Tax Alternatives for Washington State: A Report to the Legislature

Prepared Pursuant to
Chapter 7, Section 138, Laws of 2001

By the Washington State
Tax Structure Study Committee

William H. Gates Sr., Chair

Volume 2
Appendices

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Appendix A: Statutory Authority

Section 138, Engrossed Substitute Senate Bill (ESSB) 6153

The appropriations in this section are subject to the following conditions and limitations:

$269,000 of the general fund-state appropriation for fiscal year 2002 and $49,000 of the general fund-state appropriation for fiscal year 2003 are provided solely to establish and provide staff support to a committee on taxation to study the elasticity, equity, and adequacy of the state's tax system.

(1) The committee shall consist of eleven members. The department shall appoint six academic scholars from the fields of economics, taxation, business administration, public administration, public policy, and other relevant disciplines as determined by the department, after consulting with the majority and minority leaders in the senate, the co-speakers in the house of representatives, the chair of the ways and means committee in the senate, and the co-chairs of the finance committee in the house of representatives. The governor and the chairs of the majority and minority caucuses in each house of the legislature shall each appoint one member to the committee. These appointments may be legislative members. The members of the committee shall either elect a voting chair from among their membership or a nonvoting chair who is not a member of the committee. Members of the committee shall serve without compensation but shall be reimbursed for travel expenses under RCW 43.03.050 and 43.03.060.

(2) The purpose of the study is to determine how well the current tax system functions and how it might be changed to better serve the citizens of the state in the twenty-first century. In reviewing options for changes to the tax system, the committee shall develop multiple alternatives to the existing tax system. To the extent possible, the alternatives shall be designed to increase the harmony between the tax system of this state and the surrounding states, encourage commerce and business creation, and encourage home ownership. In developing alternatives, the committee shall examine and consider the effects of tax incentives, including exemptions, deferrals, and credits. The alternatives shall range from incremental improvements in the current tax structure to complete replacement of the tax structure. In conducting the study, the committee shall examine the tax structures of other states and review previous studies regarding tax reform in this state. In developing alternatives, the committee shall be guided by administrative simplicity, economic neutrality, fairness, stability, and transparency. Most of the alternatives

presented by the committee to the legislature shall be revenue neutral and contain no income tax.

(3) The department shall create an advisory group to include, but not be limited to, representatives of business, state agencies, local governments, labor, taxpayers, and other advocacy groups. The group shall provide advice and assistance to the committee.

(4) The committee shall present a final report of its findings and alternatives to the ways and means committee in the senate and the finance committee in the house of representatives by November 30, 2002.

Appendix B: Income Tax Constitutional Issues

History of Court Decisions

In 1933, the Washington State Supreme Court overturned a graduated state income tax that had been proposed by initiative and approved by more than 70 percent of the voters. *Culliton v. Chase*, 174 Wash. 363, 289 P.2d 81 (1933). Many people assume that *Culliton* is still good law and that Washington courts would reach a similar decision today. If that is true, a constitutional amendment would be necessary before the state could impose any income tax other than a flat tax on gross income at a rate no more than 1 percent. However, there is ample reason to believe that a modern income tax, established by the Legislature or by the voters, would now be upheld. The basic reason is that *Culliton* was based on an earlier Washington case which the State Supreme Court clearly misread. More importantly, the earlier case was based on a line of United States Supreme Court cases that have subsequently been reversed. Our Court would likely take a "clean slate" approach to the income tax today.

Culliton relied on *Aberdeen Savings & Loan Assoc. v. Chase*, 157 Wash. 351, 289 P. 536, *reh'g den*. 157 Wash. 391, 290 P. 697 (1930). The lead opinion in *Culliton* stated that *Aberdeen* had held that income is property, that a tax on income must therefore be uniform, and that a nonuniform income tax violated Washington's Constitution. As it happens, *Aberdeen* did not decide that income was a form of property, at least not under the Washington Constitution. In *Aberdeen*, the plaintiffs challenged a tax on savings and loan associations that was higher than taxes on banks organized as corporations. The primary thrust of the savings and loans' challenge was that under a United States Supreme Court ruling, *Quaker City Cab Co. v. Pennsylvania*, 277 U.S. 389 (1928), the differential tax treatment of corporate and non-corporate businesses violated the U.S. Constitution's Equal Protection Clause. The plaintiffs also argued that *MacAllen Co. v. Massachusetts,* 279 U.S. 620 (1929), prohibited state taxation of federal bond interest. *Aberdeen* never discussed the issue of whether an income tax was equivalent to a property tax. In fact, the majority opinion in that case assumed that the proposed levy was an excise tax on the privilege of financial institutions to engage in business. Because the Attorney General and a 1930 Advisory Tax Commission were concerned that *Aberdeen* might be misunderstood as disapproving an income tax, they expressly asked the Court to clarify whether a determination that income was or was not property was necessary for a resolution in that case. While denying reconsideration in *Aberdeen* and a companion case, the Court said that its opinions "were rendered with a view to determining the questions present by the cases at bar, and those questions only." 157 Wash. at 392. The Court also stated that its decisions were based on United States Supreme Court precedents relating to the Equal Protection Clause. *Id.* Both in the main *Aberdeen* opinion and in the opinion denying the petitions for rehearing, the

Court took pains to emphasize that it was issuing limited rulings based on the U.S. Constitution and was not ruling on the character of the corporate tax under Washington's Constitution.

In decisions rejecting later income tax proposals, the Court repeated the mistaken view that it had treated income as property in *Aberdeen*, readopted that approach in *Culliton*, and therefore regarded the matter as settled. (*See, e.g., Jensen v. Henneford*, 185 Wash. 209, 53 P.2d 607 (1936); *Power Inc. v. Huntley*, 39 Wn.2d 191, 235 P.2d 173 (1951)). But in fact the matter had not been settled in *Aberdeen*, and the United States Supreme Court decisions relied upon in *Aberdeen* have all been reversed. Today there are only two states (Pennsylvania and Washington) whose courts have not reversed earlier decisions treating income as property. In all other states where this issue has been considered, the income tax is treated as a form of excise tax or in a category of its own. Accordingly, there is a reasonable likelihood that if the Washington State Legislature or voters enacted an income tax today, Washington's courts would approach the issue with a fresh view and might very well decide the matter in a manner consistent with the dominant view in other states with similar constitutional provisions.

(This discussion has been prepared by Committee member Hugh Spitzer, based on his article, A Washington State Income Tax—Again? 16 U. Puget Sound L. Rev. 515 (1993).)

Appendix C: Details of the Analysis

Appendix C-1

QUESTIONS RELATING TO TAX PRINCIPLES

The following questions were developed by the Committee and staff economists to direct the economic analysis of Washington's existing tax system.

In answering each of these questions the analysis will also answer further analytical questions such as: How much? Why? Is it getting better or worse? How do we compare to other states (where appropriate)?

Elasticity/Volatility

1) Do our tax revenues keep up with income?
   a) over the long run?
   b) during economic expansion?
   c) during economic downturns?

2) Have changes in our tax system such as exemptions, deductions and base broadening over the past ten years changed our elasticity?

3) Are our tax revenues stable?

Stability

1) Are our tax revenues predictable?

2) Is our tax system stable? If not, why not?

3) Has the rainy day fund been an effective tool for keeping the tax base stable?

4) How stable are the major local taxes?

5) How do changes in the state tax system affect the stability of local taxes?

Equity/Fairness

Ability to Pay

1) How regressive is our tax system (on both an income and wealth basis)?

2) Is our system regressive when looking at lifetime equity?

3) How do business taxes affect regressivity when passed through to households?

4) To what extent can households shift or export taxes (to business, the federal government, etc.)?

5) What taxes are on income, assets, and consumption?

Benefits Received

6) Do people/entities that receive benefits from the state pay a corresponding amount of tax for the benefits (who is paying taxes, how are they being spent (answer at a high level))?

7) Which of our taxes are tied to benefits received? What percentage are these taxes compared to the tax system? How does that percentage compare with the percentage of these taxes in other states?

8) Regionally, where are taxes generated, and where are they spent? (Answer to the degree that information is available.)

9) To what extent are taxes targeted and earmarked?

10) Do activities that create negative impacts pay a proportionate tax?

Horizontal Equity (Equity among similarly situated taxpayers)

11) Do similar businesses (businesses in the same industry) pay similar amounts of tax?

12) Do similar households (with similar income/household size) pay similar amounts of tax?

13) Do similar taxpayers in different locations pay significantly different taxes because of local taxes?

Perceived Equity

14) Do taxpayers think our tax system is fair?

15) Which taxes do taxpayers think are fair?

Adequacy

1) Do tax revenues keep up with, fall short of, or exceed change in personal income?

2) Do tax revenues keep up with, fall short of, or exceed the same level of services given changes in caseload levels (including school caseloads), infrastructure needs, and government administration needs?

3) Do *local* tax revenues keep up with, fall short of, or exceed the same level of services given changes in caseload levels (including school caseloads), infrastructure needs, and government administration needs?

4) Do state-required mandates decrease local government's ability to provide its core services?

5) Do tax revenues provide adequate funding for infrastructure needs such as transportation?

6) How do changes in demand for services compare to changes in personal income?

7) Does dedicated funding give policymakers the flexibility they need to respond to state and local shortages?

Economic Vitality
(Encourage commerce and business creation)

1) Do Washington taxes affect the competitive position of Washington businesses?

2) Do Washington taxes affect the ability to start and grow a new business?

3) Do Washington taxes affect the ability of established businesses to survive and grow?

4) Does our tax system (especially the B&O tax) affect businesses' ability to survive during economic downturns?

5) To what extent can Washington businesses export taxes (to their customers or to the federal government)?

6) Are Washington tax incentives effective and sufficient in encouraging firms to locate and remain in the state?

7) Do the effects of taxes on wages create a positive or negative impact on the competitive position of employers?

8) How much does the sales tax decrease in-state retail activity via leakage through remote sales and cross-border shopping?

9) What is the impact on economic vitality of government investment in education, transportation, and public infrastructure?

Economic Neutrality/Efficiency

1) Does Washington's tax structure cause Washington businesses to organize or conduct business in any inefficient ways?

2) Does Washington's tax structure affect the behavior of individuals (such as consumption or residency)?

3) What do people and businesses do to avoid taxes and how much do they do it?

4) Does the sales tax cause under-capitalization?

5) Are similar items and activities taxed equally?

Intersectoral/Vertical Equity

6) What percentage of tax is paid by businesses? By households?

7) Do big and small businesses within the same industry have similar tax burdens?

8) Do businesses in different industries have similar tax burdens?

9) Do new businesses and established businesses have similar tax burdens?

10) When new exemptions are created, do tax increases shift to other taxpayers?

11) Are our taxes administered equitably?

12) Are there any sectors or groups that don't pay a proportionate share of tax?

13) Are there significant activities that are not subject to taxation?

Transparency/"Lumpiness"

1) Does Washington have any hidden taxes?

2) Do any Washington taxes pyramid (i.e. apply layers of tax to the same item or activity)?

3) Are all tax liabilities clear to taxpayers when they make business decisions?

4) Is the timing of tax payments onerous?

Administrative Simplicity

1) Does our tax system impose record-keeping and/or paperwork obligations on taxpayers above and beyond that required for normal business operations and federal tax obligations?

2) How much does the tax system cost the state to administer compared to collections?

3) Do different local taxes cause administrative burdens for businesses located in more than one local jurisdiction?

4) Is there an additional compliance burden caused by different agencies being involved in collecting different taxes?

5) Do taxpayers and decision makers understand how our tax system works when they are voting or making tax decisions?

Harmony With Other States

1) Do incompatibilities between Washington's taxes and other states' taxes cause problems in tax equity, efficiency, economic vitality, compliance, or adequacy?

Home Ownership

1) Do taxes impede the ability to purchase and retain a home?

2) Does our tax system make the purchase of a home difficult for low-income households?

3) Does our tax system cause difficulties for fixed-income homeowners to retain their homes?

4) Do impact and mitigation fees increase the cost of homes?

Appendix C-2
DEDICATED TAX AS A PERCENT OF TOTAL TAX COLLECTIONS
1997/$Millions

State	Total Collections	Total Dedicated	Percent Dedicated	Rank
Alabama	$5,116.1	$4,460.5	87.2%	1
Nevada	2,178.4	1,404.0	64.5%	2
Tennessee	6,517.8	3,934.2	60.4%	3
Michigan	19,322.9	10,529.8	54.5%	4
Utah	3,108.0	1,684.1	54.2%	5
Montana	1,085.7	552.6	50.9%	6
New Jersey	13,008.2	6,207.4	47.7%	7
Wyoming	640.3	300.6	46.9%	8
Massachusetts	12,864.5	5,391.9	41.9%	9
New Mexico	3,542.9	1,170.3	33.0%	10
Arizona	6,783.0	2,088.6	30.8%	11
Illinois	16,882.7	5,078.7	30.1%	12
Mississippi	3,742.1	1,107.1	29.6%	13
Indiana	8,535.0	2,425.7	28.4%	14
Washington	10,482.3	2,743.7	26.2%	15
South Dakota	631.0	155.5	24.6%	16
Oklahoma	5,266.4	1,263.7	24.0%	17
Missouri	7,784.8	1,860.0	23.9%	18
North Dakota	845.3	201.7	23.9%	18
Virginia	9,116.9	2,134.5	23.4%	20
West Virginia	2,970.8	632.5	21.3%	21
Florida	19,637.3	4,105.4	20.9%	22
Ohio	16,181.4	3,217.8	19.9%	23
Idaho	1,964.2	388.0	19.8%	24
Maryland	8,216.0	1,498.9	18.2%	25
South Carolina	5,233.4	937.5	17.9%	26
Arkansas	3,917.7	643.4	16.4%	27
Oregon	4,452.1	729.4	16.4%	27
Nebraska	2,548.2	410.4	16.1%	29
Kansas	4,035.2	630.9	15.6%	30
North Carolina	12,177.6	1,852.0	15.2%	31
Vermont	822.8	122.3	14.9%	32
Kentucky	6,310.1	880.8	14.0%	33
Texas	21,187.9	2,857.4	13.5%	34
Iowa	5,205.0	672.4	12.9%	35
New Hampshire	944.5	120.2	12.7%	36
Colorado	5,076.3	612.9	12.1%	37
Louisiana	5,492.7	657.5	12.0%	38
Minnesota	10,730.6	1,287.5	12.0%	38
Maine	1,948.7	231.6	11.9%	40
New York	32,061.3	3,489.9	10.9%	41
Hawaii	3,096.0	329.7	10.6%	42
California	53,264.7	5,450.4	10.2%	43
Pennsylvania	18,168.6	1,506.0	8.3%	44
Delaware	1,758.8	138.1	7.9%	45
Wisconsin	9,627.8	762.6	7.9%	45
Rhode Island	1,588.0	123.6	7.8%	47
Connecticut	8,104.4	570.1	7.0%	48
Georgia	10,483.5	592.7	5.7%	49
Alaska	1,438.8	69.3	4.8%	50
Total	$416,098.7	$90,215.8	21.7%	

Source: Dedicated State Tax Revenues, Budget and Fiscal Research Services, Inc., June 2000

Appendix C-3

TAX VARIATION BY HOUSEHOLD INCOME AND SPENDING LEVELS

In the following four charts, the average tax interquartiles are graphed as a percent of outlays (spending) by households and household income. One can infer that sales tax has the most variation by comparing the interquartile range for all excise taxes with the interquartile range for property tax. There is more variation in all excise taxes. Sales tax is the only excise tax that is large enough to affect variation for individuals.

Chart 1

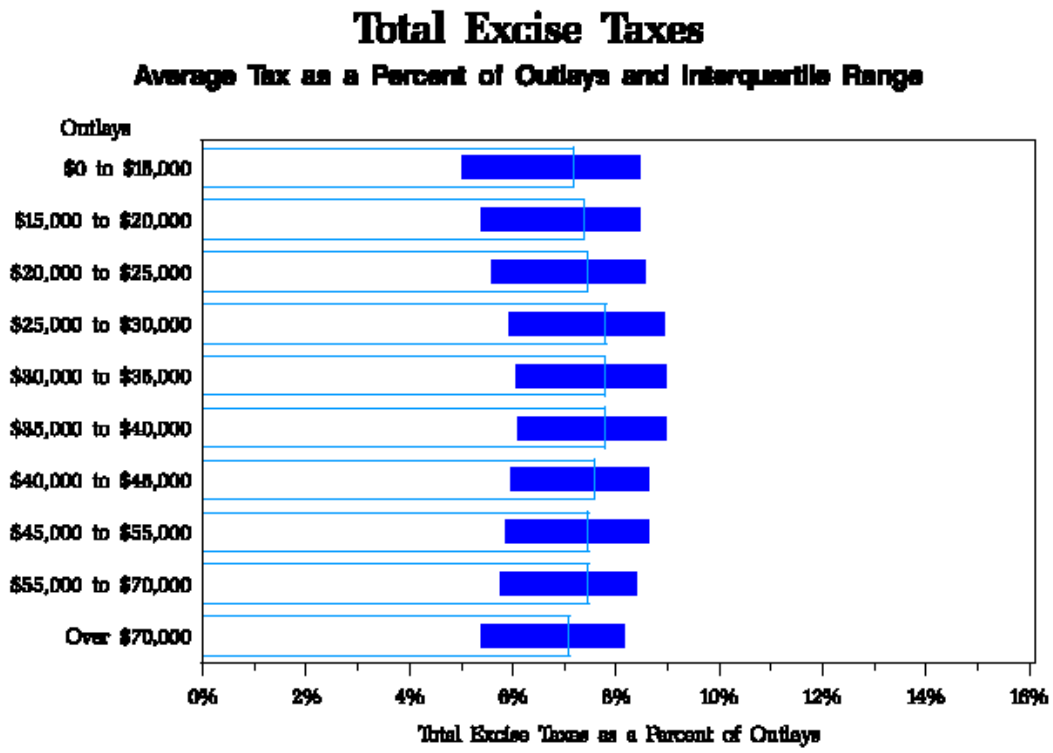


Chart 2

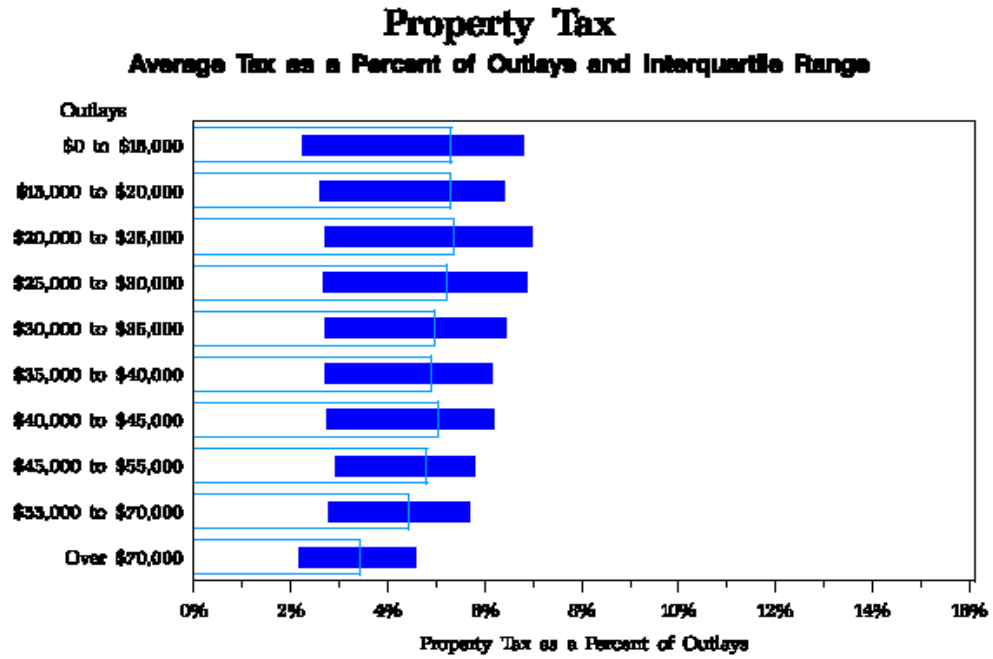


Chart 3

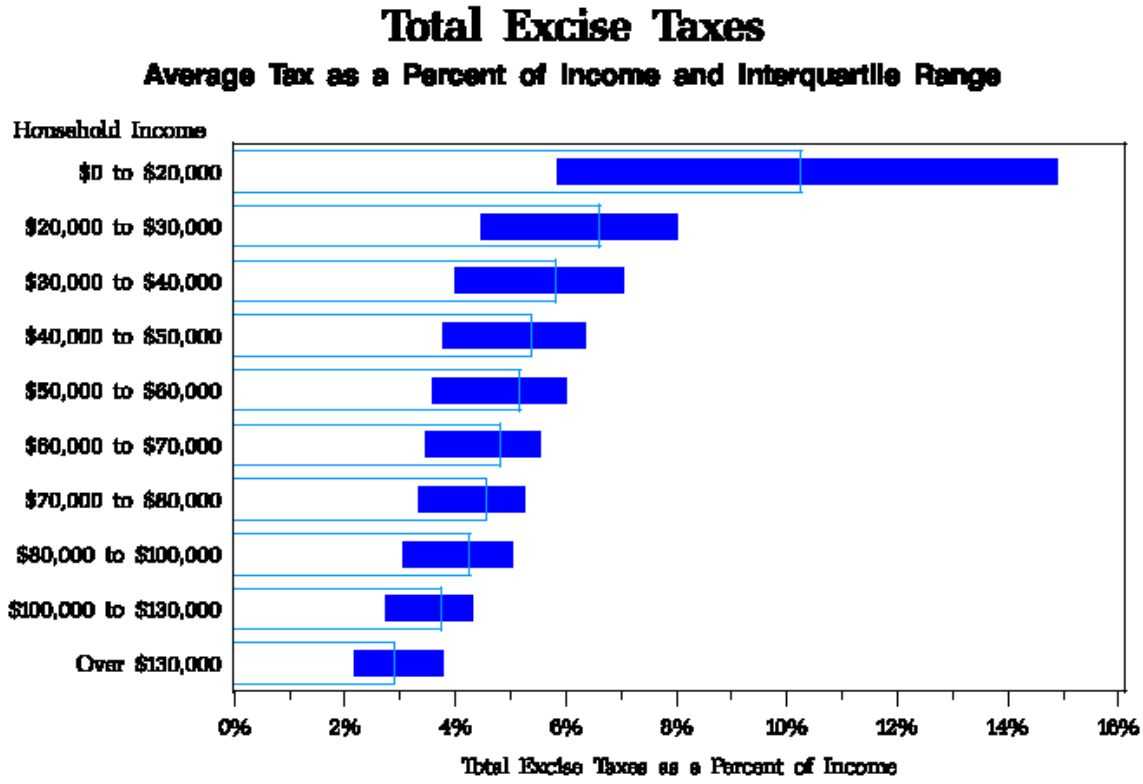
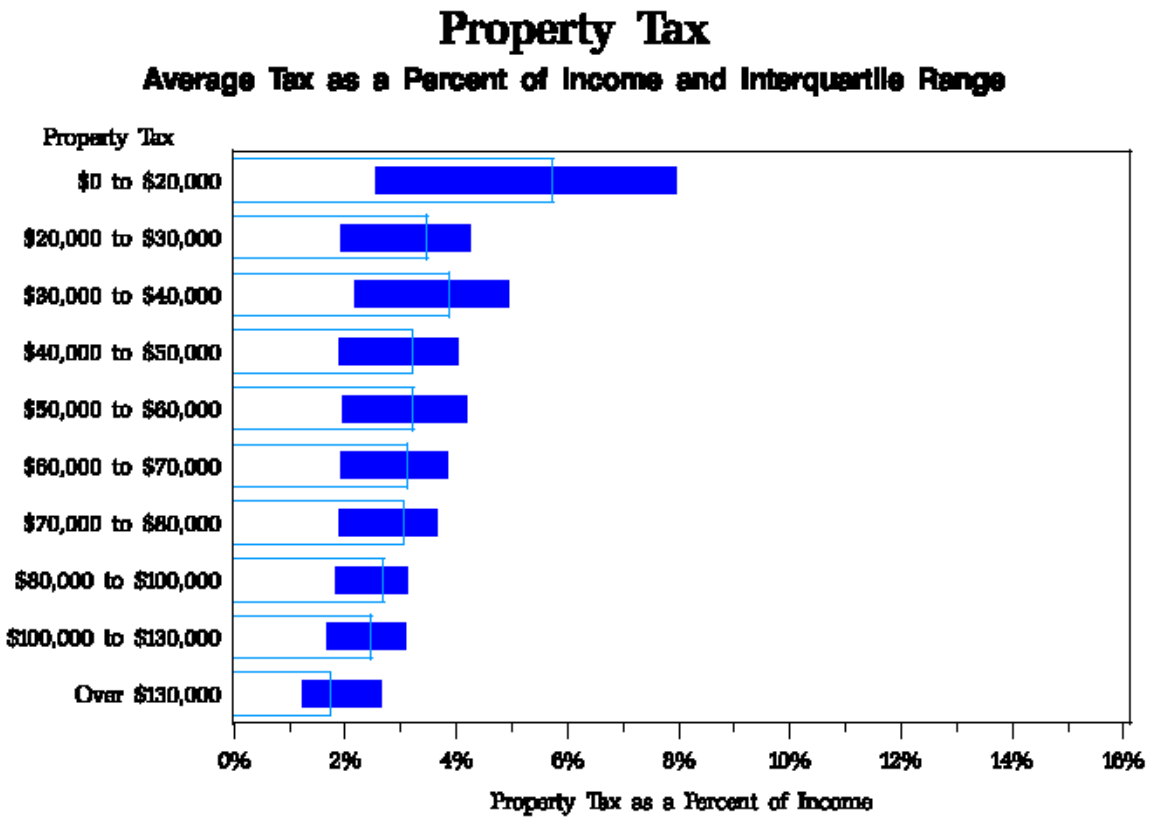


Chart 4



Source: Washington Excise Tax Microsimulation Model, April 29, 2002

Appendix C-4

TAX INCIDENCE INCLUDING FEDERAL INCOME TAX

The following tables show tax incidence for households at different income levels. Table 1 shows state and local taxes as a percentage of income for hypothetical households in Washington State compared to average taxes for 50 states plus the District of Columbia. (This data is from the study, *Tax Rates and Tax Burdens In The District of Columbia – A Nationwide Comparison: 2000*.) Table 2 shows state and local taxes plus federal income tax as a percentage of income. (Federal income taxes for the hypothetical households were calculated using data provided in the Washington, D.C. study.)

State and local taxes in Washington are regressive. They are also more regressive than the average taxes for all states. When federal income taxes are added, the total tax burden in Washington is progressive. Although the total Washington tax burden is not as progressive as the total average tax burden for all states, the difference between Washington and the U.S. average is not as great when federal taxes are added as when only state and local taxes are included.

Table 1

State and Local Taxes as a Percentage of Household Income Washington State Compared to the Mean of All 50 States Plus the District of Columbia

	$25,000 HH Income	$50,000 HH Income	$75,000 HH Income	$100,000 HH Income	$150,000 HH Income
State and Local Taxes for Washington State	8.5%	6.3%	6.3%	6.0%	5.8%
Mean State and Local Taxes for 50 States and DC	8.0%	8.0%	8.8%	9.0%	9.1%

Table 2

State and Local Taxes Plus Federal Income Tax
as a Percentage of Household Income
Washington State Compared to the Mean of All 50 States
Plus the District of Columbia

	$25,000 HH Income	$50,000 HH Income	$75,000 HH Income	$100,000 HH Income	$150,000 HH Income
State, Local and Federal Taxes for Washington State	12.3%	15.5%	17.8%	20.5%	23.3%
Mean State, Local and Federal Taxes for 50 States and DC	11.9%	17.2%	20.2%	23.4%	26.6%

Appendix C-5

SIMILAR ITEMS OR ACTIVITIES TAXED DIFFERENTLY

The following table describes examples of situations where similar items or activities are taxed differently.

Activity	B&O Tax Application	B&O Tax Rate (%)	Sales/Use/ Other Tax?
1. Movie rental	Retail	0.471	Sales tax
Movie ticket	Service	1.5	Exempt
2. Motor transportation (inter-city)	PUT	1.9	N/A
Urban transportation (within city limits)	PUT	0.6	N/A
3. Natural gas purchased from out-of-state supplier	N/A	N/A	Brokered natural gas tax
Electricity purchased from out-of-state supplier	N/A	N/A	Exempt
4. Food purchased from a restaurant	Retail	0.471	Sales tax
Food purchased from a grocery store	Retail	0.471	Exempt
Food purchased from a vending machine	Retail	0.471	57% taxable, 43% exempt
5. Wireless phone service	Retail	0.471	Sales tax
Nonresidential phone service (e.g. business, government)	Retail	0.471	Sales tax
Local residential phone service	Retail	0.471	Exempt
Long distance residential phone service	Retail	0.471	Sales tax
Coin-operated phone service	Retail	0.471	Exempt
6. Oil transported into WA via ships	N/A	N/A	Oil spill tax
Oil transported into WA via pipelines	N/A	N/A	Exempt

1. Movie rentals are retail sales. Movie rental businesses must collect and remit retail sales tax from persons who rent movies.
Movie theaters are service businesses. Movie tickets are not retail sales and are not subject to retail sales tax.

2. The motor transportation business consists of operating any motor propelled vehicle for the purpose of conveying persons or property for hire.
The urban transportation business consists of operating any motor propelled vehicle for the purpose of conveying persons or property for hire, except that the business must operate entirely within the corporate limits of any city or town, or within five miles of the corporate limits.
The same company is often engaged in both business activities and must determine its taxability on a trip-by-trip basis.

3. Natural gas purchased from an out-of-state supplier and brought into the state via one's own pipelines is subject to the brokered natural gas tax (a tax similar in structure to the use tax).
Electricity purchased from an out-of-state supplier and brought into the state via one's own wires is not subject to any form of use tax.

4. Food purchased from a restaurant or sold for immediate consumption is subject to the retail sales tax.
Food purchased from a grocery store is not subject to retail sales tax. However, food prepared "on site" at a grocery store by a person with a food handler's permit (salads, sandwiches) is subject to sales tax.
A specified percentage of food purchased from a vending machine is subject to the retail sales tax (57 percent taxable, 43 percent exempt). This percentage calculation is only applied to vending machines that sell only food. Vending machines that sell entirely taxable items (hot coffee, sodas) are subject to the full retail sales tax.

5. Cellular phone service is a retail service and subject to retail sales tax.
Nonresidential phone service (to businesses and government) is also a retail service and subject to sales tax.
Local residential phone service is a retail service but is exempt from retail sales tax.
Long distance residential phone service, however, is subject to sales tax.
Coin-operated phone service is also exempt from sales tax.

6. Oil and petroleum products brought into Washington via ships are subject to the oil spill tax on a per barrel basis.
Oil and petroleum products brought into Washington via pipelines are exempt from the oil spill tax.

Appendix C-6

EFFECTIVE TAX RATES BY SIZE OF FIRM
Calendar Year 2000

Table 1

Average Tax Rates by Size of Firm

STANDARD INDUSTRIAL CLASSIFICATION (SIC) CODES	LESS THAN $5,000,000	$5,000,000 TO $25,000,000	GREATER THAN $25,000,000
AG/ FORESTRY/ MINING - SICS 1-14	1.15%	1.30%	2.36%
CONSTRUCTION - SICS 15-17	1.78%	1.63%	1.81%
MANUF NONDURABLE - SICS 20-23, 26-31	1.72%	2.11%	1.58%
MANUF DURABLE - SICS 24, 25, 32-39	1.81%	1.66%	1.75%
TRANS/ COMM/ UTILITIES - SICS 40-49, 90s	2.10%	3.34%	2.52%
WHOLESALE - SICS 50-51	1.10%	0.66%	0.60%
RETAIL - SICS 52-59	2.04%	0.67%	0.62%
FINANCE/ INSURANCE/ REAL ESTATE – SICS 60-67	1.29%	1.54%	1.21%
SERVICES - SICS 70-79	2.26%	1.82%	1.63%
PROFESSIONAL SERVICES - SICS 80-89	1.84%	1.88%	1.82%

Table 2

Average Sales Tax Rates by Size of Firm

SIC CODES	LESS THAN $5,000,000	$5,000,000 TO $25,000,000	GREATER THAN $25,000,000
AG/ FORESTRY/ MINING - SICS 1-14	0.17%	0.57%	1.74%
CONSTRUCTION - SICS 15-17	0.45%	1.07%	1.27%
MANUF NONDURABLE - SICS 20-23, 26-31	0.41%	1.60%	1.10%
MANUF DURABLE - SICS 24, 25, 32-39	0.36%	1.10%	1.21%
TRANS/ COMM/ UTILITIES - SICS 40-49, 90s	0.17%	1.83%	1.05%
WHOLESALE - SICS 50-51	0.22%	0.18%	0.15%
RETAIL - SICS 52-59	0.35%	0.16%	0.11%
FINANCE/ INSURANCE/ REAL ESTATE – SICS 60-67	0.23%	0.30%	0.21%
SERVICES - SICS 70-79	0.41%	0.85%	0.81%
PROFESSIONAL SERVICES - SICS 80-89	0.30%	0.53%	0.60%

Table 3

Average B&O/Public Utility Tax Rates by Size of Firm

SIC CODES	LESS THAN $5,000,000	$5,000,000 TO $25,000,000	GREATER THAN $25,000,000
AG/ FORESTRY/ MINING - SICS 1-14	0.32%	0.55%	0.55%
CONSTRUCTION - SICS 15-17	0.42%	0.48%	0.48%
MANUF NONDURABLE - SICS 20-23, 26-31	0.41%	0.44%	0.42%
MANUF DURABLE - SICS 24, 25, 32-39	0.42%	0.48%	0.48%
TRANS/ COMM/ UTILITIES - SICS 40-49, 90s	0.93%	1.21%	1.28%
WHOLESALE - SICS 50-51	0.44%	0.46%	0.44%
RETAIL - SICS 52-59	0.41%	0.46%	0.48%
FINANCE/ INSURANCE/ REAL ESTATE – SICS 60-67	0.63%	1.11%	0.93%
SERVICES - SICS 70-79	0.72%	0.81%	0.74%
PROFESSIONAL SERVICES - SICS 80-89	0.92%	1.21%	1.12%

Table 4

Average Property Tax Rates by Size of Firm

SIC CODES	LESS THAN $5,000,000	$5,000,000 TO $25,000,000	GREATER THAN $25,000,000
AG/ FORESTRY/ MINING - SICS 1-14	0.58%	0.18%	0.06%
CONSTRUCTION - SICS 15-17	0.69%	0.08%	0.06%
MANUF NONDURABLE - SICS 20-23, 26-31	0.66%	0.07%	0.06%
MANUF DURABLE - SICS 24, 25, 32-39	0.67%	0.08%	0.06%
TRANS/ COMM/ UTILITIES - SICS 40-49, 90s	0.50%	0.30%	0.19%
WHOLESALE - SICS 50-51	0.35%	0.02%	0.01%
RETAIL - SICS 52-59	1.15%	0.06%	0.04%
FINANCE/ INSURANCE/ REAL ESTATE - SICS 60-67	0.41%	0.14%	0.08%
SERVICES - SICS 70-79	0.98%	0.17%	0.09%
PROFESSIONAL SERVICES - SICS 80-89	0.53%	0.14%	0.10%

Appendix C-7

EFFECTIVE TAX RATES OF NEW AND ESTABLISHED FIRMS
Calendar Year 2000

Table 1

Average Tax Rates of New and Established Firms

SIC CODES	NEW FIRM	ESTABLISHED FIRM
AG/ FORESTRY/ MINING - SICS 1-14	2.30%	0.93%
CONSTRUCTION - SICS 15-17	2.09%	1.67%
MANUF NONDURABLE - SICS 20-23, 26-31	2.23%	1.58%
MANUF DURABLE - SICS 24, 25, 32-39	2.39%	1.67%
TRANS/ COMM/ UTILITIES - SICS 40-49, 90s	2.31%	2.06%
WHOLESALE - SICS 50-51	1.20%	1.02%
RETAIL - SICS 52 - 59	2.99%	1.69%
FINANCE/ INSURANCE/ REAL ESTATE - SICS 60-67	1.60%	1.22%
SERVICES - SICS 70-79	2.80%	2.06%
PROFESSIONAL SERVICES - SICS 80-89	2.57%	1.67%

Table 2

Average Sales Tax Rates of New and Established Firms

SIC CODES	NEW FIRM	ESTABLISHED FIRM
AG/ FORESTRY/ MINING - SICS 1-14	0.32%	0.15%
CONSTRUCTION - SICS 15-17	0.43%	0.46%
MANUF NONDURABLE - SICS 20-23, 26-31	0.40%	0.45%
MANUF DURABLE - SICS 24, 25, 32-39	0.37%	0.38%
TRANS/ COMM/ UTILITIES - SICS 40-49, 90s	0.17%	0.18%
WHOLESALE - SICS 50-51	0.18%	0.22%
RETAIL - SICS 52-59	0.43%	0.31%
FINANCE/ INSURANCE/ REAL ESTATE - SICS 60-67	0.24%	0.23%
SERVICES - SICS 70-79	0.40%	0.41%
PROFESSIONAL SERVICES - SICS 80-89	0.35%	0.29%

Table 3

Average B&O/Public Utility Tax Rates of New and Established Firms

SIC CODES	NEW FIRM	ESTABLISHED FIRM
AG/ FORESTRY/ MINING - SICS 1-14	0.52%	0.28%
CONSTRUCTION - SICS 15-17	0.44%	0.41%
MANUF NONDURABLE - SICS 20-23, 26-31	0.42%	0.41%
MANUF DURABLE - SICS 24, 25, 32-39	0.46%	0.42%
TRANS/ COMM/ UTILITIES - SICS 40-49, 90s	0.86%	0.96%
WHOLESALE - SICS 50-51	0.37%	0.45%
RETAIL - SICS 52-59	0.47%	0.39%
FINANCE/ INSURANCE/ REAL ESTATE - SICS 60-67	0.67%	0.63%
SERVICES - SICS 70-79	0.79%	0.69%
PROFESSIONAL SERVICES - SICS 80-89	1.01%	0.90%

Table 4

Average Property Tax Rates of New and Established Firms

SIC CODES	NEW FIRM	ESTABLISHED FIRM
AG/ FORESTRY/ MINING - SICS 1-14	1.36%	0.43%
CONSTRUCTION - SICS 15-17	1.04%	0.55%
MANUF NONDURABLE - SICS 20-23, 26-31	1.17%	0.45%
MANUF DURABLE - SICS 24, 25, 32-39	1.24%	0.48%
TRANS/ COMM/ UTILITIES - SICS 40-49, 90's	0.75%	0.41%
WHOLESALE - SICS 50-51	0.53%	0.26%
RETAIL - SICS 52-59	1.98%	0.86%
FINANCE/ INSURANCE/ REAL ESTATE - SICS 60-67	0.67%	0.34%
SERVICES - SICS 70-79	1.48%	0.79%
PROFESSIONAL SERVICES - SICS 80-89	1.08%	0.40%

Appendix C-8

NONCOMPLIANCE BY INDUSTRY, AGE AND SIZE OF FIRM

Noncompliance varies by industry, size of firm and age of firm, as can be seen in the following tables. Tables are from the Department of Revenue's 1996 Compliance Study.

Table 1

Total Noncompliance by Industry

	Estimated Annual Noncompliance	Unreported Percentage of Taxable Income	Unreported Percentage of Tax Liability
Construction	$24,526,945	0.225%	3.6%
Manufacturing	16,742,878	0.033	3.5
Transport/Utility	2,500,376	0.026	0.8
Wholesale	10,075,328	0.047	3.4
Retail	29,787,124	0.091	1.5
Finance/Real	7,612,625	0.081	4.8
Service 7000	33,802,776	0.276	5.3
Service 8000	9,590,462	0.089	4.5
Other	1,087,360	0.060	3.5
Total	$145,725,874	0.081%	2.8%

As can be seen from Tables 2 and 3, new firms have a higher noncompliance rate than established firms. Ignorance of the law is the greatest reason for noncompliance, occurring 34 percent of the time. Computing errors accounted for another 26 percent of compliance errors. New firms are more likely to make these types of mistakes.

Table 2

Total Noncompliance by Age of Firm

	Estimated Annual Noncompliance	Unreported Percentage of Taxable Income	Unreported Percentage of Tax Liability
Newer Firms	$30,391,738	0.255%	6.4%
Older Firms	$115,334,137	0.050%	1.9%
Total	$145,725,874	0.081%	2.8%

Small firms are much less compliant than large firms. One reason for this is that the Department of Revenue administrative efforts such as audit and collection are less cost effective applied to small firms compared to large firms.

Table 3

Total Noncompliance by Size of Firm

Annual Gross Income $Thousands	Estimated Annual Noncompliance	Unreported Percentage of Taxable Income	Unreported Percentage of Tax Liability	Avg. Non-compliance Per Firm
$100 <	$27,805,014	1.750%	19.9%	$199
$100-500	18,067,570	0.265	4.9	331
$500-$1,000	27,402,879	0.363	8.8	1,340
$1,000-5,000	23,060,282	0.098	2.3	1,059
$5,000-10,000	6,785,258	0.036	1.3	1,200
$10,000-50,000	13,879,921	0.036	1.3	4,027
> $50,000	28,724,950	0.034	1.7	60,273
Total	$145,725,874	0.081%	2.8%	$591

Appendix C-9

SIGNIFICANT ACTIVITIES NOT SUBJECT TO TAXATION

The following is a short discussion of the major sectors of Washington's economy that are not subject to taxation, either as a tax policy choice made by the Legislature or the voters, or because of state constitutional prohibitions.

Income of Individuals

An initiative approved by the voters in 1932 (70 percent yes vote) provided for a statutory personal and corporate net income tax with rates graduated from 1 percent to 7 percent. The Washington State Supreme Court in a 5 to 4 decision in 1933 declared the statute to be unconstitutional on the grounds that income is property because the 14th Amendment states that property includes "everything, whether tangible or intangible, subject to ownership…." Article VII, Section 1, of the Constitution requires that "all taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax…."

Consequently, any income tax to be constitutional must be uniform in its application. The effective tax rate (tax as a percent of income) must be the same for all persons subject to the tax. A graduated income tax is obviously not uniform because the effective rates are different for different income classes. To the extent that a proposed income tax contains personal exemptions and deductions, they must be the same for all persons in order to have the effective rate be uniform.

In order for a nonuniform income tax to be imposed, Article VII must be amended or the Court must reverse its 1933 decision (see Appendix B). Proposed amendments to the Constitution must emanate from the Legislature (approved by two-thirds vote in each House) and be approved by the voters (majority).

Rental of Real Property

The 1959 Legislature enacted a law that imposed the B&O tax (rate 0.25 percent) on the gross income of any person, exceeding $300 per month, derived from the business of renting or leasing real estate. The law was immediately challenged and declared unconstitutional by the Washington State Supreme Court in 1960.

The Court ruled that the tax on rental income is a tax on property, not an excise tax. Furthermore, it said that it was a tax upon the real estate itself, as is, thus a second tax upon real estate (the other being the property tax itself). The Court also noted that there is no B&O tax levied on unrented real estate. Because of the exclusion of gross income of under $300 and it being a second tax on real property, the B&O tax on rental income failed to meet the uniformity requirements of Article VII.

Consequently, an amendment to Article VII would be required to impose a B&O tax on the gross income from the rental or lease of real property.

Agricultural Production

Income from growing or producing any agricultural or horticultural crop, animals, birds, fish, poultry, eggs, fur, etc. is exempt from the B&O tax if the products are sold at wholesale. The exemption does not extend to agricultural products manufactured by producers or to retail sales of agricultural products by producers.

The exemption for agricultural products is solely a legislative policy choice. It has been in law since the B&O tax was created in 1935. It was presumably enacted to aid an industry that was severely depressed in 1935. The exemption recognized low profit margins that prevailed in this industry, high transportation costs, and the fact that as a group farmers have little or no ability to affect the prices received for their products and were therefore unable to pass the cost of the tax on to their customers.

Investment Income of Nonfinancial Business

The B&O tax applies to the gross receipts derived from various business activities, including income from investments. Prior to legislation enacted in the 2002 session there was a specific deduction allowed for "amounts derived by persons, other than those engaging in banking, loan, security, or other financial businesses, from investments or the use of money as such…." None of the key terms were defined in statute.

In 1976 the Washington State Supreme Court established the principle that for the B&O tax to apply to investment income, the business' primary purpose and objective must be to earn income through the handling and investment of a significant amount of funds. The case involved a construction company, health care providers, a brewer, and others, each of which earned income through investing excess funds in instruments such as time certificates, commercial paper, stocks, bonds, real estate notes, mortgages, etc. The Court decided that these businesses were not engaging in banking, loan or security activities, nor were they "other financial businesses" within the meaning of the statute. The Court's reasoning was that earning income from investments was not their primary purpose or objective, and the amounts earned represented a very small portion of their gross receipts.

The principle established in 1976 remains in place. It is a statutory, not a constitutional, matter and could be changed by the Legislature. Legislation enacted in the 2002 session did not change this principle. The 2002 bill narrowed coverage of current law and clarified its application. The law now clearly states that income derived from the following activities are not deductible for purposes of the B&O tax: amounts received from loans or the extending of credit and amounts received by a banking, lending, or security business. Also not taxed is income from loans between subsidiary entities and a parent entity or between subsidiaries of a common parent if

such income is less than 5 percent of the gross receipts of the business. The terms "banking business," "lending business," and "security business" are defined. The previously used and confusing term "other financial business" is no longer part of the statute.

Food for Home Consumption

Passed by initiative in 1977 (54 percent yes vote), food for home consumption is exempt from state and local sales taxes. The exemption does not extend to the B&O tax. The exemption covers groceries and other unprepared food products. It does not cover items such as carbonated beverages, dietary supplements, seeds for growing plants, or any food handled on the vendor's premises which by law requires the vendor to have a food and beverage service worker's permit (prepared sandwiches, pizzas, cooked chicken, deli trays, salad bars, etc.).

This exemption lessens the regressivity of the sales tax (i.e., provides proportionately greater relief for low-income persons) and reduces the cost of essential items for household consumption. The exemption was temporarily removed in 1982 for fourteen months (May 1982 - June 1983). Twenty-eight states, including Washington, have sales tax exemptions for food.

Appendix C-10

SUMMARY OF TAXPAYER PERCEPTION SURVEYS

The following is a summary of the major findings of taxpayer surveys conducted in four states: Minnesota, Georgia, Colorado, and Tennessee. Each state asked citizens a wide variety of questions, not all related to taxation. The summary for each state centers on those questions that are most closely related to the issue of tax fairness and the characteristics of the tax system and individual tax sources that were mentioned as reasons for considering a tax as being fair or not fair. The relevant questions are either quoted or paraphrased and a summary of the answers is given.

Minnesota

The survey was prepared for the Minnesota Department of Revenue by Anderson, Niebuhr & Associates and published in August 2001. Taxes included in the survey included the state income tax, the state sales tax, and local property taxes.

Q: Compared to most other states, do you believe that, overall, Minnesota taxpayers pay much more, more, about the same, or less state and local tax?

A: Nearly one-quarter (27 percent) believed they paid much more tax and nearly half (47 percent) felt they paid more tax than taxpayers in other states.

Q: How satisfied are you with the overall tax system in Minnesota?

A: Taxpayers were most satisfied with fairness based on ability to pay (39 percent very satisfied/satisfied). However, 30 percent were dissatisfied or very dissatisfied with this aspect of the overall tax system. Taxpayers were most dissatisfied with the amount of taxes paid overall (45 percent dissatisfied/very dissatisfied). As age increased, so did their satisfaction with the amount of taxes they paid overall.

Q: How satisfied are you with the Minnesota income tax, local property taxes, and sales tax in terms of: understandability, fairness based on ability to pay, fairness based on the extent to which taxpayers are treated equally, predictability from year to year, the cost or time needed to comply, and the amount of tax paid?

A: Income Tax. Nearly six in ten (58 percent) were very satisfied or satisfied with the cost or time needed to comply. Over half (53 percent) were very satisfied or satisfied with the predictability of the income tax from year to year. Taxpayers were most dissatisfied with the amount of income taxes paid (47 percent dissatisfied/very dissatisfied) and fairness based on the extent to which all taxpayers were treated equally (39 percent dissatisfied/very dissatisfied).

A: Local Property Taxes. Over half (54 percent) were very satisfied or satisfied with their understanding of what property taxes paid for. More than four in ten (43

percent) were very satisfied or satisfied with the predictability of their property taxes from year to year. Taxpayers were most dissatisfied with the amount of property taxes paid (47 percent dissatisfied/very dissatisfied).

A: Minnesota Sales Tax. Nearly two-thirds (64 percent) were very satisfied or satisfied with the fairness of the sales tax based on the extent to which all taxpayers were treated equally. Approximately six in ten (59 percent) were very satisfied or satisfied with their understanding of what was taxed under the sales tax and its fairness based on their ability to pay. Taxpayers were the most dissatisfied with the amount of sales tax paid (33 percent dissatisfied/very dissatisfied).

Q: How satisfied are you with the amount of taxes paid?

A: Taxpayers were most satisfied with the sales tax (45 percent very satisfied/ satisfied) followed by the income tax (32 percent), local property tax (31 percent), and the overall amount of taxes paid (27 percent).

Q: How satisfied are you with fairness of taxes based on ability to pay?

A: Taxpayers were most satisfied with the sales tax (59 percent very satisfied/ satisfied), followed by the income tax (46 percent), the overall tax system (39 percent) and local property taxes (38 percent).

Q: How satisfied are you with fairness based on the extent to which taxpayers are treated fairly?

A: Taxpayers were most satisfied with the fairness of the sales tax (64 percent very satisfied/satisfied), followed by local property taxes (34 percent), the overall tax system (32 percent) and the income tax (31 percent).

Q: How satisfied are you with the predictability of taxes from year to year?

A: Taxpayers were most satisfied with the predictability of the income tax (53 percent very satisfied/satisfied), followed by local property taxes (43 percent).

Q: How satisfied are you with the understandability of taxes?

A: Residents were most satisfied with their understanding of the sales tax (60 percent very satisfied/satisfied), followed by the income tax (44 percent), and local property taxes (38 percent).

Q: How important are these tax issues to you (taxpayers treated equally, attractiveness/competitive for business, understandability, taxes based on ability to pay, raising funds for services, responsible for raising taxes for services, predictability of amount, and raising funds equally from three tax types)?

A: The issues that were most important were making sure that taxpayers were treated equally (86 percent essential/very important), followed by making Minnesota an attractive and competitive place for business (85 percent), and making sure the tax system was simple and easy to understand (83 percent). Taxpayers were least concerned about making sure the tax system raises revenue equally from income, sales, and property (49 percent essential/very important).

Colorado

The survey was conducted for the Colorado Commission on Taxation by Ciruli Associates based on a telephone survey of 902 adult residents of Colorado. The survey took place from July 30 to August 9, 2001.

Q: Among the following taxes, which, if any, are you most likely to support an increase for?

A: Topping the list of those taxes chosen was the sales tax (32 percent), followed by the gas tax (11 percent), property tax (8 percent), motor vehicle tax (6 percent), and income tax (4 percent). Some 37 percent indicated "none" and 2 percent said "I don't know" or refused to answer.

Q: What tax would you most like to be lowered?

A: The preferred choice was the income tax (38 percent), followed by the property tax (29 percent), gas tax (17 percent), sales tax (8 percent), and motor vehicle tax (4 percent).

Q: Do you consider the amount of state income tax you have to pay as too high, about right or too low?

A: The majority of people thought the amount was about right (58 percent), followed by 34 percent who thought the amount was too high.

Q: Do you consider the state income tax which you have to pay this year as fair?

A: Answering yes were 62 percent, followed by 31 percent who said no, and 6 percent who either don't pay income tax or did not know/refused to answer.

Q: Do you consider the amount of state sales tax you have to pay as too high, about right, or too low?

A: Answering too high were 42 percent, about right 53 percent, with 2 percent too low and 3 percent didn't know/refused to answer.

Q: Do you regard the state sales tax which you have to pay this year as fair?

A: Saying yes were 60 percent, 36 percent said no, and 4 percent said they didn't know/refused to answer.

Q: Do you believe the percentage of income tax that people pay on their income should be higher for taxpayers with higher income or the same percentage for all taxpayers?

A: Some 47 percent said higher, 51 percent said the same and 2 percent said they didn't know/refused to answer.

Q: At the present time, business and commercial property in Colorado pays three times the taxes as that of a private residence having the same value. Is this a good idea or not a good idea?

A: People responding that it was a good idea were 37 percent, while 51 percent said it was not a good idea. Twelve percent didn't know or refused to answer.

Q: Currently, property is taxed differently depending on its use. Agricultural property is taxed less, commercial property more, and residential property taxed in the middle. Is taxing land differently on its use fair or not fair?

A: Persons responding that it was fair totaled 69 percent, while 22 percent said it was not fair. Nine percent did not know or refused to answer.

Tennessee

Middle Tennessee State University conducts an annual telephone poll. This one was conducted February 18 through March 1, 2002 by college students. They interviewed 742 people age 18 or older who were chosen at random.

Q: In general, would you strongly favor, favor, oppose, or strongly oppose establishing a state personal income tax, or aren't you sure?

A: Only about one in four residents (23 percent) expressed support for an income tax. A clear majority (58 percent) expressed opposition, and a notable 19 percent said they weren't sure or didn't know.

Q: Would you favor enactment of an income tax if it meant ending the sales tax on groceries and lowering the sales tax on other items?

A: The proportion of supporters rose to 46 percent, and the proportion of opponents slid to 38 percent. The remaining 16 percent expressed uncertainty. Majority support came from those in the 18 to 34 age bracket and opposition outweighed support among older Tennesseans, especially those with no minor children living at home.

Q: Would you favor enactment of an income tax if the proceeds were to be used for education?

A: Fifty-two percent of state residents indicated support. Opposition held at 39 percent, and the proportion of those expressing uncertainty dropped to 9 percent. Strongest support came from college-educated individuals, especially those aged 18 to 34, particularly those who were female, and weakest support came from less-educated persons.

Q: If there is to be an income tax, should it charge everyone the same amount per dollar of income or charge wealthier people more per dollar of income than poorer people?

A: A flat income tax was the preference of 59 percent of the people. Only 36 percent would opt for a graduated income tax that would charge wealthier people more per dollar of income. Preference for a flat income tax was consistent across all income levels and varied little across most other demographic groups.

Georgia

The Georgia State Poll was a telephone survey of adults 18 and over who live in Georgia. It was conducted by the Applied Research Center of Georgia State University. Residents were randomly selected, and 782 residents were interviewed from January 18 - February 20, 2001 on a variety of public policy issues.

Q: Which of the following Georgia taxes do you think is the most fair? Choices were the state personal income tax, state corporate income tax, sales tax, property tax, and gas tax.

A: The sales tax was selected by substantially more respondents than were any other of the other taxes. Nearly 47 percent selected the sales tax, while the personal income tax was selected by 20.6 percent, followed by the property tax (12.5 percent), corporate income tax (10.5 percent), and the gas tax (9.6 percent). These results were consistent with national surveys conducted several years ago by the Advisory Commission on Intergovernmental Relations. The percentage choosing the sales tax as the most fair increased with family income, while the percentage choosing the property tax declined with family income. The percentage selecting the personal income tax was highest for the middle income group ($25,000 to $49,999) and was smallest for the highest income group ($55,000 or more).

Q: In your opinion, are the state and local taxes that the poor pay in Georgia much too high, too high, about right, too low, or much too low?

A: "Much too high" or "too high" was selected by 65 percent of the respondents. Only 7.2 percent said that the taxes on the poor were "too low" or "much too low." In general, respondents with lower family income were more likely to state that the taxes on the poor are high (69.6 percent) than respondents with higher income (52 percent). There was essentially no difference by age or by housing tenure.

Q: Would you support reducing state taxes on any of the following groups even if it meant increasing taxes on everyone else?

A: The group for which the largest percentage of the respondents said they would support a reduction was the "elderly" (66.3 percent). The "poor" received the second highest percentage (59.3 percent), followed by "families with children" (53.2 percent). Tax reductions for the "rich" received the support of 22.4 percent and only about 4 percent supported a tax reduction for all the groups. Between 24 percent and 33 percent said they would support a tax reduction for businesses. A higher percentage (48.3 percent) said they would support a tax reduction for "farmers."

Q: On a scale of 1 to 5, with 1 being Strongly Agree, please indicate how strongly you agree or disagree with each of the following statements: "The state should not collect sales tax when an item like a book is purchased over the Internet," and

"Someone who buys a book over the Internet should pay the same sales tax as someone who buys the book from a local store."

A: Almost 50 percent agreed with the first statement, while 55.4 percent agreed with the second statement. It would appear that there were substantial differences of opinion regarding the proper taxation of sales made over the Internet. Of the respondents who agreed with the first statement, 46.8 percent also agreed with the second.

Q: Respondents were asked to indicate on the same 1 to 5 scale, with 1 being Strongly Agree and 5 being Strongly Disagree, how strongly they agreed or disagreed with the following statements.

1. Property taxes should be based on the price a homeowner originally paid for the home rather than the current market price, even if that means property taxes on similar homes could be different.
2. It would be fair for the state government to give part of its state sales tax revenue to poorer municipal and county governments.
3. The state government should increase the state sales tax from the current 4 percent rate to 7 percent in order to eliminate all property taxes.
4. The federal government should replace the current personal income tax with a system in which everyone pays the same rate, i.e., a flat tax.

A: Statement 1. Fifty percent agreed with statement 1, while 32.9 percent disagreed. Among owners, 48.2 percent agreed, while 53.9 percent of renters did. The level of support was much lower than the percentage of voters who voted in favor of such a change in various counties in Georgia.

Statement 2. Fifty-five percent agreed and 20.6 percent disagreed.

Statement 3. Fifty-three percent agreed and 39.5 percent disagreed. This result reinforced that respondents thought the sales tax was the most fair tax.

Statement 4. Fifty-three percent agreed and 34.4 percent disagreed. Respondents were supportive of eliminating or at least reducing the progressivity of the income tax.

Appendix C-11

TAXATION OF EXTERNALITIES

Development Impact Fees

The Growth Management Act of 1990 authorized cities and counties in Washington State to impose fees on developers of property to mitigate the impact of new development on public infrastructure. Impact fees are most often used for such facilities as roads, water and sewer systems, and schools. The purpose and size of the fees must be reasonably related to the new development and must be used for public facilities where the benefits are reasonably related to the new development.

Development impact fees appear to be the most prevalent and the highest in King County where school fees can be as high as $4,186 per dwelling and transportation mitigation fees can be as high as $7,535 per dwelling in a residential development.

Environmental Taxes

Washington State has several taxes that are imposed on activities perceived to be harmful to the environment. Revenues from these taxes are dedicated to programs designed to reduce these externalities. The following table shows Washington's taxes on externalities, the incidence of the tax, and the purpose for which the funds are dedicated.

Type of Tax	Incidence of the Tax	Dedicated Purpose of Tax
Petroleum Products Tax	Possession of petroleum products	Pollution Control Liability Fund and Fund Insurance related to leakage of underground storage tanks
Oil Spill Tax	Reception of crude oil or petroleum products at a marine terminal from a waterborne vessel	Oil spill response programs and oil spill clean up
Hazardous Substance Tax	First possession of certain "hazardous" items within the state	State and local hazardous waste management projects
Solid Waste Collection Tax	Use of services of a solid waste collection business	Local government public works projects
Litter Tax	Sale of targeted items deemed most likely to contribute to litter, such as food and beverage products, and paper products	Youth litter patrol programs and education programs relating to litter control and recycling
Wood Stove Fee	Sale of a wood stove	Education about effects of wood stove smoke on air quality

Washington is not alone in the imposition of taxes on externalities. As of 2001, 40 states imposed one or more taxes specifically designed to generate revenue from activities that are perceived harmful to the environment. Taxes that are imposed by other states but not imposed by Washington State include: hazardous waste taxes, taxes on underground storage tanks, nuclear facility and waste fees, sewerage, and tire taxes.

Appendix C-12

EFFECTIVE TAX RATES ON VALUE ADDED AND THE DEGREE OF PYRAMIDING IN THE GROSS RECEIPTS TAX

I. Methodology

Gross receipts tax rates are converted into effective tax rates on value added with the use of input-output data from the Washington State Implan model. The ratio of those two tax rates can be used to measure the degree of pyramiding of the gross receipts tax.

The input-output model provides state specific estimates of business-to-business purchases. This information is used to "push down" gross receipts taxes on business purchases by attributing the taxes to producing sectors according to their sales to businesses.

II. Input-Output

Define:

Y_i = the total value of output for industry sector i,
V_i = the total value added by industry i,
y_{ij} = the value of intermediate output purchased by industry i from industry j,
$\alpha_{ij} = y_{ij} / Y_j$, where $0 \leq \alpha_{ij} \leq 1$, and
t_i = the gross receipts tax rate for industry i, where $0 \leq t_i \leq 1$; t_i is calculated by dividing each sector's total tax payment by that sector's total tax base.

V_i, the value added by sector i, is the contribution to the output's final value and is comprised of employee compensation, proprietor income, other property income, and indirect business taxes (the last component refers to most non-income taxes).

An input-output representation of the economy may be expressed by

$$
\begin{aligned}
Y_1 &= y_{11} + y_{12} + \ldots + y_{1n} + V_1 \\
Y_2 &= y_{21} + y_{22} + \ldots + y_{2n} + V_2 \\
&\vdots \qquad\quad \vdots \qquad\quad \vdots \\
Y_n &= y_{n1} + y_{n2} + \ldots + y_{nn} + V_n \, .
\end{aligned} \tag{1}
$$

Or, more generally

$$
Y_i = V_i + \sum_j \alpha_{ij} Y_j \, . \tag{2}
$$

Note that household purchases and other components of final demand are not represented because gross receipts taxes are assumed to be paid by businesses.

Equation (1) can be solved for V_i and manipulated to derive a set of simultaneous linear equations. First, α_{ij} can be substituted for y_{ij} / Y_j using the fact that $y_{ii} = (y_{ii} / Y_i)Y_i$. After Y_i is factored from $(Y_i - \alpha_{ii}Y_i)$ in each row the system may be written

$$
\begin{aligned}
V_1 &= (1 - \alpha_{11})Y_1 - \alpha_{12}Y_2 - \ldots - \alpha_{1n}Y_n \\
V_2 &= - \alpha_{21}Y_1 + (1 - \alpha_{22})Y_2 - \ldots - \alpha_{2n}Y_n \\
&\vdots \quad\quad \vdots \quad\quad\quad \vdots \quad\quad\quad \vdots \\
V_n &= - \alpha_{n1}Y_1 - \alpha_{n2}Y_2 + \ldots + (1 - \alpha_{nn})Y_n \, .
\end{aligned} \tag{3}
$$

Or, in matrix form

$$
\begin{bmatrix} V_1 \\ V_2 \\ \vdots \\ V_n \end{bmatrix} = \begin{bmatrix} (1 - \alpha_{11}) & - \alpha_{12} & \ldots & - \alpha_{1n} \\ - \alpha_{21} & (1 - \alpha_{22}) & \ldots & - \alpha_{2n} \\ \vdots & \vdots & \ddots & \vdots \\ - \alpha_{n1} & - \alpha_{n2} & \ldots & (1 - \alpha_{nn}) \end{bmatrix} \begin{bmatrix} Y_1 \\ Y_2 \\ \vdots \\ Y_n \end{bmatrix} . \tag{4}
$$

III. Gross Receipts Taxes

Calculated gross receipts tax rates, t_i , can be included in a similar fashion[1]. Hence equation (2) becomes

$$
\tilde{Y}_i = (1+t_i)\,(V_i + \sum_j \alpha_{ij}\tilde{Y}_j) \tag{5}
$$

where $\tilde{Y}_i$ = the value of industry i output, now explicitly including pyramided gross receipts taxes with rates of t_i. This system can likewise be written in matrix form similar to equation (4), as shown in equation (6) below.

[1] It is assumed that the original input-output data includes no gross receipts taxes. Alternatively, it can be assumed that we are modeling an incremental change in gross receipt tax rates. Tax rates are calculated with actual DOR collections and tax base for each sector.

(6)

$$\begin{bmatrix} [1 - \alpha_{11}\ (1 + t_1)] & -(1 + t_1)\,\alpha_{12} & \dots & -(1 + t_1)\,\alpha_{1n} \\ -(1 + t_2)\,\alpha_{21} & [1 - \alpha_{22}\ (1 + t_2)] & \dots & -(1 + t_2)\,\alpha_{2n} \\ \vdots & \vdots & \ddots & \vdots \\ -(1 + t_n)\,\alpha_{n1} & -(1 + t_n)\,\alpha_{n2} & \dots & [1 - \alpha_{nn}\ (1 + t_n)] \end{bmatrix} \begin{bmatrix} \tilde{Y}_1 \\ \tilde{Y}_2 \\ \vdots \\ \tilde{Y}_n \end{bmatrix} = \begin{bmatrix} (1 + t_1)\,V_1 \\ (1 + t_2)\,V_2 \\ \vdots \\ (1 + t_n)\,V_n \end{bmatrix}$$

call this matrix **A** .

To solve for output with gross receipts taxes, $\tilde{Y}_i$, take the inverse of matrix **A**

(7)
$$\begin{bmatrix} \tilde{Y}_1 \\ \tilde{Y}_2 \\ \vdots \\ \tilde{Y}_n \end{bmatrix} = \mathbf{A}^{-1} \begin{bmatrix} (1 + t_1)\,V_1 \\ (1 + t_2)\,V_2 \\ \vdots \\ (1 + t_n)\,V_n \end{bmatrix} .$$

IV. The Effective Tax Rate on Value Added

The effective tax rate on value added can be thought of as the incremental difference in the value of output when gross receipts taxes are added to the system, as related to value added. For industry i the effective tax rate on value added can be defined as

(8) $$\tau_i = (\tilde{Y}_i - Y_i) / V_i .$$

Table 1 presents τ_i , the effective tax rate on value added, for the 37 industry groupings that comprise the productive sectors (the "non-productive" sectors, such as general government and households, have no value added).

Also shown in Table 1 are:

t_i , the gross receipts tax rate calculated with actual tax collections and tax base,
V_i , value added,
Y_i , the original output vector, and
$\tilde{Y}_i$, industry output including pyramided gross receipts taxes.

Table 1 shows τ_i , the effective tax rate on value added, immediately following the four columns listed above. For Washington State as a whole, the effective tax rate on value added is shown to be 1.53 percent.

V. Pyramiding of the Gross Receipts Tax

Pyramiding of the gross receipts tax can be measured by dividing the effective tax rate on value added, τ_i , by the rate calculated with actual collections and tax base, t_i , or

(9) The Degree of Pyramiding = τ_i / t_i .

The degree of pyramiding for each industry is presented in the last column in Table 1, from greatest to least. The measured degree of pyramiding statewide is 2.5. This is similar to other, back-of-the-envelope, DOR calculations for gross receipts tax pyramiding.

IV. Data Sources

Tax data is from Washington State Department of Revenue sources. Implan input-output data is from the 1998 Washington State Implan model from Minnesota Implan Group, Inc.

Table 1
Effective Tax Rate on Value Added
Listed by Degree of Pyramiding

	t_i	V_i	Y_i $Millions	$\tilde{Y}_i$	Effective Tax Rate On Value Added	Degree of Pyramiding
4 MFG FOOD 20	0.30%	2,506	5,814	5,864	2.03%	**6.7**
11 MFG PETROLEUM REFINING 29	0.46%	430	1,116	1,130	3.06%	**6.7**
19 MFG AIRCRAFT & PARTS 372	0.50%	8,002	18,779	18,989	2.63%	**5.3**
12 MFG RUBBER & PLASTICS 30	0.47%	458	917	927	2.03%	**4.3**
15 MFG PRIMARY METAL 33	0.48%	883	1,705	1,723	2.00%	**4.1**
5 MFG APPAREL & TEXTILES 22-23	0.47%	324	636	642	1.95%	**4.1**
6 MFG LUMBER & WOOD PROD 24	0.48%	2,688	5,293	5,345	1.92%	**4.0**
21 MFG PROF & SCIENTFC INSTR 38	0.46%	1,004	1,918	1,936	1.83%	**4.0**
17 MFG IND/COMM/COMP M&E 35	0.49%	1,626	3,199	3,230	1.90%	**3.9**
7 MFG FURN & FIXTURES 25	0.47%	212	398	402	1.76%	**3.7**
20 MFG OTHER TRANS EQUIP 37	0.50%	854	1,650	1,666	1.85%	**3.7**
8 MFG PAPER PROD 26	0.45%	1,490	2,648	2,673	1.66%	**3.7**
14 MFG STONE/CLAY/GLASS 32	0.46%	675	1,128	1,139	1.59%	**3.4**
10 MFG CHEMICAL PROD 28	0.47%	842	1,413	1,426	1.54%	**3.3**
3 CONSTRUCTION 15-17	0.48%	11,063	19,074	19,249	1.59%	**3.3**
18 MFG ELECT M&E (NOT COMP) 36	0.49%	1,429	2,295	2,314	1.38%	**2.8**
13 MFG LEATHER ETC 31	0.51%	21	34	34	1.42%	**2.8**
35 MOVIES/AMUSE/REC 78-79	0.82%	1,700	2,835	2,873	2.25%	**2.7**
34 SVC MISC REPAIR 76	0.51%	557	859	866	1.35%	**2.7**
22 MFG MISC MFG IND 39	0.44%	575	862	869	1.16%	**2.7**
9 MFG PRINT & PUBLISHING 27	0.52%	1,340	2,039	2,057	1.35%	**2.6**
23 TRANSPORTATION ETC 40-47	0.74%	6,051	9,583	9,694	1.84%	**2.5**
2 MINING/QUARRY 10-14	0.49%	420	600	605	1.17%	**2.4**
16 MFG FABRICATED METAL 34	0.47%	1,031	1,436	1,447	1.08%	**2.3**
29 SVC LODGING 70	0.49%	1,166	1,543	1,556	1.08%	**2.2**
30 SVC PERSONAL 72	0.95%	1,107	1,638	1,660	2.04%	**2.1**
1 AG FOR FISHING 1-9	0.69%	4,847	6,764	6,831	1.39%	**2.0**
33 SVC AUTO REPAIR,SERV 75	0.49%	1,732	2,245	2,261	0.96%	**2.0**
24 COMMUNICATIONS 48	0.61%	5,608	7,455	7,521	1.18%	**1.9**
26 WHOLESALE TRADE 50-51	0.46%	13,090	16,556	16,673	0.89%	**1.9**
37 LEGAL/ENG/ACCT 81-89	1.14%	9,966	13,817	14,023	2.07%	**1.8**
32 SVC BUSINESS 73	0.95%	3,487	4,516	4,571	1.58%	**1.7**
27 RETAIL TRADE 52-59	0.47%	17,614	20,535	20,668	0.75%	**1.6**
36 SVC MEDICAL & HEALTH 80	1.25%	9,801	12,563	12,755	1.95%	**1.6**
28 FIRE 60-67	0.95%	31,021	38,511	38,969	1.48%	**1.6**
25 ELECTRIC,GAS&OTHER UTIL 49	2.14%	2,852	3,716	3,808	3.22%	**1.5**
31 SVC COMP/DATA/PROC 737	0.91%	10,510	12,313	12,445	1.26%	**1.4**
Total State	0.61%	158,980	228,401	230,841	**1.53%**	**2.5**

Notes:

$\tilde{Y}_i$ = industry output including pyramided gross receipts taxes, calculated here.

Y_i = the original industry output vector, from the WA State Implan model.

V_i = value added, from the WA Implan model.

t_i = gross receipts tax rates calculated with actual DOR tax collections and tax base.

The estimated degree of pyramiding is the effective tax on value added divided by t_i .

Appendix C-13

HYPOTHETICAL FIRM ANALYSIS

Tax Rankings for the Warehouse and Distribution Industry

The following information is derived from the *Warehouse and Distribution Study*, Washington State Department of Revenue Research Division, December 1996. Each warehouse is assumed to be new in the first of the ten analysis years. All of the firms in this example are assumed to export 80 percent of their goods. For each of the warehouses, essentially only the warehouse activity is taxed. Taxes that are related to other aspects of the firm's operations are not directly included in this analysis. However, in income tax states, the change in the firm's income tax liability caused by the increase in in-state property and payroll is included in the total tax liability.

The analysis of Washington taxes is updated to include major tax changes since 1996, including repeal of the motor vehicle excise tax.

Industries included:

- Third party warehouse
- Warehouse owned by a wholesaler
- Warehouse which is a fully owned subsidiary of a large regional retail distributor

Comparative states: 8, including Washington:

- Oregon
- Idaho
- California
- Nevada
- Louisiana
- Texas
- Utah
- WASHINGTON

Taxes included:

- Gross Receipts
- State Income Tax
- Unemployment Insurance
- Industrial Insurance
- State and Local Property Tax
- State and Local Sales and Use Tax
- Motor Vehicle Excise Tax on Trucks

Table 1

Washington's Tax Burden Rank Out of Eight States
Based on 10-year Net Present Value (NPV) Taxes for Hypothetical Warehouse and Distribution Firms
Rank 1=Lowest Tax, Rank 8=Highest Tax

Industry	Washington Tax Rank (out of 8 states)
Third Party Warehouse	2
Wholesaler	3
Large Retailer	2

Tax Rankings for Other Washington Industries with Competitors in Other States

The following information comes from the study, *Tax Incentive Comparison of Six States and One Province*, by the Washington State Department of Revenue Research Division, 1999. Net present value is calculated for firms over a period of 20 years.

Industries included:

- Semiconductor Manufacturer
- Biotech Integrated
- Biotech R&D Only
- Small Software Originator
- High Tech Call Center

Comparative states: 7, including Washington

- Arizona
- British Columbia
- California
- New Mexico
- Oregon
- Utah
- WASHINGTON

Taxes included:

- Gross Receipts
- State Income Tax
- Unemployment Insurance
- Industrial Insurance
- State and Local Property Tax
- State and Local Sales and Use Tax

Table 2

Washington's Tax Burden Rank Out of Seven States
Based on 20-year NPV Tax Burdens for
Hypothetical Manufacturing Firms
1 = Lowest tax; 7= Highest tax

Industry	Washington Tax Rank (out of 7 states)
Semiconductor Manufacturer	2
Biotech, Integrated	2
Biotech, R&D only	6
Software Originators	3
High Tech Call Center	4

Appendix C-14

COMPARISON OF PROFIT MARGINS OF HYPOTHETICAL FIRMS
10-year average NPV profit margins under Washington's tax system
(In parentheses are the lowest tax state and the highest tax state.)

Industry and firm type	Profit margin with WA taxes	Highest profit margin (State)	Lowest profit margin (State)
Food Processing:			
New	3.50%	3.51% (N. Carolina)	2.14% (Florida)
Established	1.14%	1.72% (Alabama)	0.91% (Florida)
Lumber and Wood Products:			
New	1.23%	2.44% (N. Carolina)	-2.24% (Colorado)
Established	2.60%	3.29% (N. Carolina)	0.81% (Colorado)
Paper Products:			
New	1.48%	2.26% (N. Carolina)	0.44% (Texas)
Established	2.40%	3.00% (N. Carolina)	2.02% (Montana)
Printing/Publishing:			
New	4.35%	4.83% (N. Carolina)	2.38% (Texas
Established	14.60%	14.60% (Washington)	12.46%(California)
Petroleum Products:			
New	-1.34%	-0.70% (N. Carolina)	-3.30% (Florida)
Established	0.51%	1.27% (N. Carolina)	0.51% (Washington)
Primary Metals:			
New	-2.61%	-1.51% (N. Carolina)	-5.39% (Florida)
Established	0.32%	1.86% (Alabama)	-0.49% (Texas)
Electrical Equipment:			
New	-4.15%	-3.28% (N. Carolina)	-4.79% (Minn.)
Established	6.45%	7.05% (N. Carolina)	5.66% (Minn.)
Aircraft and Parts:			
New	1.97%	2.59% (N. Carolina)	0.27% (Montana)
Established	4.93%	5.33% (N. Carolina)	4.32% (Minn.)
Instruments:			
New	1.06%	1.68% (N. Carolina)	0.72% (Florida)
Established	6.89%	7.38% (Alabama)	5.67% (Montana)
Computer Software:			
New	7.69%	7.78% (N. Carolina)	7.00% (California)
Established	3.20%	3.40% (N. Carolina)	2.84% (Florida)

Appendix C-15

FACTORS THAT INFLUENCE BUSINESS LOCATION

	Transportation & Infrastructure			*Other Factors that Government May Influence*						*Direct Governmental Factors*				*General*
	Transportation			TeleComm	Higher Ed	Skilled	Research	Technical	Land	K-12	Govt.	Regulation &	Public	Tax	Market
	Land	Water	Air	& Related	/ Univ.	Workers	Labs	Asstnce.	Availability	Expend	Subsidies	Permit Costs	Safety	Factors	Factors*
Ag/Forest/ Fish/Mine	**1**	**1**	**3**	**3**	**2**	**2**	**3**	**2**	**2**	**2**	**3**	**2**	**3**	**2**	**1***
Construction	**1**	**3**	**3**	**3**	**2**	**1**	**3**	**2**	**2**	**2**	**3**	**2**	**3**	**2**	**1***
Non-Durable Manufacturing	**1**	**3**	**2**	**3**	**2**	**2**	**3**	**2**	**1**	**2**	**3**	**2**	**3**	**2**	**1***
Durable Manufacturing	**1**	**3**	**3**	**3**	**2**	**2**	**2**	**2**	**1**	**2**	**3**	**2**	**3**	**2**	**1***
Aerospace	**1**	**3**	**1**	**1**	**1**	**1**	**1**	**1**	**1**	**2**	**3**	**2**	**3**	**2**	**1***
Computer Manf/Srvcs	**2**	**3**	**1**	**1**	**1**	**1**	**1**	**1**	**2**	**2**	**3**	**2**	**3**	**2**	**1***
BioTech	**2**	**3**	**1**	**1**	**1**	**1**	**1**	**1**	**2**	**2**	**3**	**2**	**3**	**2**	**1***
Health Services	**2**	**3**	**2**	**2**	**1**	**1**	**1**	**2**	**2**	**2**	**3**	**2**	**3**	**2**	**1***
Business Services	**2**	**3**	**1**	**2**	**1**	**1**	**3**	**2**	**2**	**2**	**3**	**2**	**3**	**2**	**1***
Transport/ Comm/Util	**1**	**3**	**1**	**1**	**1**	**1**	**3**	**2**	**1**	**2**	**3**	**2**	**3**	**2**	**1***
Wholesale	**1**	**3**	**2**	**2**	**2**	**2**	**3**	**2**	**1**	**2**	**3**	**2**	**3**	**2**	**1***
Retail	**1**	**3**	**2**	**2**	**2**	**2**	**3**	**2**	**1**	**2**	**3**	**2**	**3**	**2**	**1***
Financ/Insrn Real Estate	**2**	**3**	**1**	**2**	**2**	**2**	**3**	**2**	**2**	**2**	**3**	**2**	**3**	**2**	**1***
All Other Services	**2**	**3**	**3**	**3**	**2**	**2**	**3**	**2**	**2**	**2**	**3**	**2**	**3**	**2**	**1***

Legend **1** = a fair amount of empirical evidence and a consensus concerning a factor's importance ***most important**

2 = a small amount of evidence, no clear consensus **3** = no real evidence

Appendix C-16

SHORT-RUN VOLATILITY OF TAXES AS MEASURED BY SHORT-RUN ELASTICITIES

Table 1

Estimates of Short-Run Elasticities

Tax Base	Short-Run Elasticity
Sales and Use	1.4
B&O	1.4
Property	0.2
Public Utilities	-0.2
All Taxes	1.2

The elasticities in Table 1 are estimated with respect to the business cycle that is represented by state personal income.

Table 2

Estimates of Short-Run Elasticities for Simulated Personal Income Tax (1980-2002)

Tax Base	Short-Run Elasticity
Flat personal income tax	2.0
Combination 2.3% personal income tax and 3.5% retail sales tax with food in base	1.2
Combination 2.6% personal income tax and 3.5% retail sales tax with food exempted	1.7

A history of Washington Adjusted Gross Income (AGI) was used to simulate a flat Washington personal income tax. Note that much of the volatility in AGI comes from capital gains. It is unknown whether the high growth in capital gains in the 1990s will be repeated in the future. Therefore, the historical estimates of simulated personal income tax may not be good indicators of future elasticities.

Question: Do Washington tax bases keep up with income during economic expansions or economic downturns?

Non-food retail sales and use elasticity is the most elastic (i.e. greater than 1.0) as is the B&O. The property and public utility elasticities are less elastic (i.e. less than 1.0). The weighted average short-run elasticity for all tax bases combined is 1.3 and suggests an income elastic

relationship. What this means is that in times of economic expansion, tax revenues increase faster than income; conversely, in economic downturns when income shrinks, tax revenues shrink even more.

Methodology:

A standard double log regression model was used to estimate the short-run income elasticities of the four tax bases reported in Table 1. The model is specified as follows (Holcombe and Sobel, 1993):

(1) $\text{Ln}(B_t) = \forall + \exists \ln(Y_t) + >_t$

Where B_t = the level of the tax base in time period t
Y_t = the level of personal income in period t
T_i where i=1970…….2000

Three transformations of the data in equation (1) were done before running the linear regression equations associated with each tax base. First, the nominal data in B (the tax base) and Y (personal income) were transformed to real variables using the implicit price deflator for consumer expenditures. The logs of the real variables were then taken. And, since time series data was used, the upward trend inherent in time series data was removed by taking first differences of the real variables. The transformed model becomes the following:

(2) $)\ln(B_t) = \forall + \exists)\ln(Y_t) + >_t$

The ∃ coefficients from equation 2 yield the elasticities for each of the tax bases under consideration.

Data Sources:
A constant base series covering the time period from 1970 to 2000 was used. The data were deflated using the implicit price deflator of consumer expenditures.

Reference:
Holcombe, Randall and Russell Sobel, *Growth and Variability in State Tax Revenue: An Anatomy of State Fiscal Crises*, Greenwood Press, Westport, CT, 1993, pp. 73-96.

Appendix C-17

TIME SPENT PREPARING AND FILING TAX RETURNS

Table 1

Percentage of Taxpayers that Collect and Organize Information Solely for the Combined Excise Tax Return (CETR) or for Other Reasons

	Determination of Gross Income by Tax Classification	Deduction Information	Local Retail Sales Tax Coding Information
Collect for CETR only	30.7%	36.1%	64.3%
Collect for other purposes but collect more for CETR	40.3%	26.9%	14.1%
Collect mostly for other purposes	22.4%	11.1%	1.3%
Not applicable	6.5%	25.8%	20.3%

Table 2

Hours Spent Per Reporting Period Collecting and Organizing Data, and Filling Out and Filing the CETR

Type of taxpayer	Time spent collecting and organizing data	Time spent filling out and filing CETR
Monthly	6.6 hours	4.6 hours
Quarterly	6.5 hours	3.8 hours
Annual	7.6 hours	3.6 hours

Appendix C-18

DEPARTMENT OF REVENUE COLLECTION COST BY REVENUE SOURCE – 1996

STATE TAXES	COST PER $100 COLLECTED
Retail Sales	$0.27
Use	3.06
Business and Occupation	0.75
Public Utility	1.18
Cigarette	0.28
Liquor Sales	0.03
State Property	*
Timber Excise	6.46
PUD Privilege	0.15
Leasehold Excise	3.60
Estate	0.44
Tobacco Products	2.14
Litter	12.94
Real Estate Excise	0.18
Convention Center	2.01
Hazardous Substance	4.26
Refuse Collection	2.22
Wood Stove Fee	61.22
Refuse Collection	34.23
Carbonated Beverage Syrup	3.01
Brokered Natural Gas	2.15
Oil Spill	2.94
Rental Car	2.25
State Taxes Subtotal	$0.63
LOCAL TAXES	
Sales & Use	$0.76
Transit	0.55
Criminal Justice	*0.95*
Public Facilities	6.83
Hotel/Motel	3.81
Juvenile Correctional Facilities	14.42
Rental Car - Stadium	28.25
King Co Food & Beverage	16.85
Stadium Taxes	71.86
Local Rental Car	15.59
Combined Local Excise Tax Subtotal	$1.06
TOTAL	**$0.70**

**Property taxes are collected by the county treasurers and administered by both the Department of Revenue and the county assessors.*

Appendix C-19

RETAILERS' COSTS OF COLLECTING AND REMITTING WASHINGTON STATE SALES TAX

Summary of All Costs

As a percent of total state and local sales tax collections

	Small	Medium	Large	Total, weighted by number	Total, weighted by dollars
Additional clerk/cashier hours	--	--	--	--	--
Additional/ more complex POS* equipment	1.59%	--	--	0.69%	0.06%
Additional customer service	0.15%	0.18%	0.006%	0.13%	0.03%
Additional training	--	--	--	--	--
POS rate and base changes	0.32%	0.72%	0.07%	0.42%	0.14%
Credit and debit card fees	0.89%	0.74%	0.76%	0.81%	0.76%
Total audit costs	0.012%	0.041%	0.001%	0.021%	0.006%
Storage cost	0.03%	0.02%	0.003%	0.02%	0.006%
Appeals cost	--	0.001%	0.0001%	0.0004%	0.0002%
Total cost of filing tax return	3.27%	1.35%	0.08%	1.94%	0.34%
Cost of mistakes	0.17%	0.30%	0.05%	0.20%	0.08%
Total Costs	**6.47%**	**3.35%**	**0.97%**	**4.23%**	**1.42%**
Float	0.51%	0.40%	0.40%	0.45%	0.40%
Lower B&O	0.18%	0.20%	0.23%	0.20%	0.22%
Total Benefits	**0.69%**	**0.60%**	**0.63%**	**0.65%**	**0.62%**

Table entries with no cost indicate that costs are less than 1/1,000th of a percent.

*Point of Sale

Appendix C-20

NONTRANSPARENT TAXES

Tax	Comment
Business and Occupation	The tax is paid by the business selling the good or service and may or may not be included in the purchase price. If it is passed along it is most often not itemized and therefore is not visible to the consumer.
Cigarette	The tax is imposed at the wholesale level when the stamps are purchased/applied and becomes a part of the price of the cigarettes. The amount of the cigarette tax is not apparent to the retail consumer.
Tobacco Products	The tax is paid at the wholesale level and becomes part of the retail price, not visible to the retail purchaser.
Liquor Sales	The tax is applied to the wholesale price plus markup by the Liquor Control Board (LCB). It becomes part of the retail price of the liquor and is not visible to the retail purchaser, either on purchases from the Board or from restaurants/bars.
Liquor Liter	Same comment as for Liquor Sales Tax. The tax is based on volume, not price.
Wine	Paid by manufacturers of wine sold to wholesalers, the LCB, or directly to consumers by the wineries. This volume tax is built into the price and is not visible to retail consumers.
Beer	Paid by manufacturers, on a per 32 gallon barrel basis. It is built into the price of beer and is not visible to the retail consumer.
Fuel	Paid by refiners, importers and blenders of fuel delivered to wholesalers at the terminal rack. Built into the price to the ultimate consumer and is not visible.
Local Hotel/Motel Taxes	These taxes are a credit against the state sales tax and do not increase the charge to the user of hotel/motel rooms.
Insurance Premiums	Paid by insurers and built into the cost of insurance products.
Hazardous Substance	Paid by the first (business) possessor of the hazardous substance in Washington. Built into the price of products subsequently sold and not visible to the retail purchaser.
Soft Drinks (syrup)	Collected from wholesalers or retailers of syrup used to make carbonated beverages, based on volume. The tax is built into the price of the syrup. It is not visible in the retail price of carbonated beverages, either in bottled or drink form.
Oil Spill	Paid by the owner of crude oil or petroleum products transported into Washington via ship or barge, on a gallonage basis. The tax is passed on to the ultimate consumer of the refined products and is not visible.
Local Gambling	Paid by operators of gambling establishments (card rooms, pull tabs, etc.) and built into cost of playing.
Property	Although the tax is visible to owners of property, it is not visible to renters but is often passed along to renters as part of their rental charge.

Tax	Comment
Timber	Paid by the owner of the timber once harvested and built into the cost of the timber products sold. The tax is not visible to the ultimate purchaser of timber products.
Public Utility District Privilege	Paid by districts that generate or distribute power. The tax is built into the price of the power sold to ultimate consumers.
Real Estate Excise	Paid by sellers of real property but routinely passed on to purchasers as a non-visible part of the selling price.

Appendix C-21

TAX ELASTICITY ESTIMATES

1. SUMMARY

An adequate tax system is generally considered to be one in which tax revenues keep up with the growth of the economy as measured by the change in personal income. This implies that an adequate tax system has a tax elasticity of 1.0, the tax elasticity being defined as the percentage change in taxes divided by the percentage change in personal income. The Office of Financial Management estimated that between 1971 and 2001 the Washington State government tax elasticity with respect to personal income was 0.94. Based on an analysis of taxable retail sales covering 1982 to 1995, Kriss Sjoblom of the Washington Research Council suggested that the current elasticity might be closer to 1.0.

Using econometric models designed to forecast tax revenue, this study also attempts to estimate the state tax elasticity. Like the Sjoblom analysis, it is restricted to taxable retail sales (the tax base for retail sales taxes).

Of the 20 equations estimated during this study, five representative equations are presented here for discussion. The economic variables used to predict taxable retail sales, which have been adjusted to eliminate the effects of changes in the tax base, include personal income, the unemployment rate, and housing permits. Since each equation is expressed in logarithmic form, its regression coefficients are direct estimates of tax elasticities with respect to the explanatory variables (personal income, the unemployment rate, and housing permits).

Equation 1 has an estimated tax elasticity with respect to personal income (also called the income elasticity) of 0.880. This means that a 1 percent increase in personal income is expected to lead to a 0.880 percent increase in taxable retail sales (and by implication retail sales taxes), all else (namely, the unemployment rate and housing permits) being equal. The estimates of the income elasticities range from 0.863 (Equation 5) to 1.005 (Equation 2, which is a replication of Sjoblom's model).

In an exercise to forecast taxable retail sales from FY 2001 to FY 2005 based on the September 2002 Washington economic outlook prepared by the Office of the Forecast Council (OFC), four of the five equations predict weak growth. Their effective income elasticities, defined as the predicted percentage change in taxable retail sales divided by the predicted percentage change in personal income, are all less than the income elasticities obtained directly from the forecasting equations. The estimates of the effective elasticities range from 0.673 (Equation 5) to 1.005 (Equation 2). Note that the forecasts of taxable retail sales are influenced not only by the change in personal income but also by the changes in the unemployment rate and personal income. As a consequence, the so-called *ceteris paribus* assumption does not hold for the effective elasticities. Because personal income is the only explanatory variable in Equation 2, its effective elasticity does equal the elasticity in the forecasting equation.

When comparing these predictions with the OFC tax revenue forecasts made in September 2002, two observations are noteworthy. First, the OFC's forecast change for retail sales taxes between FY 2001 and FY 2005 (13.0 percent) is virtually the same as Equation 1's forecast change for taxable retail sales (12.8 percent), suggesting that the two models are similar. Second, the OFC outlook for tax collections is also bleak, even relative to the expected slow growth of personal income. The effective income elasticity for all taxes (retail sales, business and occupation, property, and other taxes) is expected to be only 0.767.

Tax collections are not only determined by the responsiveness of taxes to economic activity, such as consumer spending and new construction, but also by limits imposed by law. The initiative that has the greatest potential impact on state government, if it were strictly enforced, is Initiative 601. Although its objective of keeping real government spending per person constant does not seem unreasonable, strict adherence to I-601 would severely limit expenditures, as shown by an analysis of how I-601 would have worked in the 1990s. Contrary to the intention, real state government spending per capita under I-601 would have declined by at least 4 percent during the 1990s due to the high rate of inflation for many government services (e.g., prisons and health care). Relative to personal income, state government spending would have fallen by about 20 percent. Thus, if other states had increased their government expenditures along with personal income, as they appeared to have done, Washington State government spending per capita would have dropped by more than 20 percent relative to that of other states during the 1990s. This would have meant that by 2000, on a per capita basis, Washington would have had 20 percent less money for schools, roads, and other things than other states.

Although the findings do not rule out the possibility that the current tax elasticity with respect to personal income elasticity is 1.0, the weight of the evidence suggests that it is closer to 0.9. There is no evidence that it is greater than 1.0. The implication of this finding is that it is unlikely that under the current tax system future state tax revenue will keep pace with the growth of personal income without changes to the state tax base or tax rates.

2. INTRODUCTION

Adequacy refers to the ability of a tax system to generate tax revenues that keep up with the growth of the economy. Between 1980 and 2000, state and local government taxes in the United States grew at the same rate as personal income. If the norm is considered desirable, this implies that an adequate tax system has a tax elasticity of 1.0, the tax elasticity being defined as the percentage change in taxes divided by the percentage change in personal income.

Based on an analysis of personal income and state tax growth since 1971, the Office of Financial Management concluded that, without changes in either the tax base or tax rates, Washington tax revenue would have not kept pace with state personal income. Between 1971 and 2001, personal income grew at an 8.8 percent annual rate, while tax revenue, adjusted to remove the effects of changes in the tax base and tax rates, expanded at only an 8.3 percent rate, implying a tax elasticity of 0.94 (=8.3/8.8).

Kriss Sjoblom of the Washington Research Council, investigating the years between 1982 and 1995, found that retail sales taxes, which account for more than one-half of the total state tax

revenue, grew along with personal income during that period, suggesting that the current tax elasticity might be closer to 1.0. He restricted his study to those particular years because he felt that retail sales tax collections were abnormal before 1982 due to the tax boom caused by the construction of the Washington Public Power Supply System (WPPSS) nuclear power plants and after 1995 due to the phenomenal growth of stock option income.

Like the previous analyses, this study attempts to estimate the state tax elasticity. In this case, however, the estimates are derived from econometric models designed to forecast tax revenue. Given the lack of time, this study is restricted to taxable retail sales (the tax base for retail sales taxes).

3. ESTIMATING ELASTICITIES

The Office of the Forecast Council, which is responsible for predicting state tax revenues, provided the necessary data to estimate various models of Washington taxable retail sales. The data series run from the first quarter of 1969 to the last quarter of 2001.

Taxable retail sales have been adjusted to eliminate the effects of changes to the tax base, yielding a so-called constant-base series. Following the formulation of models constructed by the author to forecast Puget Sound and King County taxable retail sales, the economic variables used to predict Washington taxable retail sales include state personal income, the unemployment rate, and housing permits.

Since each forecasting equation is expressed in logarithmic form, its regression coefficients are direct estimates of the tax elasticities with respect to the explanatory variables (personal income, the unemployment rate, and housing permits). Each equation also includes an autoregressive term (AR) to obtain efficient estimates of the regression coefficients.

Of the 20 equations estimated during this study, five representative equations are presented for discussion. The five regression equations are shown in Section 5 and their respective income elasticities (i.e., their tax elasticities with respect to personal income, which are also called income elasticities) are reported in Table 1. Equation 1 has an estimated income elasticity of 0.880, which means that a 1 percent increase in personal income is expected to lead to a 0.880 percent increase in taxable retail sales (and by implication a 0.880 percent increase in retail sales taxes), all else (namely, the unemployment rate and housing permits) being equal.

The equations are also used to produce forecasts of taxable retail sales through the fourth quarter of 2005. These projections are based on the September 2002 economic outlook for the state developed by the OFC. Table 2 shows the forecast of the total percentage change in taxable retail sales and personal income between FY 2001 and FY 2005 for each equation. Also shown is the effective income elasticity, which is simply the ratio of the percentage change in taxable retail sales to the percentage change in personal income. The effective income elasticity in Table 2 differs from the income elasticity in Table 1 in that the change in taxable retail sales is now also affected by changes in the unemployment rate and housing permits. In other words, the so-called *ceteris paribus* assumption does not hold in the case of the effective income elasticity.

For purposes of comparison, Table 3 presents the FY 2001-05 forecasts of retail sales taxes and other taxes made by the OFC along with estimates of the corresponding effective income elasticities.

Since an analysis of adequacy is incomplete without some discussion of tax and spending limits, Table 4 shows the impact that Initiative 601 would have had on state spending (and presumably state taxes) had it been in effect and strictly enforced between 1990 and 2000. By limiting the growth of spending to population growth and the inflation rate (as measured by the U.S. personal consumption implicit price deflator), the intent of I-601 was to keep real state government spending per person constant.

4. OBSERVATIONS

Following are observations based on the findings of the analysis:

1. Equation 1. As previously noted, this equation follows the specification of a model constructed to forecast taxable retail sales in Puget Sound and King County. The model includes explanatory variables to predict the trend growth in taxable retail sales (personal income) as well as the cyclical fluctuations (the unemployment rate and housing permits). As expected, the estimated equation shows that taxable retail sales are positively related to personal income and housing permits and negatively related to the unemployment rate. In general, the equation is statistically strong, as indicated by its high R-squared (close to 1), its low standard error of the regression (0.016), the high t-values of its regression coefficients (all greater than 2 in absolute terms), and a good Durbin-Watson statistic (close to 2).

   Estimated with quarterly data from the second quarter of 1969 (1969.2) through the fourth quarter of 2001 (2001.4), Equation 1 gives an income elasticity estimate of 0.880 (the value of the regression coefficient for personal income), as reported in Table 1. According to the standard error of the regression coefficient (0.032), the income elasticity could be as high as 0.944 or as low as 0.816 (the 95 percent or two standard deviation confidence interval). In any case, the equation supports the notion that in the long run taxable retail sales and retail sales taxes do not keep up with the economy as measured by the growth in personal income.

Table 1

Taxable Retail Sales Elasticity Estimates

Equation	Sample Period	Income Elasticity
1	1969.2-01.4	0.880
2	1982.1-95.4	1.005
3	1982.1-95.4	0.977
4	1969.2-01.4	0.897*
5	1970.2-01.4	0.863*

*Adjusted for stock option income.

2. Equations 2 and 3. Equation 2 replicates the model of Kriss Sjoblom. Estimating an equation with data from 1982.1 to 1995.4 and including personal income as the sole explanatory variable yields an elasticity estimate of 1.005, which is virtually the same as Sjoblom's estimate (1.002).

   As shown in Equation 3, when the cyclical variables are added to the model, the elasticity estimate declines to 0.977, indicating that the cyclical forces operating during the period had the effect of making the income elasticity appear to be higher. It should be pointed out, however, that with an absolute t-value of less than two, neither the unemployment rate nor housing permits is considered to be a statistically significant variable in this equation.

3. Equation 4. Sjoblom's argument to disregard the years after 1995 (the growth of stock option income distorted the relationship between retail sales taxes and personal income) seems more reasonable than the one to disregard the years before 1982 (retail sales taxes were greatly boosted by the impact of the construction of five nuclear power plants), since there was much more to the economic boom in the 1970s than the WPPSS projects. At its height in 1999, stock option income in the software industry (principally Microsoft) accounted for about 5 percent of Washington personal income. Since much of stock option income is either taxed or saved, it tends to have a much smaller impact on consumer spending than normal wage and salary income. Thus, when stock option income is a significant portion of personal income, as it was in the late 1990s, it lowers the retail sales-personal income ratio, all else being equal.

   Equation 4, which is estimated with data from 1969.2 to 2001.4, attempts to address the stock option problem directly. Assuming that each dollar of stock option income has the equivalent effect on retail spending of only 30 cents of other personal income, a new income variable (called adjusted income), which takes into account the differential spending effects of the two types of income, is introduced into the taxable retail sales equation. See Equation 4 in Section 5 for more details. Note that software wages and salaries are used as a surrogate for stock option income in this equation.

The estimated elasticity of taxable retail sales with respect to adjusted personal income is 0.897. As expected, it is somewhat higher than the income elasticity obtained in Equation 1, indicating that stock option income does have the effect of reducing the retail sales-personal income ratio, imparting a downward bias to the income elasticity estimate.

4. Equation 5. Equation 5 is the same as Equation 4 except that it does not assume that the impact of the explanatory variables on the predicted variable is immediate. In particular, it assumes that the effects of changes in personal income and housing permits on taxable retail sales take four quarters before they are fully felt.

   This more complicated equation is interesting because, statistically speaking, it is the strongest of the five equations and, with a value of 0.863 (the sum of the lagged regression coefficients), it yields the lowest income elasticity estimate.

5. Forecasts and effective elasticities. Table 2 shows projections of taxable retail sales from each of the five equations. The forecasts of personal income, the unemployment rate, and housing permits come from the September 2002 outlook for the Washington economy prepared by the OFC.

   Equation 1 predicts that taxable retail sales will increase a total of 12.8 percent between FY 2001 and FY 2005, considerably less than the expected 15.9 percent gain in personal income. The effective income elasticity is 0.805 (=12.8/15.9), which is less than the one measured by the equation (0.880). In this case, the estimate of the effective elasticity is significantly affected by changes in the unemployment rate and housing permits. Only in the case of Equation 2, where personal income is the sole explanatory variable, is the effective elasticity equal to the elasticity in the forecasting equation.

   With the exception of Equation 2, each equation predicts weak growth in taxable retail sales relative to the growth of personal income. With an effective elasticity of only 0.673, Equation 5 is the most pessimistic, predicting a 10.7 percent increase in taxable sales during the four-year period. The principal reason for the generally gloomy outlook for taxable retail sales is the severity of the current recession, which has added three percentage points to the unemployment rate, placing it among the highest in the nation, and has dropped housing permits by 20 percent.

Table 2

Taxable Retail Sales Forecast and Effective Elasticity Estimates
FY 2001-2005
(percent change)

Equation	Taxable Retail Sales	Personal Income	Effective Income Elasticity
1	12.8	15.9	0.805
2	16.0	15.9	1.005
3	15.0	15.9	0.943
4	13.8	15.9	0.868
5	10.7	15.9	0.673

6. Office of the Forecast Council Tax Projections. The September 2002 forecasts of retail sales taxes and other taxes by the OFC are reported in Table 3.

There are two noteworthy observations. First, the forecast change for retail sales taxes (13 percent) is virtually the same as Equation 1's forecast change for taxable retail sales (12.8 percent). This suggests that the two models are very similar, which would not be surprising, since both are estimated over the same period (or close to it) and have the same principal explanatory variables (e.g., personal income). Note that this analysis was conducted without specific knowledge of the formulation of the OFC model.

Second, the OFC outlook for tax collections between FY 2001 and FY 2005 is also bleak. Indeed, other taxes (business and occupations taxes, property taxes, and miscellaneous taxes) are expected to grow more slowly than retail sales taxes. The effective income elasticity for all taxes is expected to be only 0.767.

Table 3

Office of the Forecast Council FY 2001-2005
Tax Revenue Forecast, September 2002
(billions of dollars)

	FY 2001	FY 2005	Percent Change	Effective Income Elasticity
Retail sales taxes	5.503	6.219	13.0	0.818
Other taxes*	5.024	5.589	11.2	0.704
Total*	10.527	11.808	12.2	0.767
Personal income	189.149	219.266	15.9	---

*Includes property tax transfers to Student Achievement Account.

7. Tax and spending limits. Tax collections are not only determined by the responsiveness of taxes to economic activity, such as consumer spending and new construction, but also by limits imposed by law. In recent years, a number of initiatives (e.g., the elimination of the motor vehicle excise tax) have limited state government spending by reducing taxes paid by households and businesses.

The initiative that has the greatest potential impact on state government finances, if it were strictly enforced, is Initiative 601. Rather than restricting taxes, it imposes a limit on state spending. Under I-601 state spending is restricted to grow at a rate determined by the population growth rate and the inflation rate, as measured by the U.S. implicit price deflator for personal consumption expenditures. This implies that state spending per capita adjusted for inflation remains constant.

Although the objective of keeping real government spending per person constant does not seem unreasonable, strict adherence to I-601 could have undesirable consequences, as shown by an analysis of how I-601 would have worked in the 1990s. The middle part of Table 4 shows Washington population and the U.S. consumption price deflator for 1990 and 2000. Since population grew at a 1.9 percent annual rate and the implicit price deflator rose at a 2.3 percent rate, I-601 would have restricted the growth of state spending to 4.2 percent per year.

If one believes that the growth of government services (e.g., education, safety, and transportation infrastructure) should keep up with the growth of the economy, the initiative would have led to two undesirable outcomes. The first stems from the use of the U.S. implicit price deflator for personal consumption expenditures, which fails to recognize that the cost of many government services (e.g., prisons and health care) are rising faster than the cost of consumer goods and services and that Washington has a higher inflation rate than the nation, primarily because of the state's faster growth. This implies that, if I-601 had been in force in the 1990s, real government spending per capita would have actually declined. Not counting the effect of Washington's higher inflation rate, the rapid rise in the cost of government services (2.7 percent annually) would have resulted in a 4.1 percent decline in real government spending per capita over the course of the 1990s.

Since the growth restrictions imposed by I-601 fall short of the growth of personal income (and always will by an amount equal to the growth rate of real per capita income), state spending as a fraction of personal income would have declined sharply. Under I-601 state spending would have advanced at only a 4.2 percent annual rate in the 1990s, substantially less than the 6.7 percent growth rate for personal income. In 1990, state general fund expenditures amounted to 7 percent of Washington personal income. Restricted by I-601, it would have amounted to only 5.5 percent of personal income by 2000. If other states had increased their government spending along with personal income, as they appeared to have done, Washington State government spending per capita would have dropped by more than 20 percent relative to that of other states during the 1990s. This would have meant that by 2000, on a per capita basis, Washington would have had 20 percent less money for schools, roads, and other things than other states.

Table 4

Hypothetical Impact of Initiative 601
1990-2000

	1990	2000	Annual Percent Change
Personal income (bils. $)	98.143	186.863	6.7%
Population (thous.)	4,903.0	5,908.4	1.9
Consumption price deflator (96=1.000)	0.856	1.074	2.3
I-601 spending limit	---	---	4.2
State and local price deflator (96=1.000)	0.862	1.120	2.7

5. ESTIMATED EQUATIONS

Equation 1

Dependent Variable: LWTRSA
Method: Least Squares
Date: 10/07/02 Time: 11:17
Sample: 1969:2 2001:4
Included observations: 131
Convergence achieved after 8 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5.507932	0.169562	32.48335	0.0000
LWYP	0.879546	0.032188	27.32534	0.0000
LWUNRT	-0.078444	0.024713	-3.174211	0.0019
LWHS	0.029520	0.010802	2.732669	0.0072
AR(1)	0.933309	0.034689	26.90482	0.0000

R-squared	0.999537	Mean dependent var	9.037695
Adjusted R-squared	0.999522	S.D. dependent var	0.749441
S.E. of regression	0.016377	Akaike info criterion	-5.348433
Sum squared resid	0.033795	Schwarz criterion	-5.238692
Log likelihood	355.3223	F-statistic	68026.53
Durbin-Watson stat	2.288630	Prob(F-statistic)	0.000000
Inverted AR Roots	.93		

WTRSA Washington taxable retail sales adjusted for tax base changes (mils. $ per quarter)
WYP Washington personal income (bils. $ per year)
WUNRT Washington unemployment rate (%)
WHS Washington housing permits (thous. per year)

LWTRSA=log(WTRSA)
LWYP=log(WYP)
LWUNRT=log(WUNRT)
LWHS=log(WHS)

AR(1) First-order autoregressive term (corrects for serial correlation)

Equation 2

Dependent Variable: LWTRSA
Method: Least Squares
Date: 10/07/02 Time: 11:22
Sample: 1982:1 1995:4
Included observations: 56
Convergence achieved after 3 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.885410	0.074778	65.33244	0.0000
LWYP	1.004712	0.016709	60.13127	0.0000
AR(1)	0.637516	0.101863	6.258562	0.0000

R-squared	0.998085	Mean dependent var	9.344369
Adjusted R-squared	0.998013	S.D. dependent var	0.298513
S.E. of regression	0.013307	Akaike info criterion	-5.748912
Sum squared resid	0.009386	Schwarz criterion	-5.640411
Log likelihood	163.9695	F-statistic	13811.47
Durbin-Watson stat	2.117270	Prob(F-statistic)	0.000000
Inverted AR Roots	.64		

Equation 3

Dependent Variable: LWTRSA
Method: Least Squares
Date: 10/07/02 Time: 11:24
Sample: 1982:1 1995:4
Included observations: 56
Convergence achieved after 6 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.980089	0.142431	34.96482	0.0000
LWYP	0.977285	0.020473	47.73417	0.0000
LWUNRT	-0.027708	0.025805	-1.073720	0.2880
LWHS	0.023076	0.013667	1.688446	0.0974
AR(1)	0.629749	0.100369	6.274324	0.0000

R-squared	0.998309	Mean dependent var	9.344369
Adjusted R-squared	0.998177	S.D. dependent var	0.298513
S.E. of regression	0.012746	Akaike info criterion	-5.802170
Sum squared resid	0.008285	Schwarz criterion	-5.621335
Log likelihood	167.4608	F-statistic	7529.262
Durbin-Watson stat	2.196957	Prob(F-statistic)	0.000000
Inverted AR Roots	.63		

Equation 4

Dependent Variable: LWTRSA
Method: Least Squares
Date: 10/07/02 Time: 11:25
Sample: 1969:2 2001:4
Included observations: 131
Convergence achieved after 8 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5.447631	0.154158	35.33794	0.0000
LWYPA	0.896730	0.028782	31.15594	0.0000
LWUNRT	-0.079522	0.023923	-3.324028	0.0012
LWHS	0.028512	0.010473	2.722558	0.0074
AR(1)	0.931357	0.033742	27.60209	0.0000

R-squared	0.999566	Mean dependent var	9.037695
Adjusted R-squared	0.999552	S.D. dependent var	0.749441
S.E. of regression	0.015865	Akaike info criterion	-5.411951
Sum squared resid	0.031715	Schwarz criterion	-5.302211
Log likelihood	359.4828	F-statistic	72489.71
Durbin-Watson stat	2.227846	Prob(F-statistic)	0.000000
Inverted AR Roots	.93		

WYPA	Washington personal income adjusted for stock option income (bils. $ per year)
WYWSSFT	Washington software wages and salaries* (bils. $ per year)
WYPO	Washington other personal income (bils. $ per year)

WYPA=WYP-0.7(WYWSSFT)*
LWYPA=log(WYPA)

WYP=WYSSFT+WYPO
WYPA=0.3(WYWSSFT)+WYPO
WYPA=0.3(WYWSSFT)+WYP-WYWSSFT
WYPA=WYP-0.7(WYWSSFT)

*Software wages and salaries are used as a surrogate for stock option income.

Equation 5

Dependent Variable: LWTRSA
Method: Least Squares
Date: 10/07/02 Time: 11:27
Sample(adjusted): 1970:2 2001:4
Included observations: 127 after adjusting endpoints
Convergence achieved after 8 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5.423635	0.179196	30.26652	0.0000
LWUNRT	-0.082008	0.025934	-3.162129	0.0020
PDL01	0.147972	0.004477	33.05413	0.0000
PDL02	0.014912	0.004445	3.354437	0.0011
AR(1)	0.917740	0.032655	28.10436	0.0000

R-squared	0.999561	Mean dependent var	9.080095
Adjusted R-squared	0.999546	S.D. dependent var	0.721207
S.E. of regression	0.015364	Akaike info criterion	-5.474941
Sum squared resid	0.028800	Schwarz criterion	-5.362965
Log likelihood	352.6588	F-statistic	69374.95
Durbin-Watson stat	2.092116	Prob(F-statistic)	0.000000

Inverted AR Roots .92

Lag Distribution of LWYPA	i	Coefficient	Std. Error	T-Statistic
. * |	0	0.12331	0.00373	33.0541
. * |	1	0.19730	0.00597	33.0541
. *|	2	0.22196	0.00671	33.0541
. * |	3	0.19730	0.00597	33.0541
. * |	4	0.12331	0.00373	33.0541
Sum of Lags		0.86317	0.02611	33.0541

Lag Distribution of LWHS	i	Coefficient	Std. Error	T-Statistic
. * |	0	0.01243	0.00370	3.35444
. * |	1	0.01988	0.00593	3.35444
. *|	2	0.02237	0.00667	3.35444
. * |	3	0.01988	0.00593	3.35444
. * |	4	0.01243	0.00370	3.35444
Sum of Lags		0.08699	0.02593	3.35444

Appendix C-22

STATE AND LOCAL GOVERNMENT FINANCES: IMPLICIT ELASTICITIES

By Dick Conway, Committee Member

An underlying presumption in evaluating Washington's tax structure is that the elasticity of tax revenue with respect to personal income should be one, meaning that tax revenue should grow at the same rate as personal income, at least in the long run. Thus, a tax system with an elasticity of less than one, such as that found in Washington, is viewed as deficient. But is one the most desirable value for the elasticity?

The objective of this exercise is to evaluate this presumption. However, rather than debating over "shoulds," an exercise involving value judgments, I have attempted to identify the norm with respect to the behavior of state and local government finances. Using data for 1980, 1990, and 2000 from the U.S. Bureau of Economic Analysis, I have calculated various current-dollar receipt and expenditure elasticities for all state and local governments in the United States (see Table 1). Note that this analysis does not adjust for changes in tax rates or tax bases. Furthermore, in an attempt to mitigate any effect that business cycles might have on state and local government finances, I have selected years that are all peak years.

Following are some observations:

1. If the norm were deemed desirable, the behavior of state and local government consumption expenditures and gross investment would be, at first blush, the best argument for an elasticity of one. As shown at the bottom of the table, consumption expenditures (operating expenditures on education, safety, and other government functions) and gross investment (expenditures on roads, computers, and other capital), which represent the public sector's contribution to Gross Domestic Product, have moved almost in lock-step with personal income. Not only is the expenditure elasticity very close to one (0.99) over the twenty-year period, it is also very stable over the two shorter periods (0.98 and 1.02, respectively). There is also very little difference between the longer-run consumption expenditure elasticity (1.00) and the gross investment elasticity (0.98).

2. Of course, this does not mean that the tax revenues needed to pay for these expenditures have necessarily kept up with personal income. My hunch is that every state has had to increase tax rates and broaden tax bases to satisfy the increasing demand for public services. Moreover, it would appear that this task was made more difficult in the 1990s because of the high inflation rate for state and local expenditures (2.7 percent per year) relative to household expenditures (2.3 percent).

Table 1

STATE AND LOCAL GOVERNMENT FINANCES
Billions of Dollars

				Average Annual Percent Change			Implicit Elasticity*		
	1980	1990	2000	1980-90	1990-00	1980-00	1980-90	1990-00	1980-00
Current receipts	316.6	663.4	1,222.6	7.7	6.3	7.0	0.99	1.16	1.06
Income taxes	42.6	107.7	219.8	9.7	7.4	8.6	1.25	1.36	1.30
Sales taxes	82.9	183.2	321.5	8.3	5.8	7.0	1.06	1.07	1.06
Property taxes	68.8	161.1	248.4	8.9	4.4	6.6	1.15	0.82	1.01
Other taxes and nontax receipts	50.0	100.0	187.3	7.2	6.5	6.8	0.93	1.19	1.04
Federal grants-in-aid	72.3	111.4	245.6	4.4	8.2	6.3	0.57	1.52	0.96
Current expenditures	307.8	660.8	1,189.8	7.9	6.1	7.0	1.02	1.12	1.06
Consumption expenditures	260.5	545.8	929.0	7.7	5.5	6.6	0.99	1.01	1.00
Transfer payments to persons	51.2	127.8	270.7	9.6	7.8	8.7	1.24	1.44	1.32
Other expenditures	-3.9	-12.8	-9.9	12.6	-2.5	4.8	1.63	-0.47	0.72
Current surplus or deficit	8.8	2.6	32.8	-11.5	28.9	6.8	-1.48	5.31	1.03
Current receipts less federal grants-in-aid	244.3	552.0	977.0	8.5	5.9	7.2	1.10	1.08	1.09
Income, sales, and property taxes	194.3	452.0	789.7	8.8	5.7	7.3	1.14	1.06	1.10
Other taxes and nontax receipts	50.0	100.0	187.3	7.2	6.5	6.8	0.93	1.19	1.04
Consumption expenditures and gross investment	324.4	673.0	1,150.8	7.6	5.5	6.5	0.98	1.02	0.99
Consumption expenditures	260.5	545.8	929.0	7.7	5.5	6.6	0.99	1.01	1.00
Gross investment	63.9	127.2	221.8	7.1	5.7	6.4	0.92	1.05	0.98
Personal income	2,323.9	4,903.2	8,319.2	7.8	5.4	6.6	na	na	na
State and local government expenditures deflator (1996=1.000)	na	0.862	1.121	na	2.7	na	na	na	na
Personal consumption expenditures deflator (1996=1.000)	0.552	0.856	1.075	4.5	2.3	3.4	na	na	na

*Growth rate relative to personal income growth rate.

3. The answer to the elasticity question is somewhat different when transfer payments to persons are taken into account. In addition to running schools and building roads, state and local governments make payments to people in the form of unemployment compensation, food stamps, public assistance, and disability income. With a twenty-year elasticity of 1.32, transfer payments have constituted the fastest growing category of state and local government expenditures. This has meant that state and local government current expenditures (which include transfer payments but exclude investment) have risen faster than personal income over the past twenty years, as evident by an elasticity of 1.06. Current expenditures grew even faster on a relative basis in the 1990s, yielding an implicit elasticity of 1.12.

4. State and local government funds are supplemented by federal grants-in-aid. But, with an implicit elasticity of 0.96, grants-in-aid did not keep pace with state and local spending between 1980 and 2000. As indicated by the large changes in the elasticity, the growth of grants-in-aid was also volatile, expanding very slowly during the Reagan years (0.57) and very rapidly during the Clinton years (1.52).

5. The relatively slow growth of federal grants-in-aid in the long run has meant that state and local governments have had to increase their reliance on internal sources of funds. The implicit elasticity for current receipts less federal grants-in-aid (mostly taxes) was 1.09 during the twenty-year period.

6. During the 1990s, property taxes fell out of favor as a source of funds, as the elasticity dropped to 0.82, down from 1.15 in the 1980s. As a consequence, state and local governments increasingly turned to income taxes to pick up the slack. The 1980-00 elasticity for income taxes was 1.30, by far the highest of any source of funds.

Based on recent experience in the United States, the norm for the elasticity of state and local government finances is closer to 1.1 than 1.0, driven in large part by the rapid escalation of transfer payments to persons. Since federal grants-in-aid have not grown along with expenditures in the long run, state and local governments have had to rely somewhat more on internal sources, especially income taxes, to raise the necessary funds.

This analysis raises more questions than it answers, at least in my mind: Does any state have a tax structure with an implicit elasticity of one? What are its features? Can one design such a tax structure without having a progressive income tax? Will the growth of federal grants-in-aid during the Bush administration help or hurt the financial condition of state and local governments? If Initiative 601 were strictly applied, limiting the growth of state and local government spending to population growth plus the inflation rate (as measured by the implicit price deflator for personal consumption expenditures), what would be the implicit elasticity (my back-of-the-envelope calculation is less than 0.8)? What do spiraling health care costs and teacher pay raises tied to the Seattle consumer price index (which overstates inflation) mean for the inflation rate for state and local government expenditures? As a result, will we see a decline in real state and local expenditures as a percent of real Gross State Product over time, even if revenues grew along with personal income?

Appendix C-23

TAXES PAID ON MEDIAN-PRICED HOMES IN SELECT JURISDICTIONS
Calendar Year 1998

	Rate	Spec Built or Existing	Custom Built
Unincorp. King County (outside RTA)			
Median Priced Single Family Residence		$217,000	$217,000
Sales Tax	0.082	17,794	10,675
Real Estate Excise Tax	0.0178	3,863	1,545
King Total		$21,657	$12,221
Taxes as percent of total purchase price		10.0%	5.6%
Redmond			
Median Priced Single Family Residence		$217,000	$217,000
Sales Tax	0.086	18,662	12,216
Real Estate Excise Tax	0.0178	3,863	1,334
Redmond Total		$22,525	$13,550
Taxes as percent of total purchase price		10.4%	6.2%

Note: Taxes are for Calendar Year 1998. Land values for REET on custom home based on DOR Abstract of Assessed Value.

Appendix C-24

INDICES FOR QUALIFYING FOR A MEDIAN-PRICED HOME

Charts 1 and 2 compare affordability indices across Washington counties. (The charts are based on data from the Washington State University Center for Real Estate Research and Office of Financial Management estimates of 2001 median household income.) Chart 1 shows an affordability index for all households. The index is equal to the income required to qualify for a home at the median price given the 28 percent[2] rule, divided by median income.

An index higher than 100 indicates that median income households have more income than is required to sustain a mortgage on the median-priced home. An index less than 100 indicates that the median income family does not have enough income required to sustain a mortgage on the median-priced home. For example, the dark-colored bar for Wahkiakum County in the chart below shows that the index for Wahkiakum is about 200. This means that the median income family in Wahkiakum County has about twice (200 percent) the income needed to sustain a mortgage on the median-priced home. In Jefferson County, the median income family has only 87 percent of the income to sustain a mortgage on the median-priced home. Notice that in three Washington counties, median income families are not able to qualify for median-priced homes.

The two bars on the chart represent the index with and without property taxes. The dark bar is the full index, which includes property tax in the calculation of the qualifying payment. The light bar in front is the index without property tax in the qualifying payment. By comparing the two bars, one can see the impact of property tax on affordability. The chart shows property tax is not a large driver in affordability. Also notice that generally, the less affordable a county's homes are, the smaller the role played by property taxes in affordability. Higher property values tend to have lower property tax rates. This is because jurisdictions that have a larger value base to tax are generally able to have lower property tax rates to pay for local needs.

[2] The rule of thumb for making mortgage loans is that the mortgage payment plus property taxes on the home plus homeowner insurance should not exceed 28 percent of the purchaser's income.

Chart 1
Qualifying for a Single Family Home by County
(100=Median income qualifies for a median-priced home)

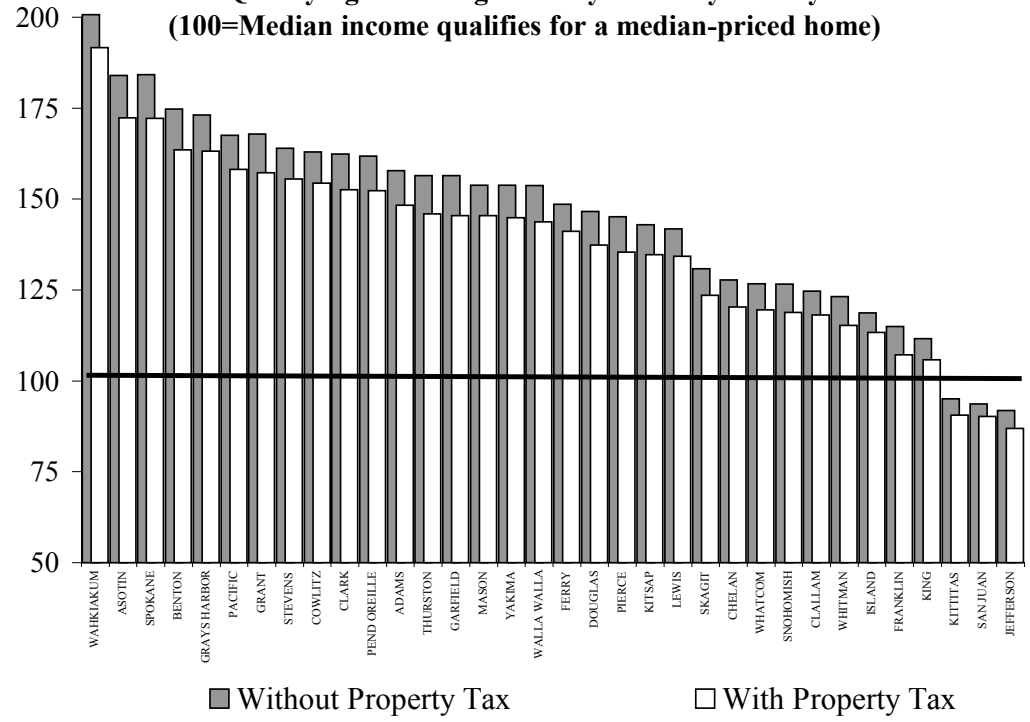


Chart 2
First Time Home Buyer Qualifying for a Single Family Home by County
(100=Median income qualifies for a median-priced home)

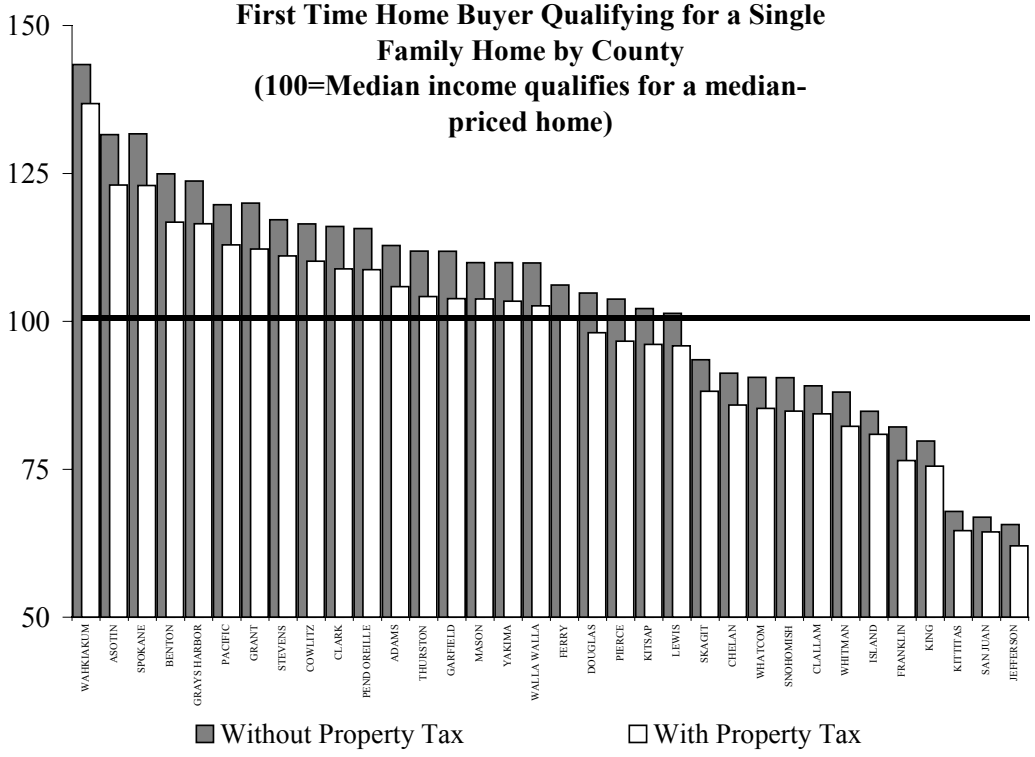


Chart 2 shows the affordability index for *first-time* homebuyers. This index compares median income for first-time homebuyers with the qualifying income needed for a home priced at 85 percent of median price. The index also differs in that the qualifying income has assumptions about a lower down payment and a higher mortgage rate to include mortgage insurance. First-time homebuyers are also assumed to have median incomes at 70 percent of county median income.

In 16 counties first-time homebuyers with median incomes are not able to qualify for median-priced homes. As in the chart for all homebuyers, Table 1 shows property tax is not a large driver in affordability and that property tax plays less of a role in the less affordable counties.

Table 1

Qualifying for a Median-Priced Home

	All Single Family Homes		First-Time Single Family Homes	
	Affordability Index	Affordability Without Property Tax	Affordability Index	Affordability Without Property Tax
Adams	148.3	157.8	105.9	112.8
Asotin	172.4	184.0	123.0	131.6
Benton	163.6	174.8	116.8	124.9
Chelan	120.3	127.7	85.9	91.3
Clallam	118.2	124.7	84.4	89.1
Clark	152.5	162.3	108.9	116.0
Cowlitz	154.4	162.9	110.2	116.5
Douglas	137.4	146.6	98.1	104.8
Ferry	141.2	148.5	100.8	106.1
Franklin	107.2	114.9	76.5	82.1
Garfield	145.5	156.5	103.8	111.9
Grant	157.2	167.9	112.2	120.0
Grays	163.2	173.1	116.5	123.7
Island	113.3	118.7	80.9	84.8
Jefferson	86.9	91.9	62.1	65.6
King	105.8	111.7	75.5	79.8
Kitsap	134.7	143.0	96.1	102.2
Kittitas	90.5	95.0	64.6	67.9
Lewis	134.3	141.8	95.9	101.4
Mason	145.4	153.8	103.8	110.0
Pacific	158.2	167.5	112.9	119.7
Pend Oreille	152.3	161.9	108.7	115.7
Pierce	135.4	145.1	96.7	103.8
San Juan	90.2	93.7	64.4	66.9
Skagit	123.5	130.8	88.2	93.5
Snohomish	118.8	126.6	84.8	90.5
Spokane	172.2	184.2	123.0	131.7
Stevens	155.6	163.9	111.1	117.2
Thurston	146.0	156.5	104.2	111.9
Wahkiakum	191.7	200.7	136.8	143.4
Walla Walla	143.8	153.7	102.7	109.9
Whatcom	119.5	126.7	85.3	90.5
Whitman	115.2	123.2	82.3	88.1
Yakima	144.9	153.8	103.4	109.9

Sources: Washington Center for Real Estate Research at WSU, Office of Financial Management. Information is not available for Columbia, Klickitat, Lincoln, Okanogan, and Skamania counties.

Appendix C-25

COMPARISON OF EFFECTIVE PROPERTY TAX RATES* FOR TAXES DUE IN 1995-2002

County	1995	1996	1997	1998	1999	2000	2001	2002
Adams	1.40 %	1.37 %	1.36 %	1.30 %	1.34 %	1.33 %	1.33 %	1.23 %
Asotin	1.24	1.15	1.17	1.19	1.22	1.29	1.31	1.31
Benton	1.62	1.24	1.33	1.38	1.36	1.32	1.31	1.26
Chelan	1.17	1.13	1.09	1.11	1.12	1.11	1.08	1.10
Clallam	1.05	1.06	1.10	1.13	1.12	1.09	1.07	1.01
Clark	1.34	1.34	1.36	1.28	1.31	1.29	1.27	1.29
Columbia	1.41	1.21	1.23	1.16	1.35	1.35	1.32	1.32
Cowlitz	1.08	1.05	1.10	1.06	1.11	1.05	1.11	1.15
Douglas	1.23	1.22	1.29	1.23	1.26	1.24	1.34	1.33
Ferry	1.04	0.99	1.07	1.00	1.04	1.06	1.03	1.02
Franklin	1.38	1.34	1.38	1.38	1.40	1.43	1.42	1.36
Garfield	1.31	1.30	1.37	1.59	1.53	1.49	1.48	1.51
Grant	1.23	1.16	1.27	1.29	1.26	1.19	1.25	1.24
Grays Harbor	1.26	1.22	1.17	1.14	1.25	1.21	1.23	1.22
Island	0.92	0.92	0.99	0.98	0.98	0.99	1.00	0.90
Jefferson	1.07	1.04	1.08	1.12	1.17	1.13	1.10	1.09
King	1.22	1.23	1.27	1.18	1.19	1.13	1.07	1.02
Kitsap	1.08	1.25	1.31	1.26	1.32	1.32	1.18	1.22
Kittitas	0.98	0.96	0.98	0.87	0.98	0.98	0.94	0.97
Klickitat	1.05	0.98	1.00	1.05	1.04	1.02	1.11	1.12
Lewis	1.08	1.04	1.06	1.08	1.13	1.13	1.13	1.08
Lincoln	1.36	1.33	1.34	1.28	1.21	1.28	1.33	1.26
Mason	1.01	1.00	1.04	1.04	1.13	1.11	1.15	1.17
Okanogan	1.17	1.14	1.12	1.07	1.05	1.09	1.12	1.10
Pacific	1.01	0.95	1.03	1.07	1.13	1.10	1.18	1.18
Pend Oreille	0.96	0.93	0.94	0.96	1.04	1.02	0.99	0.97
Pierce	1.43	1.38	1.44	1.47	1.40	1.46	1.43	1.39
San Juan	0.77	0.73	0.76	0.76	0.78	0.74	0.70	0.67
Skagit	1.13	1.15	1.20	1.21	1.23	1.18	1.18	1.16
Skamania	0.96	0.93	0.93	0.87	0.92	0.95	0.97	0.96
Snohomish	1.19	1.21	1.24	1.23	1.22	1.17	1.16	1.12
Spokane	1.34	1.33	1.37	1.30	1.32	1.31	1.32	1.34
Stevens	0.92	0.93	0.99	1.05	1.07	1.00	1.05	1.05
Thurston	1.25	1.29	1.36	1.38	1.36	1.36	1.38	1.33
Wahkiakum	0.98	0.93	0.93	0.90	0.96	0.91	0.89	0.93
Walla Walla	1.36	1.28	1.29	1.31	1.31	1.38	1.34	1.33
Whatcom	1.06	1.07	1.12	1.14	1.17	1.14	1.12	1.10
Whitman	1.24	1.20	1.28	1.26	1.29	1.33	1.31	1.35
Yakima	1.22	1.16	1.17	1.21	1.10	1.17	1.18	1.15
Statewide	1.22 %	1.19 %	1.26 %	1.22 %	1.22 %	1.20 %	1.16 %	1.13 %

*Effective property tax rates express taxes as a percent of current market value rather than current assessed value. This rate is calculated by dividing the total amount of taxes due by the total full market value.

Appendix C-26
PROPERTY TAXES PER $1,000 PERSONAL INCOME – FY 1999-2000

	1999		2000	
	Amount	**Rank**	**Amount**	**Rank**
New Hampshire	$57.24	1	$54.54	1
Maine	52.70	2	52.00	2
Vermont	52.27	3	50.69	3
New Jersey	51.61	4	49.92	4
Montana	47.51	5	47.08	5
Rhode Island	46.45	6	47.06	6
Alaska	42.40	8	43.52	7
Connecticut	42.22	10	41.54	8
New York	42.30	9	40.96	9
Wyoming	43.68	7	40.13	10
Wisconsin	40.31	11	39.71	11
Illinois	38.97	12	38.75	12
Texas	36.97	13	36.76	13
Indiana	34.80	19	35.84	14
Iowa	35.63	15	35.69	15
North Dakota	34.24	21	35.62	16
Massachusetts	35.58	16	35.08	17
Michigan	33.47	22	34.46	18
South Dakota	35.49	17	34.45	19
Nebraska	36.49	14	34.09	20
Florida	34.62	20	33.64	21
Arizona	31.82	24	32.76	22
WASHINGTON	35.39	18	31.53	23
Ohio	31.75	25	31.47	24
Oregon	30.03	28	31.29	25
Minnesota	31.98	23	31.12	26
Kansas	31.20	26	31.02	27
Idaho	30.23	27	30.38	28
South Carolina	28.60	32	29.44	29
Pennsylvania	29.42	30	29.32	30
Virginia	29.92	29	29.19	31
Maryland	26.18	35	28.93	32
Colorado	28.80	31	28.83	33
Georgia	27.17	34	27.82	34
Utah	25.45	37	26.52	35
California	27.51	33	26.31	36
Nevada	24.26	39	25.81	37
Mississippi	25.24	38	25.70	38
Missouri	23.93	40	23.66	39
North Carolina	22.65	41	22.91	40
West Virginia	22.13	42	22.80	41
Tennessee	20.10	43	20.71	42
Kentucky	18.95	44	18.89	43
Hawaii	18.69	45	18.58	44
Louisiana	16.61	47	17.53	45
Arkansas	25.98	36	17.25	46
Delaware	15.84	49	16.90	47
Oklahoma	16.70	46	16.84	48
New Mexico	16.01	48	16.38	49
Alabama	12.38	50	13.33	50
U.S. Average	**$32.52**		**$32.07**	

NOTE: Calculations include MVET as an "in-lieu" property tax. Washington MVET was repealed in 2000.

Appendix D: Rainy Day Fund

Background on State "Rainy Day" Funds

Budget stabilization funds, or "rainy day" funds as they often are called, are now common in most states. By early 2002, 47 states, the District of Columbia and Puerto Rico had created rainy day funds. The only states without such funds are Arkansas, Montana, and Oregon.

The original concept of a budget stabilization fund is straightforward: money is saved when state finances are healthy for use when the state's economy takes a downturn. Over time, however, this definition of a stabilization fund has been expanded to encompass other budgetary concerns.

Deposits to stabilization funds typically are based on year-end surpluses, are made by appropriations, or combine both. In states where the deposit is tied to a budget surplus, the deposit usually occurs through a transfer authorized by the executive budget officer or treasurer.

A majority of states limit the use of their budget stabilization funds to cover revenue shortfalls or some other budget deficiency. Several states also allow the funds to be used for emergencies. A few states have not placed any specific limitations on how the fund can be spent; funds can be appropriated for any reason the Legislature deems necessary. In almost a dozen states, some or all withdrawals can occur only with a supermajority vote of the Legislature.

At least 32 states have capped the size of their budget stabilization funds. In a third of those states, the cap is 5 percent of general fund appropriations, expenditures, prior year revenues, or some other similar base. The next most common cap is 10 percent, and applies to five funds, three of which are authorized by state constitutions. With a few exceptions, the balances in most budget stabilization funds have not reached their legal caps.

Up until the late 1990s, budget stabilization funds were generally considered to contain insufficient monies to be really useful. Although Wall Street analysts recommend that states maintain budget stabilization funds equal to 3 percent to 5 percent of their general fund budgets, most states fell far below that level.

Due to extraordinary growth in states' personal income, by the late 1990s many states reported rainy day fund balances at historical highs. Even as late as January 2002,

about 28 states and the District of Columbia were reporting fund balances greater than 3 percent of general fund expenditures and more than half of those jurisdictions had balances in excess of 5 percent of annual spending.

History of Rainy Day Funds in Washington State

1981 – The **Budget Stabilization Account** (RCW 43.88.520 - 540) was established by the Legislature. The account would receive transfers (by legislative appropriation) from the state general fund equal to 1 percent of general state revenues, plus the unobligated cash surplus in the general fund at the end of each biennium (also by legislative appropriation). The account was capped at 5 percent of biennial general state revenues. The Budget Stabilization Account could be appropriated by the Legislature to provide for the continuation of agency programs at or near existing appropriation levels when revenue projections decline.

1982 – The **Budget Stabilization Account** is modified to require transfers to the account equal to the annual growth rate in real personal income minus three percentage points, multiplied by general state revenues for the immediate preceding fiscal year. Expenditures from the account can be made only by a 60 percent vote of the Legislature, but the allowable uses are expanded to include labor force training and other purposes that would reduce unemployment caused by the economic cycle.

1993 – The Budget Stabilization Account is repealed by the voters in Initiative 601 and replaced with the **Emergency Reserve Fund** (RCW 43.135.045). The Emergency Reserve Fund receives all general fund revenue in excess of the expenditure limit, up to a maximum of 5 percent of biennial general fund revenues. Monies in the Emergency Reserve Fund may be appropriated by a two-thirds vote of the Legislature, but only if the expenditure is below the state spending limit. When the Emergency Reserve Fund reaches the 5 percent maximum, the excess is transferred to the Education Construction Fund.

2000 – The **Emergency Reserve Fund** is modified by three legislative actions: (1) $35 million from interest earnings in the Emergency Reserve Fund are transferred annually to the Transportation Multimodal Account (Senate Bill 6876); (2) the maximum level of the Emergency Reserve Fund is changed from 5 percent of biennial revenues to 5 percent of annual revenues (House Bill 3169); and (3) 75 percent of excess revenue from the Emergency Reserve Fund is transferred to the Student Achievement Fund, and the remainder flows to the general fund (Initiative 728).

2002 - The supermajority vote requirement for the Legislature to appropriate money from the **Emergency Reserve Fund** is suspended for the 2001-03 Biennium (Senate Bill 6819).

Supermajority Vote Requirements

Supermajority voting requirements are highly popular features of most states' rainy day fund statutes. While two-thirds, three-fifths or 60 percent voting requirements to tap rainy day accounts can help to ensure that use of the funds represents a truly bipartisan decision of the state Legislature, supermajorities can often be used as an impediment during times of true fiscal crisis, preventing the majority party from governing and responding in a timely way to a critical fiscal situation.

For example, some legislators may be reluctant to vote to spend rainy day funds out of fear that economic problems may be worse in future years than they are now. Others argue that use of such "one-time" monies is not a long-term solution to a budget problem or could somehow damage the state's credit or bond rating.

The Center on Budget and Policy Priorities argues that since rainy day funds are designed to provide a quick infusion of resources during a downturn to help avoid debilitating cuts to public services at the very time the services and programs are needed most, it makes little sense to save money as a means of preventing possible cuts in the future if doing so means making definite cuts in the present.

While the notion of having a supermajority requirement to spend rainy day funds which may have taken years to accumulate has some merit, the real world problem has always been getting a supermajority of legislators to agree on when it is truly raining from a budgetary perspective. During the 2002 session of the Washington Legislature, despite a real decline in general fund revenues for the first time in years, majority Democrats in the Senate and House claimed they could not persuade sufficient Republicans to join them in tapping the state's rainy day fund with a two-thirds vote. Democrats then amended the supermajority requirement to access the state's rainy day fund from two-thirds to a 50 percent vote.

Cap on the Size of the Fund

Many states set upper limits on the size of their emergency funds, generally based on 3 to 5 percent of annual spending or revenues. Five percent tends to be the most common amount, stemming from suggestions from economists and other private and public fiscal experts that states should establish reserve accounts of at least 5 percent of annual spending or revenues. For states with biennial budget requirements, the percentage amount often applies to two years' worth of spending or revenues.

Many state rainy day funds also have what are termed "spillover" provisions that dictate how monies in excess of the statutory or constitutional cap should be used. Many states simply cap the fund at a specified percentage and let the excess stay within the general fund. Others direct the excess to purposes such as capital construction, debt service and tax relief.

In practice, it has been very difficult for state legislators to let their rainy day funds build up to 3, 4 or 5 percent of budget or revenue growth because the larger the fund grows, the more it becomes a target for increased spending or tax relief. For example, in 2000, Washington's rainy day fund was projected to have a balance of almost $800 million by the end of the 1999-01 Biennium. However, during that session, the Legislature passed a measure which lowered the fund's cap from 5 percent of biennial revenue to 5 percent of annual revenue and directed all interest on the fund to pay for transportation projects. Lower interest rates and the 2001 Nisqually earthquake further depleted the rainy day fund so that when legislators came to Olympia for the 2002 session, less than half of the $800 million was available to help close a $1.5 billion budget deficit.

Just as important, then, to how excess funds above the percentage cap are disposed is the question of how to protect depletion of rainy day funds during times of economic prosperity. During the campaign for Initiative 695, proponents repeatedly pointed to the size of the state's rainy day fund as justification that government had too much money and that elimination of the motor vehicle excise tax would do little to harm the provision of public services.

Criteria for Making Deposits and Withdrawals

Perhaps the most critical feature of any rainy day fund is the method by which funds are deposited into and withdrawn from the account. Many states use an "automatic deposit" feature that is tied to either a percentage of annual revenues or spending. Others require all or a portion of the excess general fund balance at the end of the fiscal period to be deposited into the fund. Such "forced" savings plans make good financial sense provided the amount is regular, predictable, and unlikely to severely hamper the provision of public services.

What is less common, however, are criteria for making withdrawals from the fund. Most states simply rely on the supermajority voting requirement to serve as the gatekeeper for when funds should be withdrawn. The underlying logic of this approach is that if two-thirds or three-fifths of the Legislature votes to tap the monies, then it must truly be an emergency. However, as the 2002 session of the Washington Legislature proved, there is rarely universal or even supermajority agreement on when it is appropriate to make a withdrawal from a rainy day fund.

It would be possible to define a "rainy day" in statute and create a "trigger" mechanism that would automatically make funds available for appropriation. Although rainy days are often discussed in terms of revenue declines, it would be more appropriate to use an economic indicator outside the control of the Legislature. Otherwise the Legislature could simply cut taxes to the point that revenues meet the rainy day criteria and thereby drain the fund.

Typical indicators might include employment growth, personal income growth or real (inflation-adjusted) personal income growth. Personal income is a very common measure of the overall size of the economy. It is similar to the concept of gross

domestic product at the national level and is a fundamental piece of the state's official economic and revenue forecast.

For example, personal income growth reached the extremely high levels of almost 8 percent in the late 1990s but has since decreased to only 0.2 percent in 2002. A possible threshold could be set at (for example) 2 percent growth of personal income and when the official revenue forecast projected slower growth, funds could then be transferred.

States with Economic Triggers for Withdrawals from Rainy Day Fund

Arizona (ARS 35-144)
The Budget Stabilization Fund is capped at 7 percent of fiscal year general fund revenue. Any surplus is transferred to the general fund. If real personal income growth is less than 2 percent and less than the seven-year trend, transfers may be made to the general fund. A two-thirds vote is required for other transfers.

Colorado (CRS 24-75-201.1, 201.5)
The Required Reserve must be maintained at 4 percent of general fund appropriations. The reserve is used automatically when revenue declines from forecasted level. If expenditures are made from the Required Reserve, the Governor must submit a plan to the Legislature to maintain at least a 2 percent reserve.

Indiana (IC 4-10-18-3)
Deposits are made to the Counter-Cyclical Revenue and Economic Stabilization Fund when personal income grows faster than 2 percent. If annual growth in personal income is less than negative 2 percent, automatic transfers are made to the general fund in an amount determined by the following formula: annual general fund revenues multiplied by the percentage by which personal income growth is less than negative 2 percent. (If personal income grows at negative 5 percent, the automatic transfer would be 3 percent of general fund revenues.)

Michigan (MSA 18-1351 – 1359)
Deposits are made to the Countercyclical Revenue and Economic Stabilization Fund when personal income grows faster than 2 percent. If annual growth in personal income is negative, transfers shall be made to the general fund in an amount equal to the percentage decline in personal income multiplied by annual general fund revenues (not to exceed the amount necessary to balance the budget).

Minnesota (MS 16A.152)
The Governor may make withdrawals from the Budget Reserve Account when a deficit in the general fund is projected and "objective measures, such as reduced growth in total wages, retail sales, or employment, reflect downturns in the state's economy."

Texas (Texas Const. Art. 3, sec. 49-g)
The Legislature may appropriate moneys from the Economic Stabilization Fund if general revenues are less than the appropriations made by the preceding Legislature, or if anticipated revenues for a succeeding biennium are less than revenues available for the current biennium. Other appropriations from the fund may be made by a two-thirds vote of the Legislature.

Other Considerations in Designing an Effective Rainy Day Fund

Rainy day funds have often provided little stability for state budgets because they are only one part of a state's financial health. Faster than normal revenue growth has historically been accompanied by tax cuts and/or other diversions of revenue to non-general fund spending that prevent the fund from reaching a level that is truly useful during an economic downturn.

In Washington State the failure to accumulate a large rainy day fund is associated with the Initiative 601 spending limit and the initiative process. The tax cut and revenue diversions stemming from Referendum 47 and Referendum 49 were cast with consideration of supporting future expenditures at or below the I-601 growth rate. Had these been the only tax cuts and revenue diversions adopted in the last five years, the balance in the Emergency Reserve Fund would have been much greater.

However, the growth rate of current state services is inherently faster than population and inflation. To live within the I-601 limit would require the continued downsizing of state government. A rainy day fund could be more effective if it were adopted in conjunction with a new spending limit that prevents spending fast-growing revenues during boom times without requiring the dismantling of current state services. Some have suggested that a spending limit based on a percentage of personal income could provide the flexibility for policymakers to grow state government, while still providing a limit to prevent double-digit government growth during economic "boom" times. Such a spending limit could also provide some discipline for the Legislature to accumulate larger budget reserves.

Initiatives in the last five years have been the other major reason why the Emergency Reserve Fund has not provided more counter-cyclical relief. Large reserves were used as justification for why certain initiatives (I-695 and I-747) were sustainable. It is not evident that a spending limit would influence the public and prevent the adoption of initiatives that reduce revenue or divert it from the general fund. Changes in the initiative process to limit tax reduction or diversions would also be useful in strengthening and protecting a rainy day fund. For example, if the voter's pamphlet was required to show the long-term fiscal implication of an initiative, it could provide some support to maintaining higher reserves.

Sample Draft Revenue Stabilization Account Constitutional Provision

The following section provides sample language for a constitutional amendment to enact a rainy day fund.

"A new section shall be added to Article VII of the Washington State Constitution as follows:

(a) A revenue stabilization fund shall be established and maintained in the treasury.

(b) If the forecast growth of general state revenues for any fiscal year from the prior fiscal year is estimated to be greater than [one][three] percent, as adjusted for inflation, there shall be appropriated to the revenue stabilization fund in that fiscal year an amount equal to one percent of the forecasted general state revenues for that fiscal year. Nothing in this paragraph (b) shall prevent the appropriation of additional amounts to the revenue stabilization fund.

(c) If the forecast growth of general state revenues for any fiscal year is estimated to be less than [zero], as adjusted for inflation, there shall be appropriated from the revenue stabilization fund to the general fund in that fiscal year, an amount equal to the difference between the forecast general state revenues for that fiscal year (as adjusted for inflation from the prior year) and the estimated general state revenues for the year prior to that fiscal year. Any amount may be withdrawn and appropriated from the revenue stabilization fund at any time by the favorable vote of at least three-fifths of the members elected to each house.

(d) Amounts in the revenue stabilization fund may be invested as provided by law and retained in that fund. The legislature may at any time for any fiscal year by the favorable vote of a majority of the members elected to each house, withdraw and appropriate amounts in the revenue stabilization fund, including investment earnings, when the balance in the fund equals more than [five][ten] percent of the estimated general state revenues in the prior fiscal year.

(e) As used in this section, general state revenues shall have the meaning set forth in Article VIII, Section 1. Forecasts and estimates shall be made by a state forecast council appointed as provided by statute and approved by the favorable vote of three-fifths of the members of the Senate. Adjustments for inflation shall be based on an index selected by the forecast council that is applicable to the state or to one or more selected metropolitan areas within the state that is prepared by an agency of the United States.

(f) The legislature shall enact appropriate laws to carry out the purposes of this section. The legislature, by the favorable vote of three-fifths of the members elected to each house, may adjust the term [one] [three] percent in subsection (b) to no

greater than (x) percent , and may adjust the term "zero" as used in subsection (c), to no greater than one percent and no less than negative one.

(g) This section shall be effective as of the third fiscal year following the fiscal year in which it is approved by the qualified electors of the state."

Fiscal Performance of the Proposed Rainy Day Fund Triggers

Proposal and Simulation

1. INTRODUCTION

Two criteria for an effective rainy day fund are the following: (1) the fund collects and dispenses appropriate amounts of money at appropriate times; and (2) it is simple to operate. Of the various alternatives studied by the Washington State Tax Structure Study Committee, the rainy day fund proposed here comes closest to satisfying these criteria.

The purpose of this section is to describe the operation of the proposed rainy day fund and to simulate its behavior over time. In particular, the operation of the rainy day fund is simulated from FY 1989 to FY 2002 using actual data and forecasts published by the Washington State Office of the Forecast Council (OFC). Thus, the simulation shows exactly how the rainy day fund would have performed during this period of time.

2. RAINY DAY FUND

Following is a brief description of the rainy day fund:

1. Objective. The rainy day fund is designed to provide money for the general fund for fiscal years in which general fund revenue is expected to increase less than the inflation rate, as measured by the Seattle consumer price index. In such a year, the so-called rainy day, the amount of money withdrawn from the rainy day fund and deposited into the general fund is just sufficient to keep general fund revenue constant with respect to the prior year's level after adjusting for inflation. In other years, a specified amount of money is appropriated from the general fund and deposited into the rainy day fund.

2. Data and forecasts. The source of data and forecasts required to operate the rainy day fund is the quarterly publication prepared by the OFC entitled "Washington Economic and Revenue Forecast." In particular, the rainy day fund makes use of actual and forecast fiscal-year estimates of general fund revenue (cash basis) and the Seattle consumer price index obtained from the November issues of the publication.

3. Restrictions. The operation of the rainy day fund is subject to three restrictions: (1) no more than 1 percent of the general fund revenue in a year will be deposited into the fund; (2) no more than the current balance of the rainy day fund in any year will be withdrawn from the fund (i.e., the fund's balance cannot be negative); and (3) the total amount of money in the rainy day fund in any year will not exceed 10 percent of the general fund revenue.

4. Operation. As part of the budgetary process, each November, just before the legislative session, OFC produces economic and revenue forecasts for the upcoming fiscal year, including predictions of general fund revenue (cash basis) and the Seattle consumer price index. In accordance with the objective of the rainy day fund, the difference between the predicted growth rate for general fund revenue and the predicted growth rate for the Seattle consumer price index, expressed as a percentage, ultimately determines how much will be contributed to or withdrawn from the rainy day fund in the upcoming fiscal year.

   If the percentage point difference is positive, an amount of money equal to that percentage point difference multiplied by the general fund revenue in the current fiscal year (i.e., the year in which this determination is taking place) will be deposited into the rainy day fund during the upcoming fiscal year. In no case, however, will the deposit amount to more than 1 percent of the general fund revenue in the upcoming fiscal year.

   If the percentage point difference is negative, an amount of money equal to the percentage point difference multiplied by the general fund revenue in the current fiscal year will be withdrawn from the rainy day fund during the upcoming fiscal year. In no case, however, will the withdrawal amount to more than the balance of the rainy day fund at the end of the current fiscal year.

   Since the operation of the rainy day fund uses forecasts, which are subject to error, a second step is required. In the following November, which will be five months into the fiscal year in question, the above calculations will be repeated using up-to-date data and forecasts from OFC. Based on the new calculations and in accordance with the objective of the fund, an adjustment to the previously determined deposit to or withdrawal from the fund will be made.

   As an illustration, consider how the rainy day fund would have operated in FY 2002, which was in the middle of the current recession. In November 2000, when there was little sign of the downturn, OFC predicted that general fund revenue would increase 1.7 percent from $10,735.8 million in FY 2001 to $10,923.4 million in FY 2002, while the Seattle consumer price index would increase 2.2 percent from 1.818 (1982-84=1.000) in FY 2001 to 1.858 in FY 2002 (see Table 2). The difference between these

two growth rates is -0.5 (=1.7-2.2) percent. Accordingly, an amount equal to $48.6 (=0.005[10,753.8]) million would have been withdrawn from the rainy day fund, raising general fund revenue to $10,972.0 (=10,923.4+48.6) million. At this level the expected general fund revenue for FY 2002 equals the level for FY 2001 after adjusting for inflation (i.e., 10,972.0/1.858=10,735.8/1.818=5,905.3 in 1982-84 dollars).

In November 2001, the fifth month of FY 2002, the seriousness of the recession was fully recognized. OFC's revised forecasts now called for a 3.7 percent decline in general fund revenue (from $10,828.8 million in FY 2001 to $10,427.9 million in FY 2002) and a 2.6 percent increase in the Seattle consumer price index (from 1.828 in FY 2001 to 1.876 in FY 2002). The difference in the growth rates was -6.3 (=-3.7-2.6) percent, implying a withdrawal from the rainy day fund amounting to $685.2 million (=0.063[10,828.2]) million. Since a withdrawal of $48.6 million had already been authorized the year before, an additional withdrawal of $636.6 (=685.2-48.6) million would have been made, assuming that there was sufficient money in the rainy day fund.

5. Override. At any time, the Legislature with a 60 percent vote of approval may contribute money to or withdraw money from the rainy day fund. Such occasions may arise from unanticipated events, such as an economic boom or a natural disaster, or simply from the imperfect operation of the fund.

3. SIMULATION

Tables 1, 2, and 3 show how the proposed rainy day fund would have worked from FY 1989 to the present. Table 1 simulates the operation of the fund with actual data on general fund revenue and the Seattle consumer price index. This is tantamount to assuming that the forecasts made each November are perfectly accurate. Following the same line of calculations made in the above example, the first seven columns in Table 1 lead to an estimate of the potential rainy day fund contribution or withdrawal. The actual contribution or withdrawal, shown in the next column, will be different from the potential contribution or withdrawal if one of the two restrictions on fund size, such as the fund balance cannot drop below zero, is violated. The next four columns show the operation of the fund under two different starting assumptions: (1) the fund balance is zero at the end of FY 1988; and (2) the fund balance is $500 million at the end of FY 1988. The last column shows the maximum allowable balance, which in this case is assumed to be 10 percent of the general fund revenue in the year.

Table 2 shows the operation of the fund using November forecasts of general fund revenue and the Seattle consumer price index made by OFC instead of actual data. Note that in November of any year, OFC is not only forecasting these variables for the upcoming fiscal year but also does not know their exact values in the current fiscal year (labeled “prior year” in Table 2).

Finally, using FY 2002 as an example, Table 3 shows the second step of the rainy day fund process, namely the adjustment to the fund's inflows or outflows as a result of the revised forecasts one year later.

Table 1 shows that in the ideal world of perfect forecasts the rainy day fund works well. The fund builds up money when revenue growth is relatively strong and dispenses it when revenue is needed to supplement general fund revenue (FY 1991, FY 1996, FY 2001, and FY 2002). The simulation of the fund with a zero beginning balance shows the difficulty of building up a rainy day fund from scratch. The second simulation shows that once the fund is built up, it can be easily maintained. Table 2 shows that in the real world of imperfect forecasts, the rainy day fund works less well. In particular, the timing and the amounts of money contributed to or withdrawn from the fund are not always appropriate because of inaccurate forecasts. For example, based on forecasts made in November 1998, $49 million would have been withdrawn from the rainy day fund for use in FY 1990. As shown in Table 1, actual data reveal that, instead of withdrawing $49 million from the fund, $65.1 million should have been deposited. Table 2 clearly demonstrates the need to correct for inaccurate errors.

Table 3 shows the correction for FY 2002 that would have been made in November 2001, one year after the initial forecasts had been prepared. The correction is very large, implying that there is a great need to provide additional money to the general fund revenue in FY 2002. The correction is also timely, since November 2001 is only the fifth month of FY 2002. In general, such corrections permit the rainy day fund to operate much like it would have operated had there been accurate forecasts in the first place (i.e., much like the simulation shown in Table 1).

4. COMMENTS

1. Administration of the rainy day fund. A simple way to administer the fund is to incorporate its operation into the activities of the Washington State Economic and Revenue Forecast Council, which is composed of members of the legislative and the executive branches of state government. The principal responsibility of the council is approving the economic and revenue forecasts produced by OFC. Overseeing the operation of the rainy day fund would be a natural extension of the council's current responsibility.

2. February forecasts. The proposed rainy day fund makes use of forecasts produced in November. The predictions for the upcoming fiscal year would in general be more accurate if they were made three months later in February, since more would be known about the future course of the economy at that time. A February determination, however, may be too late in the legislative session to be helpful.

3. Quarterly updates. Since economic and revenue forecasts are prepared quarterly, there is no reason why the rainy day fund could not be

maintained on a quarterly or at least semi-annual basis. It would make operation of the fund more responsive to the immediate revenue needs of state government.

4. Actual data versus forecasts. Some states use actual data on such variables as personal income to determine the inflows and outflows of their rainy day funds, sidestepping the problem of using inaccurate forecasts. The problem with this approach is that the delay in waiting for accurate published estimates makes it difficult to control the flow of funds in a timely manner. For example, by the time one has learned that personal income growth over the last year was sluggish, justifying a withdrawal from the rainy day fund, the economy and revenue collections might have speeded up again. In general, it seems more reasonable to forecast the need for money, if any, from the rainy day fund and then make the necessary adjustment if that forecast turns out to be incorrect.

5. Consumer price index. Using the Seattle consumer price index as a measure of inflation has its shortcomings: (1) it is not a measure of inflation for government; (2) it tends to overestimate inflation for consumer goods and services; (3) it applies only to the greater Seattle area (about two-thirds of the state economy); and (4) its estimates are sometimes inaccurate because of small-sample errors.

   But there are good reasons for using it: (1) it is published; (2) it is the only measure of local inflation available; (3) it is probably not a bad surrogate for the local inflation rate for government; (4) it is better than a fixed "adjustment factor," since inflation rates, even in the long run, vary over time; and (5) while it is subject to small-sample errors, these errors tend to be random in nature and result in relatively small measurement errors when estimating inflation over long periods of time (two or more years).

   With regard to the third reason above, estimates have been made of the ten-year average inflation rates for the Seattle consumer price index, the U.S. consumer price index, and the U.S. implicit price deflator for state and local government expenditures. Noting the similarity between the inflation rate for the U.S. consumer price index (2.7 percent) and the U.S. government deflator (2.6 percent), it would appear that the use of the consumer price index as a surrogate for the government deflator is justified. Noting the significantly higher inflation rate for the Seattle consumer price index (3.3 percent), attributable to the rapid growth of the local economy during the 1990s, it would appear that it is better to use a local price index than a national price index.

6. Alternative fund triggers and limits. Concerns have been expressed about the large size of the contributions that would be made to the rainy day fund in some years and the potentially large size of the fund itself under

the proposed operating parameters. In the course of this study, simulations have also been conducted assuming less demanding triggers for the fund, such as adding money to the rainy day fund only if the difference between the forecast growth of general fund revenue and the inflation rate is 1 percent or more, or restricting the maximum allowable size of the fund to 5 percent of general fund revenue. The impact of these changes is to significantly reduce the size of the rainy day fund and thus its effectiveness as a means of stabilizing state government revenue. For example, a simulation in which both of the above changes are made shows that the rainy day fund is totally depleted by the end of FY 2000, the year before the big downturn in general fund revenue.

Table 1. Rainy Day Fund Operation Based on Actual Data (millions of dollars)

	General Fund Revenue Cash Basis	Percent Change	Seattle Consumer Price Index (82-84=1.000)	Percent Change	Percent Change Difference	Rainy Day Fund Contribution or Withdrawal Percent
Initial Balance	na	na	na	na	na	na
FY1989	$5,686.0	8.3	1.153	3.8	4.6	1.0
FY1990	$6,505.4	14.4	1.219	5.7	8.7	1.0
FY1991	$6,801.9	4.6	1.312	7.6	-3.1	-3.1
FY1992	$7,297.6	7.3	1.365	4.0	3.2	1.0
FY1993	$7,564.6	3.7	1.411	3.4	0.3	0.3
FY1994	$8,013.4	5.9	1.451	2.8	3.1	1.0
FY1995	$8,551.3	6.7	1.502	3.5	3.2	1.0
FY1996	$8,581.2	0.3	1.544	2.8	-2.4	-2.4
FY1997	$9,056.6	5.5	1.606	4.0	1.5	1.0
FY1998	$9,640.9	6.5	1.653	2.9	3.5	1.0
FY1999	$9,979.2	3.5	1.702	3.0	0.5	0.5
FY2000	$10,433.2	4.5	1.757	3.2	1.3	1.0
FY2001	$10,828.9	3.8	1.828	4.0	-0.2	-0.2
FY2002	$10,453.9	-3.5	1.876	2.6	-6.1	-6.1

	Potential Rainy Day Fund Contribution or Withdrawal	Actual Rainy Day Fund Contribution or Withdrawal	Rainy Day Fund End-of-Year Balance (FY88=0)	Actual Rainy Day Fund Contribution or Withdrawal	Rainy Day Fund End-of-Year Balance (FY88=500)	Rainy Day Fund Maximum Allowable Balance 10 percent
Initial Balance	na	na	0.0	na	500.0	na
FY1989	$56.9	$56.9	$56.9	$56.9	$556.9	$568.6
FY1990	$65.1	$65.1	$121.9	$65.1	$621.9	$650.5
FY1991	-$199.8	-$121.9	$0.0	-$199.8	$422.1	$680.2
FY1992	$73.0	$73.0	$73.0	$73.0	$495.1	$729.8
FY1993	$21.1	$21.1	$94.0	$21.1	$516.2	$756.5
FY1994	$80.1	$80.1	$174.2	$80.1	$596.3	$801.3
FY1995	$85.5	$85.5	$259.7	$85.5	$681.8	$855.1
FY1996	-$209.2	-$209.2	$50.5	-$209.2	$472.6	$858.1
FY1997	$90.6	$90.6	$141.0	$90.6	$563.1	$905.7
FY1998	$96.4	$96.4	$237.5	$96.4	$659.6	$964.1
FY1999	$52.5	$52.5	$290.0	$52.5	$712.1	$997.9
FY2000	$104.3	$104.3	$394.3	$104.3	$816.4	$1,043.3
FY2001	-$25.9	-$25.9	$368.4	-$25.9	$790.5	$1,082.9
FY2002	-$659.3	-$368.4	$0.0	-$659.3	$131.2	$1,045.4

Table 2. Rainy Day Fund Operation Based on Forecasts (millions of dollars)*

	General Fund Revenue Cash Basis	Prior Year Estimate	Percent Change	Seattle CPI (82-84=1.000)**	Prior Year Estimate	Percent Change	Percent Change Difference
Initial Balance	na	na	na	na	na	na	na
FY1989	$5,202.4	$4,996.1	4.1	3.629	3.477	4.4	-0.2
FY1990	$5,707.6	$5,489.4	4.0	1.271	1.212	4.9	-0.9
FY1991	$6,390.1	$6,185.9	3.3	1.323	1.267	4.4	-1.1
FY1992	$7,124.7	$6,747.2	5.6	1.395	1.345	3.7	1.9
FY1993	$7,479.7	$7,100.5	5.3	1.435	1.385	3.6	1.7
FY1994	$7,750.8	$7,483.3	3.6	1.461	1.414	3.3	0.3
FY1995	$8,279.7	$7,856.7	5.4	1.497	1.448	3.4	2.0
FY1996	$8,720.2	$8,496.7	2.6	1.555	1.503	3.5	-0.8
FY1997	$9,049.2	$8,619.3	5.0	1.587	1.541	3.0	2.0
FY1998	$9,430.6	$9,009.4	4.7	1.638	1.590	3.0	1.7
FY1999	$9,856.5	$9,576.1	2.9	1.688	1.647	2.5	0.4
FY2000	$9,909.1	$9,881.6	0.3	1.737	1.699	2.2	-2.0
FY2001	$10,451.7	$10,275.7	1.7	1.787	1.753	1.9	-0.2
FY2002	$10,923.4	$10,735.8	1.7	1.858	1.818	2.2	-0.5
FY2003	$10,780.7	$10,427.9	3.4	1.906	1.876	1.6	1.8

	Rainy Day Fund Contribution or Withdrawal Percent	Potential Rainy Day Fund Contribution or Withdrawal	Actual Rainy Day Fund Contribution or Withdrawal	Rainy Day Fund End-of-Year Balance (FY88=0)	Actual Rainy Day Fund Contribution or Withdrawal	Rainy Day Fund End-of-Year Balance (FY88=500)	Rainy Day Fund Maximum Allowable Balance 10 percent
Initial Balance	na	na	na	0.0	na	$500.0	na
FY1989	-0.2	-$12.1	$0.0	$0.0	-$12.1	$487.9	$520.2
FY1990	-0.9	-$49.0	$0.0	$0.0	-$49.0	$438.9	$570.8
FY1991	-1.1	-$69.2	$0.0	$0.0	-$69.2	$369.7	$639.0
FY1992	1.0	$71.2	$71.2	$71.2	$71.2	$440.9	$712.5
FY1993	1.0	$74.8	$74.8	$146.0	$74.8	$515.7	$748.0
FY1994	0.3	$18.8	$18.8	$164.8	$18.8	$534.5	$775.1
FY1995	1.0	$82.8	$82.8	$247.6	$82.8	$617.3	$828.0
FY1996	-0.8	-$70.5	-$70.5	$177.1	-$70.5	$546.8	$872.0
FY1997	1.0	$90.5	$90.5	$267.6	$90.5	$637.3	$904.9
FY1998	1.0	$94.3	$94.3	$361.9	$94.3	$731.6	$943.1
FY1999	0.4	$42.0	$42.0	$404.0	$42.0	$773.6	$985.7
FY2000	-2.0	-$193.5	-$193.5	$210.4	-$193.5	$580.1	$990.9
FY2001	-0.2	-$23.3	-$23.3	$187.1	-$23.3	$556.8	$1,045.2
FY2002	-0.5	-$48.6	-$48.6	$138.5	-$48.6	$508.2	$1,092.3
FY2003	1.0	$107.8	$107.8	$246.3	$107.8	$616.0	$1,078.1

*Forecasts are produced in November of prior fiscal year.

**FY1989 estimate is for U.S. consumer price index (67=1.000) and FY1990, FY1991, FY1992, and FY1993 estimates are for U.S. consumer price index (82-84=1.000).

Table 3. Rainy Day Fund Adjustment for FY2002 (millions of dollars)

	General Fund Revenue Cash Basis	Prior Year Estimate	Percent Change	Seattle Consumer Price Index (82-84=1.000)	Prior Year Estimate
FY2002 November 2000 Forecast	$10,923.4	$10,735.8	1.7	1.9	1.8
FY2002 November 2001 Forecast	$10,427.9	$10,828.8	-3.7	1.9	1.8
Adjustment	na	na	na	na	na

	Percent Change	Percent Change Difference	Rainy Day Fund Contribution or Withdrawal Percent	Potential Rainy Day Fund Contribution or Withdrawal
FY2002 November 2000 Forecast	2.2	-0.5	-0.5	-48.6
FY2002 November 2001 Forecast	2.6	-6.3	-6.3	-685.2
Adjustment	na	na	na	-636.6

Table 4. Budget Stabilization Funds as a Percent of State Expenditures

	Budget Stabilization Fund			Expenditures			Budget Stabilization Percent			
State	**2000**	**2001**	**2002**	**2000**	**2001**	**2002**	**2000**	**2001**	**2002**	**Rank**
Alabama	$3	$8	$13	$5,215	$5,248	$5,286	0.06%	0.15%	0.25%	42
Alaska	2,734	3,078	2,857	2,262	2,287	2,413	120.87%	134.59%	118.40%	1
Arizona	408	374	266	6,012	6,370	6,546	6.79%	5.87%	4.06%	23
Arkansas	0	0	0	3,177	3,259	3,392	0.00%	0.00%	0.00%	43
California	8,666	6,348	2,596	66,494	80,087	78,763	13.03%	7.93%	3.30%	26
Colorado	583	256	0	5,992	6,670	6,976	9.73%	3.84%	0.00%	44
Connecticut	564	595	595	10,913	11,955	11,894	5.17%	4.98%	5.00%	14
Delaware	114	120	126	2,246	2,429	2,457	5.08%	4.94%	5.13%	13
Florida	1,666	1,187	941	18,554	20,033	20,290	8.98%	5.93%	4.64%	19
Georgia	551	579	618	13,782	14,770	14,773	4.00%	3.92%	4.18%	21
Hawaii	6	21	54	3,201	3,381	3,651	0.19%	0.62%	1.48%	39
Idaho	36	53	73	1,681	1,829	2,044	2.14%	2.90%	3.57%	25
Illinois	0	225	230	23,084	24,497	24,876	0.00%	0.92%	0.92%	41
Indiana	540	526	526	8,967	9,623	9,598	6.02%	5.47%	5.48%	9
Iowa	444	462	463	4,763	4,874	4,848	9.32%	9.48%	9.55%	3
Kansas	0	0	0	4,368	4,430	4,509	0.00%	0.00%	0.00%	45
Kentucky	279	240	239	6,549	7,041	7,332	4.26%	3.41%	3.26%	28
Louisiana	59	150	150	5,811	6,306	6,412	1.02%	2.38%	2.34%	33
Maine	144	144	123	2,317	2,645	2,593	6.21%	5.44%	4.74%	17
Maryland	582	888	563	9,022	10,230	10,789	6.45%	8.68%	5.22%	12
Massachusetts	1,608	2,295	1,715	20,838	21,939	22,616	7.72%	10.46%	7.58%	5
Michigan	1,264	1,031	500	9,576	9,722	9,306	13.20%	10.60%	5.37%	11
Minnesota	1,380	1,109	1,140	11,476	13,115	12,940	12.03%	8.46%	8.81%	4
Mississippi	232	189	192	3,515	3,512	3,552	6.60%	5.38%	5.41%	10
Missouri	143	151	156	7,350	7,730	7,820	1.95%	1.95%	1.99%	36
Montana	0	0	0	1,105	1,260	1,420	0.00%	0.00%	0.00%	46
Nebraska	142	170	110	2,344	2,478	2,660	6.06%	6.86%	4.14%	22
Nevada	136	136	136	1,608	1,838	1,847	8.46%	7.40%	7.36%	6
New Hampshire	20	55	55	1,028	1,063	1,151	1.95%	5.17%	4.78%	16
New Jersey	698	720	720	19,459	20,756	22,489	3.59%	3.47%	3.20%	30
New Mexico	0	0	0	3,390	3,827	3,896	0.00%	0.00%	0.00%	47
New York	547	627	627	37,170	39,702	41,993	1.47%	1.58%	1.49%	38
North Carolina	38	158	339	13,854	13,446	14,528	0.27%	1.18%	2.33%	34
North Dakota	0	0	0	773	822	847	0.00%	0.00%	0.00%	48
Ohio	1,003	1,011	1,011	19,244	21,144	22,138	5.21%	4.78%	4.57%	20
Oklahoma	158	340	170	4,545	4,819	5,206	3.48%	7.06%	3.27%	27
Oregon	0	0	0	4,849	5,253	5,458	0.00%	0.00%	0.00%	49
Pennsylvania	1,097	1,127	1,223	19,295	19,981	20,690	5.69%	5.64%	5.91%	8
Rhode Island	71	80	81	2,231	2,485	2,651	3.18%	3.22%	3.06%	31
South Carolina	145	61	63	5,156	5,520	5,552	2.81%	1.11%	1.13%	40
South Dakota	37	38	40	771	803	851	4.80%	4.73%	4.70%	18
Tennessee	165	178	178	6,593	7,233	7,551	2.50%	2.46%	2.36%	32
Texas	85	198	550	27,493	28,641	31,171	0.31%	0.69%	1.76%	37
Utah	110	120	125	3,364	3,711	3,890	3.27%	3.23%	3.21%	29
Vermont	41	43	44	855	881	893	4.80%	4.88%	4.93%	15
Virginia	575	678	865	11,282	12,238	12,306	5.10%	5.54%	7.03%	7
Washington	754	463	421	10,220	10,826	11,217	7.38%	4.28%	3.75%	24
West Virginia	73	79	63	2,639	2,707	2,974	2.77%	2.92%	2.12%	35
Wisconsin	0	0	0	11,271	11,078	11,383	0.00%	0.00%	0.00%	50
Wyoming	39	65	130	518	630	630	7.53%	10.32%	20.63%	2
Total	$27,389	$26,372	$21,087	$468,216	$507,118	$521,066	5.85%	5.20%	4.05%	

Source: Fiscal Survey of the States: Dec. 2001, National Governors Association and the National Association of State Budget Officers

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.*

Appendix F: Tax Reform Efforts in Other States

A Summary

At the request of the Committee, tax reform efforts in several other states were researched and analyzed to determine common factors that prompted the tax reform efforts and whether the reform efforts were successful. The following states are included in this analysis:

Connecticut
Florida
Illinois
Michigan
Minnesota
New Hampshire
New Jersey
Oklahoma
Tennessee

What Prompted the Tax Reform Efforts in Other States?

In most of the above states, efforts for tax reform were in response to one of two factors:

- Taxpayer perceptions of high tax burdens; or
- Immediate or future budget shortfalls.

In the last decade, several states have responded to the public perception of high tax burdens by undertaking studies to evaluate the relative tax burdens of taxpayers in the state, and developing alternative proposals to reduce the burdens. For example, tax reform efforts in New Hampshire, Michigan, and Minnesota were prompted in part by taxpayers' perceptions that the property tax burdens were too high and that the taxes themselves were too complex.

Also in the last decade, many states have experienced a budget shortfall or were anticipating that revenues would fall short of budget needs in future years. Tennessee's tax reform study and legislation was driven by the $900 million shortfall in the Governor's proposed budget in 1998. While Connecticut completed its study of the state tax structure in 1990 in a period of relative economic prosperity, the

subsequent enactment of a personal income tax (one of the analyzed alternatives) occurred in a period of severe budget crisis.

Were the Reform Efforts Successful?

The majority of states listed above have undertaken their tax reform efforts in response to a major crisis: after taxpayer perceptions have reached an all-time low, or when the state is in the throes of a budget deficit.

Although one could ascribe many reasons for the failure of various tax reform efforts in the remaining states, the common sense response is that the unsuccessful states were not experiencing the same level of state crisis, either real or perceived, to add urgency to the desire for tax reform. Oklahoma, for example, undertook its tax study to determine the economic effects of a hypothetical tax reform package that never materialized in legislation.

The list below describes briefly each state's reform efforts and the results:

- **Connecticut** – Study recommended business tax reform, broadening the sales tax base, and possible implementation of a personal income tax. Successful implementation of a state personal income tax and eventual incremental business tax reform (rate reductions and credits).

- **Illinois** – Study recommended various incremental reforms to state income taxes, property tax, and sales taxes. Incremental sales tax reforms successful; namely reduced sales tax on food and drugs, and inclusion of some services in the tax base.

- **Florida** – Study recommended various incremental reforms to state tax system, including constitutional limitations on the state's ability to increase taxes. The Task Force also recommended the repeal of certain small tax sources.

- **Michigan** – No formal study conducted. Legislation virtually eliminated local property taxes and subsequent legislation was approved by voters to increase the state sales tax as an alternative funding source. Legislation provided for eventual repeal of state single business tax, no alternative tax imposed.

- **Minnesota** – Study recommended significant reforms to property, sales, and income taxes. Successful implementation of property tax reform including reducing classifications of property and tax rates and elimination of state property tax levy.

- **New Hampshire** – Court decision struck down local property tax system. Legislation imposed a statewide property tax as a replacement revenue source. Study group convened to study alternative tax sources and analyzed personal

income taxes, sales taxes, value added taxes, and additional property tax reform. No further tax reform implemented.

- **New Jersey** – Study recommended reforms to sharing of service burdens by state and local government to reduce heavy reliance on local property taxes. Study also recommended budget and administrative reforms. Successful implementation of rainy day fund for administrative reform but little reduction in local property tax burden.

- **Oklahoma** – Governor and legislative leaders formed Study Committee with the goal of finding a revenue-neutral way to eliminate the state personal income tax and provide a sales tax exemption for groceries. Study developed five options, none of which were implemented.

- **Tennessee** – Legislation significantly expanded the state business tax. Subsequent legislation convened a study committee to evaluate the state tax system, focusing attention on tax exemptions. No further tax reform was successful.

CONNECTICUT

Task Force on State Tax Revenue – Final Report

In 1989, Public Act 89-251 was passed by the Connecticut General Assembly to set up a Task Force on State Tax Revenue. The Task Force started its proceedings in September of 1989 and concluded in December 1990.

The Task Force generated a three-part final report, evaluating three major revenue sources: the state's currently imposed business tax, retail sales tax, and a proposed personal income tax.

Business Taxes:

The Task Force was instructed to focus its analysis on the following areas:

- Effects of the business tax on business investment;
- Other states' business tax policy compared with Connecticut;
- Effects of the business tax on different size firms in different industries;
- Effects of the business tax on corporations versus other forms of businesses (such as partnerships and proprietorships);
- How different tax bases would impact state revenues and taxpayers; and
- Effects of federal tax policy reform on the corporate income tax base.

The Task Force made various recommendations in response to the analysis of business tax issues. The following recommendations address the major business tax issues raised in the report:

- Expand the definition of taxable income;
- Create a new apportionment formula for multistate income;
- Implement "throwback" or "throwout" rules; and
- Reduce the overall tax burden on businesses.

In addition to the above business tax recommendations, the Task Force commissioned a consulting firm to develop two statistical tax models which would be installed on state computers. The models would enable the testing of a wide range of corporate tax scenarios and trends and their impact on state and local taxes on hypothetical businesses in a variety of the major industries in the state.

Sales and Use Taxes:

In the sales and use tax area, the Task Force was charged with evaluating the following issues:

- The role of the sales tax in the Connecticut tax mix;
- The tax rate;
- Additional changes in the tax base;
- Stability of the tax base;

- Implications of tax policy for economic development;
- A level playing field;
- Local taxes;
- Administrative issues;
- Equity of the sales tax; and
- Exemptions from the tax base, e.g. services not subject to sales tax.

The Task Force considered the following principles in its evaluation of sales and use taxes:

- Competitiveness;
- Cascading and uniformity;
- Distributional effects; and
- Tax exporting.

The Task Force developed four different scenarios for restructuring the sales tax system. Each scenario was presented with both a revenue-neutral and revenue-enhancing variation (an additional $500 million per year). The four options included:

1. A complete broadening of the tax base at the consumer level without changing business tax rates.
2. Eliminate all business taxes. Completely broaden the tax base at the consumer level.
3. Add all services to the tax base but exempt business purchases of services. Businesses would pay sales and use tax on only 75 percent of their equipment purchases.
4. Broaden the tax base by including consumer purchases of food and clothing.

Personal Income Tax:

The objective of the personal income tax component of the overall Tax Task Force mandate was to analyze alternatives to personal income tax with a focus on:

- Comparison of Connecticut's tax system with other states (neighbors New York, New Jersey, and Rhode Island);
- Stability of current revenue sources; and
- Impacts of the current tax structure on the fiscal and economic environment.

Due to the fact that Connecticut did not at the time impose a personal income tax, the Task Force commissioned a consulting firm to develop a simulation model to analyze the effects of various personal income tax options and their tax burden patterns. The following are the results of a tax incidence analysis using this model.

Comparison with New York, New Jersey, and Rhode Island:

- Current Connecticut taxes are more regressive than in the three comparison states;

- For one scenario of the analysis, all four states were found to have very regressive taxes. The implication is that a large proportion of sales taxes on business purchases, business property taxes and corporate income taxes are shifted to consumers and employees;
- Under another scenario, Connecticut taxes were found to be only moderately regressive for incomes over $30,000;
- A major source of regressivity is the sales tax; and
- Capital gains, interest and dividends are steeply progressive in all four states.

Stability of Tax Sources:

- Sales and use taxes, corporate income taxes, capital gains taxes, and interest and dividend taxes were found to be relatively unstable;
- Sales taxes were found to be volatile due to exemption of many consumer expenditures and the inclusion of cyclical durable goods purchases in the tax base;
- There is a need to broaden the tax base to include a wider range of consumer expenditures;
- The sales tax is less volatile compared to corporate income and capital gains, interest and dividends taxes; and
- A broad-based personal income tax would be more stable than existing main sources of tax revenues. The stability of a broad-based sales tax would be similar to a broad-based personal income tax.

Impacts of Current Tax Structure on the Fiscal and Economic Environments:

- Since 1984 there have been more frequent tax changes in Connecticut compared to the three comparison states;
- Due to lack of a broad-based personal income tax, business taxes have been increased to meet state revenue needs; and
- There is a lack of conclusive evidence for quantifying the economic impact of instituting a personal income tax in Connecticut relative to other alternative fiscal policies.

The Task Force developed the following recommendations regarding personal income taxes. The group did not express a position for or against imposing a personal income tax, but developed recommendations for further study if the state decided to explore personal income tax alternatives. The recommendations for future consideration included:

- Designing different tax base definitions and rate structures that specifically target a revenue group;
- Determine how and at what point to conform to the federal code;
- Choose between having a flat tax rate or a graduated tax rate;
- Alternative tax structures that are designed to be revenue neutral;

- Necessity for implementing a tax withholding system and developing easily accessible taxpayer services to administer a personal income tax efficiently; and
- Necessity for modernization of administrative information systems to implement a personal income tax.

In 1991, the Connecticut Legislature enacted a state personal income tax. After the completion of the Task Force report, the state budget experienced a shortfall of approximately $800 million in 1990. Despite significant disagreements about the structure and advisability of a personal income tax, the budget crisis was severe and immediate enough to convince the Legislature to enact, and the Governor to sign, Public Act 91-3, a budget bill that also implemented a personal income tax.

Implementation of the income tax was complicated, since the budget bill imposing the tax required a one-year phase in tax rate of 1.5 percent, after which the rate increased to 4.5 percent. However, in recent years, the income tax rate has been reduced and personal exemptions have been increased. In addition, the state's corporate business tax rate has been reduced, and more corporate business tax credits have been enacted (for example, credits for fixed and human capital investment).

FLORIDA

State Tax Reform Task Force – Final Report

In June 2000, Governor Bush signed legislation creating a Task Force to examine the state's tax structure and make recommendations on how the state's tax structure could be improved to ensure a stable revenue base that is adequate to fund the needs of the state. The final recommendations were reported to the Governor and the Legislature on February 1, 2002.

The authorizing legislation directed the Task Force to consider principles of sound tax policy such as effectiveness, efficiency, and equity as the group evaluated the state's tax system. The group was also directed to consider the following factors in their analysis:

- Other states' tax treatment of tax issues;
- Florida's tax base, rates, and tax burdens;
- Justification of tax exemptions; and
- Alternative tax sources.

The Task Force and its subcommittees met several times beginning in August 2000. Most of the meetings consisted of presentations by economists, tax policy experts, legislative committee staff, and others. The Task Force was presented with more than 20 topics of discussion on multiple issues such as the state's tax structure, discussions of individual taxes, current national tax policy projects, and more. Following is a listing of the subjects the presentations have covered:

- State Tax Reform Task Force Objectives
- Florida's Tax Structure
- Commerce and the Internet
- Florida State Taxes
- General Tax Administration
- Estate Tax
- Major Changes in Tax Policy
- Sales Tax Exemptions: A Tool for Lowering the Sales Tax Rate in Florida
- Florida's Revenues, Expenditures, and the Constitutional Revenue Limitation Relationship of Taxes and Economic Development
- Streamlined Sales Tax Project
- Crossroads
- Florida's 1987 Sales Tax Experience
- Taxes and Florida Business Climate
- Municipal Funding
- County Funding
- School District Funding
- Review of Tax Administration/Simplification Issues

- Florida's Tax Structure: An Overview
- State Tax Reform Task Force
- County Tax Structure Responses to Questions From the State Tax Reform Task Force

After examining the materials and presentations listed above, the Task Force issued its final report and recommendations in February 2002. The final report concluded that Florida's tax system was inadequate to carry the state into the twenty-first century. The Task Force also developed several tax and spending limitations that they concluded would improve the state tax system, as well as some recommendations for improved administration of state taxes. These recommendations included:

- Constitutional limitations on state appropriations, state tax increases, and local tax increases;
- Continued active participation in the Streamlined Sales Tax Project to reduce the complexity of the state sales tax;
- Repeal or reduction in various small tax sources such as the Alcoholic Beverage Surcharge, sales tax on commercial electricity, and documentary stamp taxes; and
- Various recommendations to improve tax administration, such as revisions to tax filing requirements and consistent application of tax laws by the Department of Revenue.

To this date, no action has been taken on the recommendations of the State Tax Reform Task Force.

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Florida State Tax Reform Task Force – Final Report, February 1, 2002

ILLINOIS

Tax Reform Commission – Final Report

In 1982, Governor Thompson created a state Tax Reform Commission to examine the tax structure of Illinois and make recommendations which would create the lowest, most equitable tax burden possible while still meeting budgetary needs.

The Commission formed five subcommittees to study specific issues and taxes. The groups analyzed the following taxes: business taxes, individual income taxes, property tax, occupation and use taxes, and excise and other consumption taxes. In its final report, the Commission summarized the findings for each tax and outlined possible modifications which would address the identified areas of concern.

Governor Thompson asked the Commission to examine the major state taxes in relation to general tax principles as guidelines: simplicity, neutrality/efficiency, elasticity, equity, and reliance. In the final analysis, the Commission drew the following conclusions regarding the state's current tax system:

- Corporate income tax: simple and neutral, although revenues tend to vary with business cycles.
- Individual income tax: flat rate tax is simple and neutral and a large revenue producer for Illinois. Personal exemptions make the tax progressive.
- Property tax: complex and regressive but neutral. Illinois relies heavily on property tax revenues.
- Occupation and use taxes: this version of a "sales tax" is not simple or uniform between state and local governments. Taxation of food and drugs is regressive.
- Tobacco, fuel and utility taxes: simple to administer but not as neutral as the above taxes.

The Commission then developed alternative recommendations for improving the tax system. The recommendations included:

Corporate income tax:
- Reform apportionment calculation.
- Join a multi-state organization to harmonize state tax laws.

Individual income tax:
- Increase personal exemptions and increase the tax rate.
- Include military pay for residents in gross income.

Property tax:
- Require full market valuation of property on tax bills.
- Allow installment payments of property taxes.
- Enact sunset legislation for exemptions.
- Reform school financing system using more state revenues rather than local.

Occupation and use taxes:

- Require local governments to use the same sales tax base as the state.
- Exempt food and drugs from taxation.
- Broaden the sales tax base to services.

Excise and other consumption taxes:

- Apply the tobacco tax to all tobacco products.
- Change the fuel tax to a variable rate tax.
- Impose higher fuel taxes on heavy trucks.

Few of the Commission's recommendations were implemented. Perhaps the most significant change in Illinois tax administration was the legislation in 1990 that transferred administration of local governments' sales taxes to the state Department of Revenue, thereby addressing at least in part the recommendation for uniformity of the tax base among taxing jurisdictions. In addition, the sales tax on food and drugs was eventually reduced from the general state rate of 6.25 percent to 1 percent, and completely exempted from local sales tax. In recent years legislation was enacted to add many services to the sales tax base (primarily services in which tangible personal property is transferred as an incident of the service).

Tax Reform Commission – Final Report - December 1982

MICHIGAN

Property Tax Reform and Single Business Tax Repeal

In the last ten years, Michigan has undergone significant tax reform that included major revisions to the school financing system and business taxes in the state. None of these reforms were prompted by an "official" tax reform study or commission.

Property Tax Reform

In August 1993, Governor Engler signed legislation that virtually eliminated local property taxes as a source for school funding. High reliance on local property tax revenues for school financing and growing tax burdens for taxpayers prompted several efforts for tax reform in the 1970s and 80s, which were finally successful in 1993. The tax reform legislation did not contain an alternative funding mechanism to fill the $7 billion hole this legislation caused in the school funding system.

In December 1993, the Legislature adopted a bill that gave Michigan voters the choice between two tax reform and funding options. In March 1994, the voters approved a plan to raise necessary school revenues through an increase in the state sales tax, voting down the alternative funding option of an increase in the state personal income tax. The approved ballot measure contained additional tax modifications, such as:

- Two percentage point increase in the state sales tax;
- 0.2 percentage point reduction in the state income tax;
- Threefold increase in the state cigarette tax (to $0.75 per pack);
- Net reduction in property tax rates;
- Constitutional cap on property tax assessment increases; and
- Other tax modifications.

Single Business Tax Repeal

In 1999, Governor Engler signed into law a bill that provided tax relief for businesses through the gradual repeal of the state's Single Business Tax (SBT). Public Act 115 of 1999 allowed for a 23-year phase-out of the tax by reducing the tax rate by one-tenth of 1 percent each year (the rate was 2.3 percent in 1999). However, the rate reduction would be halted any year in which the state's Budget Stabilization Fund (BSF) held a balance of $250 million or less. The legislation did not include a replacement tax to offset the reduced revenues to the state.

The SBT is a value added tax based on several factors of business activity (profits, compensation costs, interest paid, and depreciation). It was enacted in 1975 as a single replacement tax for several previous state business taxes. The SBT replaced the corporate income tax, a local tax on business inventory, the corporate franchise tax, and several other smaller taxes. The SBT was enacted in a period of fiscal crisis

in Michigan, with the hopes that the single tax would provide a less complex, more stable revenue stream for the state.

Since the enactment of the SBT in 1975 the tax has been amended many times. Critics of the SBT argued that the amendments contradicted the original goal of the tax by narrowing the tax base and providing special tax treatment for businesses in different circumstances. Critics also argued that due to the increased complexity of the SBT, it is susceptible to costly and complex litigation.

In response to these concerns, Governor Engler proposed the legislation to phase out the tax. The gradual phase-out was intended to strike a balance between protecting the state budget from the shock of instant repeal and providing business taxpayers the certainty of rate reductions and tax relief.

Critics of the legislative proposal to repeal the SBT voiced the concern that doing away with this tax would effectively eliminate state taxes on business. Although the repeal legislation did not include a replacement business tax, proponents of the bill pointed out that businesses would continue to pay real and personal property taxes as well as sales and use taxes.

Since enactment of the SBT repeal legislation, rate reductions have commenced. On September 30, 2000, the BSF reported a balance of $1.26 billion, well above the $250 million threshold for allowing annual rate reductions. The effective tax rate as of December 2001 will be 2 percent (reduced from 2.3 percent).

Proposal A: A Retrospective – Michigan Department of Treasury, August 1998
House Bill 4745 – House Legislative Analysis, Michigan Legislature 1999

Property Tax Reform

In 1999, Governor Ventura set in motion an initiative for statewide tax reform. The proposal called for three steps in the reform process: assessment, design, and implementation. The Governor's administration charged the Department of Revenue with coordinating the tax reform process, focusing attention on the state property tax system.

Assessment

Gathering public input was the primary charge in the assessment phase of the tax reform initiative. A local research organization convened a Citizens' Jury, a randomly selected panel of state citizens who heard public testimony on the state's tax structure and developed recommendations for property tax reform. In August of 1999, the Jury released their report on their recommendations for tax reform. Following is a summary of the recommendations:

What role should the property tax play in financing local government?

- Less reliance on property tax across the board;
- Minimal changes in local sales taxes;
- No new local income tax;
- More state aid in school funding;
- More reliance on fees and charges;
- No unfunded mandates; and
- Direct relationship between fees and charges and the services provided.

What should be done to improve the property tax system?

- Simplify classes of property;
- Review tax credits for continued validity, repeal out-dated credits;
- No unfunded mandates;
- Allow counties to set own classifications and rates;
- Conduct cost of collection study for property tax; and
- Other recommendations on administration and simplification of the property tax.

Design

The design phase commenced in Spring 2000. In developing specific recommendations to reform the tax system, several tax policy teams were formed to discuss different taxes. Each team started with the principles the citizens of the state had identified as important: fairness, simplicity, predictability, and competitiveness. Each team also developed possible options for reform proposals. A sample of recommendations follows:

- *Property tax* – Make the tax more "local." Target state aid to shared state and local services. Rely more on targeted tax relief options. Eliminate arbitrary classifications of property.
- *Sales tax* – Create a "streamlined" system to simplify collection duties for retailers. Coordinate tax policy with neighboring states on certain goods and services.
- *Income tax* – Use the federal Adjusted Gross Income standard to keep the income tax progressive. Keep the income tax "marriage neutral." Simplify the tax form.

Implementation

The various tax reform proposals were packaged and presented to Governor Ventura, who had legislation introduced in the 2001 legislative session to implement a broad package of tax reform plans. Senate File (SF) 473 included provisions for reforms to the state income tax, sales tax, property tax, corporate franchise tax, gambling and other special taxes, petroleum tax, minerals taxes, and tax administration. However, a legislative stalemate prevented action on the bill.

In May 2001, Governor Ventura developed and presented a compromise tax reform proposal and called a special legislative session to deliberate the new ideas. The Governor's proposal made significant revisions to the state and local property tax system aimed at providing substantial relief to property taxpayers.

In June 2001, Governor Ventura signed the final version of tax reform legislation. House File (HF) 1 provided over $900 million of property tax relief, various education finance reforms, and approximately $850 million of sales tax relief in the form of a sales tax rebate to taxpayers. Specific tax reform provisions in HF 1 included:

- Elimination of the state general education property tax levy;
- Compression of class rates within and across property classes;
- A new statewide property tax levy on business and seasonal recreational property. Revenues are dedicated to education funding;
- Exemption for farms and forests from local school levies and the new statewide levy;
- Average property tax reductions for all classes of property, ranging from a 23 percent reduction for homesteads to a 10 percent reduction for businesses;
- Expanded property tax refund program by increasing the maximum refund amount and expanding eligibility; and
- Average sales tax rebate of $232 to each taxpayer that had income tax liability in the state.

Citizens Jury Report on Minnesota Property Tax Reform – August 1999
A Tax System that Makes Sense for Minnesota – Volume I, What We've Heard – May 2000

A Tax System that Makes Sense for Minnesota – Volume II, Design Guide for Tax Reform – September 2000
Governor's Compromise Budget Proposal – May 25, 2001
Senate File 473, introduced 2001 legislative session
Chapter 5, Laws of 2001 First Special Session (House File 1)

NEW HAMPSHIRE

New Hampshire Commission on Education Funding

In 1997, the New Hampshire Supreme Court, in the Claremont I decision, struck down the state's public school financing system and created an $825 million budget shortfall.

Prior to the court decision, the school financing system depended on locally assessed property taxes as a source of revenue. The court reasoned that the tax system imposed an unreasonable and disproportionate burden on taxpayers. The New Hampshire Legislature responded in 1999 by enacting Chapter 17, Laws of 1999, an omnibus tax reform bill which imposed:

- Statewide property tax amendments, phased in over a period of five years for certain taxpayers;
- Utility property tax provisions;
- Real estate transfer taxes; and
- Other revenue sources.

This legislation was also challenged and struck down by the New Hampshire Supreme Court in 1999 in the Claremont II decision. Although the Legislature intended the phase-in provisions of the property tax amendments to provide tax relief to certain taxpayers that would be adversely affected by the new legislation, the court found the phase-in provisions to be unconstitutional. The court reasoned that since the phase-in period only took effect for certain taxpayers whose property taxes would rise substantially in the first few years of implementation, the legislation did not treat taxpayers proportionally and was therefore unconstitutional. The court made no recommendations about alternative funding sources, indicating instead that the development and choice of funding options was properly a legislative responsibility.

In response to the court's decision, the Legislature reenacted the property tax funding measure in Chapter 338, Laws of 1999. The bill removed the unconstitutional phase-in provision, providing tax relief to low and moderate income taxpayers in the form of a rebate of the increase in property taxes.

In April of 2000, Governor Jeanne Shaheen issued an Executive Order establishing a Commission to study various school funding options in response to the continuing budget shortfall. The Commission was directed to study additional alternative funding options and report to the state Legislature. The group was composed of business and economics experts and was directed to evaluate potential funding alternatives and their effects on the state economy in general and certain types of taxpayers.

In their analysis, the Commission evaluated the alternatives according to the principles of equity, adequacy, competitiveness, exportability, neutrality, and simplicity. The specific tax alternatives included:

- Personal income taxes;
- Retail sales taxes;
- Property taxes;
- Value added taxes (VAT); and
- Legalization of video lottery terminals.

The Commission examined each alternative as if each source alone would recoup the budget shortfall, and then examined hybrid options combining property and income taxes, property and sales taxes, and VAT and income taxes.

The Commission did not give an opinion as to which of the alternatives the Legislature should adopt. For each option, the study report discussed positive and negative aspects of the tax source, with evaluations of how each option fit with the tax principles and the effects on the economy and taxpayers. The Commission directed that the study report was intended to be used as a summary of various tax alternatives, but that each tax option would require further analysis before implementation.

Due to the reenactment of the statewide property tax measures in Chapter 338, Laws of 1999, the immediate pressure to fill the budget shortfall caused by the court decisions has been lessened. At this time, none of the additional tax alternatives proposed by the Commission have been enacted.

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New Hampshire Commission on Education Funding – final report
Claremont I (Claremont School District v. Governor, 138 N.H. 183)
Claremont II (Claremont School District v. Governor, 142 N.H. 462)
Chapter 17, New Hampshire Laws of 1999
Chapter 338, New Hampshire Laws of 1999

NEW JERSEY

State and Local Expenditure and Revenue Policy Commission

In December 1984, the New Jersey Legislature enacted Public Law 1984, Chapter 213, which established the State and Local Expenditure and Revenue Policy Commission and directed the group to systematically review the state and local tax structure.

The Commission was charged with evaluating the tax system in relation to the state and local expenditure structures and spending formulae. Particular attention was also directed on the tax system in relation to the following principles:

- State and local economic vitality;
- Taxpayer's ability to pay taxes and bear increased government spending costs;
- Adequacy of the tax system; and
- Reasonableness, efficiency and fairness of the tax system.

In July 1988, the Commission presented its final report to the Governor and Legislature. The report included an in-depth analysis of the tax system and state fiscal policies and expenditures, identified major fiscal problems, and provided recommendations for reform. In its report, the Commission focused on the following two problems: over-reliance on services provided by local governments and unfair distribution of tax burdens based on taxpayers' ability to pay.

The Commission's recommendations focused on the objectives of expenditure reform, revenue reform, and long-term planning recommendations to safeguard the reform efforts. The following is a list of specific recommendations.

Expenditure Reforms:

- Reform local school financing systems to reduce disparities among districts;
- Define roles for state and local governments in regards to financing certain services, increasing the state role in financing certain "statewide" services; and
- Create a local tax equalization aid program to assist local governments in financing services.

Revenue Reforms:

- Expand the sales tax base;
- Expand the state gross income tax by widening the tax base and changing the rate structure;
- Increase the progressivity of the tax system overall by instituting a targeted property tax relief program;
- Centralize property tax administration; and
- Various reforms to public utility and business taxes.

Safeguarding Reforms:

- Implement programs to evaluate economic development programs and incentives;
- Implement budget reforms such as a rainy day fund, annual accounting of tax incentives, limits to dedicated taxes, and cost-sharing for state mandates to local governments.

The Commission analyzed the effects of the proposed reforms according to the principles mandated by the Legislature. The Commission determined that the overall effect of the reforms would be to create a more equitable distribution of property tax rates and revenues among local governments, and to impose less regressive tax burdens among households.

Few of the proposed reforms were actually implemented by the Legislature. In 1984 when the Commission was created, the state's economy was booming and both the Legislature and the Commission hoped that the recommendations of the group would be easily implemented. However, by 1988 and the completion of the report, the economy had taken a slight downturn and by 1989 the state was in the midst of a budget shortfall. Some of the administrative recommendations (such as the rainy day fund) were implemented, but none of the tax relief proposals were implemented.

Also, in the effort to achieve the goal of reducing local property tax burdens, the state implemented some reforms to transfer local taxing authority to the state, with the intention that the state would assume some of the financing burden for services. However, with the state's budget concerns, sharing of funds was increasingly difficult and local governments still rely heavily on local property taxes for revenues.

Recent Activities

In March 2000, the New Jersey Legislature enacted a bill that created a Sales and Use Tax Review Commission. The purpose of the group is to review and report to the Legislature on proposed sales and use tax exemption legislation. The group is charged with reviewing proposed legislation according to the principles of equity, simplicity, economic neutrality, and cost efficiency. The group provides analysis of the fiscal impact of the proposed legislation and a brief policy discussion, and reports to the Legislature within 90 days of the introduction of the legislation.

New Jersey State and Local Expenditure and Revenue Policy Commission - Final Report - July 1988

OKLAHOMA

Revenue-Neutral Tax Reform

In April 2001, Governor Frank Keating, Senate President Pro Tempore Stratton Taylor, and House Speaker Larry Adair formed an academic committee and charged the group with developing a tax reform program that accomplished the following goals:

- Eliminate the personal income tax;
- Eliminate the retail sales tax on groceries;
- Alter the Oklahoma estate tax to become a "pick up" tax; and
- Maintain revenue neutrality.

Unlike many other states that investigated tax reform options due to budget constraints or revenue shortfalls, Oklahoma's tax reform effort was driven by the predetermined policy goals of the three officials who requested the study. The study consisted of a search for new or expanded tax sources to replace the revenue that would be lost by implementing the above reforms. The committee developed revenue estimates for the tax reforms and the new tax sources.

The committee also considered lessons from other states when developing their recommendations. The group examined states with tax systems similar to their desired end results, namely: Florida, Nevada, Texas, and Washington, in the hopes that one of these states would demonstrate a successful alternative tax source.

The committee was charged with developing recommendations for replacement revenues. The committee presented five scenarios that represented a range of options for restructuring the tax system. Three of the scenarios relied on a single tax to fund the shortfall. The final two options are hybrid alternatives relying on multiple tax sources, making the relative increases in each tax source smaller than if each were relied upon exclusively. The options included:

- Property tax: Institute a state property tax (in addition to the existing local property taxes) and triple the tax rate.
- Sales tax: Expand the sales tax base to include many business service activities and increase the tax rate.
- Gross receipts tax: Impose a broad-based gross receipts business tax (similar to Washington's B&O tax).
- Hybrid #1: Increase property tax rates, impose sales tax on services, and impose a low-rate gross receipts business tax.
- Hybrid #2: Increase property tax rates, and impose a gross receipts business tax.

The stated goal of the committee's report was to outline the alternatives and develop some background for making a policy choice, without endorsing a particular tax reform option. However, the committee did consider several tax principles when

developing the alternatives and conducted a high-level analysis of the alternatives as they related to revenue stability, tax exportation, economic efficiency, tax equity, and administrative simplicity. In the final conclusions, the committee indicated a preference for the hybrid scenarios with incremental changes to a variety of tax sources.

In the 2001 legislative session, the Oklahoma Legislature enacted HB 1933, a bill providing income tax relief in the form of an earned income tax credit. However, the legislation was enacted prior to the release of the Commission's final report. At this time, none of the wholesale tax reforms proposed by the Governor or the alternatives developed by the committee have been enacted.

Revenue-Neutral Tax Reform for Oklahoma – Issues and Options – Final Report, June 2001

Tax Revision and Reform Act of 1999 and Joint Select Committee on Business Taxes

In 1998, Governor Sundquist's budget proposal required approximately $950 million more than the current tax system would support. In response, the 1999 Legislature enacted a bill to reform and expand the state's franchise and excise taxes on businesses to alleviate some of the budget shortfall. The bill also required the Joint Select Committee on Business Taxes to evaluate the state tax structure, exemptions, and develop recommendations for alternative funding sources.

Prior to the enactment of Public Chapter (P.C.) 406, the state excise tax on business consisted of a 6 percent tax on the net earnings of corporations and cooperatives. The franchise tax was imposed on all taxpayers subject to the excise tax, in the amount of $0.25 per $100 of profits. The legislation made substantial expansions to the state franchise and excise taxes on businesses. The revisions included:

- Expanded the excise tax base to all for-profit businesses in the state, including various limited liability companies and partnerships;
- Expanded the franchise tax base to all for-profit businesses in the state;
- Expanded the franchise tax base to taxpayers' net worth (as opposed to profits);
- Raised the minimum amount of franchise tax paid by taxpayers to $100 (originally $10 minimum);
- Required quarterly estimated payments for both taxes for taxpayers with tax liability over $5,000 annually; and
- Transferred collection and administration responsibilities to the State Commissioner of Revenue for the local option sales taxes imposed by cities and counties.

In addition to the tax revisions mentioned above, P.C. 406 also required the state Joint Select Committee on Business Taxes (the Committee) to evaluate all statutory tax exemptions causing state revenue losses over $1,000,000 per year. The legislation included additional provisions to:

- Require the Committee to review all current statutory exemptions to determine whether they are serving a valid state purpose;
- Require the Committee to draft and introduce legislation to amend or repeal an exemption if so decided by the Committee;
- Established a four-year schedule for evaluating the current statutory exemptions;
- Established a four-year automatic sunset date for exemptions enacted after January 1, 2000.

The Committee was also directed to evaluate the state's tax system in general. In August 1999, the Committee initiated a series of public meetings to solicit testimony regarding the tax study. In October 1999, the Committee issued a final report

outlining the results of the Committee's evaluation of the tax system. The group did not reach conclusions about recommendations for alternative funding sources, but made the following findings:

- The state's current revenue system is inadequate and suffers from "structural flaws;"
- The state should develop a "vision of the future," which would include the key strengths of the state;
- The state should develop a set of goals which would achieve the state vision; and
- The state should develop a revenue system that adheres to basic tax principles and would assist in achieving the goals and vision.

In the Committee's final report, the group included drafts of each of the above findings, in which the importance of fully funding state education programs emerged as a key theme in both the state vision and state goals. The Committee did not develop any recommendations for alternative funding sources to implement any substantial tax reform to achieve the above goals.

In addition to the tax reform efforts enacted in P.C. 406 and outlined above, various legislative proposals have been floated to enact a state personal income tax. Although the state currently imposes a tax on interest and dividend income, it does not impose a tax on salaries and wages. None of the proposals have passed the Legislature, however.

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Joint Select Committee on Business Taxes – Final Report, October 21, 1999
Public Chapter 406, Laws of 1999

Appendix G: Competitiveness Council Recommendations and Directions

Excerpt from the Competitiveness Council Report

Recommendation 3: Direction to the Tax Study Committee

The Tax Structure Study Committee should examine our state and local tax structure to promote competitiveness. Attention should be directed towards:

- Modernization – the current tax structure should be evaluated in terms of suitability to the new economy. For instance, the current apportionment system does not provide the best environment in which to locate either a regional or national headquarters. Likewise, alternatives to the taxation of royalty income should also be examined, such as apportioning the income. Finally, the committee should evaluate the taxation of those multistate businesses whose products and services are almost exclusively Internet-based.
- Equity – evaluate the relative tax burden of businesses and households and provide alternatives for a more balanced distribution.
- Certainty –changes in state and local taxes should be gradual and well planned, and result in certainty for both the state and business.
- Flexibility – where possible, consider the elimination of dedicated funding, allowing policymakers more flexibility to respond to state and local revenue shortages.
- Volatility – examine how the tax structure responds to up and downs in the economy.

<u>Other Views</u>

Some members of the council recommend that the Tax Study Committee also examine the regressivity of the tax structure.

Appendix H: Committee Voting on Replacement and Incremental Alternatives

Voting Results

This "voting tool" was sent to the Committee members prior to the November 8, 2002, Committee meeting. The results of the members' votes are shown below.

Washington State Tax Structure Committee Meeting
November 8, 2002

In the final report, there will be a recommendations chapter that will include a package of recommendations that the majority of the Committee agrees upon. At the November 8 meeting, the Committee will discuss and vote on what to recommend in the final report. The following is a tool to help you prepare for the meeting.

The questions start with general statements and become more specific. For value added tax (VAT) and personal income tax alternatives, we are asking three levels of questions. For example, the first level is whether, *in general*, a VAT and/or personal income tax should be recommended. The second level is whether specific alternatives should be recommended and, if so, which specific alternatives are *acceptable as recommendations*. The third level is which specific alternatives you *prefer*. Please answer the following questions and come prepared to discuss your answers and cast your vote. Unlike the previous poll of the Committee, this document is for your personal use and you do not need to return it to the Department of Revenue.

Part I: Neutrality and VAT

1) The Committee should recommend some type of VAT to mainly address the problem of neutrality/pyramiding of the B&O.

Yes 9
No 2

(if no, skip to Question 4)

2) Do you want to recommend one or more of the specific VAT proposals outlined in Chapter 6?
Choose all acceptable recommendations.
(You may vote for more than one, or none.)

4	**a) Subtraction method VAT (as described in draft Chapter 6)**
_____	b) GST (as described in draft Chapter 6)
_____	c) Progressive VAT (as described in draft Chapter 6)

3) If you prefer just one of the VAT proposals, vote for that one.

9	**a) Subtraction method VAT (as described in draft Chapter 6)**
_____	b) GST (as described in draft Chapter 6)
_____	c) Progressive VAT (as described in draft Chapter 6)

Part II: Income Tax

4) The Committee should recommend a personal income tax to address regressivity and/or other problems of Washington's tax structure.

Yes	**9**
No	**2**

(if no, skip to question 9)

5) Do you want to recommend specific types of personal income taxes?
(You can vote for both, or none)

a) Flat rate personal income tax (with exemptions generally as described in draft Chapter 7)

Yes	**9**

b) Graduated rate personal income tax (with brackets and exemptions generally as described in draft Chapter 7)

Yes	**7**
No	**1**
Abstain	**1**

6) In respect to an income tax, which one of the following is your preference?

a) Flat rate personal income tax (as described in draft Chapter 7)

Yes 6
No 3

b) Graduated rate personal income tax (as described in draft Chapter 7)

Yes 2
No 6
Abstain 1

In Chapter 7, there are three different sets of existing taxes that the personal income tax could reduce or replace. Check all the recommendations that are *acceptable.*

7) The Committee should recommend using a personal income tax to:

a) Reduce the retail sales tax (RST).

Yes 10
No 0

b) Eliminate the retail sales tax.

Yes 6
No 3
Abstain 1

c) Eliminate the state property tax.

Yes 5
No 4
Abstain 1

d) Eliminate the state property tax and share all or part of it with local governments and/or schools.

Yes 10
No 0

e) Reduce business taxes (added at meeting)

Yes 6
No 1
Abstain 2

If you have a preference, choose the one combination of taxes that you think the personal income tax should reduce or replace.

8) Use a personal income tax to (choose one or none):

0 a) Reduce the retail sales tax only
2 b) Eliminate the retail sales tax only
1 c) Eliminate the state property tax only
6 **d) Reduce the retail sales tax and eliminate the state property tax (Join options D & F)**
1 e) Eliminate the retail sales tax and eliminate the state property tax
f) Eliminate the state property tax and share all or part of it with local governments and/or schools. **(Join to D)**
_____ g) Reduce business taxes (added at the meeting)

9) The Committee should recommend, in addition to a personal income tax, a corporate income tax to replace B&O.

Yes 6
No 4

Part III: Adjustment Alternatives

10) Which of the following adjustment alternatives would you like to include as recommendations? Refer to meeting notes or draft Chapter 8 for specifics.

(Check all that you would like to include.)

a) Extend RST to consumer services.

Yes 10
No 1

b) Impose a 1% personal property tax on the market value of motor vehicles.

Yes 4
No 6
Abstain 1

c) Impose a 1% personal property tax on the market value of motor homes and boats.

Yes 9
No 2

d) Exempt construction labor from RST.

Yes 6
No 5

e) Increase B&O tax credit from $35 to $70 and adjust periodically for inflation.

Yes 11
No 0

f) Simplify local B&O tax.

Yes 11
No 0

g) Streamline RST and reaching remote sales.

Yes 10
No 1

h) Simplify state B&O structure.

Vote tabled.

i) Compensate retailers for collection costs (add language for upper limit).

Yes 4
No 7

j) Provide $20,000 homestead exemption for occupied residence.

Yes 3
No 8
(Committee decided to eliminate this option from the report.)

k) Extend property tax deferral option to seniors regardless of income level.

Yes 3
No 7
Abstain 1
(Eliminate from report.)

l) Extend property tax exemption and deferral to low-income regardless of age.

Yes 2
No 9
(Eliminate from report.)

m) Impose an estate tax to replace former provision for state credit.

Yes 7
No 4

n) Impose an estate tax if federal estate tax is repealed.

Vote tabled.
(Eliminate from report.)

o) Identify more opportunities to impose user fees.

Yes 5
No 6

p) Recommend avoidance of dedicated taxes.

Yes 11
No 0

q) Review exemptions for economic or social goals every ten years.

Yes 11
No 0

r) Eliminate sales tax exemption on gasoline.

Yes 3
No 8
(Eliminate from report.)

s) Allow credits for B&O tax paid "upstream."

Yes 4
No 6
Abstain 1

t) Change B&O rates to address inequalities of pyramiding.

Yes 0
No 11
(Eliminate from report.)

u) Create a constitutionally-mandated rainy day fund with objective criteria for deposits, maximum required balance, and withdrawals.

Yes 8
No 3

Appendix I: Advisory Group

The Department was required by the statutory mandate to create an advisory group to provide advice and assistance to the Tax Study Committee. The mandate required that the group include representatives of business, state and local government, labor, taxpayers, and other advocacy groups.

In forming the Advisory Group, the Department solicited the advice of key legislative leaders on how to make the group most useful and successful for the Tax Study Committee. Due to the broad scope of the study and the far-reaching issues surrounding tax administration, the consensus was to invite participation from a large and inclusive group. Invitations to participate in the Advisory Group were delivered to approximately 70 individuals and associations.

In October 2001, the Department held the first meeting of the Advisory Group. Over 60 individuals attended, representing various interest groups and organizations in the fields mentioned above. At this meeting, Advisory Group members were asked to explain the significant issues they felt the Tax Study Committee should address. From the information contained in those responses, the Committee compiled a comprehensive list of issues to be examined in the economic analysis of Washington's existing tax structure. (See Appendix C-1.)

After the first meeting, the Department formed an electronic mailing list to provide regular updates on the progress of the study and to distribute materials, agendas, and presentations from each study meeting to the group. Over the course of the study, many individuals and organizations asked to join the advisory group; no one was refused. At the close of the study, the mailing list contained over 190 individuals, many of whom represented organizations with larger memberships. In addition to the electronic mailing list, the Department created a website for the Tax Study where all meeting materials and presentations were posted. The website also contained a link where citizens and organizations could e-mail additional comments or questions, which were then forwarded to the Tax Study Committee.

Since that initial meeting of the Advisory Group, its members have participated primarily through written input and comments to the Tax Study Committee. Over the course of the study, the Tax Study Committee has asked the Advisory Group to respond to specific questions regarding the principles addressed in the tax study, as well as general requests for comments on the materials presented in the public meetings.

In addition to the process developed for submitting written comments, the Advisory Group was invited in July 2002 to present their comments to the Tax Study Committee at a public meeting. On July 14, 2002, 20 individuals and organizations provided input to the Committee on issues of importance in relation to the tax alternatives under consideration by the Committee. The Advisory Group was also asked to submit additional comments in writing.

The Department would like to thank the Advisory Group for its participation in the study. Advisory Group members included the original organizations who were contacted for their input, plus additional individuals and organizations who joined the study by way of the electronic mailing list or public meetings.

The Department initially contacted over 60 organizations to participate in the Advisory Group. The original organizations include:

AARP Washington State Office
American Association of University Women of Washington
American Electronics Association
Associated General Contractors of Washington
Association of Washington Business
Association of Washington Cities
AVISTA Corporation
Boeing Tax Office, The Boeing Company
Building Industry Association of Washington
Catholic Community Services
City of Seattle, Office of Intergovernmental Relations
Coalition for a Jewish Voice
Common Ground - USA
Department of Ecology
Department of Labor and Industries
Economic Development Council of Seattle & King County
Evergreen Freedom Foundation
Friends Committee on Washington State Public Policy
Friends of the Earth
Governor’s Office
Governor's Office of Indian Affairs
Higher Education Coordinating Board
Independent Business Association
League of Education Voters
League of Women Voters
Microsoft Corporation
National Federation of Independent Business
Northwest Environment Watch
Office of Community Development
Office of Trade and Economic Development
Patrick Dunn & Associates
People for Fair Taxes
Puget Sound Regional Council
Senior Citizens' Lobby
State Coalition for the Homeless
Superintendent of Public Instruction
Tax Executives Institute
Verizon Wireless
Washington Assoc. of Community Action Agencies
Washington Association of Area Agencies on Aging
Washington Association of County Officials
Washington Association of Realtors
Washington Citizens Action
Washington Education Association
Washington Environmental Council
Washington Food Industry
Washington Food Processors Council
Washington Forest Protection Association
Washington Policy Center
Washington Property Rights Alliance
Washington Public Ports Association
Washington Public Utilities District Association
Washington Research Council
Washington Restaurant Association

Washington Retail Association
Washington Roundtable
Washington Society of CPAs
Washington Software Alliance
Washington State Association for Substance Abuse and Violence Prevention
Washington State Association of Child and Adolescent Psychiatrists Advocacy Group
Washington State Association of Counties
Washington State Association of County Assessors
Washington State Association of County Treasurers
Washington State Association of Neighborhood Stores
Washington State Bar Association
Washington State Coalition for Community Action
Washington State Farm Bureau
Washington State Hospital Association
Washington State Labor Council
Washington State Parent Teacher Association
Washington State School Director's Association
Washington Transportation Alliance
Western States Petroleum Association

Since then the group has grown to include additional individuals and organizations who have asked to be included on the Advisory Group electronic mailing list or who have provided additional written input. This list includes:

Alan Harvey
Alan Thein Durning
Amy Brackenbury
Andrea Alexander
Art Scheunemann
Barb Mertens
Barbara Cory
Barbara Barron Flye
Beth Wilson
Betty Spieth
Bill Alkire
Bill Williams
Bob Butts
Bob Carlton
Bob Craves
Bob Longman
Bob Rhule
Brad Shannon
Brian Minnick
Bruce Ramsey
Bruce Reeves
Bruce Reid
Bryan Wahl
Caren Adams
Carlos Marentes
Carol Taylor Cann
Caroline Davis
Carolyn Busch
Carolyn Logue
Carson Strege-Flora
Charles Hasse
Charles Mott
Chelsea Buchanan
Chris Rose
Christina Bridston
Christina Scheel
Cliff Webster
Collins Sprague
Corky Senecal
Dan Coyne
Dan Fazio
Dan Silver
Dana Warn
Daniel Mead Smith
Danny Harris
Darcy Kooiker
Dave Wood
David Foster
David Retz
David Rolf
David Schumacher
Deb Eddy
Deborah Diamond
Deborah Stephens
Dedi Hitchens
Deric Young
Diane Baer
Dick Burton
Doug Levy
Drew Desilver
Duke Schaub
Eleanor Hamburger
Elise McClure
Elizabeth Selleck
Ellie Menzies
Eric Montague
Everett Billingslea
Fred Kiga
Gail Stone
Garry Fujita
Gary Smith
Gene Lux
Gene Vosberg
Gerald Reilly
Glenn Olson
Gordy Lindstrom
Greg Hanon
Greg Pierce

Guy Hobbs
Guz Schwarz
Hamlet Hilpert
Heather Ballash
Heather Morgan
Hunter Goodman
Irv Lefberg
Jan Gee
Jan Leth
Janet Levenger
Jason Mercier
Jean Six
Jeanne Large
Jeff Johnson
Jeremy Aguero
Jerry Cronk
Jerry Martin
Jim Fridley
Jim Hedrick
Jim Justin
Jim Schmidt
Jo Senters
John Ehrenreich
John Mihalyo
John Penney
Josh Baldi
Judy Hedden
Karl Seeley
Kate Smith
Kathy Kimbel
Kelly Croman
Kevin Lyon
Kimberly Craven
Kris Kennedy
Kriss Sjoblom
Kristin Pula
Kurt Nulph
LaNita Wacker
Larry Eyer
Larry Stout
Leland Johnson
Len McComb
Lew McMurran
Linda Hill
Lisa Macfarlane
Lynn McKinnon
Maralyn Chase
Marcia Stedman
Maria Cain
Marianne Kirsten
Mark Brown
Mark Guidry
Mark Johnson
Mark Matteson
Mary Clogston
Mary Fairhurst
Matt Bergeron
Maureen Morris
Mel McDonald
Melville Forde
Merril Cousin
Meta Heller
Michelle Hagen
Micki Hasen
Mike Sloan
Nancy Duncan
Pat Dunn
Patrick Higgins
Patty Van Den Broek
Paul Benz
Paul Vronsky
Perry Keithley
Peter Roth
Rachel Le Mieux
Ralph Amon
Randy Parr
Renee Peare
Renee Radcliff
Richard Dorsett
Richard Stuffler
Rick Bender
Rick Peterson
Robert Stern
Robin Matisse
Ron Bueing
Ron Newbry
Ron Rosenbloom
Ross Hunter
Roy Wilkinson
Russ Hartman
Sandi Swarthout
Scott Noble
Scott Pinegar
Scott Taylor
Seth Dawson
Shawn Cantrell
Sheila Martin
Sherry Appleton
Steve Duncan
Steve Idemoto
Steve Miller
Steve Mullin
Sung Yang
Susan Crowley
Susan Mielke
Terri Kimball
Terry Bergeson
Terry Wilson
Thomas Fitzsimmons
Tina Frank
TK Bentler
Tom Dooley
Trent Matson
Vanessa Spinazola
William D. Ward
Yona Makowski
Yoram Bauman

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