

WASHINGTON'S TAX HISTORY

A Brief Overview of the Development of State and Local Taxes in Washington

Early Tax History

From the establishment of Washington as a territory in 1853 until the Depression years of the 1930s, the property tax was the principal revenue source for both state and local governments. The property tax was considered to be a good measure of ability to pay during these years which featured a largely agrarian economy, and most governmental programs directly benefited property owners. Upon achieving statehood in 1889, a major provision of the state Constitution required that all taxes on property be applied uniformly. Several other taxes were established during this early period:

- tax of 2 percent levied on premiums received by insurance companies (1891).
- inheritance tax established; rates range from 1 percent to 12 percent, depending upon the relationship between the beneficiary and the decedent (1901).
- tax on motor vehicle fuel at a rate of 1 cent per gallon (1921).
- poll tax of \$5 on each citizen between the ages of 21 and 49 (1921). The tax was so unpopular that it was repealed by initiative the following year.

The Depression and the Revenue Act of 1935

As the scope of governmental programs increased during the early part of the 20th Century, greater reliance was made of the property tax. By 1930 the average property tax rate had reached 2.8 percent of market value (by comparison, the current statewide average effective tax rate is well below 1 percent at 0.83 percent). Washington's economy was shifting toward an industrial basis, and the value of property owned was no longer necessarily a good measure of an individual's wealth. Thus, the property tax increasingly violated the ability-to-pay criterion for a good tax. With the advent of the Depression, many homeowners had lost their jobs and were not able to pay their property taxes. On the one hand, government revenues plummeted as property tax delinquencies grew, while at the same time there was increased need for expanded governmental services for welfare and relief programs to assist unemployed persons.

Two special tax study groups met during the 1920s and recommended that Washington's tax structure be broadened so that the reliance on property taxes could be reduced. In the first of many subsequent instances of citizens attempting to directly influence the tax system, the voters approved two initiatives in 1932. One imposed a limitation on property tax rates equal to 40 mills (one mill = 0.001). The other established a state personal and corporate income tax. This was intended to provide more balance to the tax system and reduce property taxes. However, in a landmark decision handed down in early 1933, the State Supreme Court disallowed the income tax by interpreting income as constituting property and therefore implying that a tax on income

would be in violation of the Constitution unless it were applied uniformly. (Because of personal exemptions and graduated rates, income taxes are rarely uniform.)

In response to the court decision, the 1933 Legislature adopted a temporary gross receipts tax on business as a stop-gap measure to balance the state budget. This represented Washington's first excise tax on general business activities.

To address the deepening financial crisis, the Legislature enacted the most comprehensive tax bill in state history - the Revenue Act of 1935. As a result, the state's principal form of taxation shifted from property taxes to excise taxation. The term excise refers to a category of taxes that are generally imposed on or measured by a transaction, e.g., the selling price of an item. The 1935 legislation contained many of the tax sources which today form the basis of Washington's tax system. In Fiscal Year 2008, Revenue Act taxes generated more than three-quarters of all state tax receipts supporting the state general fund. These sources included:

- Retail sales tax
- Compensating (use) tax
- Business and occupation tax (replacing the 1933 tax)
- Public utility tax
- Liquor sales tax
- Cigarette tax

The 1935 act also included other taxes which were either vetoed by the Governor, ruled unconstitutional, or subsequently repealed:

- Stock transfer tax*
- Radio tax**
- Conveyance tax (incorporated with real estate excise tax in 1987)
- Admissions tax (became a local tax in 1951)
- Fuel oil tax (repealed in 1947)
- Toiletries and medicines tax*
- Store license tax*
- Gift tax* (reimposed in 1941)
- Corporate income tax**

*Vetoed.

**Overturned by court decision.

Subsequent Major Tax Changes

Many of the changes in Washington's taxes over the past 70 years have involved either tax base revisions - broadening to new areas for existing taxes or reductions in the form of new exemptions, deductions, credits, etc. - or changes in tax rates. The one-page table at the end of this chapter contains a summary of the rate changes for several of the principal state taxes. Adoption of major new taxes and significant tax base changes are noted below:

- 1937 Motor vehicle excise tax adopted (previously, vehicles subject to personal property tax).
- 1944 Two constitutional amendments adopted: (1) 40 mill property tax limit with assessment at 50 percent of true and fair value, and (2) motor vehicle fuel tax earmarked for highways.
- 1951 Sales tax extended to hotel/motel accommodations. Real estate excise tax of 1 percent on property that is sold authorized for counties and earmarked for schools; the tax was shifted to the state level in 1981.
- 1955 State assistance to counties to bring property valuations up to market value.
- 1959 Sales tax extended to rental of personal property and certain other services. B&O tax extended to rental of real estate but was overturned in 1960 by State Supreme Court as constituting double taxation of property.
- 1961 Sales tax extended to certain amusement/recreational services. New tax on liquor measured by volume (originally per ounce, now per liter).
- 1965 Constitutional amendment allowing property tax exemptions for senior citizens was approved; the initial exemption program for seniors and disabled homeowners was adopted in 1967. Manufacturers tax credit allowed B&O tax credit for sales tax paid on major investments.
- 1967 First "hotel-motel" tax; King County authorized to receive 2 percent of state sales tax on lodging for construction of Kingdome.
- 1968 Constitutional amendment allowing current use assessment of open space, agricultural, and timber lands for property tax purposes. Program was implemented in 1970.
- 1969 Court decision required assessment of property at 50 percent of true and fair value.
- 1970 B&O tax extended to financial institutions, after a change in federal policy allowing states to tax national banks. Local sales tax of 0.5 percent authorized for cities/counties.
- 1971 Annual increases in local regular property tax levies limited to 6 percent.
- 1972 Constitutional amendment limiting regular property tax levies to 1 percent. Timber excise tax imposed on the stumpage value of timber harvested on private lands. Timber tax phased in as property tax on timber was phased out.
- 1974 Phase-out of property tax on business inventories over ten years. An increasing portion of the property tax on inventories was allowed as a credit against B&O tax until 1984 when inventories were exempted from property tax outright.

- 1975 Property assessments increased to 100 percent of true and fair value. Levy rates switched from mills to dollars per \$1,000 with reallocation of levies among state and local taxing districts designed to meet constitutional 1 percent limit on regular levies.
- 1976 Leasehold excise tax imposed on leases of publicly-owned property.
- 1977 Phase-in of limitation on special school levies, equal to 10 percent of the district budget. Voters approve initiative exempting food for off-premises consumption from sales tax.
- 1981 Voters approve initiative repealing inheritance and gift taxes. Estate tax, comprised of the amount of federal tax credit, remains in place.
- 1981 Some telephone services shifted from utility tax to B&O and sales tax; expanded to all telephone service except local residential service in 1983.
- 1982 Sales tax temporarily re-imposed on food products and a variety of tax rates were increased during fiscal crisis due to economic recession. Second ("optional") 0.5 percent local sales tax authorized for cities and counties.
- 1984 Voters approve initiative exempting trade-ins from sales tax.
- 1985 Sales tax deferral for manufacturing investments in economically distressed areas (became outright exemption in 1995 and changed to rural counties in 1999).
- 1993 Major increase in B&O tax rates and establishment of new 2.5 percent rate on business services; these increases were phased down starting in 1994 and eliminated by 1998. Sales tax deferral for research and development investments by certain high technology firms. B&O tax credit for R&D expenditures for same firms in 1994.
- 1995 Sales tax exemption for manufacturing machinery. Local sales tax of 0.5 percent authorized for food and beverages only in King County to finance construction of a professional baseball stadium; this represents the first differential sales tax rate upon a particular type of product.
- 1997 Referendum approved limiting annual growth in regular property tax levies to rate of inflation.
- 2000 Legislature repeals motor vehicle excise tax, leaving \$30 license fees. (In 1999, the voters had approved a similar initiative, but this was ruled unconstitutional.)
- 2001 Voters approve initiative limiting annual growth in regular property tax levies to 1 percent. Voters approve initiative increasing cigarette tax rate from \$0.825 to \$1.425.
- 2003 Additional state sales/use tax of 0.3 percent applied to sales/leases of new or used motor vehicles; represents first differential state sales tax upon a particular type of product. Major portions of Streamlined Sales Tax Agreement adopted, making Washington's sales

- tax base more uniform with those of many other states. New nursing home fee of \$6.50 per patient per day enacted. Significant new tax incentives for manufacturers of aircraft and semiconductors.
- 2004 Extension of tax incentives for high technology firms and certain firms in rural areas; new incentives for aluminum smelters.
- 2005 Phased-in increase of gas tax from 28 to 37.5 cents per gallon by 2008. Sixty cent increase in the cigarette tax from \$1.425 to \$2.025 per pack. Rollback of tobacco products tax rate from 129.4 percent to 75 percent of wholesale price. Increase in liquor liter tax from \$2.44 to \$3.77 per liter. Phase-out of nursing home fee. New B&O tax enacted on games of chance and pari-mutuel wagering. New fee of \$1.00 on replacement vehicle tires. Exemption from B&O tax for processors of fresh fruit and vegetables.
- 2005 Washington's estate tax, which was tied to the federal estate tax credit, was overturned by the State Supreme Court in February. In response, the Legislature enacted a new stand-alone estate tax on estates above \$2 million (as of 2006); receipts dedicated to a new education legacy fund.
- 2006 B&O tax exemption for production of dairy and seafood products. B&O rate reduction for timber harvesters and manufacturers of timber and wood products; partially offset by new tax rate to finance fish habitat programs. Daily nursing home fee is repealed.
- 2007 Adoption of Streamlined Sales Tax Agreement, effective July 1, 2008. Authorization of new local sales tax for health services authority. New property tax deferral program enacted; low-income homeowners may qualify with no age restrictions.
- 2008 Major new program to provide rebates as an offset for retail sales taxes paid by low-income households that qualify for the federal earned income tax credit. However, the program has yet to be funded by the Legislature.
- 2009 Electronic filing and payment of excise taxes required for all taxpayers that file monthly. Sales tax applied to digital goods – electronic books, music, etc. Resale certificate replaced by reseller's permit issued by the Department for wholesale purchasers. Annual updating of assessed property values required in all counties by 2014.

Local Government Finance

One of the tax areas that has received significant attention in the past three decades is local government. The revenue sources of cities, counties, and junior taxing districts are strictly controlled by the Legislature and only specifically authorized taxes can be imposed at the local level. Traditionally, the property tax has been the mainstay of local government, but its dominant role has declined somewhat. In 1970 property taxes accounted for 86.5 percent of local tax revenues; by 2007 that percentage had declined to 57.8 percent.

Picking up the slack has been a variety of local sales taxes and taxes on lodging. There are currently 25 different types of local sales taxes; the following lists the maximum rates allowed by law and the year the tax was first authorized. Ten of these local taxes do not represent additional taxes for purchasers. Instead, they are credited against the state sales tax, thereby allowing the state to assist in the financing of certain local programs. The maximum local sales tax rate currently levied totals 3 percent in portions of southwestern Snohomish County and in all of the metropolitan areas (within the RTA) of King County. Combined with the state rate of 6.5 percent, Washington's maximum sales tax rate that applies to most taxable items is now 9.5 percent (9.8 percent for motor vehicles).

ENACTMENT OF LOCAL SALES TAX PROGRAMS:

- Cities - basic rate of 0.5% (1970) and "optional" rates up to 0.5% (1982).
- Counties - basic rate of 0.5% (1970) and "optional" rates up to 0.5% (1982).
- Public transit districts - up to 0.9% (1971).
- High capacity transit (RTA) - up to 1%, 0.4% actually imposed (1990).
- Criminal justice - county tax of 0.1%, receipts shared with cities (1990).
- Public facilities - 0.1% tax (1991).
- Baseball stadium - 0.017% in King County (1995).*
- Food/beverage tax - 0.5% in King County (1995).
- Juvenile correctional facilities - 0.1% (1995).
- Football stadium tax - 0.016% in King County (1997).*
- Rural counties - 0.08% (1997).*
- Zoo/aquarium tax - 0.1% in Pierce County (1999).
- Regional centers of public facility districts - 0.033% (1999).*
- Emergency communications - 0.1% (2002).
- Regional transportation - 0.5% (2002).
- Public safety - 0.3% (2003).
- Passenger ferries - 0.4% (2003).
- Transportation benefit districts - 0.2% (2005).
- Mental health/chemical dependency - 0.1% (2005).
- Hospital benefit zone - 6.5% (2006).*
- Local infrastructure financing (revenue development area) - 6.5% (2006).*
- Municipal services for annexation areas - 0.2% (2006).*
- Regional theaters of public facility districts - 0.02 or 0.025% (2007).*
- Health sciences and services – 0.2% (2007).*
- Local revitalization financing – 6.5% (2009).*

*Local tax is credited against the state sales/use tax; no additional tax for purchasers.

Environmental Taxes

Several taxes and fees have been enacted in recent decades to help finance programs designed to restore and protect the environment.

- Litter tax - 0.015%, wholesale value of certain products (1971).
- Replacement tire fee - \$1 per tire (1985 - 1994; reenacted in 2005).
- Solid waste collection tax – 3.6% (1986).*
- Wood stove fee - \$30 per new wood stove (1988).
- Hazardous substance tax - 0.7%, wholesale value of certain chemicals (1989).
- Petroleum products tax - 0.5%, wholesale value of oil-based products (1989).
- Oil spill tax - 5 cents/42 gallon barrel of products imported via water (1991).

*Receipts not used exclusively for environmental programs.

MAJOR WASHINGTON STATE TAXES History of Rate Changes for Selected Taxes

RETAIL SALES/USE TAX

1935 - Enacted at 2.0%
 1941 - Increased to 3.0%
 1955 - Increased to 3.33%
 1959 - Increased to 4.0%
 1965 - Increased to 4.2%
 1967 - Increased to 4.5%
 1976 - Increased to 4.6%
 1979 - Decreased to 4.5%
 1981 - Increased to 5.5%
 1982 - Decreased to 5.4%
 1983 - Increased to 6.5%

B&O TAX - Manufacturing

1935 - Enacted at 0.25%
 1951 - Increased to 0.3%
 1955 - Increased to 0.4%
 1959 - Increased to 0.44%
 1976 - Increased to 0.4664%
 1979 - Decreased to 0.44%
 1982 - Increased to 0.458%
 1983 - Increased to 0.581%
 1983 - Decreased to 0.484%
 1993 - Increased to 0.515%
 1995 - Decreased to 0.506%
 1997 - Decreased to 0.484%

CIGARETTE TAX

1935 - Enacted at 1¢ per pack
 1939 - Increased to 2¢
 1949 - Increased to 4¢
 1955 - Increased to 5¢
 1959 - Increased to 6¢
 1961 - Increased to 7¢
 1965 - Increased to 11¢
 1971 - Increased to 16¢
 1981 - Increased to 20¢
 1982 - Increased to 20.8¢
 1982 - Increased to 23¢
 1986 - Increased to 31¢
 1989 - Increased to 34¢
 1993 - Increased to 54¢
 1994 - Increased to 56.5¢
 1995 - Increased to 81.5¢
 1996 - Increased to 82.5¢
 2002 - Increased to \$1.425
 2005 - Increased to \$2.025

GASOLINE TAX

1921 - Enacted at 1¢ per gallon
 1924 - Increased to 2¢
 1929 - Increased to 3¢
 1931 - Increased to 4¢
 1933 - Increased to 5¢
 1949 - Increased to 6.5¢
 1961 - Increased to 7.5¢
 1967 - Increased to 9¢
 1977 - Increased to 11¢
 1979 - Increased to 12¢
 1981 - Increased to 13.5¢
 1982 - Decreased to 12¢
 1983 - Increased to 16¢
 1984 - Increased to 18¢
 1990 - Increased to 22¢
 1991 - Increased to 23¢
 2003 - Increased to 28¢
 2005 - Increased to 31¢
 2006 - Increased to 34¢
 2007 - Increased to 36¢
 2008 - Increased to 37.5¢