

Problems as Identified by the Committee
7/12/02

I guess the problems that are implicit in my alternatives packages are:

With respect to sales tax:

- 1) regressivity
- 2) non-neutrality (between goods & services and between in-state and out-of-state sellers)

With respect to B&O tax:

non-neutrality between different industries and between vertically integrated and non-integrated firms

The two basic problems are regressivity and economic neutrality.

I believe the exacerbation of revenue shortfall in a declining economy by the repeal and limitation of revenues (and by dedication) is a serious problem.

Stability, in my opinion, cannot be achieved by new tax scenarios—it requires forced savings for the rainy day ahead and I do believe we should devise such a requirement for our State.

I accept the assertion that sustenance of local government is a problem and I have, as yet, nothing much to offer to deal with that problem.

Long-term adequacy –

I think that this is a critical issue. Diversity & expansion of the tax should be considered. This would hopefully help with the volatility issue also.

Nature of WA taxing system –

Whether it is really regressive and whether this is a negative trait.

WA Citizens feelings about the taxing system –

Do the taxpayers care if the system is regressive?

Do they feel that they have more control over their taxation with the current system versus one with an income tax?

Should people know how much taxes they pay or are they happier not knowing?

Should we make them know if they don't want to? (This argument is similar to making overweight people know how many calories they eat. They may not want to know. People avoid disconfirming information).

Do we want a taxing system that the citizens like or one that is perceived from a theoretical point of view as equitable? That is, do we recommend a taxing system that is what people want or what is best for them if the two are not the same.

Is Federal deductibility of taxes important to the citizens of WA?

Federal deductibility of taxes –

At present only about 30 % of WA taxpayers itemize for Federal purposes. Can we determine how many WA more taxpayers would be able to itemize if we had an income tax?

Problems the committee should address (in rough order of priority, in my view):

- Regressivity.
- Volatility (and over-reliance on sales taxes).
- Federal deductibility.
- Narrowness of sales tax base (in particular, nontaxation of services).
- Neutrality (provided we can get better quantitative indications of the magnitude of the problem).
- Lumpiness.

1) Problem. Washington has a highly non-neutral tax structure. The base of the RST is too narrow and growing more so because most services are not taxed. The B&O is a multiple tax on value added causing pyramiding. Pyramiding, and multiple B&O rates, cause non-neutralities and economic inefficiency. Constitutional and political restrictions make a personal income tax problematic.

2) Problem. The RST is not deductible from Federal income taxes. As a result, Washingtonians pay nearly half a billion dollars more in Federal taxes than they need to. In addition, revenue from a destination-based tax like the RST does not grow sufficiently for government to provide for established programs, because the tax base excludes most services and is vulnerable to avoidance as internet commerce grows. The distribution of the RST tax burden is known to be very regressive with respect to income.

3) Problem. All of the problems in 1) and 2), plus the existing tax structure is a very unstable revenue source. Fluctuations in economic activity create fiscal crises. Heavy reliance on RST leads to high tax rates, exacerbating economic distortion and tax avoidance. In addition, local governments lack tax capacity, and the property tax is

resisted by voters except where the benefits are clear. The state is required to fund schools, so lost state property tax revenue must be made up.