RETAIL SALES TAX
Chapter 82.08 RCW

Tax Base — Selling price of tangible personal property and certain services purchased at retail, i.e. by consumers. In general, the tax applies to goods, construction including labor and services, repair of tangible personal property, lodging for less than 30 days, telephone service, and participatory recreational activities. Some personal and professional services, such as landscape maintenance and physical fitness, are taxable. The basic definition of items and transactions subject to sales tax appears in RCW 82.04.050. (NOTE: Use tax applies to taxable items used within the state if retail sales tax was not paid; see following section.)

Tax Rate — 6.5 percent levied by the state. An additional 0.3 percent state tax applies to sales of new or used motor vehicles. Including local sales taxes (see section on local sales/use tax), the combined sales tax rate now ranges from 7 to 9.5 percent for most taxable retail sales (7.3 to 9.8 percent for vehicles).

Levied by — State (also see section on local sales/use taxes).

Recent Collections ($000)

Fiscal Year	Collections	% Change	% of All State Taxes
2009	$6,903,654	(10.9)%	44.6%
2008	7,747,276	4.3	46.1
2007	7,431,002	8.0	44.5
2006	6,882,255	11.6	44.7
2005	6,166,266	6.5	44.6
2004	5,791,960	4.2	44.5
2003	5,560,658	2.1	45.8
2002	5,444,365	(1.4)	46.0
2001	5,519,106	2.1	46.5
2000	5,405,602	9.2	45.8

Administration — Department of Revenue. The tax is collected from purchasers by retail vendors at the time of sale using tax rate schedules supplied by the Department. Sales tax receipts are legally considered as trust funds of the state. Total transactions are reported on the seller's Combined Excise Tax Return (or a version of this return such as the Retailing and Other Activities Return) and receipts are forwarded to the Department on a monthly or quarterly basis. Monthly taxpayers are required to file their return electronically and to submit payment via electronic funds transfer. Firms that pay more than $240,000 annually in state/local sales tax may pay the tax directly to the Department, rather than to the vendor, with the use of a direct pay permit.

Starting in January 2010 firms that purchase at wholesale and resell the items will be required to obtain a reseller's permit from the Department; the permit relieves the vendor from responsibility for collecting sales tax on the transaction. Previously, the buyer simply provided the vendor with a resale certificate, stating that the items would be resold at retail.

<u>Distribution of Receipts</u>

Nearly all of the receipts from the state sales tax go to the state general fund (99.5 percent of the total).

Proceeds from the additional 0.3 percent tax on new/used motor vehicles goes to the multimodal transportation account for use in financing improvements to the state transportation system (RCW 82.08.020(3)). The 0.3 percent sales tax produced $22.5 million in Fiscal Year 2009.

State sales tax paid on expansion of the state convention center is credited to the convention center account (RCW 67.40.160). State sales/use tax paid on leaded racing fuel is dedicated to the advanced environmental mitigation account (RCW 82.32.394). State sales/use tax paid on transportation projects undertaken by a regional transportation investment district is earmarked to pay for debt service on the project (RCW 82.32.470).

Pursuant to Initiative 900, adopted in November 2005, 0.16 percent of state sales tax collections are deposited in the Performance Audits of Government Account and are used to finance the costs of such audits by the State Auditor (RCW 82.08.020(5)). This earmarking produced $10.9 million in Fiscal Year 2009.

Receipts are also transferred to the various local programs indicated below in which local taxes are credited against the state sales tax.

<u>Local Taxes Credited Against the State Sales Tax</u>

- A 2 percent hotel-motel tax upon accommodations is provided for cities and counties. Receipts are credited against the state sales tax, thus shifting the burden to the state general fund. Approximately 138 cities and 37 counties currently participate in this revenue sharing program. (RCW 67.28.180 - 67.28.1801)

- A 2 percent hotel-motel tax for establishments with 60 or more units is provided within Seattle for use in financing expansion of the state convention center. Funds are transferred from the state general fund to the state convention and trade center account as provided in RCW 67.40.170. (RCW 67.40.130 - 67.40.140)

- A local sales tax of 0.017 percent levied in King County diverts a portion of the 6.5 percent state sales tax reported from King County retailers to pay the state's share of the principal/interest payments on the professional baseball stadium (Safeco Field) in Seattle. The local tax is credited against the state sales tax, thus shifting the burden to the state general fund. (RCW 82.14.0485)

- A local sales tax of 0.016 percent is authorized for county public stadium authorities to finance a stadium (Qwest Field) to be used for professional football and soccer and an adjacent exhibition center. The local tax is credited against the state sales tax, thereby shifting the burden to the state general fund. (RCW 82.14.0494)

- Local sales taxes of 0.09 percent are provided for rural counties (those with an average population density of less than 100 residents per square mile or are smaller than 225 square miles). Receipts are to be used for public facilities and are credited against the state sales tax, thus shifting the burden to the state general fund. All 32 eligible counties have utilized this authority. (RCW 82.14.370)

- Local sales taxes of 0.033 percent are established for public facility districts (PFDs) to finance construction of new or existing regional centers. These include convention centers and special events facilities. These taxes were authorized in 1999 and are currently levied by 22 jurisdictions. (RCW 82.14.390)

- A variation of the PFD tax is directed toward specialized regional centers which have permanent seating of no more than 2,000. The state-credited local tax rate is either 0.02 or 0.025 percent, depending upon when the PFD was formed. Population limits for this local tax restrict it to Yakima and Cowlitz counties, and the proceeds are used for improvements at two regional theaters. (RCW 82.14.485)

- A new form of tax increment financing was established in 2006 to encourage public infrastructure improvements in a designated hospital benefit zone (HBZ). The program includes a local sales tax of up to 6.5 percent with the receipts credited against the state sales tax, thereby shifting the entire state tax on taxable purchases within the zone to finance the cost of the improvements. A single HBZ has been formed under this authorization; it is located in Gig Harbor. (RCW 82.14.465)

- Another type of tax increment financing tax was instituted in 2006. Known as the local infrastructure financing tool (LIFT) program, it is intended to encourage economic development within a revenue development area (RDA). Nine cities have established RDAs under this program. The program includes a local sales tax of up to 6.5 percent with the receipts credited against the state sales tax, thereby shifting the entire state tax on taxable purchases within the zone to finance the cost of the improvements. The program expires on June 30, 2039. (RCW 82.14.475)

- A local sales/use tax of up to 0.2 percent was authorized in 2006 for certain cities to provide for municipal services related to annexation areas. The tax may be imposed only if the cost of extending municipal services exceeds the potential local revenue to be derived from the annexation area. The local tax is credited against the state sales tax, thus shifting the cost to the state general fund. The tax is restricted to cities in King, Pierce, or Snohomish counties. Legislation in 2009 broadened the local tax to Seattle at a rate of up to 0.85 percent and to certain other cities at a rate of up to 0.3 percent. The local tax may commence on July 1, 2007, and may run for a maximum of ten years. To date it has been levied by two cities. (RCW 82.14.415)

- A new state-credited local tax of up to 0.02 percent was authorized in 2007 for a single health sciences and services authority. The authority promotes bioscience-based investments to advance new medical techniques and procedures. The authority has been formed in Spokane County and the tax commenced in August 2008. (RCW 82.14.480)

- In 2009 another program to encourage local revitalization was established. Similar to the LIFT program, it targets seven demonstration projects, plus other investments by cities and counties. The state-credited local tax rate may be as high as the state rate, except for other state-credited local taxes and the performance audit portion of the 6.5 percent state rate. (RCW 82.14.510)

<u>Major Business Tax Incentives</u>

Listed below are some of the important sales tax incentive programs intended to encourage business expansion in Washington. Following this section is a more general listing of some examples of sales tax exemptions, credits, deferrals, and other tax preference items.

Some of the following programs require that participants report annually to the Department and provide data on the utilization of the tax incentive and related employment statistics. Various "accountability" statutes require the Department to report to the Legislature in the form of annual descriptive statistics. Further, some of the tax incentive statutes require a follow-up evaluation to determine the effectiveness of the program, often shortly before the scheduled termination of the program. These evaluations are to be conducted by the Department, by the staff of legislative fiscal committees, or by the Joint Legislative Audit and Review Committee.

- New and replacement machinery and equipment used directly in a manufacturing process is exempt from sales/use tax. (RCW 82.08.02565) NOTE: This exemption has no scheduled expiration date, and no reporting by participants is required.

- Deferral/exemption of retail sales/use tax has been provided since 1985 for new or expanding manufacturing and R&D firms in rural counties. The program is scheduled to expire on July 1, 2010. Rural counties are those with an average population density of less than 100 residents per square mile or a total area of less than 225 square miles; currently 32 of the state's 39 counties qualify. Also, eligible firms located in community empowerment zones (CEZs) which are not in a rural county may qualify. The tax on construction labor and materials, as well as machinery (separate exemption noted above also applies) was originally deferrable for three years, followed by a five-year repayment period. However, since 1994, the sales/use tax need not be repaid if employment criteria are maintained, thus effectively converting the program to an outright exemption. (Chapter 82.60 RCW)

- Sales/use tax paid by specified high technology firms for investment in structures and equipment used in research and development or for pilot-scale manufacturing is exempt, as long as program requirements are met. Established in 1994, the program is scheduled to expire on January 1, 2015. An amendment in 2009 extended the deferral to a new category: multiple qualified buildings, which are more than one structure located within a five-mile radius, if they are leased to the same firm. (Chapter 82.63 RCW)

- Exemption from sales/use tax for construction of facilities and acquisition of machinery used to assemble a "super-efficient" aircraft. Adopted in 2003, the exemption became effective in December 2003 (upon signing an agreement between the state and a major aircraft manufacturer) and will expire on July 1, 2024. (RCW 82.08.980)

- Exemption from sales/use tax for computer hardware and software used to design commercial aircraft by aircraft manufacturers and firms that provide aerospace products and services; expires July 1, 2024. (RCW 82.08.975)

- Exemption from sales/use tax for construction of facilities and acquisition of machinery and equipment used to produce semiconductor materials. Also exempt are gasses and chemicals used in the production of semiconductor materials. The exemption is contingent upon siting and commercial operation of a significant semiconductor microchip fabrication facility in this state (which has yet to occur). The exemption expires 12 years after the effective date. (RCWs 82.08.965, .970, and .9651)

- Deferral of sales tax on construction of facilities for processing of fresh fruit and vegetables, dairy products, and raw seafood products, as well as related equipment. This program commences on July 1, 2007, and applications must be submitted before July 1, 2012. As long as program requirements continue to be met, the deferred tax does not have to be repaid, thus turning the incentive into an outright tax exemption. (Chapter 82.74 RCW)

- Credit for state sales tax paid on labor and services related to construction of aluminum smelters and for related machinery and equipment until January 1, 2012. (RCW 82.08.805)

- Deferral of sales tax is provided for investment in biotechnology manufacturing facilities and related equipment. This program commenced on July 1, 2006, and applications must be submitted before January 1, 2017. As long as program requirements continue to be met, the deferred tax does not have to be repaid, thus turning the incentive into an outright tax exemption. (Chapter 82.75 RCW)

- Remittance of state sales tax (not local) on construction/expansion of eligible warehouse facilities and grain elevators and related material-handling and racking equipment. The incentive was established in 1997 and has no scheduled termination date. (RCW 82.08.820)

- Deferral of state/local sales tax on construction of a corporate headquarters facility housing at least 300 employees that is located in a community empowerment zone. As with other sales tax deferrals, if the program requirements continue to be met, repayment of the deferred tax is waived. (Chapter 82.82 RCW)

- Exemption from sales/use tax for machinery and equipment used to produce electricity from renewable resources. Only facilities that generate at least 1,000 watts are eligible for the exemption. The exemption for most renewable resources, except solar, is 100 percent of the equipment cost for the first two years (2009-11 Biennium) and 75 percent for the 2011-13 Biennium; it expires on June 30, 2013. Eligible solar equipment is restricted to facilities that produce up to ten kilowatts. The exemption is 100 percent of the cost and lasts for four years until June 30, 2013. (RCWs 82.08.962 and 82.08.963)

<u>Other Exemptions, Credits and Deferrals</u>

The definition of retail sale is contained in RCW 82.04.050. Because services are not specifically defined as being taxable, most services rendered to persons and businesses are not subject to sales tax. This includes medical, legal, accounting, and similar services performed by professionals, as well as services of barber shops, beauty parlors, funeral homes, cable TV companies, etc. The definition also excludes from tax transactions such as sales for resale (raw materials and component parts of items produced for sale) because they are not retail sales to final consumers; janitorial and laundry services; charges for labor and service of contractors who build roads and structures for the federal government; and feed, seed, fertilizer, spray, and horticultural services used in commercial agricultural production.

In addition to definitional exclusions, there are exemptions and other tax incentives for specific items or types of purchasers. Some of the more significant ones are listed below, grouped by major category.

EXAMPLES OF EXEMPTIONS - FARM PRODUCTS:
- items sold via auction sales on farms;
- livestock used for breeding purposes;
- materials used in packing fresh horticultural products for producers;
- materials used to construct farm-worker housing;

- leased irrigation equipment;
- equipment and structures for disposing of straw-based products, as an alternative to field burning;
- propane/natural gas used to heat barns and straw/wood shavings used in production of chickens;
- pharmaceuticals used to treat commercial livestock;
- equipment and facilities used for nutrient management programs for livestock;
- anaerobic digesters for treatment of livestock manure;
- replacement parts for farm machinery;
- honey bees purchased by apiarists;
- diesel, biodiesel, and aircraft fuel (not gasoline) used for agricultural purposes.

EXAMPLES OF EXEMPTIONS - PRODUCER GOODS:
- several specific items, e.g. ferrosilicon and form lumber;
- air pollution equipment installed in thermal, coal-fired electric generating plants;
- coal used to generate electricity at thermal generating facilities;
- rental of film and video production equipment;
- machinery used to generate electricity via solar energy and other renewable resources;
- equipment for distribution of biodiesel and wood biomass fuels;
- hog fuel and forest biomass used to produce electricity (expires 6/30/2015);
- computer equipment and software purchased by printers and publishers.

EXAMPLES OF EXEMPTIONS - INTERSTATE COMMERCE/NONRESIDENTS:
- motor vehicles, airplanes, locomotives, vessels, and railroad equipment used in interstate commerce;
- motor vehicles, trailers, campers, watercraft, and farm equipment sold to nonresidents;
- items delivered out of state to nonresidents and property used temporarily in state by nonresidents;
- purchases of items for use outside Washington by residents of states with sales taxes < 3 percent;
- repair of tangible personal property owned by nonresidents when the repaired item is delivered out of state.

EXAMPLES OF EXEMPTIONS - PUBLIC ACTIVITIES:
- items which the state is constitutionally prohibited from taxing (U.S. government, Indian tribes, etc.);
- labor for local road construction and federal government structures;
- fuel used in urban transportation;
- sand and gravel for streets and roads of local governments;
- purchase and repair of government-owned ferry boats;
- vehicles used in commuter ride-sharing programs (vanpools);
- donations to nonprofits and schools;
- purchases by regional transit authority (Sound Transit).

EXAMPLES OF EXEMPTIONS - OTHER ITEMS:
- casual/isolated sales by persons not engaged in selling that type of item;
- the value of trade-ins accepted by dealers (e.g. used vehicles);
- newspapers;
- motor vehicle and special fuel that is subject to fuel tax (i.e., fuel used on public highways);
- prescription drugs and medical devices (eyeglass lens, orthotic items, hearing aids, etc.);
- purchases by blood, bone, and tissue banks;
- self-service laundries and hospital laundry service;
- customized computer software;
- returnable food and beverage containers;
- food for human consumption (except prepared food) and prescribed dietary supplements;
- local residential telephone service and coin-operated telephone service;
- charges by nonprofit youth organizations for amusement/recreation and physical fitness activities;
- items purchased by artistic/cultural organizations for performance/display purposes;
- sales made for fundraising purposes by nonprofit organizations;
- used mobile homes, floating homes, and park-model trailers;

- equipment used to heat water via solar energy;
- batteries for powering electric vehicles and recharging infrastructure.

CREDITS/REFUNDS
- bad debts which are uncollectible by the seller;
- sales or use tax previously paid upon the item in other states;
- remittance for low-income families that qualify for federal earned income credit (unfunded).

OTHER SALES TAX DEFERRALS
- A public facilities district in any county may apply for deferral of sales tax paid on construction of public facilities such as a stadium or convention center. Pursuant to this authority, sales tax on costs of construction of the professional baseball stadium in King County (Safeco Field) was deferred. The deferral period lasted until four years after the facility was complete, and the taxes are currently being repaid over a period of ten years. (RCW 36.100.090)
- A public stadium authority may defer sales tax on the construction of a stadium and exhibition center. This statute was enacted in 1997 to facilitate a new football stadium to replace the Kingdome. The tax was deferred for four years following completion of Qwest Field, and repayments are now being made over a ten-year period. (RCW 36.102.070)
- Deferral of sales tax on construction of a museum for historic automobiles by a nonprofit organization is permitted by RCW 82.32.580. Eligible costs are those incurred after July 1, 2007, and the deferred taxes must be repaid over a ten-year period starting five years after the facility is complete.
- Legislation in 2008 allowed deferral of state/local sales tax on construction of a replacement floating bridge across Lake Washington (Highway 520). Repayment of the tax starts five years after the new bridge is completed and takes place over a ten-year period.

History

The sales tax was adopted in 1935 as an integral part of the Revenue Act, which established several of Washington's current state taxes. The initial rate was 2 percent effective May 1, 1935, and the tax was limited to sales of tangible personal property. Most food items, except dairy products, eggs, unprocessed fruit and vegetables, and bread, were taxable. Over the years many changes have been made to the base of the tax. Major revisions were:

1939 - all food items and services to personal property became taxable.
1941 - services rendered to real property subject to tax.
1951 - tax extended to hotel and motel accommodations.
1959 - tax extended to rental of personal property and clearing land.
1961 - tax extended to amusement/recreation activities, parking, title/escrow services.
1965 - exemption for residents of states with sales taxes below 3 percent.
1967 - initial sharing of tax (2 percent of the 4.5 percent rate) on hotel-motel accommodations with local government (see local hotel-motel tax).
1970 - initial local sales/use tax authorized (see local sales/use tax).
1971 - state road construction is subject to tax.
1972 - sales tax deferral for certain manufacturing improvements.
1974 - prescription drugs exempted.
1975 - tax paid by the contractor as a consumer is extended to materials incorporated into construction projects for the federal government (upheld by the U.S. Supreme Court in 1983).
1977 - voters approve initiative exempting food for off-premises consumption,

effective July 1, 1978.

- 1981 - the 1972 manufacturer's tax deferral is repealed.
- 1982 - tax temporarily reimposed on food for 14 months.
- 1983 - telephone service, except local residential and coin-operated, subject to tax.
- 1984 - voters approve initiative exempting trade-ins.
- 1985 - sales tax deferral for qualified improvements by manufacturing and R&D firms in rural counties.
- 1993 - tax extended to landscape maintenance, tour operators, physical fitness and certain personal services such as health spas, massage (repealed in 1995), and tanning and dating services.
- 1994 - tax deferral for high technology businesses.
- 1995 - exemption for manufacturing machinery and equipment.
- 1997 - remittance for state sales tax paid on construction of certain large warehouse and distribution facilities and grain elevators.
- 2003 - the first differential state sales tax rate according to the item being purchased: an additional 0.3 percent rate applies only to new/used motor vehicles.
- 2003 - major portions of the national model streamlined sales tax base adopted to make Washington's tax more uniform with other states.
- 2004 - deferral/exemption programs extended (rural counties to 2010 and high technology R&D to 2015).
- 2005 - deferral/exemption for fruit and vegetable processing facilities.
- 2006 - deferral/exemption for biotechnology manufacturing facilities in any county; exemptions for diesel fuel used on farms and replacement parts for farm machinery; three new state-credited local taxes authorized.
- 2007 - final adoption of national streamlined sales tax, effective July 1, 2008.
- 2008 - remittance program adopted for low-income families eligible for the federal earned income tax credit. (Program remains unfunded.)

Numerous changes in the sales tax rate have occurred since 1935. The state rate has been increased nine times and twice it has been reduced. The changes affecting the state rate are listed below; see the local sales/use tax section for information on local rate changes.

- 1941 - 2 to 3 percent (5/1/41);
- 1955 - 3 to 3.3 percent (5/l/55);
- 1959 - 3.3 to 4 percent (4/1/59);
- 1965 - 4 to 4.2 percent (6/1/65);
- 1967 - 4.2 to 4.5 percent (7/1/67);
- 1976 - 4.5 to 4.6 percent (6/1/76);
- 1979 - 4.6 to 4.5 percent (7/1/79);
- 1981 - 4.5 to 5.5 percent (12/4/81);
- 1982 - 5.5 to 5.4 percent (5/1/82);
- 1983 - 5.4 to 6.5 percent (3/1/83);*
- 2003 - additional 0.3 percent for new/used motor vehicles (7/1/03).

*Initially effective in 35 counties, excluding Clark, Cowlitz, Klickitat, and Skamania. The State Supreme Court overturned the differential state sales tax rate, effective 1/1/1985, and the 6.5 percent rate became uniform statewide.

With the advent of the sales tax in 1935, Washington pioneered the use of "tax tokens." There were several forms of such tokens, but the most common was an aluminum disk about the size of a quarter but with a hole punched in the middle. Because prices of taxable items were much less in the 1930s and because the initial tax rate was much lower, there were instances of sales tax liability totaling less than one cent. Tokens – initially worth one-half of one cent – helped solve this administrative dilemma. Tokens were widely used from 1935 until they were discontinued in 1951.

Discussion/Major Issues

The sales tax is by far the largest revenue source for the state. Together, revenues for the sales and its companion use tax account for 55 percent of state revenues supporting the state general fund. Of total state/local taxes, the general sales tax (including gross receipts taxes) represents 47.5 percent of state/local taxes in Washington. In terms of reliance on a single tax type, this degree of reliance is only exceeded by New Hampshire's dependence upon property taxes.

Washington's 6.5 percent state sales tax rate is currently exceeded by eight other states:

California	-	8.25%
Indiana	-	7.0%*
Mississippi	-	7.0%*
New Jersey	-	7.0%*
Rhode Island	-	7.0%*
Tennessee	-	7.0%
Minnesota	-	6.875%
Nevada	-	6.85%

*states without significant local sales taxes

Although Washington's state sales tax rate ranks ninth out of 45 sales tax states, the addition of significant local sales taxes in this state and the somewhat broader sales tax base in Washington (construction labor, repair of tangible personal property, etc.) results in a very heavy reliance on the tax. As noted above, the general sales tax category produces 47.5 percent of total state/local taxes in Washington. <u>When ranked on a per capita basis, the amount of total tax revenue attributable to general sales taxes in relation to population in Washington is higher than any other state.</u>

Including local sales taxes, the maximum combined rate of 9.5 percent in Washington is exceeded only in a few other states. Among major cities, the highest combined state and local sales tax rate in the country is presently 10.25 percent in Chicago. The largest two cities in Alabama have rates of 10 percent, and approximately one dozen California cities now have rates of 9.75 percent. Next comes the 9.5 percent rates in four major cities: San Francisco, California; Mobile, Alabama; and our own Seattle and Bellevue.

A sales tax has certain desirable features. It is relatively "popular" with taxpayers, partly because it is usually paid in small increments rather than in a large lump sum. Even in situations where a ticket item or construction project is purchased, often the cost of the item or the project is financed over time and the sales tax liability is spread over an extended period of time. Compared with other major revenue sources, the sales tax produces a large amount of revenue with very low costs of administration compared with other revenue sources. The tax is actually collected and reported by approximately 194,000 retail firms, not the actual purchasers who pay the tax.

Taxing consumption assures that all persons contribute toward the cost of government services, even low-income households and most businesses. It is one method of obtaining tax from persons who are in the state temporarily - tourists, migrant workers, etc. - and for materials incorporated into federal government construction projects (because the contractor is considered to be the consumer of the materials).

However, there are many objections to the tax, mostly as a result of the very high rate. Many retailers believe that they should be compensated for their costs incurred in collecting the tax. Currently, 24 of the 45 states that levy sales taxes at the state level allow some retention by vendors; many of these discounts are characterized as a discount for prompt payment of the tax. The typical discount is about 1 to 3 percent of the vendors' sales tax receipts; Washington is one of 21 states that provides no discount to sellers.

Also, the high tax rates may encourage Washington residents to purchase goods using other methods that are difficult to effectively enforce the collection of sales or use tax. Examples include purchases via mail order catalogs, the Internet, through the "underground economy" consisting of unreported cash transactions, and by buying directly in other states. In particular, the difficulty of collecting sales tax from vendors (or use tax from Washington purchasers) on transactions involving mail order or the Internet is viewed as a growing problem for tax compliance in states like Washington that rely heavily on the retail sales tax. The latest available estimates indicate that E-commerce and mail order purchases from remote sellers are costing the state and local jurisdictions approximately $465 million in annual retail sales/use tax revenues.

Because of the heavy initial impact of sales tax on construction due to the broad tax base and the high tax rate, the tax may inhibit the development of new businesses in Washington, especially capital intensive industries. Despite the sales tax deferral/exemption program for manufacturers in rural counties and the exemption of manufacturing machinery, the tax may be a deterrent to economic development by other types of firms. However, a variety of tax incentives established in recent years help to alleviate the sales tax burden for certain new and expanding industries.

The proximity of retail outlets in adjacent states with lower (or no) tax rates provides opportunity for Washington residents to effectively escape the tax, especially in the Clark

County area. This "border problem" causes an estimated reduction in revenues for the state and local jurisdictions, which has been estimated at $260 million annually. Also, it results in unfair competition for Washington retailers in border areas. The state has attempted to at least partially offset some of these problems by encouraging nonresidents to make purchases in Washington by providing exemption for residents of states that have no sales tax (or a sales tax rate no greater than 3 percent); this exemption applies only to items purchased in Washington that are consumed outside the state.

The federal income tax deduction for state/local sales taxes was eliminated by Congress in 1986. This resulted in a higher federal income tax burden for many Washington residents; this additional federal tax burden has been estimated at more than $400 million annually. Further-more, state income taxes have remained deductible for households that itemize. Thus, a significant inequity has existed for Washington residents vis-a-vis other states with income taxes that do not rely so heavily upon sales taxes. In 2004 Congress temporarily reinstituted the sales tax deduction for households that itemize their federal income tax deductions; however, the deduction will currently end after 2009. Efforts are currently underway in Congress to at least extend the deduction for two more years.

Sales tax collections can fluctuate widely as economic conditions change, producing difficulties for governmental budgets during recessionary periods. Consumer spending tends to decline faster and further than does overall personal income during times of economic slowdown or recession. For example, during the early 1980s sales tax receipts grew very slowly and actually declined in 1981 (and again in 2002) as consumers retrenched during the recession. The largest decline in sales tax receipts in Washington's history occurred this past year in Fiscal Year 2009, when the state sales/use tax receipts dropped by 10.8 percent over the prior year. Conversely, the sales tax can produce unanticipated revenue surpluses during good times, largely as a result of debt-financed purchases by consumers.

Finally, despite the exemption of food products, the tax is regressive, because lower income households must spend a higher percentage of their income for necessities that are subject to sales tax. In contrast, higher income households are able to devote a greater share of their income on nontaxable items, e.g., savings, investment in stocks, purchase of real estate, travel outside the state, etc. Income is generally considered a better measure of ability to pay tax than is consumption, and, in terms of income, the sales tax imposes a greater relative burden at lower income levels. The tax also discriminates on the basis of age and size. Households that are larger and/or in their formative years may pay a substantially greater tax burden as they acquire household goods, autos, etc.

In order to help alleviate the heavy impact of the sales tax upon low-income families, in 2008 the Legislature enacted a program to "remit" a portion of the sales tax for families that are eligible for the federal earned income tax credit. However, funding for the cost of the program has yet to be implemented, so the remit payments have yet to be made.

To combat the growing trend for on-line retail transactions and to lessen the inherently unfair competition for in-state retail establishments, Washington has joined with other states to implement a national Streamlined Sales and Use Tax Agreement (SSTA), intended to make reporting of sales taxes easier for multistate vendors and particularly remote sellers. To date, 20 states have become full members of the Agreement, and there are three additional associate member states. Washington became a full member on July 1, 2008. Tax base changes have already been adopted in order to make Washington's tax base more consistent with those in other states. The goal is to ease the compliance burden for multistate vendors and encourage remote sellers to collect and report sales tax on interstate purchases by Washington residents.