

State inches toward first income tax on wages over \$1M

Legislative proposal targets roughly 30,000 Washingtonians

BY MITCHELL ROLAND THE SPOKESMAN-REVIEW

OLYMPIA – Lawmakers in the state Capitol have spent nearly two months debating whether Washington should impose an income tax on individual earnings that exceed \$1 million per year.

With less than two weeks left in the short session, their plan is coming closer to fruition as legislators hammer out the details.

The general structure has been finished for weeks: The bill would impose a 9.9% tax on income above \$1 million, with the money used to help level out the state's tax code.

Under the proposal, only income, and not assets such as a home, would be subject to the tax on individual and joint filers once it would take effect in 2029.

But as the session draws to a close, questions remain as Democrats push to re-imagine the state's tax system.

Would people leave?

Estimates from Democratic lawmakers indicate that the tax would be applicable to approximately 30,000 people, with some concerned that a significant portion of the state's top earners will be motivated to relocate to another state.

Lucy Dadayan, a principal research associate at the Urban-Brookings Tax Policy Center, said in an interview Friday that Washington is not the first state to try to tax higher-income earners. However, Dadayan said there "is not clear evidence" that taxes in other states have served as a motivation to move.

The research, she said, showed that those who relocated tended to move between states and areas with higher tax rates, such as New York, California and Washington, D.C., rather than to places with low or no income tax.

"The reason is very simple, because what matters is another host of issues such as business opportunities, work demand, as well as the family and quality of life of the state," Dadayan said. "Not just the tax alone."

Will the income threshold be lowered in the future?

Gov. Bob Ferguson and Democratic leaders have repeatedly said they do not support lowering the income threshold so that the tax would be applicable to more people in the coming years. As he announced his support in late December, the governor said he would support an amendment to the state constitution to ensure the tax would not be paid by more Washingtonians in the future.

"My position is clear that the millionaires tax should only apply to folks who make that million dollars," Ferguson said during a Feb. 17 news conference. "I've also said there needs to be an inflation index so that amount goes up every single year."

During a Feb. 3 media availability, House Majority Leader Joe Fitzgibbon, D-West Seattle, said "there is not support in the Legislature" for decreasing the threshold.

"We're not going to bind future legislatures, but that's not a proposal we support," Fitzgibbon said.

Still, Republicans remain skeptical.

During a Feb. 10 media availability, Senate Minority Leader John Braun, R-Centralia, said Democrats have “tried to brand” the bill “in a way that’s attractive.”

“Despite the fact that it is very clearly just an income tax,” Braun said. “And the Senate Majority leader couldn’t have been more clear: that while the question in front of us this year is whether to just tax high earners, that future question remains open for future legislators.”

What will the money be used for?

Although passage of the tax seems to be a near certainty for the session, lawmakers are still wrangling over what to do with the additional revenue.

The legislation would exempt hygiene products from sales tax, and on Friday, members of the House Finance Committee added their preferred methods of tax relief on Friday, which included an amendment that would exempt diapers from the state sales tax. Ferguson has previously expressed support for the idea, though Democrats in the Senate rejected a similar amendment by Sen. Nikki Torres, R-Pasco, on the Senate floor.

Ferguson has also backed the idea of tax holidays, or two weekends each year where sales taxes are not charged on items that cost less than \$1,000. The idea, Dadayan said, is “not the most effective tool.”

“It creates a lot of administrative burden on the states,” Dadayan said. “But as well as on businesses who administer the sales tax. And it doesn’t really provide the necessary relief on lower-income families.”

The best method, Dadayan said, would be through sales tax exemptions on necessary items or expanding the Working Families Tax Credit, which Ferguson and lawmakers have supported.

Ferguson has proposed expanding the Working Families Tax Credit so that an additional 460,000 households would qualify for the tax credit. The plan calls for the credit to be increased by 30%. The expansion of the credit would cost about \$380 million a year.

The credit is essentially a payment to families meant as a rebate for sales

taxes they paid. Eligible families currently earn between \$50-\$1,330 a year depending on their income and number of children.

Ferguson has also proposed raising the threshold for the small business tax credit to exempt a business' first \$2.5 million from the business and occupation tax. If adopted, Ferguson said the plan would exempt 170,000 small businesses from the tax, while 30,000 businesses would have their business and occupation tax reduced.

The state's business and occupation tax is paid by businesses based on their revenue, not their profits, meaning businesses losing money still have to pay it.

The current legislation would eliminate the B&O on businesses that earn less than \$250,000 a year. The legislation would also distribute 7% of the revenue collected to counties for their public defense system and "increasing public safety."

Is it constitutional?

It depends on who you ask, and ultimately, it will likely be up to the court to decide whether the tax survives legal scrutiny. In 1933, the state Supreme Court found in a 5-4 court that the state's graduated income tax was unconstitutional because income is property and, under the state tax constitution, property must be taxed at the same rate. The income tax the court invalidated taxed richer people at higher rates.

Rob McKenna, a Republican who preceded Ferguson as the attorney general, has consistently said the proposal would violate the state constitution. In a legal memo, McKenna wrote that "based on nearly a century of Washington Supreme Court precedent and the plain language of the Washington State constitution" the tax is unconstitutional.

To adopt an income tax on those who make more than \$1 million, McKenna suggested that legislators should adopt a constitutional amendment.

"The proper avenue for enacting a graduated income tax with a rate in Washington is through constitutional amendment, not judicial reinterpretation of plain constitutional language," McKenna wrote.

Democratic lawmakers, including the governor, acknowledge the legislation will almost certainly result in court challenges. As he announced his support,

Ferguson said he is confident the proposal could survive a lawsuit.

“I wouldn’t be supporting a proposal unless I felt confident that we could navigate that path, and also, there’s going to be a public conversation. If this goes forward, there’s going to be a public conversation, there’s no doubt about that, and the people will have their chance to weigh in on it as well,” Ferguson said during a Dec. 23 news conference.

During a Feb. 16 floor speech, Senate Majority Leader Jaimie Pedersen, D-Seattle, said there has “been a lot of evolution in the thinking of courts” since the 1933 ruling.

“It has been more than 60 years since our Supreme Court has considered this question most recently,” Pedersen said. “And I believe that the court now would come to a different conclusion.”

What are the next steps?

The bill has cleared the state Senate and passed out of the House Finance Committee on Friday. Speaker of the House Laurie Jinkins, D-Tacoma, said Wednesday it will likely not be brought up for a vote before the full House of Representatives until after a cutoff for policy bills on March 6.

“We’ve got additional things we need to do, but I just have a hard time imagining doing it before the opposite House cutoff,” Jinkins said.

During a Feb. 17 news conference, state Rep. April Connors, R-Kennewick, said House Republicans would do “everything that we can” to stop it in their chamber.

“I think they’re going to have a harder time passing the income tax in the House than they had in the Senate,” Connors said. “So we will be working all angles to make sure that doesn’t happen.”

Assuming the bill reaches the finish line, legal challenges are expected immediately. However, it could be years before the court system reaches a conclusive answer.

At some point, voters likely will have the opportunity to decide whether the tax should be repealed, though it’s not yet clear when the income tax may appear on the ballot.

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