

# SENATE BILL REPORT

## SB 5150

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As of March 15, 2007

**Title:** An act relating to fiscal reform.

**Brief Description:** Providing fiscal reform.

**Sponsors:** Senator Franklin.

**Brief History:**

**Committee Activity:** Ways & Means: 3/15/07.

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### SENATE COMMITTEE ON WAYS & MEANS

**Staff:** Dianne Criswell (786-7433)

**Background:** There are three general types of taxes common to most state and local governments. One type of taxation is imposed on the assessed valuation of asset ownership including real, personal, and intangible property. A second type, common to most states, is imposed on personal and corporate net income. The final type is imposed on transactions and measured by the gross proceeds of each sale.

Of the three general methods for imposing taxes (property, income, and excise taxes) Washington State and local governments rely on property and excise taxes. Washington does not impose taxes on net income.

Income Taxes - In General: Income taxes for persons and corporations are measured by the net income received by individuals, households, and business entities. The federal income tax is imposed on individuals, estates, trusts, and corporations. Income taxes are also levied by most states: 45 states impose a corporate net income tax and 43 states levy a personal income tax. Only Washington, Nevada, South Dakota, and Wyoming do not impose any form of personal or corporate income tax.

Washington State's Current Tax Structure: In 1935, the Legislature enacted the comprehensive Revenue Act, which set the basic structure of Washington's current tax system: a property tax primarily on real estate, a business and occupation (B&O) tax on business receipts, and a sales tax on consumers.

The State Supreme Court has held that Washington's B&O tax, measured by gross receipts, is an excise tax rather than an income tax. All taxes levied in Washington, except for property taxes, represent some form of excise tax. Since the comprehensive Revenue Act of 1935, excise taxes have been the principal source for funding state government in Washington.

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Uniformity: Article 7, section 1 of the State Constitution provides that all taxes must be uniform on the same class of property. This means that: (1) all taxes on the same class of property must be uniform within the territorial limits of the authority levying the tax; and (2) real estate constitutes one class. The amendment also defined "property" to include everything, whether tangible or intangible, subject to ownership.

Uniformity and Income Tax: The Washington State Legislature and Washington voters have considered income tax proposals in the past. Some of these proposals have been adopted by public vote or through legislation, but were later invalidated by state courts. The Washington State Supreme Court concluded that previous income tax proposals were unconstitutional, holding that income is property and that graduated income taxes were not uniform. Other income tax proposals were submitted to the voters, but were not approved.

**Summary of Bill:** Individual income earned from Washington sources is subject to a new income tax. The income tax has a graduated three-rate structure with rates of 2.2 percent, 3.5 percent, and 6.0 percent. The tax is imposed on individuals, estates, and trusts. The tax does not apply to corporations. However, partners of partnerships and shareholders are subject to tax in their separate or individual capacities. Both resident and non-resident individuals are subject to this tax. To avoid double taxation, the bill allows a credit for income taxes due on the same income in other jurisdictions.

Retail Sales Tax and State Property Tax Adjustments: The rate of the state retail sales and use tax is reduced from 6.5 percent to 3.5 percent. Further, the state property tax levy is eliminated starting in calendar year 2009. The 1 percent levy lid is changed to 0.64 percent.

Married, Filing Jointly: For every married individual who makes a single return jointly with his or her spouse and for every surviving spouse, the tax must be:

If taxable income is:	The tax is:
Not over \$49,900	2.2 percent of taxable income
Over \$49,900 but not over \$120,650	\$1,098 plus 3.5 percent of the excess over \$49,900
Over \$120,650	\$3,574 plus 6 percent of the excess over \$120,650

Head of Household: For every head of a household, the tax must be:

If taxable income is:	The tax is:
Not over \$37,425	2.2 percent of taxable income
Over \$37,425 but not over \$90,488	\$823 plus 3.5 percent of the excess over \$37,425
Over \$90,488	\$2,681 plus 6.0 percent of the excess over \$90,488

Single Tax Return: For every individual, other than a surviving spouse or the head of a household, who is not a married individual and for every married individual who does not make a single return jointly with his or her spouse and for every estate and trust, the tax must be:

If taxable income is:	The tax is:
Not over \$24,950	2.2 percent of taxable income
Over \$24,950 but not over \$60,325	\$549 plus 3.5 percent of the excess over \$24,950
Over \$60,325	\$1,787 plus 6.0 percent of the excess over \$60,325

**Appropriation:** None.

**Fiscal Note:** Available.

**Committee/Commission/Task Force Created:** No.

**Effective Date:** If SJR 8209 (the proposed amendment to Article VII of the state Constitution authorizing income taxes) is submitted, approved, and ratified by the voters at a general election held in November 2007, then section 1201 (state property tax levy) takes effect January 1, 2008, and the remainder of this act takes effect January 1, 2009. If the proposed amendment is not approved and ratified, this act is null and void in its entirety.

**Staff Summary of Public Testimony:** PRO: The hearing on SB 5150 and SJR 8209 opens the dialog about the sustainability of Washington State's tax structure, which has remained relatively unchanged since the Revenue Act in 1935. That structure is not designed to meet our state's current needs. The world has changed since 1935. We have growing demands to provide education and health services. There are children and elderly whose needs are not being addressed and who need community support. Our tax system only has two of the three legs of the stool: excise and property taxes. Because our tax system is not balanced by an income tax, we have a boom-bust cycle to our state's revenue. Further, the B&O tax, which the state is depending on, is an unfair burden on business in Washington. The 2002 Tax Structure Study made many recommendations, including enacting an income tax. There is no better time than the current budget climate, when we have a surplus, to begin the dialog with our citizens about where revenue comes from and where it should go.

OTHER: This bill gets rid of the myth that we have a fair tax system. Property and sales taxes have no relationship with one's ability to bear the tax burden. In this regard, income tax is the most fair. This proposal should also address property tax relief for low income persons. Further, there are concerns about this proposal shifting the tax burden from businesses on to individuals. While SB 5150 needs more consideration of the larger tax structure, it is a good beginning.

**Persons Testifying:** PRO: Senator Rosa Franklin, prime sponsor.

OTHER: Steve Zemke, Taxpayers for Washington's Future.