent to 6.5 percent.
- Impose corporate net income tax of 10 percent.

Outcome:

The Committee's proposal became HJR 82 in the 1972 session. It was modified slightly by a Legislative Ad Hoc Committee on Tax Reform during 1972 to become HJR 37 which was submitted to the voters in 1973. HJR 37 was defeated at the polls by more than a three to one margin (228,823 yes; 770,033 no) in November 1973.

1982 Tax Advisory Council

Background:

Appointed by Governor Spellman pursuant to Chapter 43.38 RCW. The 15-member group met from June through December of 1982 during the period of Washington's most severe recession in recent decades.

Recommendations:

- Single rate personal income tax based on federal AGI with substantial personal exemptions.
- Single rate corporate net income tax with credit for remaining B&O tax liability.
- Revenue neutral with income tax revenues used to reduce existing taxes.
- Maximum income tax rates to be specified in the Constitution.
- Ratio of taxes paid by individuals and businesses to remain the same.
- Food exempt from sales tax.*

In 1977, Initiative 345 passed the state providing a sales tax exemption for food products for human consumption. In 1982, the Legislature temporarily re-imposed the sales tax on food in Engrossed Senate Bill (ESB) 4250. The same bill also re-enacted the exemption on food beginning July 1, 1983. The net effect was approximately a year and a half of sales tax on food.

- Business with gross receipts less than \$2,000 per month to be exempt from B&O tax.*
Since 1979, taxpayers with gross receipts less than \$1,000 per month were exempt from B&O taxes and tax registration requirements. In 1996, the Legislature enacted HB 2789, which increased the exemption to \$2,000 per month. HB 2789 was requested by Governor Lowry.
- Manufacturers and wholesalers with no employees or place of business in Washington to be taxed at 50 percent of prevailing B&O tax rates.
- The 106 percent property tax limit on taxing district levy growth to be modified to allow all districts a minimum of two-thirds of the statutory millage rate.
- Noncommercial boats and aircraft to be exempt from property taxes but subject to a 1.0 percent excise tax.*
In 1983, the Legislature enacted ESB 3258, which provided an excise tax on noncommercial vessels and aircraft and exempted both from property taxes. Governor Spellman vetoed the aircraft excise tax sections because he felt the 1 percent excise tax rate was too high an increase.

In response, the Legislature reconvened in the 1983 2nd Extraordinary Session and enacted 2nd Re-engrossed Senate Bill 3909. This bill amended the aircraft excise tax and provided a rate table for different types of aircraft.

- Senior citizen property tax exemption to be increased and a circuit-breaker linking property taxes to household income should be considered.
- The state to assist County Assessors with annual revaluation of property.*
In 1983, the Department of Revenue adopted a new chapter of rules outlining revaluation procedures to assist County Assessors in annual revaluation. WAC 458-12-326, 327, 330, 335, 336, 337, 338, and 339 were adopted. In addition, in the mid-1990s, the Department created a Revaluation Specialist position in the Department to provide additional revaluation assistance to the Assessors.

Outcome:

The recommendations were presented as a package to the 1983 Legislature, but no bill was drafted, adopted or referred to the voters on the income tax provisions. Some of the other recommendations were enacted as described above.

1988 Governor's Committee on Washington's Financial Future

Background:

Governor Gardner appointed the 19-member group which met from April through November of 1988. In addition to examining the state tax structure, subcommittees looked at the adequacy of funding for transportation and local government finance. Also, the Committee studied ways to limit state expenditures. A series of focus groups met throughout the state to obtain input from local officials, businesses and citizens.

Tax Recommendations:

OPTION #1 (no income tax):

- Sales tax exemption for construction labor incurred by businesses.
- Exemption of first \$96,000 of gross receipts for small businesses.*
In 1994, the Legislature enacted SHB 2671, which created the Small Business Tax Credit. The maximum credit per taxpayer is \$35 per month. If the tax due exceeds the \$35 maximum credit, a reduced credit is allowed.

The Small Business Tax Credit effectively exempts the first \$90,000 of gross income for small retail businesses. Wholesale, service, and other categories of businesses are exempted from a lesser amount of gross income (\$85,000 - \$28,000 depending on the category) due to the higher tax rates for these activities.

In 1997, the Legislature enacted HB 2789, which relieved certain small taxpayers of the requirement to file tax returns. The bill established a threshold whereby taxpayers with less than \$24,000 of gross income were not required to file tax returns. This threshold was later revised to \$28,000.

- Increase B&O tax rate on services from 1.5 percent to 2 percent.*
In 1993, the Legislature enacted 2ESSB 5967, which imposed various revenue enhancement measures. One provision of the bill created a new business tax category for “selected business services” and imposed a B&O tax of 2.5 percent on these businesses. The bill also increased the tax rate on financial business services from 1.5 percent to 1.75 percent, and increased the tax rate on all other services from 1.5 percent to 2 percent. These rate increases were later repealed.

OPTION #2 (with income tax):

- Reduce state sales tax rate from 6.5 percent to 3.75 percent.
- Impose a personal income tax of 3.75 percent based on federal AGI with large personal exemptions.
- Exemption of first \$96,000 of gross receipts for small businesses.*
See above.

Outcome:

Option 2 was presented to the 1989 Legislature in the form of HB 1195, with a corresponding constitutional amendment proposal, but neither of these bills were adopted or referred to the voters.

HB 1195 was an omnibus tax reform bill with provisions implementing many of the recommendations of the Financial Futures report. The bill was heard in the House Committee on Revenue and a substitute bill passed out of the Committee with few substantive changes. The bill was not passed by the House.

HB 1195 contained:

- A personal income tax with a base rate of 4.1 percent.
- A corporate income tax with a base rate of 4.1 percent.
- A reduction in B&O and public utility taxes of 20 percent.
- Exemption of the first \$96,000 in gross receipts for small businesses.
- A reduction in the state sales and use tax rates from 6.5 percent to 4.1 percent.
- A reduction in the state property tax levy from \$3.60 per \$1,000 of assessed value to \$3.05.
- Amendments to the existing state revenue limit and reserve account.
- Other provisions regarding distribution of transportation revenues and local government taxing authority.

SB 5642 was an omnibus tax reform and transportation financing proposal. The bill was heard in the Senate Committee on Transportation and did not pass out of Committee.

SB 5642 contained:

- An increase in motor fuel tax.
- An increase in vehicle license fees.
- Authority to create regional transportation plans for cities, counties, and other interested parties.
- Authority to impose certain regional taxes to fund the transportation plans (including local motor fuel taxes).

Although the major tax reform recommendations in Option 2 were not implemented, some of the analysis in the area of state expenditures may have been instrumental in subsequent adoption of certain programs, such as the rainy day fund and the tax limitation mechanism (Initiative 601) which was approved by the voters in 1993.

* *subsequently the proposal was at least partially implemented.*