

DEVELOPING CONSENSUS TAX REFORM PROPOSAL FOR 2007 LEGISLATIVE SESSION



Prosperity
PARTNERSHIP

Washington's tax structure burdens fledgling companies with a B&O tax levied on gross receipts, fails to sufficiently fund transportation and education, and vexes businesses with its complexity. All five of the Prosperity Partnership's cluster working groups identified the state's tax structure as an obstacle to job creation. We must take action to *implement balanced, pro-competitive tax reforms.*

In 2006, the Prosperity Partnership will develop a consensus tax reform proposal for the 2007 legislative session.

What Are The Issues?

BUSINESSES PAY A VERY HIGH SHARE OF TAXES IN WASHINGTON

Washington ranks 10th in the nation in terms of the share of taxes borne by business.¹ The 2002 Tax Structure Study Committee (commonly known as the Gates Commission) concluded that "high business tax burdens reduce the economic vitality of the state, discourage firms from locating their operations here, and invite firms already located in Washington to consider other locations."²

Share of Tax by Households/Businesses

Washington State



Average for Seven Western States

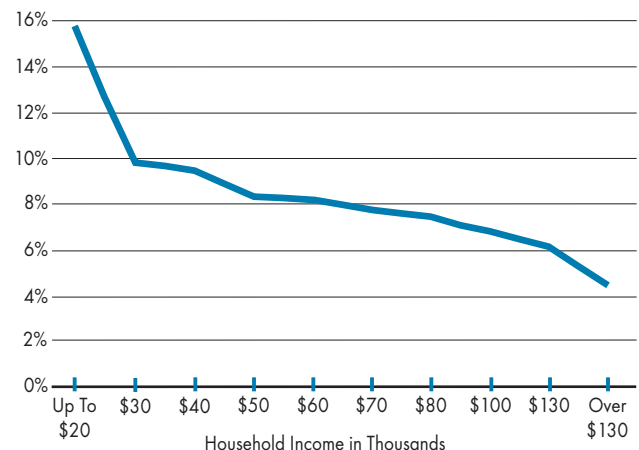


Source: Washington State Tax Structure Study Committee Report 2002, Utah State Tax Commission, Western States Tax Burden FY 1999-2000.

WASHINGTON'S TAX SYSTEM IS REGRESSIVE

Washington's absence of a personal income tax and its reliance on sales and property taxes are generally advantageous to high-income residents, but place a disproportionately high burden on low-income residents. One study found Washington's tax system to be the most regressive in the U.S.³

Percent of Income Devoted to State and Local Taxes



Source: Washington State Tax Structure Study Committee Report 2002, Washington Excise and Property Tax Microsimulation Model

BUSINESS AND OCCUPATION (B&O) TAX IS LEVIED ON GROSS RECEIPTS

The B&O tax typically costs up to 2 percent of a company's gross revenue. This tax is collected regardless of whether the company makes a profit. As a result, small businesses and entrepreneurs are drained of resources in the critical early stage of business development, when they most need to reinvest their limited resources. It is undoubtedly a contributor to Washington's rank of 48th in the nation in keeping businesses open – even while we have the country's highest rate of new company formation.⁴ The B&O particularly hurts industries with a large number of start-up firms, such as IT and life sciences.

WASHINGTON'S TAX SYSTEM IS COMPLEX

To compensate for the effect the B&O tax has on small businesses, the government has implemented numerous credits and incentives over the years, particularly for manufacturing machinery and equipment, R&D, and other technology-related activities. As a result, the state's fiscal structure has become increasingly complex over the years.

What's Been Done?

In 2002 the Gates Commission was created to report to the Legislature on how well Washington's current tax system works and how it might be improved. The commission published three key findings:

1. The current system is fundamentally inequitable to low- and middle-income people, unfair to many businesses and subject to sharp fluctuations in revenue.
2. The current system does not work well in today's economy with its greater dependence on the service sector.
3. The ever expanding "Internet economy" is eroding our retail sales tax base. This impedes the state's ability to collect its fair share from economic activities occurring over the Internet.

This and other studies by various organizations underscore the need for tax reform in our region and state. The complexity and contentiousness of this issue demands that a broad coalition consider all possible solutions in its quest for a balanced and effective tax system.

The Plan

The Prosperity Partnership will develop a balanced, pro-competitive tax structure bill for the 2007 legislative session, and show progress toward its completion in 2006. The coalition will also work to educate the public about the importance of tax reform to the region's economic health.

GOAL: Reform our tax system to increase our economic competitiveness while providing sufficient revenues to fund important services and infrastructure.

Specifically, the Prosperity Partnership will:

- Recruit a statewide coalition of organizations to develop a consensus-based package of reforms that will adequately fund our state's service and infrastructure needs while making Washington more conducive to job creation. The coalition will present a consensus tax reform package to the 2007 Legislature and Governor.
- Convene the principals from the Gates Commission to integrate their findings with the concerns of the Prosperity Partnership coalition.
- Educate the general public, leaders in minority and low-income communities, key opinion-makers in the public and private sectors, and legislators, on the importance of tax reform to our economy and communities.

A Broad Coalition

The Prosperity Partnership is a coalition of over 150 organizations, which has developed and is implementing a shared economic strategy for the four-county central Puget Sound region. The coalition will expand its partnerships to other regions around the state and include as many interests as possible to find effective, consensus-based tax reform. This is the best opportunity Washington has had in many years to achieve truly meaningful reform to improve our competitiveness and reform our tax code.

The Central Puget Sound Economic Development District (EDD) unanimously approved the Prosperity Partnership's regional economic strategy on September 27, 2005. The strategy takes a two-pronged approach, creating action initiatives to increase this region's competitiveness in important industry clusters, as well as targeting concerns shared by all industry sectors about key economic foundations. Tax structure is one of these foundations. To view the full strategy, visit www.prosperitypartnership.org.

¹ Washington Alliance for a Competitive Economy. "Tax Increases would Stifle Fragile Recovery." January 21, 2005.

² Ibid.

³ The Institute on Taxation and Economic Policy. "Who Pays: A Distributional Analysis of the Tax System in all 50 States." January 2003.

⁴ Corporation for Enterprise Development. 2004.