ECONOMIC OPPORTUNITY INSTITUTE

Adding Up:

New Tax Breaks in Washington 2004-2006

by Marilyn P. Watkins, Ph.D.

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Economic Opportunity Institute

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EOI's work focuses on state taxation policies, early childhood education, family leave insurance, retirement security, Social Security, minimum wage and the state of the Washington State economy.

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Executive Summary
Adding Up: New Tax Breaks in Washington 2004-2006

by Marilyn P. Watkins, Ph.D.

Bargaining for tax breaks has become a routine part of doing business. Across the United States, state and local governments are providing an estimated $50 billion in tax subsidies to businesses.[1]

Fearful of losing jobs, Washington, like other states, is giving away public revenue while underfunding the services necessary for a vibrant economy and a healthy democracy. In the three legislative sessions from 2004 through 2006, the Washington legislature passed at least 61 measures either granting new tax preferences or extending old ones. These new tax breaks will cost the state nearly half a billion dollars in the 2007-09 biennium.

New and Expanded Tax Breaks Passed 2004-2006

	Total #	**Revenue Loss 2005-07** (in millions)		**Revenue Loss 2007-09** (in millions)	
		State	Local	State	Local
2004	13	$239.617	$55.956	$295.476	$70.001
2005	23	$17.277	$2.276	$45.091	$11.256
2006	25	$48.518	$3.835	$133.912	$8.075
Total	**61**	**$305.412**	**$62.067**	**$474.479**	**$89.332**

Source: Compiled by author from Washington State Legislature website and OFM Fiscal Notes.

Every state faces pressure to cut business taxes. However, Washington's tax structure makes it especially vulnerable to requests by particular industries for tax breaks. The uniqueness of the business and occupation (B&O) tax and the relatively high sales tax rate make both taxes ripe targets for criticism. At the same time, without an income tax or a way to tax intangible wealth such as stocks and bonds, Washington has a particularly large structural deficit and no easy way to replace revenue lost to tax breaks.

Most of the tax breaks passed in the last three legislative sessions are framed as business incentives or economic development measures. Some boost industries that are declining in communities where alternative jobs are scarce, such as aluminum smelting and fruit and vegetable processing.[2] Others target industries that state policymakers hope will expand, for example high technology and biodiesel.[3] Others encourage beneficial investment, including truck stop operators installing equipment to reduce diesel emissions, dairy farmers treating manure, and hospitals purchasing equipment to safely lift patients.[4] Ten measures help specific communities finance local projects.[5] Only six of the new tax breaks are oriented primarily to individuals.

Tax breaks, in contrast to other parts of the state budget, are rarely evaluated against other public needs and usually remain entrenched through future budget negotiations. Often the full fiscal impact of new tax breaks is seen only in future biennia. Business advocates argue successfully for tax breaks during times of recession and times of economic growth, for industries that are struggling and industries that are booming.

The legislature has made progress towards accountability. Of the 61 tax breaks that have passed in Washington since January 2004, 27 include some kind of accountability measures and 24 include sunset dates. However, accountability standards vary widely.

New and Expanded Tax Breaks Passed 2004-2006

	Total	Accountability measures		Sunsetting	
		Yes	No	Yes	No
Business incentive	31	18	13	16	15
Local development	10	4	6	3	7
Agricultural	6	4	2	3	3
Environmental	3	1	2	1	2
Non-profit	5	0	5	0	5
Individual	6	0	6	1	5
Total	**61**	**27**	**34**	**24**	**37**

Source: Compiled by author from Washington State Legislature website and OFM Fiscal Notes.

In 2006 the legislature also passed House Bill 1069 which establishes a commission to regularly review and make recommendations on most tax preferences. However, the legislature failed to establish uniform standards for accountability and disclosure of tax breaks. It also did not pass House Bill 1096 which would have required the Department of Revenue to prepare a new accounting of tax breaks each biennium to accompany the Governor's budget proposal.

Conclusions and Recommendations

The half billion dollars in new tax breaks approved by the Washington legislature in the past three sessions is part of a national problem. The explicit or implicit promise is that tax breaks will result in jobs – and that without tax deals, jobs will be lost. But literally hundreds of studies across the nation over the past two decades have failed to prove that higher tax subsidies create more jobs. There are undoubtedly cases where a particular tax break helped save or create jobs, but there are also many cases where tax breaks merely assured higher profits for actions a corporation would have taken anyway.[6]

In fact, the evidence suggests that providing high quality public services, particularly transportation, education, and public safety, is a better way to generate a vibrant economy than cutting taxes.[7] Tax giveaways are undermining the ability of states to provide the very services that all companies and state residents need to thrive.

Each new tax cut erodes the tax base, exacerbates inequities and the structural deficit, and leads to demands for more tax breaks.

No doubt policy makers will continue to use the tax code to provide a variety of incentives and preferences to particular individuals and companies. But the legislature and governor can make the system far more effective in promoting an economy that provides opportunity for all state residents and all businesses. Specific policies that would strengthen the state's ability to raise revenue for services while building the state's economy include:

1. Use the performance audits and recommendations of the Citizen's Commission for Performance Measurement of Tax Preferences created by HB 1069 in 2006 to weed out tax breaks that are no longer efficiently delivering a high priority public benefit.

2. Replace out-moded tax breaks with short-term targeted investment programs to help particular industries transition to new technologies and to meet emerging needs. For example, many agricultural incentives were adopted 30 or more years ago when state farmers faced far different circumstances. Today the beef industry must eliminate the possibility of mad cow disease, asparagus farmers who no longer have a local cannery must find replacement crops, and everyone must find ways to curb use of fossil fuels. Helping farmers make these or similar transitions would be far more effective public investments than the current hodge-podge of tax breaks.

3. Require consistent sunsetting, accountability, and public disclosure standards for all tax breaks. The public has a right to know how tax breaks are being used. Public disclosure will increase confidence that public purposes are being served. Consistency will increase fairness while decreasing the costs of administering incentive programs.

4. Require the Department of Revenue to prepare a tax expenditure report every biennium as part of the budget process. With an up-to-date accounting of all tax breaks before

them, the governor and legislators could more easily adopt a state budget that truly reflects priorities for public investment.

5. Revisit the recommendations of the 2002 Tax Structure Study Commission as a starting point for a thorough overhaul of the state tax system. Our current regressive tax system simply is incapable of meeting the needs of Washington residents in the 21st century. A new structure should include revamped business taxes, lower sales taxes on a broader array of goods and services, and a graduated income tax on earned and unearned income.

Business leaders, policy makers, and the general public agree that significantly improving Washington's education system and transportation infrastructure is critical to the state's future. If we are to prepare all Washington children to be engaged citizens and productive workers in the global economy of the 21st century, we must greatly expand preschool and higher education and increase investment in the K-12 system. People and goods need to move freely around the state and through our ports for every business sector to prosper. Meanwhile, evidence is mounting that we must transition to renewable energy sources soon, or face devastating consequences from global warming. Yet Washington does not have sufficient revenue to provide basic services today, let alone invest at the level we need in order to face the challenges of the coming decades.

Doling out tax breaks to particular communities and industries is a poor way to promote job growth in a constantly changing global economy. Moreover, all the tax breaks are draining away public revenue needed for more important investments. Washington has taken the first steps necessary to move past the deal-making war among the states. Now it is time to adopt new economic policies that emphasize investing in the people of our state.

Notes

[1] Alan Peters and Peter Fisher, "The Failures of Economic Development Incentives," Journal of the American Planning Association, Winter 2004, http://www.planning.org/japa/pdf/04winterecondev.pdf.

[2] SB 6304 (2004), HB2348 (2006), and HB2221(2005), http://www1.leg.wa.gov/legislature/.

[3] HB2466 (2006), HB2546 (2004), HB 2640, and SB6558 (2006).

[4] HB3222, SB6512, HB1672 (2006).

[5] HB2670 and SB6230 (2006), and HB2314 (2005).

[6] LeRoy, The Great American Jobs Scam.

[7] Peters and Fisher, "The Failures of Economic Development Incentives;" Robert G. Lynch, Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development, Economic Policy Institute, March 2004, http://www.epi.org/content.cfm/books_rethinking_growth.

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Introduction

Bargaining for tax breaks from state and local governments has become a routine part of doing business for companies across the United States.[1] Fearful of losing jobs, Washington, like other states, is giving away public revenue while under-funding the services necessary for a vibrant economy and a healthy democracy. Public schools must meet higher standards and we must greatly expand access to preschool and higher education in order for our young people to become engaged citizens and compete in a global economy. The transportation infrastructure needs repair and upgrading after decades of neglect. The threat of global warming requires major new investment in alternative structures and energies. Meanwhile, health care costs are spiraling upward and consuming bigger chunks of the state budget every year.

Despite these needs for more public investment, budget deficits exacerbated by recession forced the state to cut services from 2002 through 2005. Nevertheless, the legislature has continued to hand out new tax breaks every year. In the three legislative sessions from 2004 through 2006, the Washington legislature passed at least 61 measures either granting new tax preferences or extending old ones. Many individual bills included multiple tax cuts as part of an incentive package. For example, a tax incentive package for seafood and dairy producers passed in 2006 included a sales tax deferral, a partial business and occupation (B&O) tax exemption, and a reduced B&O rate.[2] Tax breaks authorized since January 2004 will cost the state nearly half a billion dollars in the 2007-09 biennium. City, county and other local governments will have $89 million less for local services in the 2007-09 biennium because of these same tax breaks.

Business advocates have argued successfully for tax breaks during times of recession and times of economic growth, for industries that were struggling and industries that were booming. Meanwhile, across the nation corporate taxes are falling as a percentage of federal and state revenues, state general fund spending has fallen as a percentage of gross domestic product, and corporate profits are at record highs.[3]

While the problem is national, Washington's contribution to the tax-cutting binge has unique elements. Washington's tax structure was designed for the economy of the 1930s and no longer provides adequate revenue for needed services. As one of only seven states with no form of income tax, Washington relies more heavily on sales and business taxes than most states, and leaves intangible wealth such as stocks and bonds completely untaxed.[4] Washington has the most regressive tax structure in the country. Low and moderate income state residents pay much higher percentages of their income in state and local taxes than do high income residents.[5] Business taxes are also widely perceived to be unfair, particularly to new, expanding, and low-profit margin companies. Another negative consequence of our tax system is a structural deficit. Tax revenues in Washington are growing more slowly than the economy and the demand for services. The state enjoyed a modest budget surplus in 2006 as recovery from the recession finally gained traction, but new public investments did not come close to making up the cuts of previous years, and deficits could reappear as soon as the 2007-09 biennium.[6]

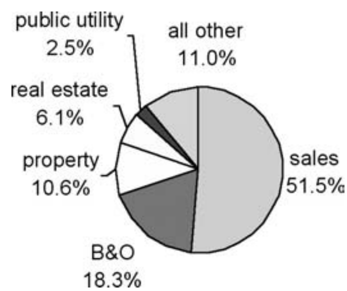
Of course, each new tax break erodes the tax base further, exacerbates inequities and the structural deficit, and leads to demands for more tax breaks.

The legislature has made progress towards more accountability in tax preferences. About half of the individual tax break bills passed between 2004 and 2006 include some reporting and evaluation measures and expiration dates. In 2006 the legislature also passed House Bill 1069 which establishes a commission to regularly review and make recommendations on most tax preferences.[7] However, the legislature failed to establish uniform standards for accountability and disclosure of tax breaks or to pass House Bill 1096 which would have required the Department of Revenue to prepare a new accounting of tax breaks each biennium to accompany the Governor's budget proposal.

Washington's Tax Structure

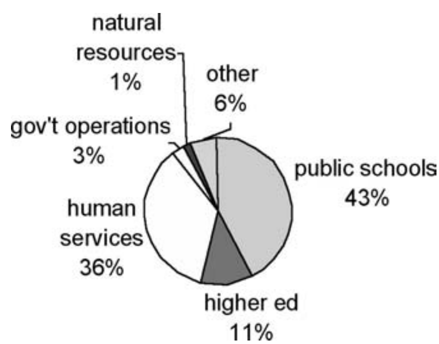
The basic framework of Washington's tax structure was established in the 1930s. The state's general fund relies on three major sources of revenue: sales, business and occupation, and property taxes. The retail sales and use tax contributes over half of the general fund, $13.6 billion in the 2005-2007 budget. The state collects 6.5% on the sale of most goods and some services, such as construction and car repair. Local governments collect an additional 0.5% to 2.4% sales tax, so sales tax exemptions affect local government services, too.

Sources of Tax Revenue for Washington's General Fund, 2005-07



Source: Washington Senate Ways and Means Committee, Citizen's Guide

Washington General Fund Spending, 2005-07



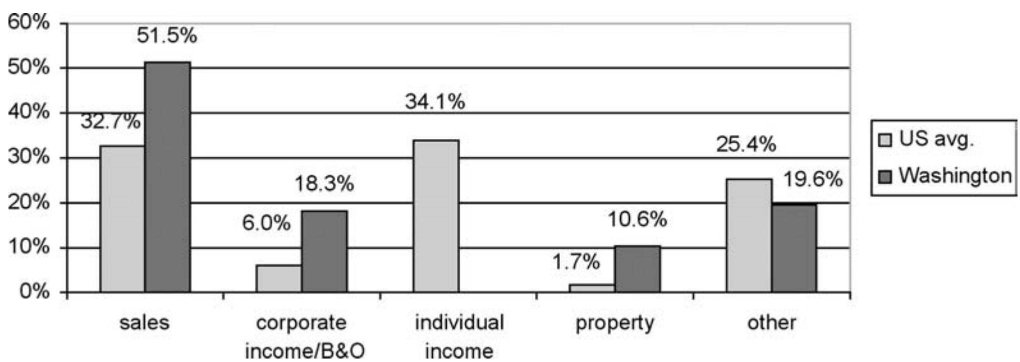
Source: Washington Senate Ways and Means Committee, Citizen's Guide

The B&O tax is the next largest source of state revenue, adding $4.8 billion to the 2005-07 budget. It is levied on a business's gross receipts without allowing deductions for costs – except for the multitude of special exemptions and credits that have been passed over the years. B&O rates vary by type of business and whether sales are subject to sales tax.

Property taxes are the third major ingredient, contributing 10.6% and $2.8 billion to the state general fund. The state portion of the property tax, which supports public schools, represents about one quarter of the total property tax paid by Washington residents. The rest stays in local communities to fund city and county services, fire districts, libraries, local school bonds, and the like. Other sources of revenue for the general fund include real estate, public utility, estate, tobacco, liquor and a variety of smaller taxes and fees.[8]

Washington's unusual tax structure makes it particularly regressive and unable to keep up with demands for public services. Among all 50 states, on average income taxes contribute over one third of general funds. Washington is one of seven states with no individual income tax.[9] Most of the other six states have another major source of revenue, for example, gambling in Nevada and oil and mining in Alaska, Texas, and Wyoming. Income taxes provide several key advantages. They can be progressive, based on ability to pay. Personal income tends to grow with the economy over time, so income tax revenues generally increase at the same pace as the demand for state services.[10] By taxing unearned as well as wage and salary income, income taxes provide a way for states to tax the intangible wealth held in stocks and bonds, an important part of the modern economy.[11] And the federal government provides the basic mechanism for calculating, collecting, and enforcing the income tax, as well as allowing state income taxes to be deducted from federal taxes.

2005 Sources of State Revenue, U.S. Average and Washington



Source: Federation of Tax Administrators and Washington Department of Revenue

With no income tax, Washington relies more heavily on sales tax than most other states. The sales tax has the advantages of being robust, easy to understand, and collected in small increments, so that most people do not perceive it as difficult to pay. However, it falls most heavily on low and moderate income people who spend the bulk of their income on goods in their local communities. High income people spend a much lower percentage on sales taxes, because they devote far more of their income to investments and to services, which are generally not subject to sales tax.

Sales tax revenues are also not keeping pace with overall economic growth and demand for state services. Over the past 40 years, spending on goods has declined as a proportion of consumer spending, while spending on untaxed services has increased.[12] Consumers are also buying more goods over the internet, often escaping sales taxes in the process.[13] According to a recent study by the Center on Budget and Policy Priorities, the percentage of sales subject to sales tax in Washington state fell by 16% between 1990 and 2003.[14]

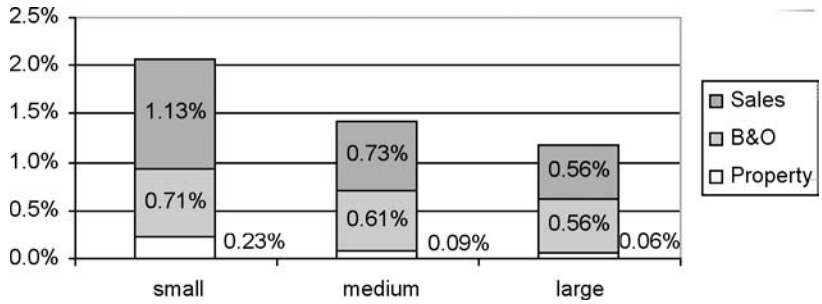
Per capita state and local property taxes are slightly lower in Washington than the national average. However, in most states all but a tiny fraction of property taxes stay in local communities. Therefore, property taxes make up a higher percentage of state funds in Washington than the national average.[15]

Between 1981 and 2001, Washington's sources of general fund revenues have only grown at 87% the rate of the state's economy, meaning that without rate increases or expansions of the tax base, public revenues do not keep pace with demands for services.[16] Among the states, Washington fell from 11th place in 1995 to 32nd in 2002 in collection of state and local taxes per $1,000 of personal income. During that seven year period, the amount collected fell by 18%, from $123 to $101 per $1,000 of personal income.[17] Washington ranked 34th in per pupil spending on public schools in the 2002-03 school year and a dismal 47th in public school spending in relation to personal income.[18] With its current tax structure, Washington's ability to expand preschool and higher educational opportunities, or make other high priority new investments, is limited.

Business Taxes

The business and occupation tax (B&O) is the major tax in Washington that applies specifically to businesses. However, many firms pay as much or more in sales tax as they do in B&O tax. According to a recent study by the Washington Department of Revenue, small firms, with less than $5 million in annual gross income, pay 0.71% of their gross income in B&O taxes, 1.13% in sales taxes, and 0.23% in property taxes. Medium size firms, with $5 to $25 million in gross income, pay on average 0.61% in B&O and 0.73% in sales taxes. Larger firms pay 0.56% each for B&O and sales taxes.[19]

State Taxes Paid by Washington Businesses as a Percentage of Gross Income, by Firm Size



Source: Washington Department of Revenue, 2002 data

Unlike the corporate income tax that most states rely on, Washington's B&O tax is unrelated to a firm's profits, making it particularly hard on start-up businesses. In theory, the B&O tax is levied on a firm's gross receipts, with no deductions allowed for the cost of doing business, but a number of special exemptions and deductions have been adopted over the years. B&O rates are quite low, and vary by industry: 1.5% on most services that are not subject to sales tax, 0.484% on most manufacturing, and 0.471% on most retailing, including those services on which sales tax is levied. Other special rates have been adopted for specific activities, including airplane manufacturing, certain food and biodiesel processing, and environmental cleanup.[20]

With the B&O tax on gross receipts, Washington raises more revenue than states do with a tax on profits alone. In order to replace the revenue generated by the B&O tax with a corporate income tax, the rate would have to be set at 16% or higher, higher than in any other state. Top corporate income tax rates in other states now range from 4.63% in Colorado to 12% in Iowa.[21]

In contrast to the sales tax or the corporate income tax, the B&O tax has been generally keeping pace with personal income. Since 1985, B&O tax collections have represented very close to 1% of personal income in Washington. [22]

The amount of revenue it generates is deemed both a strength and weakness of the B&O tax. A frequent source of complaint for Washington business lobbyists is that businesses pay 47% of state taxes in Washington, compared to an average of 33% among seven western states.[23] Washington's B&O tax is also criticized for being inequitable among firms, being difficult for firms new to the state to understand, and for pyramiding. Since firms cannot deduct the cost of goods and services they purchase, the B&O tax is often paid multiple times through the production process. Of course, some portion of business taxes are passed on to consumers.[24]

An Overview of Tax Exemptions through 2003

Washington law currently requires the Department of Revenue to report on tax exemptions every four years. The last report was issued in January 2004, based on the tax code as it existed in 2003. That report listed 503 distinct tax exemptions, deductions, credits, preferences, and other forms of tax breaks. DOR estimated that $13.6 billion in additional state and local revenue could be collected if all the tax breaks not required by federal law were repealed.[25]

Of course, many exemptions will never be repealed. Some are highly popular with voters, others would be difficult to collect, and most have strong advocates. However, the accumulation and proliferation of tax breaks means that the state is forced to rely on ever shrinking portions of the economy to generate revenues for public services on which the entire economy depends. The larger the tax base, the lower tax rates can be. The more items and activities that are eliminated from the tax base, the higher rates must be, or state residents must accept larger class sizes, fewer places in colleges, more children without health care, longer lines to get a driver's license, and a lower level of other public services.

Washington's single biggest exemption excludes intangible personal property from the property tax. Most other states include the intangible wealth held in stocks, bonds, and other investments, or the income it generates, in their tax base. The state of Florida taxes intangible wealth as property, but at a much lower rate than real property.[26] New Hampshire and Tennessee have a tax on interest and dividend income, but not on earned income.[27] Most other states and the federal government include income from intangible wealth in their general income tax. Washington could use any of these three methods to incorporate intangible property into the tax base.

The exemption of most services from sales tax cost Washington an estimated $6 billion in the 2005-07 biennium, and cost local governments an additional $1.8 billion.[28] Over the years Washington has added some services to the sales tax base, including construction, repair, and some recreational activities, but continues to exclude business and professional, financial, medical, and many consumer services. In 2002, Washington's Tax Structure Study Committee recommended including all consumer services, such as veterinarians, hair dressers, cable television, and recreation, in the sales tax.[29] In the 2005-07 biennium, a sales tax on consumer services in Washington would have generated $280 million for the state and $82 million for local governments.[30] Only a few states apply sales tax to business and professional services such as lawyers and consultants, but a number of states have gradually been including more consumer services.[31]

The sales tax exemptions on food and prescription drugs are also among the largest exemptions. These two tax breaks are highly popular, benefit all state residents, and help mitigate the regressivity of the state's overall tax structure. Rescinding these two exemptions would fall hardest on low income and elderly state residents. In the 2005-07 biennium, the food exemption was worth $1.5 billion in state revenue and $448 million in local government revenue. The prescription drug exemption was worth $501 million in state and $147 million in local revenue.

While many of the tax exemptions passed during the early and mid-20th century benefited broad categories of state residents or most businesses, narrower exemptions targeting particular industries or communities have become increasingly common. Between 1990 and 2003, the legislature adopted 109 business-related tax preferences. Many of these later tax breaks were intended to provide certain businesses with incentives for particular behaviors, such as expanding in rural areas or investing in pollution control.

Business-Related Tax Exemptions Through 2003, by Date Adopted

Category	before 1970	1970-89	1990-99	2000-03	Total
Agriculture	18	18	8	11	55
Business	17	30	22	6	75
Business incentive	6	13	30	31	80
Services	2		1		3
Total	**43**	**61**	**61**	**48**	**213**

Source: Washington Department of Revenue, "Tax Exemptions 2004"

Tax Breaks Passed 2004 through 2006

The trend toward more and more targeted tax incentives has picked up pace in the 21st century. In 2004 and 2005, even while Washington's state government faced deficits and was forced to cut programs, the legislature passed 36 new or extended tax break packages. In 2006, with tax revenues finally rising faster than service costs, the legislature granted 25 tax reductions. Together, these 61 measures reduced state revenues during the 2005-07 biennium by $305 million, and will cost the general fund $474 million in 2007-09. Local governments will lose $89 million next biennium because of these measures.[32]

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New and Expanded Tax Breaks Passed 2004-2006

	Total	Accountability measures		Sunsetting	
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Business incentive	31	18	13	16	15
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Total	**61**	**27**	**34**	**24**	**37**

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Accountability Measures

Each biennium when the legislature adopts a budget, every program receiving a direct appropriation of funds is evaluated against both other demands for public money and the budget bottom line. Even high priority programs that have proven to be effective in attaining public goals, such as early childhood education, small class sizes, and preventative health care, have never been fully funded and are cut when the state faces a deficit. Tax breaks, in contrast, are rarely evaluated against other public needs and usually remain entrenched through future budget negotiations. Proponents are free to talk about the projected benefits of a proposed tax preference, without having to address the costs in foregone services. Since the full fiscal impact of new tax breaks is often seen only in future biennia, even when tax exemptions are passed as part of a budget they are not fully evaluated against other public needs. Legislators are rightly concerned about the bow wave effect of new services – the rising cost in future budget cycles as programs are fully implemented. The bow wave affect of tax breaks, however, gets less attention.

As the number of tax exemptions has mushroomed and economic development has become the dominant rationale, legislators have paid more attention to evaluation and accountability. However, Washington has yet to adopt uniform standards for all business tax breaks. In 1982, the legislature took initial steps to review and sunset tax preferences, but did not follow through.[38] Since the early 1990s, some new tax preferences have included sunset, accountability, and evaluation provisions. While including such provisions in tax break legislation is a clear step in the right direction, there is no guarantee that new job creation will follow, and the question remains whether companies are accepting tax breaks for actions they would have taken anyway.

Perhaps the highest profile tax incentive package passed in Washington in recent years was the $3.2 billion deal negotiated by then-Governor Gary Locke with the Boeing Company, which was entertaining bids from competing states for the assembly of its new 787 jet. While Washington's trained aerospace workforce, existing airplane manufacturing facilities, access to ports, and history with the company were clear advantages, Boeing's move of its headquarters to Chicago two years earlier gave it the upper hand in negotiations. In addition to $3.2 billion in tax breaks over 20 years, the state agreed to provide transportation improvements, upgrades to the Port of Everett, changes in the unemployment insurance system, and other incentives. With that package in hand, Boeing agreed to locate the new aircraft assembly and an estimated 800 to 1,200 jobs in Everett.[39] The tax breaks came with accountability measures, including an annual reporting of employment, wages, benefits and other information that is open to the public.[40]

Most reaction to Washington official actions to land the 787 have been positive.[41] However, some of the new jobs are going not to Boeing's unionized workers, but to non-union contractors. For example, in February 2006 Boeing announced that the North Carolina-based company New Breed Logistics would manage the delivery of airplane parts to the 787 assembly line. Traditionally on other aircraft, that work had been done by Boeing's own Machinists. Because all companies associated with commercial airplane manufacturing in Washington qualify for the Boeing negotiated tax breaks, New Breed will probably also profit from them, even though it intends to pay significantly lower wages than Boeing, according to newspaper quotes of company executives.[42]

In 2004, several tax breaks originally passed in the 1990s were set to expire, including two incentives for high technology firms conducting research and development, a B&O tax credit and a waiver of sales tax for new or expanded facilities or machinery. The Department of Revenue produced three evaluations of the high tech tax breaks in 1997, 2000, and 2003, and contracted for an additional econometric study of job creation associated with those incentives. DOR's 2003 study found that while employment had grown in firms taking the tax breaks between 1995 and 2002, high tech employment in other states had grown at the same rate, and Washington's share of the nation's high tech jobs had held steady. The econometric study found no connection between the B&O credit and job growth, but did find job growth associated with those companies that took the sales tax incentive for new or expanded facilities. In 2002, 590 firms took a B&O credit and 49 firms applied for the sales tax exemption, 95% of the latter in King county.[43] The 2004 legislature renewed both the B&O and sales tax incentives until 2015, at the same time that it cut public services. In the 2007-09 biennium, those tax breaks will cost the state $221.5 million and local governments $51.7 million.[44]

Of the 61 tax breaks that have passed in Washington since January 2004, 27 include some kind of accountability measures and 24 include sunset dates. However, accountability standards vary widely. In many cases, companies benefiting from a tax break must report annually on jobs, wages, and benefits, but these reports are available to the public in only a handful of cases. Both the high tech exemptions and rural development incentives that were renewed in 2004 require annual reports to the Department of Revenue, but only the amount of credits taken can be disclosed to the public. DOR is to report on the efficacy of both programs in 2009 and on the high tech incentives again in 2013.[45] In 2004, the legislature also passed two years of tax breaks for struggling aluminum smelters. This package required detailed reports on employment that were to be open to the public.[46] When the aluminum tax breaks expired in 2006, the legislature concluded that although employment in the industry had continued to decline, the incentive program had met its target employment levels. The legislature renewed the aluminum industry incentives through 2012, but employment information would no longer be publicly available. Instead, fiscal committees were required to report on the program in 2007, 2010, and 2015.[47]

Of the 25 tax break packages passed in 2006, 14 include some accountability and evaluation measures, but only 3 include full public disclosure.[48] One 2006 tax break that will have significant impact on future public revenues, a B&O credit to off-set the pop syrup tax, has no accountability requirements or sunset date. That tax subsidy reduced revenues in the 2006 supplemental budget by only $2 million, but will grow to $21 million in the 2009-11 biennium. It primarily benefits the restaurant industry, which has been adding jobs at a rate well above the state average since 2001, pays average monthly wages at only half the state average, and is expected to continue expanding in future years.[49]

A positive move in 2006 was passage of House Bill 1069, which establishes a commission to review most tax preferences. The commission will establish a schedule for reviewing tax breaks at least every 10 years. The Joint Legislative Audit and Review Committee will conduct evaluations according to the commission's schedule, including recommendations to continue, modify, or terminate each tax exemption. Several tax breaks are excluded from the Commission's review, including the sales tax exemption for food and drugs, the senior property tax break, and exemptions for manufacturing equipment, research and development, and testing.[50] However, the legislature failed to pass House Bill 1096 that would have required the Department of Revenue to compile and report on the fiscal impact of all tax preferences as part of the biennial budget cycle.[51]

Conclusions and Recommendations

Across the United States, state and local governments are providing an estimated $50 billion in tax subsidies to businesses.[52] The half billion dollars in new tax breaks approved by the Washington legislature in the past three sessions is a small piece of a much larger pattern. From major corporations launching bidding wars for the location of a new corporate headquarters or manufacturing plant, to sports teams threatening to pull up stakes unless taxpayers provide a new stadium before the old one is paid for, to local community development deals, negotiating tax breaks has become an industry in itself.[53]

The explicit or implicit promise is that tax breaks will result in jobs – and that without tax deals, jobs will be lost. But literally hundreds of studies across the nation over the past two decades have failed to prove that higher tax subsidies create more jobs. There are undoubtedly cases where a particular tax break helped save or create jobs, but there are also many cases where tax breaks merely assured higher profits for actions a corporation would have taken anyway.[54] In fact, the evidence suggests that providing high quality public services, particularly transportation, education, and public safety, is a better way to generate a vibrant economy than cutting taxes.[55] Tax giveaways are undermining the ability of states to provide the very services that all companies and state residents need to thrive.

State and local taxes contribute a tiny amount to the overall cost of doing business for most companies, and enter into decision making only on the margins. Companies can deduct their state and local taxes from federal taxes, further reducing the cost and any differential among states. Of course companies would prefer to pay less in taxes, and will take a lower rate if they can get it. But demand for products, availability of a skilled workforce, proximity of ports and natural resources, quality of transportation and other infrastructure, and a variety of quality of life factors are all more important than taxes in determining costs and in a company's decisions about where to locate and whether to expand.

Every state faces pressure to cut business taxes, no matter what the tax structure. Across all 50 states, the percentage of state revenue contributed by corporate income taxes fell from 5.6% in 1994-95 to 3.8% in 2002-03.[56] In Oregon, which in contrast to Washington has a graduated income tax but no sales tax, the corporate share of income taxes paid has fallen from 18.5% in 1973-75 to a projected 4.5% of 2007-09 state revenues.[57] Washington's B&O tax has actually resisted the general trend. From 1985 to 2005, B&O taxes have represented between 15.1% and 16.6% of all the state's tax collections, varying up and down within that range.[58]

Nevertheless, Washington's tax structure makes it especially vulnerable to requests by particular industries for tax breaks. The uniqueness of the B&O tax and the relatively high sales tax rate make both taxes ripe targets for criticism. At the same time, without an income tax or a way to tax intangible wealth, Washington has a particularly large structural deficit and no easy way to replace revenue lost to tax breaks.

No doubt policy makers will continue to use the tax code to provide a variety of incentives and preferences to particular individuals and companies. But the legislature and governor can make the system far more effective in promoting an economy that provides opportunity for all state residents and all businesses. Specific policies that would strengthen the state's ability to raise revenue for services while building the state's economy include:

1. Use the performance audits and recommendations of the new Citizen's Commission for Performance Measurement of Tax Preferences created by HB 1069 to weed out tax breaks that are no longer efficiently delivering a high priority public benefit. Doing so will require standing up to high pressure lobbying.

2. Replace out-moded tax breaks with short-term targeted investment programs to help particular industries transition to new technologies and to meet emerging needs. For example, many agricultural incentives were adopted 30 or more years ago when state farmers faced far different circumstances. Today the beef industry must eliminate the possibility of mad cow disease, asparagus farmers who no longer have a local cannery must find replacement crops, and everyone must find ways to curb use of fossil fuels. Helping farmers make these or similar transitions would be far more effective public investments than the current hodge-podge of tax breaks.

3. Require consistent sunsetting, accountability, and public disclosure standards for all tax breaks. The public has a right to know how tax breaks are being used. Public disclosure will increase confidence that public purposes are being served. Consistency will increase fairness while decreasing the costs of administering incentive programs.

4. Require the Department of Revenue to prepare a tax expenditure report every biennium as part of the budget process. With an up-to-date accounting of all tax breaks before them, the governor and legislators could more easily adopt a state budget that truly reflects priorities for public investment.

5. Revisit the recommendations of the 2002 Tax Structure Study Commission as a starting point for a thorough overhaul of the state tax system. Our current regressive tax system simply is incapable of meeting the needs of Washington residents in the 21st century. A new structure should include revamped business taxes, lower sales taxes on a broader array of goods and services, and a graduated income tax on earned and unearned income.

Business leaders, policy makers, and the general public agree that significantly improving Washington's education system and transportation infrastructure is critical to the state's future. If we are to prepare all Washington children to be engaged citizens and productive workers in the global economy of the 21st century, we must greatly expand preschool and higher education and increase investment in the K-12 system. Goods and people need to move freely around the state and through our ports for every business sector to prosper. Meanwhile, evidence is mounting that we must transition to renewable energy sources soon, or face devastating consequences from global warming. Yet Washington does not have sufficient revenue to provide basic services today, let alone invest at the level we need in order to face the challenges of the coming decades.

Doling out tax breaks to particular communities and industries is a poor way to promote job growth in a constantly changing global economy. Moreover, all the tax breaks are draining away public revenue needed for more important investments. Washington has taken the first steps necessary to move past the deal-making war among the states. Now it is time to adopt new economic policies that emphasize investing in the people of our state.

Washington State Tax Break

Tax Breaks Passed in 2004	Accountability Measures
1328 Boarding homes - Lowers rates and allows B&O deduction for DSHS payments for Medicaid patients	
2453 Amends B&O exemption on wholesaling of new cars between dealers. Conforms law to practice.	
2518 Electrolitic chemical processors - Gives certain chemical processors that require large amounts of electricity similar Public Utility Tax exemptions as aluminum smelters. 1 known firm would qualify	Companies must report jobs, wages, benefits, and output to DOR; reports open to public disclosure. Fiscal committees to study in 2007 and 2010.
2929 Slaughter firms - B&O tax exemption for income from processing and selling beef (for those hurt by international bans on American beef due to mad cow disease)	
2968 B&O tax deductions for nonprofits receiving government grants for salmon restoration	
3116 B&O and sales tax exemptions extended to blood & tissue banks (reenacts 1995 exemptions invalidated by court)	
3158 Sales tax exemption on computer equipment used by printer or publisher.	
5034 Increases income levels to qualify for low income senior/ disabled property tax deferral from $34,000 to $40,000; partial exemption program eligibility raised from $30,000 to $35,000. Shifts about $58 million to other tax payers in 2005-07.	
6304 Aluminum smelters - Lowers B&O rate and provides property and sales tax credits; exempts from brokered natural gas use tax; assumes 1 smelter in operation.	Company must report on employment and quantity of aluminum, open to public. Fiscal committees to report in 2005, 2006, 2010.
6490 Exempts fuel cells from sales and use tax.	
2546 High tech firms conducting research and development - Extends expiring sales tax exemptions for new facilities and B&O tax credits.	Requires annual reporting on jobs, patents, and other indicators; only amount of credits taken public; DOR reports in 2009 and 2013.
2675 Extends electric utility tax credit; provides incentives to develop infrastructure for job growth in rural areas.	
6240 Rural and distressed counties incentives - Extends B&O credit for help desks or computer software; extends sales tax deferral for manufacturing, computer programming, R&D (21 firms have taken software credit, 17 help desk; 90-160 applicants for sales tax deferral received each year)	Requires annual reporting on jobs, patents, and other indicators; only amount of credits taken and summary statistics public; DOR report in 2009.
Subtotal for 2004 - 13 tax breaks	

Legislation Enacted 2004-2006*

Sunsetting	Primary Beneficiaries, *Type*	Revenue Loss 2005-07		Revenue Loss 2007-09	
		State	Local	State	Local
	Boarding homes *Non-profit*	$12.91 million	0	$18.19 million	0
	Car dealers *Business incentive*	$8,000	0	$8,000	0
2011	Electrolitic chemical processors *Business incentive*	$650,000	0	$650,000	0
Until Japan, Mexico, and Republic of Korea lift beef bans.	Beef industry *Agricultural*	$3.875 million	0	$4.032 million	0
	Environmental	$840,000	0	$935,000	0
	Non-profit	$552,000	$79,000	$598,000	$85,000
	Newspapers *Business incentive*	$3.12 million	$910,000	$3.44 million	$1 million
	Low income seniors/disabled *Individual*	0	$4.38 million	0	$4.485 million
2006	Aluminum smelters *Business incentive*	$3.038 million	0	0	0
	Environmental	$242,666	$70,000	$242,666	$70,000
2015	High tech firms *Business incentive*	$175.063 million	$39.536 million	$221.51 million	$51.681 million
2011	Rural communities *Local development*	$200,000	0	$600,000	0
2010	Firms locating in rural areas *Business incentive*	$39.118 million	$10.981 million	$45.27 million	$12.68 million
		$239.617 million	**$55.956 million**	**$295.476 million**	**$70.001 million**

* Not all revenue measures are included in this list, just those that can be deemed tax breaks. Bills that merely transfer money among different funds or government units are excluded.

Washington State Tax Break

Tax Breaks Passed in 2005	Accountability Measures
1019 Extends property tax breaks for low income seniors and disabled to disabled veterans.	
1401 Nightclubs adding fire suppression systems receive a property tax exemption on the resulting increase in value for 10 years following installation. Minimal tax shift among tax payers.	Must apply to county assessor.
1502 Reduction in property taxes for individuals whose property is damaged in a natural disaster.	
1509 Property tax exemption for widows and widowers of veterans. Minimal tax shift among tax payers.	
1887 Litter tax exemption enacted for restaurants in 2003 extended to food courts and caterers. (The litter tax applies to the manufacture and sale of certain products including food, cigarettes, soft drinks, and household products, with proceeds dedicated to litter control programs.)	
2221 B&O tax exemption for fruit and vegetable processing and sale to wholesalers who transport out of state. Defers/waives sales tax on investments in facilities or equipment.	Requires annual survey; amount of tax benefits are public. DOR to prepare annual summaries and evaluation in 2011
2314* (5911, 1609) Extends exclusion from sales tax to all self-serve laundries (previously laundries in apartment houses, etc. for exclusive use of tenants were excluded); and raises B&O tax. (Assumes industry will continue decline.)	
2314* (5455, 1273) Provides B&O and PUT credits for contributions to a downtown or neighborhood commercial district revitalization program in towns with populations under 190,000.	CTED oversees program; DOR must approve and track credits. Limited to $1.5 million statewide per year.
2314* (1376, 5398) Extends B&O and sales tax exemptions already in place for blood and tissue banks to comprehensive cancer centers.	
2314* (5972) Amends B&O credit for property taxes on new or renovated buildings used for manufacture of commercial airplanes or components.	As in 2003 Boeing incentives – company must file annual report with employment, wages, and benefits for full-time, part-time, and temporary workers, open to the public. Legislative committee reports due in 2010 and 2023.
2314* (1618, 5571) B&O tax exemption for nonprofit boarding homes for providing room and domiciliary care (typically for people with mental illness, developmental disabilities, or dementia).	
2314* (1785) B&O deduction and sales tax exemption for the cost of postage for mail service companies. (Printing and mailing services are subject to sales tax; this reinstates a long-standing practice that was disallowed in 2005)	

* *Introduced separately, but passed as part of budget bill*

Legislation Enacted 2004-2006

Sunsetting	Primary Beneficiaries, *Type*	Revenue Loss 2005-07		Revenue Loss 2007-09	
		State	Local	State	Local
	Disabled veterans *Individual*	0	$206,000	0	$278,000
	Nightclubs *Business incentive*	0	0	0	0
	Property owners *Individual*	$46,000	$166,000	$66,000	$241,000
	Individual	0	0	0	0
	Food court restaurants and caterers *Business incentive*	$40,000	0	$53,000	0
sales tax deferral expires 2012	Fruit and vegetable processors and wholesalers *Business incentive*	$7.1 million	0	$19.46 million	$3.4 million
	Owners of self-serve laundries *Business incentive*	$2.46 million	$900,000	$2.42 million	$890,000
	Businesses in "Mainstreet" program districts *Local development*	$1.5 million	0	$1.5 million	0
	Fred Hutchison Cancer Center *Non-profit*	$1.3 million	$410,000	$3.07 million	$960,000
2024	Boeing *Business incentive*	$364,000	0	$494,000	0
	Approx. 19 boarding homes *Non-profit*	$385,000	0	$519,000	0
	Mail service companies *Business incentive*	$336,000	$97,000	$383,000	$111,000

Washington State Tax Break

Tax Breaks Passed in 2005 (continued)	Accountability Measures
2314* (1679) Leasehold excise tax exemption for very narrowly defined amphitheaters, applicable to Clark County fairgrounds amphitheater.	
2314* (2134, 5990) Allows historic auto museum to defer sales tax payments on new museum construction for 5 years, and pay over 10 years.	Governing board must supply detailed proposal to DOR; information available to public.
5101 Public Utility Tax credit to power companies who provide incentive payments to customers who generate their own electricity from renewable sources.	DOR certifies systems meet requirements. DOR to report on impact in 2009.
5111 B&O rate reduction for manufacturers and wholesalers of solar energy systems using photovoltaic modules. B&O credit for taxes paid. (Assumes 1 plant will be built, employing 35 people.)	Businesses must file an annual report on jobs, wages, and benefits with DOR. DOR to submit evaluation in 2013.
5154 Exempts municipally owned historic property in national historic reserves (i.e. Fort Vancouver or Ebey's Landing) from leasehold excise tax (tax paid in lieu of property tax by those who lease public property for private purposes).	
5663 Extends and narrows B&O credit and sales tax exemption on equipment and structures to reduce field burning or reduce emissions (previously set to expire in 2006 and 2007). Available to farmers with at least 50% of acreage in covered crops in certain counties.	Person taking exemption must keep records establishing eligibility for DOR; records not available to public.
5782 Linked deposit program - Removes sunset and doubles amount available, from $50 M to $100 M annually. Under program, state deposits excess funds in banks at lower rates of interest and the banks loan the money to women and minority businesses. Currently 9 month waiting period for participation. State will earn lower interest.	Program monitored by Office of Minority and Women's Business Enterprises
5857 B&O deduction for government payments to hospitals is extended to nonprofit community health centers. (Estimated fewer than 20)	
5916 Exempts new cars and light trucks using clean alternative fuels or hybrids from sales tax.	
5999 Exempts Chambers of Commerce or similar organizations from B&O taxes for amounts they receive to administer Parking and Business Improvement Areas (special assessments for improvements to foster business growth - 11 in 2005)	
6003 Adds $500,000 annually to the commute trip reduction (CTR) tax credit cap, to a total of $2.75 million annually. Employers may apply for a tax credit on B&O or PUT tax for up to $60 per employee or 50% of the cost of financial incentives to employees to commute by bus, bike, car pool, etc.	
Subtotal for 2005 - 23 tax breaks	

* *Introduced separately, but passed as part of budget bill*

Legislation Enacted 2004-2006

Sunsetting	Primary Beneficiaries, *Type*	Revenue Loss 2005-07		Revenue Loss 2007-09	
		State	Local	State	Local
	Q-Prime, whose subsidiary built and operates Clark County amphitheater *Local development*	$75,000	$85,000	$85,000	$96,000
	Harold E. Lamay museum in Tacoma *Local development*	0	0	$5.229 million	$1.83 million
2014	Individuals with renewable energy electric generators *Environmental*	$130,000	0	$1.03 million	0
2014	Possible future photovoltaic solar energy manufacturer *Business incentive*	$130,000	0	$170,000	$5,000
	Individuals who lease Fort Vancouver properties *Local development*	$26,000	$22,000	$62,000	$55,000
2011	Eastern Washington farmers *Agricultural*	$1.33 million	$370,000	$3 million	$830,000
	Women and minority business owners; banks *Business incentives*	$1.17 million	0	$2.57 million	0
	Nonprofit community health centers *Non-profit*	$240,000	0	$280,000	0
In effect 2009-2011	Vehicle dealers and individuals *Business incentive*	0	0	$4.04 million	$2.54 million
	Chambers and other administrators of PBIAs *Local development*	$145,000	$20,000	$160,000	$20,000
	Businesses that promote commute trip reduction of employees *Business incentive*	$500,000	0	$500,000	0
		$17.277 million	**$2.276 million**	**$45.091 million**	**$11.256 million**

Washington State Tax Break

Tax Breaks Passed in 2006	Accountability Measures
1523 Adds conditioning of vegetable seeds to manufacturing activities eligible for sales tax exemption on new equipment or construction in rural counties.	Must submit annual report to DOR confirming eligibility. DOR to report on job growth, economic diversification, and other factors in 2009
1672 B&O credit for hospitals purchasing lift equipment. Limits of $1,000 per bed and $10 million state wide. (B&O payments from non-profit hospitals are credited to Health Services Account (HAS). HSA will lose an estimated $9.4 million in 2007-09, and the General Fund will lose $600,000.)	Hospitals required to establish Safe Patient Handling Committees and programs. Dept. of Labor & Industries to report on effect on Workers Compensation claims.
2348 Renews tax break for aluminum smelters: reduced B&O rate, B&O credit for property taxes, sales tax credit, and gas tax exemption. (Wenatchee plant reopened)	Goal to maintain 75% of employment. Reports to the legislature due in 2007, 2010, 2015
2364 Creates a use tax exemption for personal property, services, and warranties acquired by a state-chartered credit union from a federal or out-of-state credit union as a result of conversion or merger	
2424 Sales tax exemption for farm fuel (non-highway farm diesel is subject to special sales tax rather than fuel tax)	
2457 Exempts farmers from sales tax on replacement parts for farm machinery	Farmers must apply to DOR for an exemption certificate every 5 yrs.
2466 Adds non-manufacturers such as software and repair services to 2003 aerospace incentives (Sales tax exemption for computers and software; B&O credit of 1.5% of pre-production development expenditures; B&O credit for property taxes; reduced B&O rate for repair stations.) Governor request.	Companies claiming development credit must make annual report of jobs, wages, benefits, patents, copyrights, etc. Only amount of credit is open to public. DOR to report on effectiveness in 2010 and 2023.
2569 Lowers interest rate on property tax deferred by low income seniors and disabled from 8% to 5% (deferred taxes must be paid when property sold)	
2640 Sales tax deferral for biotech and medical device manufacturing for building construction and equipment	Firms must report on amount of deferral, jobs, wages, and benefits annually; only amount of tax incentive publicly disclosable. DOR to report in 2009 and 2015.
2644 Temporarily increases cap for customer assistance public utility tax credit, to encourage public utilities to assist low income customers	
2670 Allows local governments to finance bonds for transportation improvements in a hospital benefit zone by using state portion of sales tax, up to $2 million annually (statewide limit is also $2 million annually). Expected to cost state $4 million in 2009-11 and subsequent biennia.	Local government must submit annual report on use of revenues, business, employment and wages in benefit zone; report to be available to the public.
2671 Modifies due dates and eliminates some penalties on deficient business taxes, such as sales tax and B&O.	

Legislation Enacted 2004-2006

Sunsetting	Primary Beneficiaries, *Type*	Revenue Loss 2005-07		Revenue Loss 2007-09	
		State	Local	State	Local
2010	Skagit county seed company and potentially 15 to 20 firms. *Agricultural*	$1.085 million	$315,000	$2.614 million	$758,000
	Hospitals that have not yet purchased lift equipment. *Business incentive*	$0	0	$10 million	0
from 2006 to 2012	2 smelters, in Ferndale and Wenatchee *Business incentive*	$1.14 million	0	$4.66 million	0
	Credit unions (assumes 1 conversion and 2 mergers per year) *Business incentive*	$158,000	$49,000	$338,000	$104,000
	Farmers and fuel companies *Agricultural*	$4.55 million	$1.33 million	$8.132 million	$2.377 million
	Farmers *Agricultural*	$5.829 million	$1.704 million	$13.277 million	$3.881 million
Tax breaks expire 2024, except reduced rate for repair stations expires 2011.	Non-manufacturing firms that contract with Boeing *Business incentive*	$2.912 million	$351,000	$7.48 million	$833,000
	Low income seniors and disabled home-owners *Individual*	$15,000	0	$150,000	0
	Biotech and medical device manufacturing companies (assumes 60 firms per year) *Business incentive*	$1.39 million	$432,000	$3.34 million	$1.033 million
2007	Low income public utility customers *Individual*	$3 million	0	0	0
	Allows construction of a Gig Harbor hospital and business park including Costco. Other localities can also use *Local development*	0	0	0	0
	Businesses *Business incentive*	$11.41 million	0	$14.62 million?	0

Washington State Tax Break

Tax Breaks Passed in 2006 (continued)	Accountability Measures
2673 Creates Local Infrastructure Financing Tool Demo program, providing up to $5 million annually to promote economic development. Allows local governments to finance improvements using the state portion of the sales tax.	Local government must submit annual report on use of revenues, business, employment and wages in benefit zone; report to be available to the public.
2778 B&O tax exemptions for payments to nonprofits from local governments to promote tourism.	
2799 Exempts solar hot water equipment and related labor from sales tax	
3159 Extends B&O and sales tax exemptions for fruit and vegetable production to seafood and diary products; lowers B&O rate.	Those taking tax break must file an annual survey.
3190 Lowers B&O rate for semiconductor manufacturing and exempts related chemicals and gases from sales tax to support semiconductor cluster. Contingent on at least $350 million investment in buildings and equipment in state. (In 2003, similar incentives passed contingent on $1 million investment.)	Must file annual report detailing jobs, wages, benefits; contents are public. In 5th and 11th year, fiscal committees must evaluate effectiveness of incentives.
3222 Extends sales tax exemptions for dairy farmers purchasing equipment to treat livestock waste in environmentally friendly manner (in compliance with state regulations)	Beneficiaries must be certified under state law, approved as part of state water pollution control permit, or approved by conservation district. Conservation Commission to report to legislature by Dec. 2007.
6230 Provides sales tax credit against state sales tax for construction of new regional centers.	
6326 Allows businesses to recover 50% of cost for customized work force training by crediting B&O taxes.	Requires employers to file an annual survey with DOR and maintain a minimum number of in-state employees. DOR to report to legislature in 2011.
6512 Provides B&O deduction and sales tax exemption to truck stops for electrical power hook up equipment which will reduce idling of diesel engines and air pollution	
6533 B&O tax credit for soft drink syrup taxes. Phased in. Will cost $21.183 in 2009-11.	
6558 Allows B&O credits for contributions to Motion Picture Competitiveness Program, which is authorized to provide up to 20% of the cost of certain film projects. Capped at $3.5 million annually.	Recipients must file annual report with DCTED, which must provide annual summary report to legislature.
6671/3059 B&O deduction for professional employer organizations (allows firms providing payroll services to deduct wages, etc. that they pay on behalf of clients, i.e., pass-through funds. Restores status quo after court case.)	
6874 Provides preferential B&O rate for timber extraction, manufacturing, and wholesaling. Taxpayers also contribute 0.052% to the Forest and Fish Support account.	Requires filing of annual survey; a summary of the surveys will be provided to the legislature annually. Evaluations in 2011 and 2023.
Subtotal 2006 – 25 tax breaks	
Total for 2004, 2005, 2006 – 61 tax breaks	

Legislation Enacted 2004-2006

Sunsetting	Primary Beneficiaries, *Type*	Revenue Loss 2005-07		Revenue Loss 2007-09	
		State	Local	State	Local
Applications must be made by September 2009.	Projects in Bellingham, Vancouver, and Spokane; other projects to be developed *Local development*	0	0	$5 million	0
	Tourism industry *Local development*	$200,000	0	$430,000	0
2009	Solar water heating industry *Business incentive*	$14,000	$4,000	$28,000	$8,000
2012	Seafood and dairy producers *Business incentive*	$2.866 million	$17,000	$6.6 million	$39,000
expires 12 years after take effect.	A Vancouver firm has announced plans to expand *Business incentive*			$1.76 million	$297,000
	Dairy farmers *Agricultural*	$41,000	$11,000	$93,000	$25,000
Construction must begin by Feb. 2007	New center in Wenatchee *Local development*	$389,000	+$389,000	$1.28 million	+$1.28 million
2012	*Business incentive*	$.91 million	0	$3 million	0
	Truck stops and truckers *Business incentive*	$35,000	$11,000	$3,000	0
	Restaurants *Business incentive*	$2.294 million	0	$12.857 million	0
2011	Motion picture industry *Business incentive*	$3.5 million	0	$7 million	0
	Professional employer organizations *Business incentive*	$2.15 million	0	$6.65 million	0
2024	Timber and related industry *Business incentives*	$4.63 million	0	$24.6 million?	0
		$48.518 mil	**$3.835 mil**	**$133.912 mil**	**$8.075 mil**
		$305.412 mil	**$62.067 mil**	**$474.479 mil**	**$89.332 mil**

Notes

[1] On the economic war between the states, see, Good Jobs First, www.goodjobsfirst.org; Peter Fisher, "Tax Incentives and Disappearing State Corporate Income Tax," *State Tax Notes*, March 4, 2002, pp. 767-774; Michael Mazerov, "Should Congress Authorize States to Continue Giving Tax Breaks to Businesses?" Center on Budget and Policy Priorities, June 2005, http://www.cbpp.org/2-18-05sfp.pdf; Robert G. Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development*, Economic Policy Institute, March 2004, http://www.epi.org/content.cfm/books_rethinking_growth.

[2] See bill analysis for House Bill 3159 passed in 2006, www1.leg.wa.gov.

[3] Bureau of Economic Analysis, "News Release: Gross Domestic Product and Corporate Profits," May 25, 2006, http://www.bea.gov/bea/newsrelarchive/2006/gdp106p.htm; Market Watch, "Profits surge to 40-year high," March 30, 2006, www.marketwatch.com; U.S. Census Bureau, Summary of State and Local Government Finance, www.census.gov; Citizens for Tax Justice and Institute on Taxation and Tax Policy, "Corporate Income Taxes in the Bush Years," September 2004, http://www.ctj.org/corpfed04an.pdf; CTJ "Corporate Tax Avoidance in States Even Worse than Federal," February 2005, http://www.ctj.org/html/corp0205.htm.

[4] Federation of Tax Administrators, "2004 State Tax Collections by Source," http://www.taxadmin.org/fta/rate/04taxdis.html; and U.S. Census Bureau, "State Government Finances: 2004," www.census.gov.

[5] The Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, 2002, January, 2003, http://www.ctj.org/itep/whopays.htm.

[6] Washington's Office of Financial Management projected a $718 million deficit for 2007-09 in February 2006. The revised June 2006 forecast projects higher revenues and no deficit, but there are warning signs that economic growth could slow, including the growing impact of high energy costs. OFM, "Six Year Outlook," February 2006, http://www.ofm.wa.gov/fiscal/outlook/; "Washington's Quarterly Revenue Projection Up," June 15, 2006, http://www.ofm.wa.gov/news/release/2006/060615.asp.

[7] Tax breaks that will not be reviewed by the Commission include the sales tax exemption for food and drugs, the senior property tax break, and exemptions for manufacturing equipment, research and development, and testing. http://apps.leg.wa.gov/billinfo/summary.aspx?bill=1069.

[8] 2005-07 General Fund numbers are from Senate Ways and Means Committee, "A Citizen's Guide to the State Budget," March 2006, http://www1.leg.wa.gov/NR/rdonlyres/E12CAA70-BFBB-4BC5-A713-74E949301E62/19473/CGTBrevised5.pdf. General information on Washington's taxes can be found in Washington State Department of Revenue, *Tax Reference Manual 2005*, http://dor.wa.gov/content/statistics/2005/Tax_Reference_2005/default.aspx.

[9] The other states without an income tax are Alaska, Florida, Nevada, South Dakota, Texas, and Wyoming. Tennessee and New Hampshire have a limited income tax on unearned income (from interest and dividends) but not wage and salary income. Federation of Tax Administrators, "2004 State Tax Collections by Source," http://www.taxadmin.org/fta/rate/04taxdis.html.

[10] For discussion of the link between economic growth and demand for public services, see Marilyn P. Watkins and Jason Smith, "It's Not Just the Recession: The Budget Crisis and Washington State's Structural Deficit," July 2003, Economic Opportunity Institute, www.eoionline.org.

[11] Income taxes on unearned income can be less stable than on earned income. The stock market bubble of the late 1990s produced a surge in tax income, but was followed by a stock market crash and a sharp drop in tax income for some states. Still, over longer periods of time, unearned income also grows with the economy.

[12] US Bureau of Economic Analysis, Department of Commerce, Personal Consumption Expenditures, http://www.bea.doc.gov/.

[13] The Streamlined Sales Tax agreement among the states, to which Washington is a party, sets the stage for collecting sales tax on a greater portion of internet sales, but full implementation is still several years away.

[14] Center on Budget and Policy Priorities, "Faulty Foundations: State Structural Budget Problems and How to Fix Them," Washington Fact Sheet, March 2005, http://www.cbpp.org/states/5-17-05sfp-fact-wa.pdf.

[15] In Washington, state and local property taxes averaged $954 per capita in 2002, compared to $971 nationally. Senate Ways and Means Committee, "Citizen's Guide," p. 17.

[16] DOR, "Adequacy of State Revenues," Powerpoint presentation, 2002, http://www.ofm.wa.gov/budget/manage/adequacy/ofm20020208.pdf. For further discussion of the relationship between economic growth and the demand for state services, see Marilyn P. Watkins and Jason Smith, "It's Not Just the Recession: The Budget Crisis and Washington State's Structural Deficit," July 2003. Many states face a structural deficit: see Center on Budget and Policy Priorities, "Faulty Foundations: State Structural Budget Problems and How to Fix Them," March 2005, http://www.cbpp.org/5-17-05sfp.pdf.

[17] Washington State Department of Revenue (DOR), *Comparative State and Local Taxes, 2002*, August 2004, Introduction, Tables 1 and 3, http://www.dor.wa.gov/content/statistics/2002/Compare02/default.aspx.

[18] U.S. Census Bureau, *Public Education Finances*, 2003, March 2005, http://ftp2.census.gov/govs/school/03f33pub.pdf.

[19] DOR, "Incidence of Washington Taxes," presentation to the House Finance Committee, February 15, 2005. These numbers are for established firms. Start-up companies pay somewhat different rates, on average.

[20] DOR, *Tax Reference Manual*, p. 97.

[21] The B&O replacement rate would be 16% if the business income tax applied to both C and S corporations, 22% if only C corporations were included. Washington Department of Revenue for the Tax Structure Study Committee, "Major Replacement Alternatives for Washington Taxes," August 9, 2002, http://www.dor.wa.gov/. (C corporations are taxed at the federal corporate rate and may have an unlimited number of share holders. S corporations must be domestically owned and have no more than 100 shareholders. Partners in S corporations pay taxes on their share of company profits at the personal rate. http://en.wikipedia.org/wiki/S_corporation.)

[22] B&O tax has also contributed a steady 15.5% to 16.6% of total state tax collections since 1990. Tax data from Department of Revenue, *Tax Statistics 2005*, Table 13D, "State Tax Collections in Washington Historical Data: 1985-2005," http://dor.wa.gov/content/statistics/2005/Tax_Statistics_2005/default.aspx; Washington state personal income data from US Bureau of Economic Analysis, www.bea.gov.

[23] Based on a Utah Tax Commission study. The seven states are Utah, California, Oregon, Idaho, Colorado, Arizona, and Washington. Washington Department of Revenue, "Washington's Tax Structure," PowerPoint, November 17, 2004, http://dor.wa.gov/docs/reports/WA_Tax_System_11_17_2004.pdf.

[24] Most comparative studies of taxes treat Washington's B&O tax as a sales tax and assume it is largely passed on to consumers. See Institute on Taxation and Economic Policy, "Who Pays: A Distributional Analysis of the Tax Systems in All 50 States?" January 2003, http://www.itepnet.org/whopays.htm, and Federation of Tax Administrators, "Sales Taxation of Services," 1996, http://www.taxadmin.org/fta/pub/services/rr147srv.pdf. Taxes can also be passed on to workers and other businesses.

[25] DOR, *Tax Exemptions 2004*, www.dor.wa.gov. See also Marilyn Watkins, "Lost Revenue, Lost Opportunities: Tax Exemptions in Washington State," April 2004, Economic Opportunity Institute, www.eoionline.org.

[26] Florida Department of Revenue, "Florida's Intangible Personal Property Tax," http://www.myflorida.com/dor/taxes/ippt.html.

[27] New Hampshire's tax rate in 2006 is 5%: http://www.nh.gov/revenue/gti-rev.htm#Interest%20&%20Dividends%20Tax; Tennessee's tax rate in 2006 is 6%: http://tennessee.gov/revenue/tntaxes/indinc.htm.

[28] DOR, *Tax Exemptions 2004*, p. 230.

[29] Washington Tax Structure Study Committee, *Tax Alternatives for Washington State: A Report to the Legislature*, vol. 1, November 2002, p. 74, www.dor.wa.gov. The most frequent arguments against including business and professional services in the sales tax are that it would compound the problem of pyramiding that already exists with the B&O tax, and discriminate against firms that are not vertically integrated. Medical services are a growing part of the economy, and some economists have argued for including them in sales tax for that reason. However, medical care is also a basic necessity like food and medicine, which are exempted from the tax base, and the state and federal governments are already paying for a significant share of medical costs.

[30] Marilyn Watkins, "Reforming Washington's Tax Structure: Where Do We Go From Here?" January 2005, p. 7, http://www.eoionline.org/Taxes/ReformingWATaxSystem2005.pdf. Revenue estimates from DOR.

[31] Hawaii, New Mexico, South Dakota, Texas, and West Virginia apply retail sales tax rates to many business services. Federation of Tax Administrators, "State Sales Taxation of Services," 1997, with 2002 Update, http://www.taxadmin.org/fta/pub/services/rr147srv.pdf; http://www.taxadmin.org/fta/rate/tax_stru.html.

Exempting most services from the sales tax base is contributing to a structural deficit in many states. The situation is particularly bad in Washington because we rely so heavily on this particular tax. CBPP, "Faulty Foundations," March 2005, http://www.cbpp.org/states/5-17-05sfp-fact-wa.pdf.

[32] Many additional tax breaks were proposed, but not adopted. Among the failed proposals were a sales tax exemption for physical fitness services in 2004 and a B&O credit for job creation in 2006. Washington State Legislature, Bill Information, HB 1357 (2004) and HB 1351 (2006), http://www1.leg.wa.gov/legislature/.

[33] See SB 6304 (2004) and HB 2348 (2006) on aluminum smelters, HB 2221 fruit and vegetable processing (2005), http://www1.leg.wa.gov/legislature/.

[34] See HB 2466 on aerospace incentives (2006), HB 2546 on high tech incentives (2004), HB 2640 on biotech, and SB 6558 on motion picture incentives (2006).

[35] See HB 3222 dairy farms, SB 6512 truck stops, HB 1672 lifts (2006).

[36] See HB 2670 and SB 6230 (2006), and HB 2314 (2005).

[37] Five measures reduce property taxes for certain individuals, including low income seniors, disabled veterans, widows or widowers of veterans, and people with property damaged in a natural disaster. The sixth encourages public utilities to assist low income customers.

[38] Washington State House of Representatives, Final Bill Report EHB 1069, http://www.leg.wa.gov/pub/billinfo/2005-06/Pdf/Bill%20Reports/House%20Final/1069.FBR.pdf.

[39] Washington Department of Community, Trade, and Economic Development, Action Washington, "Behind the Landing of the 787," http://dir.cted.wa.gov/site/30/default.aspx; Site Selection, "The Battle to Land Boeing's 7E7: California, Texas, Washington Look Like Early Favorites," June 2003, http://www.siteselection.com/ssinsider/incentive/ti0306.htm; *Seattle Post-Intelligencer*, "Stage set for battle to woo 7E7," May 17, 2003.

[40] See bill report for HB 2294 (2003), http://www.leg.wa.gov/pub/billinfo/2003-04/Pdf/Bill%20Reports/House%20Final/2294.FBR.pdf.

[41] See, for example, Association of Washington Business, "Boeing 7E7 an Emotional Lift for Washington," December 16, 2003, http://www.awb.org/cgi-bin/absolutenm/templates/?a=496&z=2; *Seattle Post-Intelligencer*, Bill Virgin, "Why state needs 7E7 deal," May 27, 2003, http://seattlepi.nwsource.com/virgin/123677_virgin27.html; *Spokane Spokesman-Review*, "End justifies means in Boeing 7E7 deal," January 26, 2004, http://www.spokesmanreview.com/news-story.asp?date=012604&ID=s1478091&cat=section.commentary.

[42] *Seattle Times*, "Boeing goes outside for 787 parts delivery," February 24, 2006, http://seattletimes.nwsource.com/; *Seattle Post-Intelligencer*, "Non-union contractor gets 787 parts job," February 25, 2006, http://seattlepi.nwsource.com/.

[43] DOR, "High Technology R&D Tax Incentives Study," September 2003, http://dor.wa.gov/content/statistics/2003/High_Tech_RandD_Study_2003/default.aspx; and DOR, "High Tech Study Addendum: The Effect of High Tech R&D Incentives on Jobs," January 19, 2004.

[44] See bill reports for high tech renewal HB 2546 (2004), www1.leg.wa.gov.

[45] See bill reports for HB 2546 and SB 6240 (2004), www1.leg.wa.gov.

[46] See bill reports for SB 6304 (2004), www1.leg.wa.gov.

[47] See bill reports HB 2348 (2006), www1.leg.wa.gov.

[48] Those with disclosable information are HB 2670 and 2673, both of which concern local government development incentives, and HB 3190 with incentives for semiconductor manufacturing.

[49] See fiscal note for SB 6533 (2006). Employment and wage information is available from Washington Employment Security Department, Workforceexplorer.com. For analysis of restaurant employment, see Marilyn P. Watkins, "Washington State Jobs Update: Year End Report for 2005," January 2006, Economic Opportunity Institute, http://www.eoionline.org/StateEconomy/YearEndUpdate2005.pdf. For trends contributing to continued growth of restaurants, see Bruce Grundy, "Restaurant Industry Job Growth Will Continue to Outpace Economy in 2006", March 10, 2006, National Restaurant Association, http://www.restaurant.org/research/economy/commentary_20060310.cfm; and *Seattle Post-Intelligencer*, "Family Dinners of Yore Are Gone for Sure," February 15, 2006, http://seattlepi.nwsource.com/food/259480_dinnergone15.html;

[50] The five voting members are appointed by the Governor and the two largest party caucuses in the House and Senate, See HB 1069, www1.leg.wa.gov.

[51] See HB 1096. Other states are also moving toward greater accountability of tax breaks. According to Good Jobs First, at least 43 states have some accountability provisions, and at least 12 states provide company-specific disclosure of some tax subsidies. Four states, Illinois, Maine, Minnesota, and North Dakota, provide company-specific disclosure for almost all tax breaks. Good Jobs First, "Company Specific Subsidy Disclosure in the States," September 2005, http://www.goodjobsfirst.org/pdf/disclosure_chart.pdf.

[52] Alan Peters and Peter Fisher, "The Failures of Economic Development Incentives," *Journal of the American Planning Association*, Winter 2004, pp. 27-38, http://www.planning.org/japa/pdf/04winterecondev.pdf.

[53] Greg LeRoy, *The Great American Jobs Scam: Corporate Tax Dodging and the Myth of Job Creation*, (San Francisco: Berrett-Koehler Publishers, Inc.) 2005.

[54] LeRoy, *The Great American Jobs Scam*.

[55] Peters and Fisher, "The Failures of Economic Development Incentives;" Robert G. Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development*, Economic Policy Institute, March 2004, http://www.epi.org/content.cfm/books_rethinking_growth.

[56] Figures are for state revenues from their own sources, such as state taxes and fees (but not transfer payments from the federal government). U.S. Census Bureau, "Summary of State and Local Government Finances by Level of Government: 2002-03," and "United States State & Local Government Finances by Level of Government: 1994-95," www.census.gov.

[57] Oregon Center for Public Policy, "The Great Corporate Tax Shift," April 2006, http://www.ocpp.org/2006/rpt060414%20taxshift.pdf.

[58] Since passage of Initiative 695 in 1999, Washington has lost another source of revenue, the vehicle excise tax, that contributed between 5% and 7% of state tax revenues prior to 2000. Department of Revenue, *Tax Statistics 2005*, Table 13D, "State Tax Collections in Washington Historical Data: 1985-2005," http://dor.wa.gov/content/statistics/2005/Tax_Statistics_2005/default.aspx.

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