INTRODUCTION AND OVERVIEW

Taxpayers and government officials have shown considerable interest in Washington's relative tax position among the states. In order to properly compare tax burdens, uniform and reliable data must be utilized. The best source of tax collection figures for all state and local governments in the nation is compiled annually by the Census Bureau of the U.S. Department of Commerce. The figures covering Fiscal Year 2008-2009 were posted to the Census Bureau website (census.gov) on October 31, 2011. The specific data appear under the field of Government, the category of Government Finance Statistics, and the subcategory of State and Local Government Finances.

For Fiscal Year 2009, the amount of taxes reported for Washington State equaled $27.0 billion ($26,980,749,000). This figure includes all state and local taxes, according to the definitions used by the Census Bureau. The majority of Washington's taxes – $16.4 billion – went to state government, while $10.6 billion was attributable to local jurisdictions. Compared with the previous year, the Washington state tax amount decreased by $1.6 billion to $16.4 billion, while local government taxes remained at the same level, $10.6 billion.

Taxes are defined to include compulsory payments not related to particular governmental services; that is, tax liability is independent from the benefit taxpayers receive from government operations. Instead, taxes are determined by other measures such as income, purchases, and property values. However, license fees are included by the Bureau in the tax collection data, even though these receipts are associated with specific rights or privileges. Tax revenues are the source of funding for general programs over which legislatures typically have the most discretion in terms of spending, since nontax revenue sources are often dedicated to specific programs.

Examples of revenues excluded from the tax category are sales of commodities and services directly benefiting individuals (e.g., utility charges, tuitions, and fees). Also, enterprise revenues from liquor sales and utility operations are omitted. Required payments for unemployment and workmen's compensation programs are other significant exclusions; these are not considered general tax revenues because they are earmarked to provide assistance to employees who are laid off from work or injured while on the job.

Tax burdens can be measured in several ways. Each approach has its own merits and is suited to a particular purpose. The two primary methods used in this report are the amount of taxes in relation to population and in relation to personal income.

PER CAPITA TAXES

A first step often taken in measuring relative tax burdens is to divide total state and local tax collections for each state by their respective populations. For the Fiscal Year 2009 calculations, this report uses the July 1, 2009, Census Bureau population estimates for each state – Washington's population was then indicated as 6,664,195. This calculation results in a state and local tax amount of $4,049 for each Washington resident and gives Washington a ranking among the 50 states of 21st from the highest state for Fiscal Year 2009 (Table 7).

For the second year in a row, Washington per capita taxes were below the national average ($4,141). Further, Washington's ranking of 21st matches its all-time low (since 1960) in per capita taxes; the position of 21st was also achieved in 1981 and 2005. Chart 2 portrays the change in per capita state and local taxes since 1975 for Washington and the average for all states.

A per capita tax comparison is far from complete, however, because differences in the level of income among the states greatly influence their capability to finance the cost of government services. Furthermore, the per capita approach assumes that all citizens are identical for purposes of computing the "average" tax burden. In addition to income, many other factors - age, family size, and consumption preferences for housing and other taxable items, etc. - are significant in determining the tax burden for any particular individual or family. Also, tax collections include taxes initially paid by businesses, so the per capita amount does not correspond to what the "average" individual would pay in direct state and local taxes.

TAXES PER $1,000 PERSONAL INCOME

For another measure of tax burden, one that considers the relative ability of states to finance the cost of government, the total state and local tax receipts may be divided by total state personal income - a statistic representing the "wealth" of all residents living in each state. For purposes of this report, the latest personal income data for calendar year 2008 (covering the first half of Fiscal Year 2009) compiled by the U.S. Bureau of Economic Analysis is used. The calendar year 2008 personal income figure for Washington was $289.4 billion.

This computation produces a Fiscal Year 2009 Washington state and local tax burden of $93.24 for each $1,000 of personal income (Table 1). Stated another way, Washington state and local taxes equaled about 9.3 percent of personal income in Fiscal Year 2009. By this measure Washington ranks 35th in the nation and 9th among the 13 western states. For the third year in a row, Washington's tax burden dropped significantly, and the state's ranking of 35th dropped by five places from the prior year. <u>The tax burden of $93.24 is the all-time lowest level for this state in the past fifty years (see Table 6)</u>. The ranking of 35th has only been lower twice – in 1981 (39th) and 2005 (37th).

Washington's average tax burden remains well below the national average - $93.24 compared with the U.S. at $102.10. The reason that Washington ranks higher in per capita taxes than for taxes in relationship to personal income is that Washington enjoys relatively high per capita personal income (see Table 5). Even during the past three years of economic recession, Washington has remained high in average personal income, ranking 11th from the highest in 2008 (the year used for the Fiscal Year 2009 comparisons in this report), then increasing to 10th in 2009 and finally dropping slightly to 13th for 2010.

Chart 1 illustrates the trend in state and local taxes per $1,000 of personal income since 1975 for Washington and the national average.

STATE TAXES VS. LOCAL TAXES

Both of the above tax comparison methods include state and local government taxes, since most taxpayers are concerned with their total tax burden. (Federal taxes are assumed to apply uniformly throughout the country and therefore are not significant in explaining differences in tax burden among the states.) Another comparison that is sometimes made is to look at only state or local taxes. Washington has traditionally ranked high in state taxes but low in local taxes. For Fiscal Year 2009, Washington state taxes per $1,000 of income are ranked 33rd, while Washington local taxes are ranked 32nd (Table 3). On the per capita basis, Washington state taxes are ranked 19th and local taxes are in 25th place (Table 9).

The explanation for these differences is provided in Table 12 which indicates that over 60 percent of Washington's state and local tax dollar is collected at the state level while less than 40 percent is attributable to local taxes. (Note: the ratio of state taxes to the total in Washington is significantly lower for Fiscal Year 2009 compared with earlier years, because of the large reduction in state tax collections for this year.) This is in contrast to many other states in which the relative share of state and local taxes is more evenly balanced. In fact, in five states (CO, FL, NH, NY, and TX) local tax collections exceed the amount received by the state. Washington collects a greater share of total state and local taxes at the state level for several reasons: limitations have been placed upon the revenue-producing ability of the property tax; Washington funds public education and certain other programs to a larger degree by state tax sources than many states; and local taxing authority is controlled by state law and new local tax sources must be authorized by the Legislature.

ANALYSIS OF TAX BURDEN

Both the per capita and the personal income approach are based on total state and local tax collections obtained from surveys of governmental jurisdictions by the Census Bureau. Taxes include amounts paid by individuals as well as businesses, and there is no accurate way of classifying tax burdens by type of taxpayer for most tax sources. For example, in Washington it is estimated that households pay about 60 percent of total sales tax collections, with the remainder paid by businesses (supplies, nonmanufacturing machinery, construction, etc.), government, and tourists. But the exact amounts are not known because vendors do not record the type of purchaser who pays the tax. Similarly, the actual burden of the property tax and other major taxes by taxpayer type is not precisely known in this or other states.

Further, the initial tax burdens may be shifted to other entities. Business taxes are particularly susceptible to shifting, either forward to consumers (increased prices) or backward to owners (reduced earnings) and workers (lower wages). Tax burdens may also be shifted to persons in other states. For example, Alaska typically has a very high tax burden due to its petroleum tax revenues. However, consumers in many other states pay a portion of this tax, which is included in the price of oil delivered via Alaska’s pipeline. Unfortunately, there is no adequate way to estimate such shifts of tax burden. Some studies attempt to do so, but they require significant resources to model tax impacts, and the results are no better than the underlying assumptions.

Many state and local taxes in Washington are based on consumption expenditures. Thus, revenues are dependent upon price changes, and inflation can have a direct influence upon collections. Population growth is also a major factor, but the rate of increase in tax collections typically exceeds the rate of population growth. Therefore, per capita taxes usually increase from year to year; the last two years were a notable exception to this general trend.

Two factors influence the tax burden calculation in relation to income: the amount of state/local tax collections and the rate of growth in state personal income. Often the income statistic, which is the denominator of the calculation, is a more significant variable than the tax figure, which tends to fluctuate less dramatically. As noted above, the state's tax burden ranking is dependent upon not only changes in Washington, but also in the other states.

In the 1960's, state and local tax burdens of about $115 per $1,000 of personal income were typical for Washington, and the state usually ranked about 18th among all states. The economic downturn, which occurred around 1970, caused some reduction in the growth rate of tax collections. However, the fall-off in personal income was even greater. The relatively smaller income caused the tax burden calculation to rise to as high as $128 in 1972 and 1973. Rankings ranged from as high as 17th to as low as 25th during this period.

In the late 1970's, growth in consumer expenditures exceeded the rate of income growth due to strong demand for housing and durable goods. Such purchases are often financed from savings or by borrowing rather than current income; thus short-term tax elasticity was very high. The result was a very high tax burden, reaching $127 in 1978.

During the recession of 1981-82, the percentage of personal income devoted to taxable retail purchases - a major driver of Washington tax revenues - dropped from over 70 percent to less than 60 percent in just two years. Also contributing to the reduction in Washington tax revenues was the exemption of food from sales tax in 1978, limitation of local special school levies, extension of the 106 percent limit on property taxes to the state levy, and repeal of the state's inheritance tax. Somewhat ironically, personal income remained rather high during most of this period, at least compared with many other states. The high level of income, coupled with the reduced tax collections, produced a precipitous drop in the tax burden for this state to $100 in 1981 and the lowest-ever ranking of 39th.

Later in the 1980's, Washington's tax burden returned to about $115, and rankings of about 16th were common. In the 1990's, Washington's tax burden by the income measure declined steadily from $123 in 1995 to $100.90 in 2002, and the state's ranking dropped from 11th to 32nd. By the midpoint of the decade, Washington's tax burden ranking had fallen to 37th - the second lowest since the tax comparisons have been compiled.

The latest state/local tax figures used for this report cover the fiscal year which ended on June 30, 2009. This year included the onset of the current economic recession which began in the fall of 2008. Washington State tax receipts in Fiscal Year 2009 were 8.0 percent lower than Fiscal Year 2008 – by far the largest year-to-year drop in collections on record in this state. Nearly all other states also experienced comparable declines in revenues. As a result, most states experienced reduced tax burdens in Fiscal Year 2009 by either the income or the population measure. However, the reduction in Washington's tax collections was far greater in comparison with the change in personal income or population; hence the drop in both tax measures for this state was among the largest in the nation.