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## **Committee Recommends Improvements to "Flawed" State Tax System**

**Olympia**, Dec. 3, 2002 -- The Washington Tax Structure Study Committee today presented the Legislature with a list of potential improvements to what it called a "flawed" state tax system.

The revenue-neutral alternatives range from incremental changes such as doubling the Business & Occupation tax credit for small businesses, to replacement taxes such as a flat rate personal income tax coupled with reductions in sales and property taxes.

The Legislature had asked the committee to determine how well the current tax system functions, and how it might be improved.

Committee Chairman Bill Gates Sr. said the current tax system is extremely regressive, with low- and middle-income households paying a higher percentage of their incomes in taxes than upper-income households.

"The committee's view is that the current structure is so flawed that it must be judged as unsatisfactory," Gates said. "A fair system is one in which contribution to state revenue is *at least* proportional across the spectrum of incomes, but ours is among the worst in the nation on this count."

He said the committee of legislators and tax and finance experts developed the recommended alternatives not as a "quick fix" to the current budget crisis, but as the starting point for what they hoped would be intelligent debate on how Washington's 1935-era tax system could be modified to work effectively in the 21<sup>st</sup> century.

"We urgently need to promote an informed dialog among legislators, the press and voters on a range of alternatives for improving our system, rather than standing by as one unpopular tax after another is picked off through the initiative process," he said.

Gates said creating a flat personal income tax in conjunction with lowering the sales tax rate and eliminating the state property tax levy would improve Washington's tax system and

could be combined with a lowering of the high initial tax burdens imposed on businesses in this state.

One revenue-neutral scenario is a 3.8 percent flat income tax coupled with a reduction of the state sales tax from its current 6.5 percent to 3.5 percent and a 24 percent reduction in property taxes through elimination of the state levy.

"We are saying that *if* the Legislature wants to overhaul our tax system to make it more fair and less regressive, *then* asking voters to create an income tax is a way to do that," Gates said.

Washingtonians would save as much as \$1.5 billion annually in federal taxes if they could deduct state income taxes on their federal returns, he noted. Washingtonians used to be able to deduct state sales taxes on their returns, but that deduction was eliminated in 1986.

He said the competitiveness of Washington businesses could be improved by replacing the business-and-occupation tax with a "subtraction method" value-added tax (VAT). This would eliminate the current pyramiding of the B&O tax among businesses in which taxes are imposed repeatedly as a product moves through the chain of production.

Incremental improvements recommended by the committee include:

- Extending the sales tax to certain consumer services such as cable TV;
- Imposing a one percent personal property tax on the market value of motor homes and boats because these often are a substitute for vacation homes;
- Reviewing tax exemptions every 10 years to make sure they are achieving economic and social goals;
- Avoiding dedicated taxes that bear no clear relationship between taxpayers and those who receive benefits;
- Creating a constitutionally mandated rainy-day fund;
- Streamlining the sales tax to reduce collection costs and stem erosion of the tax base;
- Simplifying local B&O taxes to reduce the burden on business;
- Doubling the B&O tax credit for small businesses and indexing it to inflation;

A copy of the study, including details on each of the recommendations, plus other alternatives reviewed by the committee, can be found on the committee's web site, <http://dor.wa.gov/content/WAtaxstudy/wataxstudy.htm>. The site includes the latest version of SimTax, Excel-based modeling software that enables users to "roll their own" tax systems.