



Summary of Initiative 1098

Prepared for members of the Washington House of Representatives by the House Office of Program Research.

This information has been prepared in response to various requests for a summary of Initiative 1098. It is provided for analytical and legislative policy purposes only. It is not provided as an expression of support for or opposition to any ballot measure. These materials are intended to provide general information and are not intended to be an exhaustive analysis of all issues presented by the measure.

BRIEF SUMMARY

- Establishes a state tax (State Tax), beginning in calendar year 2012, on the receipt of income in excess of \$400,000 for taxpayers filing jointly and \$200,000 for taxpayers filing separately.
- Reduces the state property tax by 20 percent beginning in calendar year 2012.
- Increases the annual amount of the state business and occupation tax small business credit beginning in calendar year 2012.
- Dedicates revenue from the State Tax in excess of the amount necessary to offset revenue reductions from the expanded small business credit and property tax reduction to education and health services.

BACKGROUND

Initiative 1098

Initiative 1098 was certified to the ballot on July 16, 2010. The ballot title and ballot measure summary prepared by the Attorney General, and amended by court order on May 18, 2010, are as follows:

Ballot Title

Statement of Subject: Initiative Measure No. 1098 concerns establishing a state income tax and reducing other taxes.

Concise Description: This measure would tax “adjusted gross income” above \$200,000

(individuals) and \$400,000 (joint-filers), reduce state property tax levies, reduce certain business and occupation taxes, and direct any increased revenues to education and health.

Should this measure be enacted into law? Yes [] No []

Ballot Measure Summary

This measure would establish a tax on “adjusted gross income” (as determined under the federal internal revenue code) above \$200,000 for individuals and \$400,000 for married couples or domestic partners filing jointly; reduce the limit on statewide property taxes by 20%; and increase the business and occupation tax credit to \$4,800. The tax revenues would replace revenues lost from the reduced levy and increased credit; remaining revenues would be directed to education and health services.

Excise Versus Property Taxes

Under Washington State law, taxes come in two principal varieties: excise taxes and property taxes. An excise tax is a tax triggered by some voluntary act of the taxpayer such as conducting a business or selling goods or services. The state sales tax and state business and occupation tax are examples of excise taxes. A property tax is a tax triggered by the mere ownership of property without some other intervening activity necessary to trigger the tax. If a tax is considered a property tax, the uniformity requirements of the state Constitution apply to the tax. Tax uniformity requires a uniform tax rate and uniformity in the valuation of property.

Net Income Taxes

In general, a net income tax is a tax on total personal or business income less various deductions related to personal or business expenses. Tax rates can be either flat or graduated (tax rate increases as taxable income increases). Forty-three states impose a personal net income tax and forty-five states impose a corporate net income tax. State net income taxes are generally tied, in varying degrees, to the federal income tax.

Washington does not have a net income tax. In 1932 Washington voters approved an initiative establishing a personal and corporate net income tax. However, the Washington State Supreme Court, in *Culliton v. Chase*, 174 Wash. 363 (1933), ruled a tax on net income is a property tax and therefore subject to the uniformity requirements of the state Constitution. The net income tax at issue in the *Culliton* decision contained a graduated (non-uniform) tax rate structure, and therefore the Court ruled that the tax failed to satisfy uniformity requirements.

Property Taxes

All real and personal property in this state is subject to state and local property taxes each year

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based on the property's value unless a specific exemption is provided by law.

The amount in property taxes collected by a taxing district (i.e. the state, cities, counties, etc.) from year to year is subject to a statutory revenue limit. This limit requires reduction of property tax rates as necessary to limit the total amount of property taxes received by a taxing district each year. The limit for each year is the sum of (a) 100 percent plus a growth factor times the highest amount of property taxes levied in the three most recent years, plus (b) an amount equal to last year's levy rate multiplied by the value of new construction. For the state, the growth factor is the lesser of inflation, as measured by the implicit price deflator for personal consumption, or one percent.

Business and Occupation Taxes

Washington's major business tax is the business and occupation (B&O) tax. The B&O tax is imposed on the gross receipts of all business activities conducted within the state, without any deduction for the costs of doing business. Revenues are deposited in the State General Fund.

A B&O tax credit is provided for small businesses ("Small Business Credit"). Generally, the Small Business Credit is \$35 per month for each month in the tax reporting period (\$420 per year). In 2010, through the enactment of Second Engrossed Substitute Senate Bill 6143, the Small Business Credit amount was increased from \$35 per month to \$70 per month (\$840 per year) for businesses that report at least 50 percent of their taxable amount under the general service rate.

Education Legacy Trust Account

In 2005 the Education Legacy Trust Account (Account) was created. Money in the Account is dedicated to K-12 education, expanding access to higher education, and other educational improvement efforts. Revenues from the Washington estate tax and a portion of state cigarette taxes are deposited into the Account.

SUMMARY

Excise Tax on Receipt by Individuals of Taxable Income

Imposition of Tax. Beginning in calendar year 2012, a tax ("State Tax") is established on the receipt of all taxable income received by resident individuals and all individuals deriving income from sources within the state. "Taxable income" is defined to mean "adjusted gross income" as determined under the federal Internal Revenue Code (IRC).

Tax Rate. For married couples and domestic partners filing jointly and for every surviving spouse or partner, the State Tax is determined in accordance with the following table:

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If taxable income received is:	The tax is:
Not over \$400,000	0
Over \$400,000, but not over \$1,000,000	5 percent of the excess over \$400,000
Over \$1,000,000	\$30,000 plus 9 percent of the excess over \$1,000,000

For every individual and every married individual or domestic partner who does not file jointly with his or her spouse or partner, the State Tax is determined in accordance with the following table:

If taxable income received is:	The tax is:
Not over \$200,000	0
Over \$200,000, but not over \$500,000	5 percent of the excess over \$200,000
Over \$500,000	\$15,000 plus 9 percent of the excess over \$500,000

Modifications to Tax Rate. The tax rates on taxable income subject to the State Tax may not be increased for any income level without a majority vote of the Legislature and submission of the changes to the voters for their approval.

Credit for Washington Residents for Income Taxes Due in Another Jurisdiction. A tax credit is provided for Washington residents earning income in another jurisdiction where the income is subject to the other jurisdiction's income tax. Generally, the tax credit is equal to the tax paid to the other jurisdiction. The tax credit may not exceed the total amount of tax due and carrybacks and carryforwards are not permitted. If a jurisdiction exempts Washington residents from its income tax, the Director of the Department of Revenue (Department) is authorized to enter into a reciprocal agreement with the other jurisdiction to provide a similar exemption for the jurisdiction's residents working within Washington.

Credit for Dual Residence Individuals. Individuals with dual residency may reduce their State Tax liability on income that is also subject to another jurisdiction's personal income tax. The amount of the tax credit is equal to the lesser of the two taxes imposed on the same income multiplied by a fraction. The fraction is the tax imposed by this state on the income taxed twice and the denominator is the tax imposed by both jurisdictions on the same income.

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Nonresident Income within the State. For nonresident individuals, income derived from sources within this state is apportioned to Washington.

Business Entities. Partnerships, corporations, and other business entities are not subject to the State Tax. In other words, corporate shareholders as well as other business owners are subject to tax in their separate or individual capacities on their distributive share.

Withholding and Estimated Payments. Beginning in calendar year 2012, employers who pay wages or salaries earned in this state and who are required under the federal IRC to withhold taxes must withhold the State Tax as provided by the Department. Individuals required by the federal IRC to make federal estimated tax payments must also make estimated tax payments to the state if the individual is subject to the State Tax.

Filing Tax Returns. State Tax returns must be filed by the same due date required for federal personal income taxes, which is April 15. (The filing due date for initial tax returns for the State Tax is April 15, 2013.) Only married couples or individuals meeting the \$400,000 or \$200,000 threshold, respectively, are required to file an annual State Tax return. The State Tax return is required to be no more than two pages in length. The Department may grant extensions for the payment of tax; however, penalties and interest may apply. Individuals subject to State Tax must keep records, render statements, make returns, file reports, and perform other acts as the Department requires by rule. These records, statements, returns, and reports are subject to inspection by the Department.

State Property Tax Reduction

Beginning in calendar year 2012, the state property tax is reduced by 20 percent each year from the amount that would otherwise be collected under the property tax revenue limit without regard to the 20 percent reduction.

State Small Business Tax Credit Increase

Beginning in calendar year 2012, the maximum annual amount for the Small Business Credit is increased to \$400 for each month in the tax reporting period (\$4,800 per year).

Creation of Education, Health Services, and Middle Class Tax Relief Trust

The Education, Health Services, and Middle Class Tax Relief Trust is created. Revenue from the State Tax is first deposited into this fund. The amount necessary to annually backfill reductions to the State General Fund from the state property tax reduction and expanded small business credit is then transferred to the State General Fund. The remaining amounts, referred to as "net revenue," are further dedicated with 70 percent deposited into the Education Legacy Trust Account (for education purposes) and the remaining 30 percent dedicated to supplementing funding the basic health plan and for state and local public health services, long-term care

services, and other health services.

The Office of Financial Management (OFM) is required to prepare an annual report summarizing how funds deposited in the Education, Health Services, and Middle Class Tax Relief Trust have been spent and estimating the number of state residents benefitted. The OFM and the Office of the State Treasurer are required to post monthly State Tax collections and expenditures on their websites.

Effective Date:

The initiative takes effect December 2, 2010, subject to the following: (1) the State Tax is collected beginning in calendar year 2012; (2) the 20 percent property tax reduction begins with property taxes due in calendar year 2012; and (3) the increase in the small business tax credit applies beginning with taxes due in January 2012.

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