

# A LEGISLATIVE GUIDE TO WASHINGTON'S TAX STRUCTURE



# 2023

# Introduction

*A Legislative Guide to Washington's Tax Structure* is offered as a resource to members of the Senate, their staff, and other interested persons to provide an overview of the tax system in this state. It describes the evolution and characteristics of our tax structure and provides practical information on state tax uses, credits and exemption programs.

This guide was prepared by the Senate Ways & Means Committee staff (within Senate Committee Services) and the Legislative Evaluation and Accountability Program to provide answers to many of the typical questions regarding taxes. It is a summary of our tax system intended to assist readers in understanding basic terminology and gain a perspective with which to evaluate potential reforms.

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# **A LEGISLATIVE GUIDE TO WASHINGTON'S TAX STRUCTURE**

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# Major Categories of State Revenue in Washington

Taxes are an important revenue source for Washington, comprising almost all of the state revenues deposited in the state general fund, but slightly less than 50 percent of all revenues received by the state. Other sources of revenue include grants both federal and other, license and permit fees, charges for services, and borrowing. Washington relies on the sales tax, the business and occupation (B&O) tax, and property tax. Unlike most states, Washington does not have either a personal or corporate net income tax. The following chart shows the general fund share of each major state tax source.

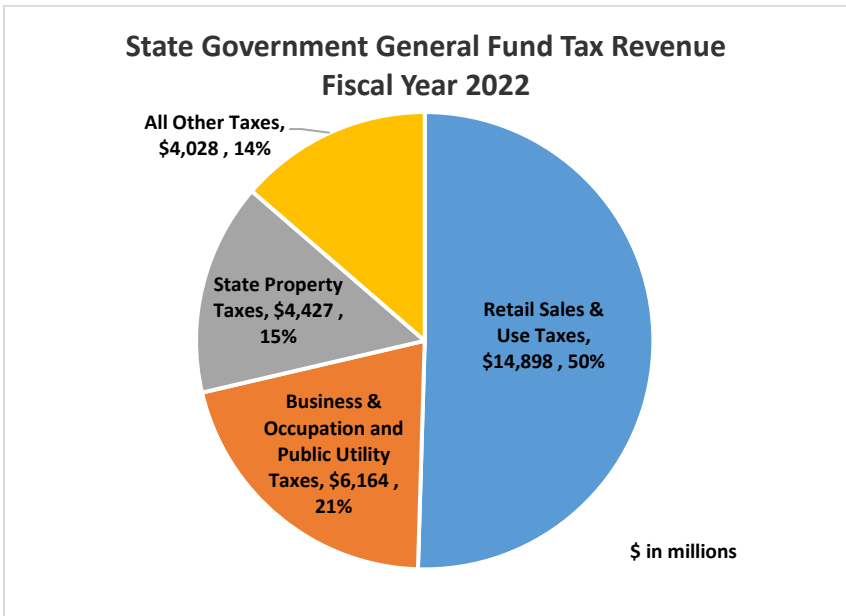


Table 3.11 from the Economic and Revenue Forecast Council - <http://www.erfc.wa.gov/>

# Major Excise Taxes

## Sales and Use Tax

The largest source of tax revenue to the general fund is the retail sales and use tax. Sales and use taxes are estimated to generate \$30.6 billion in the 2021-23 biennium and comprise about 50 percent of general fund revenue.

### **Tax Base:**

The sales tax is paid on each retail sale of most articles of tangible personal property and certain services. Examples of taxable services include construction, repair, telephone, lodging of less than 30 days, physical fitness, and some recreation and amusement services. In addition, the sales tax applies to extended warranties.

The use tax is imposed on the use of articles of tangible personal property when the sale or acquisition has not been subject to the sales tax. The use tax commonly applies to purchases made from out-of-state firms.

### **Rate:**

A sales tax rate of 6.5 percent applies to the total selling price of the article or service. An additional sales tax of 5.9 percent applies to car rentals (not leases). An additional sales and use tax of 0.3 percent applies to sales of motor vehicles other than farm tractors or farm vehicles, off-road and non-highway vehicles, and snowmobiles.

### **Major Exemptions:**

Major items not taxed include:

- Groceries;
- Prescription drugs;
- Motor vehicle fuel;
- Utility services;

- Professional services (e.g. medical, legal);
- Certain business services (e.g. accounting, engineering);
- Manufacturing, research and development machinery and equipment (including repair and replacement);
- Machinery and equipment used in a testing operation for manufacturers;
- Printer and publisher computer equipment (including repair and replacement);
- Certain machinery and equipment to reduce field burning sold to qualified farmers; and
- Items that become a component part of a final product for sale.

### **Deferral/Exemption/Credit Programs:**

There are five major sales tax deferral/exemption/credit programs where a taxpayer must file an application and meet other requirements.

The qualifying county deferral/exemption program, enacted in 2022 (ESB 5901), targets manufacturers and research and developers located in counties with a population of less than 650,000 at the time of application. The application must be submitted before initiation of construction or purchase of equipment. The amount of sales/use tax that can be deferred is limited to \$400,000 per person. The deferred taxes are forgiven if the investment project meets the program criteria for eight years after the project is complete.

The solar canopy sales and use tax deferral, enacted in 2022 (ESSB 5714), is available to persons constructing solar canopies placed on large-scale commercial parking lots at qualifying commercial centers. The application must be submitted before initiation of construction. The program expires in 2032. A qualifying solar canopy must be at least 50,000 square feet and must have a nameplate capacity of at least one megawatt of alternating current. The deferral recipient must repay all of the deferred sales and use taxes over an 8 year period, except if the recipient meets certain labor standards, in which case all or a portion of deferred tax may be exempted from repayment.

The tax deferral program for clean energy investment projects, enacted in 2022 (2SHB 1988), provides a sales and use tax deferral for businesses purchasing materials, equipment, labor, and services incorporated in an eligible “clean technology” investment project, which is a project with a cost of \$2 million in either qualified buildings and/or qualified machinery and equipment, for any of the following new, renovated, or expanded:

- Clean technology manufacturing operations.
- Facilities for renewable energy storage.
- Production facilities for clean fuel, renewable hydrogen, green electrolytic hydrogen or green hydrogen carriers.

The deferral recipient must repay all of the deferred sales and use taxes over a 10 year period, except if the recipient meets certain labor standards, in which case all or a portion of deferred tax may be exempted from repayment.

The server equipment and power infrastructure deferral/exemption program is a sales and use tax exemption available to owners and tenants of eligible data centers. An eligible data center is one located in a rural county that has a combined square footage of at least 100,000 square feet. Eligible data centers are exempt from sales and use tax on the purchase of server equipment, labor to install such equipment, power infrastructure, and labor and services to construct, install, repair, alter, or improve eligible power infrastructure and survey.

The working families tax credit is a state-level benefit program that is based in part on the federal Earned Income Tax Credit. It was enacted in 2008 but was not funded until 2021 when the legislature passed ESHB 1297, which expanded eligibility and provided funding for the program. The program provides a credit for a portion of sales taxes paid by eligible taxpayers. People will be able to claim the credit in the form of a payment starting in 2023.

To qualify for this credit, all of the following must apply for the year the credit is claimed:

- Filed a federal income tax return (individual or joint) as a Washington resident.
- Resided in the state for more than 180 days of the year.
- Either filed a federal income tax return with a valid Social Security Number and met the qualifications for the federal Earned Income Tax Credit, or filed the federal income tax return with an Individual Taxpayer Identification Number and would have otherwise qualified for the federal Earned Income Tax Credit.

The maximum amount ranges from \$300 to \$1,200 depending on the number of qualifying children. These amounts are then reduced based on income thresholds, similar to the federal program. The minimum credit amount is \$50, regardless of the number of qualifying children.

See the Department of Revenue's website for specifics:  
<https://dor.wa.gov/taxes-rates/tax-incentives/credits/working-families-tax-credit>

**Distribution of Revenues:**

All state sales and use tax revenues are deposited in the state general fund, except the additional sales tax on car rentals and the additional tax on motor vehicle sales, which are deposited in the multimodal transportation account.

**Local Sales and Use Taxes**

**General Taxes:** Local governments may impose local sales and use taxes at the following rates on the same tax base as the state.

Local Sales and Use Tax	Tax Rate (up to 1.0%)	Taxing Authority	Distribution
Additional Local Tax (optional)	0.50%	Counties and cities	If county only, then taxing authority receives 100%; if county and city, then distribution varies



<b>Additional Local Tax (regular)</b>	0.50% for counties; up to 0.50% for cities (not to exceed 0.425% if county is also imposing a tax)	Counties and cities	If county/city only, then taxing authority receives 100%; if county and city, then distribution varies
<b>Criminal Justice</b>	0.10%	Counties	10% to counties; 90% to cities/county per capita
<b>Cultural Access Program*</b>	0.10%	Counties and cities	Taxing authority receives 100%
<b>Distressed Public Facilities Districts</b>	0.20%	Anchor jurisdictions	Taxing authority receives 100%
<b>Emergency Communications Systems/Facilities*</b>	0.10%	Counties	Taxing authority receives 100%
<b>Housing and Related Services*</b>	0.10%	Counties and cities	Taxing authority receives 100%
<b>Juvenile Detention Facilities/Jails*</b>	0.10%	Counties below 1 million in population	Taxing authority receives 100%
<b>King County Food/Beverage</b>	0.50%	Counties above 1 million in population	Taxing authority receives 100%
<b>Mental Health Treatment</b>	0.10%	Any county; cities w/a population over 30,000 located in a county w/a population over 800,000.	Taxing authority receives 100%
<b>Passenger-Only Ferry District*</b>	0.30%	Passenger-Only Ferry District	Taxing authority receives 100%

<b>Passenger-Only Ferry Service*</b>	0.40%	Public Transportation Benefit Area	Taxing authority receives 100%
<b>Public Facilities Districts (PFD)*</b>	up to 0.2%	Governing board of a PFD	Taxing authority receives 100%
<b>Public Safety*</b>	up to 0.3% for counties; up to 0.01% for cities; not to exceed 0.3% combined	Counties and cities	County only is 60% to county/40% to cities per capita; city only is 15% to county/85% to city (county and city combined follows same distribution)
<b>Regional Transit Authority (RTA)*</b>	up 0.01% or up to 0.9% if in a county w/criminal justice tax	Cities w/transit systems, County Transportation Authorities, Metropolitan Municipal Corporation, Public Transportation Benefit Areas, High Capacity Transportation Corridor Areas, and RTAs	Taxing authority receives 100%

<b>Transit*</b>	up to 0.90% (min. of .10%)	Cities, counties w/an unincorporated transportation benefit area; Public Transportation Benefit Areas; County Transportation Authorities; and Metropolitan Municipal Corporations located in a county w/a population above 1 million	Taxing authority receives 100%
<b>Transportation Benefit District*</b>	up to 0.20%	Transportation benefit districts	Taxing authority receives 100%
<b>Zoo/Aquarium/Parks*</b>	0.10%	Counties 500k to 1.5 million in population w/national park	Taxing authority receives 100% if no funds allocated to national parks; if funds allocated to national parks, then 50% to zoo/aquarium advisory authority and 50% to county on per capita basis for parks-related costs
<b>State Shared Local Taxes (tax is credited against the state rate)</b>			
<b>Affordable and Supportive Housing Tax</b>	up to 0.0146 or 0.0073%	Counties and cities	Taxing authority receives 100%

<b>Annexation Tax</b>	up to 0.10%; up to 0.20% for annex area w/a population above 20,000	Certain cities w/an annexed area	100% to taxing authority up to threshold amount (excess goes to the State)
<b>Health Sciences and Services Authorities (HSSA)</b>	up to 0.20%	Local jurisdictions w/an HSSA	Taxing authority receives 100%
<b>Hospital Benefit Zone (HBZ)</b>	up to the state rate less the aggregate of any other taxes imposed on the same taxable events also credited against the state sales tax	Local jurisdictions w/an HBZ	Taxing authority receives 100%
<b>King County Baseball Stadium</b>	up to 0.017%	Counties above 1 million in population	Taxing authority receives 100%
<b>King County Football Stadium</b>	up to 0.016%	Counties w/public stadium authority	Taxing authority receives 100%
<b>Local Infrastructure Financing Tool (LIFT)</b>	Lesser of state rate, aggregate rate, 0.0104%, or rate reasonably necessary to collect award amount over 10 months	Counties and cities (w/certain local approval)	Taxing authority receives 100%

<b>Local Revitalization Financing (LRF)</b>	Lesser of state rate, aggregate rate, 0.0104%, or rate reasonably necessary to collect award amount over 10 months	Counties and cities (w/project approval)	Taxing authority receives 100%
<b>Public Facilities District (PFD)</b>	up to 0.025% (up to 0.020% if PFD created before 01/01/2000)	Certain public facilities districts	Taxing authority receives 100%
<b>Public Facilities Regional Centers</b>	up to 0.033%	Certain public facilities districts	Taxing authority receives 100%
<b>Rural Counties</b>	up to 0.09%	Rural counties (counties w/a population density of less than 100 persons per square mile or smaller than 225 square miles)	Taxing authority receives 100%

\*Voter approval required.

**Taxes on Car Rentals:** Local governments may impose additional local sales and use taxes on car rentals at the following rates:

<b>Local Sales and Use Tax</b>	<b>Tax Rate (up to 1.0%)</b>	<b>Taxing Authority</b>	<b>Distribution</b>
<b>Local - Rental Car</b>	up to 1.0%	Counties	Taxing authority receives 100%
<b>City Transportation Authority</b>	up to 1.944% (tax has not been levied)	Seattle (for monorail)	Taxing authority receives 100%
<b>High Capacity Rapid Transportation Services</b>	up to 2.172%	Agencies or high capacity	Taxing authority receives 100%

		transp. corridor areas	
<b>High Occupancy Vehicle (HOV)</b>	up to 0.805% (tax has not been levied)	Certain counties (King, Pierce, Snohomish)	Taxing authority receives 100% (deducted from high capacity rate)
<b>King County Stadium</b>	up to 0.20%	Counties w/a population above 1 million	Taxing authority receives 100%

\* Voter approval required.

## **Business and Occupation Tax**

The B&O tax is levied for the privilege of doing business in Washington and is the second-largest revenue source for the general fund. The B&O tax is estimated to generate \$11.5 billion in the 2021-23 biennium and comprise 19 percent of general fund revenues.

### **Tax Base:**

The tax is levied on the gross receipts of all business activities (except utility activities) conducted within the state. Unlike a corporate net income tax, there are no deductions for the costs of doing business.

### **Rates:**

Currently, there are several different B&O tax rates. The three principal rates include:

- Manufacturing, wholesaling, and extracting: 0.484 percent;
- Retailing: 0.471 percent; and
- Services and other activities: 1.5 and 1.75 percent (depending on taxable income as described in next section below).

### **Workforce Education Funding:**

Beginning April 1, 2020, the B&O tax has two tax rates under the Service and Other Activities classification. The tax rates replace the Workforce Education Investment Surcharge that was created in 2019.

### **Rates:**

- Service and Other Activities totaling \$1,000,000 or greater in the prior year – 1.75 percent.
- Service and Other Activities – 1.5 percent.

### **B&O Surcharge on Financial Institutions:**

Beginning January 1, 2020, a surcharge is imposed on financial institutions with an annual net income of at least \$1 billion for the previous calendar year. The surcharge applies to the business' income subject to the B&O tax under the service and other activities B&O tax classification.

### **Rate:**

The surcharge on financial institutions is 1.2 percent of gross taxable service and other income.

### **Major Exemptions:**

Non-retailing businesses with incomes of \$12,000 per year or less do not need to register with the Department of Revenue or file tax returns. Non-retailing businesses with incomes of \$28,000 per year or less are required to register with the Department but do not need to file tax returns. Other exemptions include public utility activity, agricultural production, rental of real property, and investment income earned by businesses other than financial institutions.

### **Tax Credits: A tax credit is a dollar-for-dollar reduction in a taxpayer's tax liability.**

A small business tax credit is authorized. Under the credit, if the amount of tax due is less than \$660 per year, then the credit is equal to

the amount of tax due. If the amount of tax due is greater than \$420 per year, then the amount of the credit is equal to \$1,320 minus the amount of tax due. These thresholds are approximately tripled for businesses under the service category of the B&O tax. The credit results in a certain amount of income being exempt from tax, but the exemption is phased out on a dollar-for-dollar basis until no exemption remains at twice the amount of the exemption. The following table shows the credit expressed in terms of a roughly equivalent exemption amount and the amount at which it is phased out for most businesses.

<b>B&amp;O Tax Credit - Exemption Equivalents</b>		
<b>Tax Category</b>	<b>Exemption</b>	<b>Phased-Out Amount</b>
Manufacturing, wholesaling, & extracting	\$136,364	\$272,727
Retailing	\$140,127	\$280,255
Services	\$128,000	\$256,000

A credit for job creation in rural counties is available for manufacturing and research and development located in rural counties (population density of less than 100 per square mile), counties smaller than 225 square miles, or community empowerment zones if they create employment at least 15 percent above the prior year. Businesses may claim \$2,000 as a credit against the tax for each new job created, except the credit is \$4,000 if the wages and benefits exceed \$40,000 per year. No more than \$7.5 million may be taken in any fiscal year by all businesses. No credit is available if a B&O tax credit is taken for international services job creation (see following).

A credit for international services job creation is available equal to \$3,000 per year for a five-year period for each net new job created after July 1, 1998, for businesses providing international services if the jobs are created inside community empowerment zones or designated



areas in cities or contiguous cities with a population above 80,000 that also meet the unemployment and poverty criteria of empowerment zones. An international service is a service that is for a person outside the United States or is for use primarily outside the United States.

A credit for job training in rural counties is available to manufacturing, research and development, and computer service businesses located in rural counties (population density of less than 100 per square mile), counties smaller than 225 square miles, community empowerment zones, and counties containing a community empowerment zone that provide job-related training at no charge to their employees. The tax credit is equal to 20 percent of the value of the job training, not to exceed \$5,000 per business per year.

A credit for commercial district revitalization became available January 1, 2006, for 75 percent of the amount donated directly to a revitalization program operated by a nonprofit organization, or 50 percent of the contribution amount to the Main Street Trust Fund administered by the Department of Commerce. Total credits cannot exceed \$100,000 per calendar year for an individual program or \$250,000 per calendar year for a business, and may only be claimed against tax due in the calendar year following approval. The total amount of credits per year statewide is capped at \$1.5 million per calendar year. Credits may not be approved for cities with populations of 190,000 or more.

A credit for hiring qualified veterans is available equal to 20 percent of wages and benefits paid up to a maximum of \$1,500 per employment position per year and may not exceed \$500,000 in any fiscal year. Credits can be earned through June 30, 2021.

### **Distribution of Revenues:**

All B&O tax revenues are deposited in the state general fund, except for revenues generated from the Workforce Education Investment surcharge. Surcharge revenues are deposited in the workforce education investment account and may only be used for higher

education programs, higher education operations, higher education compensation, and state-funded student aid programs.

### **Local B&O Taxes:**

Cities and towns may also impose municipal B&O taxes. Businesses are subject to tax based on their business activity, which includes manufacturing, wholesaling, retailing, and service activities. Generally, the maximum rate for a municipal B&O tax imposed on gross receipts is 0.2 percent. The rate must be the same within each class but may differ among classes. Forty-three of Washington's 281 cities levy a municipal B&O tax.

In 2003, the Legislature directed the Association of Washington Cities to convene a committee to develop a model ordinance that would be adopted by all cities imposing a municipal B&O tax no later than December 31, 2004. The model ordinance was required to contain certain mandatory provisions, which included a system of credits that prevent multiple taxation of the same income, a gross receipts threshold for small businesses, tax reporting frequency requirements, and provisions for penalties and interest, refunds, and deductions comparable with state law. Beginning January 1, 2008, cities levying a municipal B&O tax were also required to allow for allocation and apportionment of taxes between cities.

Cities and towns that levy a municipal B&O tax must follow a two-factor apportionment formula set by statute. In 2015, legislation directed the Department of Revenue to lead a Local Tax and Licensing Simplification Task Force to evaluate and develop options for improving the local business licensing and tax collection process. In 2017, the task force presented a report to the Legislature that examined the differences in apportionment and nexus between state and local business taxes, and how these differences affect taxpayers and cities, evaluated additional and alternative options to improve the administration of local business taxes and licensing, and provided several recommendations. However, the task force did not provide a recommendation on how to centralize municipal B&O tax collection.

In response to those recommendations, the Legislature implemented changes to the business licensing process and established the Local Business and Occupation Tax Apportionment Task Force (Engrossed House Bill 2005; Chapter 209, Laws of 2017). The task force was charged with developing recommendations for simplifying the two-factor apportionment formula. A report of recommendations was submitted to the Legislature on October 31, 2018.

### **Real Estate Excise Tax**

Sales of real property are subject to the real estate excise tax. This tax is estimated to generate about \$3.2 billion in the 2021-23 biennium and comprise 5.0 percent of state general fund revenues.

#### **Tax Base:**

The tax is applied to the selling price of real property and is typically paid by the seller. The tax also applies to the transfer or acquisition for a valuable consideration within any 36-month period of a controlling interest in any entity with an interest in real property in this state. The tax is applied to the value of the real estate transferred.

#### **Rate:**

Until December 31, 2019, the state tax rate was a flat 1.28 percent, regardless of property type or selling price.

Beginning January 1, 2020, a graduated rate structure was imposed on sales of real property as follows:

- Selling price of \$500,000 or less are subject to a tax rate of 1.10 percent;
- Selling price of \$500,000.01 - \$1,500,000 are subject to a tax rate of 1.28 percent;
- Selling price of \$1,500,000.01 - \$3,000,000 are subject to a tax rate of 2.75 percent; and

- Selling price of \$3,000,000.01 or more are subject to a tax rate of 3 percent.

The sale of agricultural land and timberland is excluded from the graduated rate structure and will be subject to a state tax rate of 1.28 percent.

**Major Exemptions:**

Sales of property by a governmental entity, and property acquired by gift, inheritance, or a similar transfer are exempt from taxation.

**Distribution of Revenues:**

Until December 31, 2019, 2 percent of revenues are dedicated to local public works projects, 1.6 percent of revenues are dedicated to city-county assistance, 4.1 percent of revenues are deposited into the education legacy trust account, and the remainder is deposited into the state general fund.

Beginning January 1, 2020, and ending June 30, 2023, 1.7 percent of revenues are dedicated to local public works projects; 1.4 percent of revenues are dedicated to city-county assistance; 79.4 percent must be deposited in the general fund; and the remaining amount must be deposited in the education legacy trust account.

Beginning July 1, 2023, and thereafter, revenue distributions dedicated to local public works projects increases to 5.2 percent.

**Local Real Estate Excise Tax:**

Cities and counties may levy a tax of 0.25 percent for capital improvements. Cities and counties may impose an additional 0.5 percent for general purposes if they do not impose the second 0.5 percent of the local sales tax, but this tax is subject to referendum. Cities and counties may levy additional taxes of up to 0.25 percent for growth management programs, but cities and counties not required but choosing to plan under the Growth Management Act must obtain voter approval before imposing the tax. Counties may impose a tax of up to

1.0 percent to finance the acquisition of conservation areas, subject to voter approval. Counties may levy additional taxes of up to 0.5 percent for the development of affordable housing, subject to voter approval, if the county imposes the 1.0 percent tax for conservation areas at the maximum rate and imposed the tax by January 1, 2003. City taxes are imposed in the city and county taxes are imposed in the unincorporated areas of the county, except the taxes for conservation areas and affordable housing, which are county-wide. The taxes are paid by the seller, except the conservation area tax is paid by the buyer and the affordable housing tax is paid by both the buyer and the seller, as determined by the county legislative authority, with at least one-half of the tax paid by the buyer. The typical combined state and local tax rate is 1.53 percent or 1.78 percent.

### **Public Utility Tax**

Public utility activity is exempt from the B&O tax and is subject to a gross receipts public utility tax instead. The tax is passed directly on to customers through the rate structure. Therefore, it effectively becomes a sales tax. The public utility tax is estimated to generate \$863 million in the 2019-21 biennium and comprise about 1.6 percent of state general fund revenues.

#### **Tax Base:**

Public utility activities, including electricity, water, natural gas, sewerage collection, and various transportation services comprise the tax base.

#### **Rates:**

There are five state tax rates depending on the type of utility activity, but most public utilities pay at the 3.852 percent rate. The following table lists the rates for various activities.

<b>Public Utility</b>	<b>Rate</b>
Express, telegraph, natural gas, and sewerage	3.852%
Light and power companies	3.873%
Water distribution companies	5.029%
Taxicabs, limousine services, other urban transportation carriers, and marine vessels for hire under 65 ft. (except tugboats)	0.642%
Motor transportation (except urban transportation), railroad, railroad car, tugboat firms, and public utilities not elsewhere classified	1.926%
Hauling of logs on public roads	1.396%

**Major Exemptions:**

Public utilities with gross receipts of less than \$2,000 per month are exempt from taxation. Also, two major exemptions include telephone services, which are subject to sales tax, and solid waste collection, which is subject to a separate tax.

**Credits:**

A low-income home energy assistance program (LIHEAP) credit is available against the public utility tax due from gas and electric utilities for qualifying contributions and billing discounts offered to qualifying low-income customers. To qualify for the credit, the amount of billing discounts or qualifying contributions must be at least 125 percent greater than discounts or contributions given by the utility in 2000 or the first year after 2000 in which qualifying contributions are given. The amount of the credit for each utility is equal to one-half the discount or contribution given in a fiscal year. The maximum total credit available statewide each year is \$8.8 million. Each utility is also limited to a maximum credit amount based on its proportional share of

energy assistance grants received by its low-income customers. Any credit not used in a fiscal year lapses for that utility and may be reapportioned to other qualifying utilities. The total credit available to a utility is its maximum available credit plus any portion of unused credits reapportioned to it.

A credit for international services job creation is available equal to \$3,000 per year for a five-year period for each net new job created after July 1, 1998, for businesses providing international services if the jobs are created inside community empowerment zones or designated areas in cities or contiguous cities larger than 80,000 that meet the unemployment and poverty criteria of empowerment zones. An international service is a service for a person outside the United States or is for use primarily outside the United States.

A credit for commercial district revitalization is available January 1, 2006, for 75 percent of the amount donated directly to a revitalization program operated by a nonprofit organization or 50 percent of the contribution amount to the Main Street Trust Fund administered by the Department of Commerce. Total credits cannot exceed \$100,000 per calendar year for an individual program or \$250,000 per calendar year for a business, and may only be claimed against tax due in the calendar year following approval. The total amount of credits per year statewide is capped at \$1.5 million per calendar year. Credits may not be approved for cities with populations of 190,000 or more.

A credit for hiring qualified veterans is available equal to 20 percent of wages and benefits paid up to a maximum of \$1,500 per employment position per year and may not exceed \$500,000 in any fiscal year. Credits can be earned through June 30, 2021.

### **Distribution of Revenues:**

The majority of the revenues collected from the public utility tax are deposited in the state general fund. Twenty percent of the revenues collected from water distribution and 60 percent of the revenues collected from sewerage collection businesses are deposited in the

education legacy trust account until July 1, 2023, and the public works assistance account thereafter.

### **Local Public Utility Taxes:**

Cities and towns may levy a public utility tax of up to 6.0 percent on electricity, telephone, natural gas, and steam energy utilities. There is no rate limit on other services, such as garbage, water, sewer, and cable television. The tax may not be levied on broadcast satellite television or internet services.

The authority of cities and towns to impose the tax derives from their general authority to impose excise taxes on businesses doing business within their boundaries. A 2014 court of appeals decision, *City of Wenatchee v. Chelan County Public Utility District No. 1*, held that cities may impose the tax on other municipalities providing utility service within their boundaries. The court further held the authority to impose the tax on other municipalities does not apply to revenues "derived from governmental activities."

There are no limits on how cities may use local public utility tax revenues. Most cities use these revenues for general fund purposes. However, when a city seeks voter approval to increase the tax above 6.0 percent, the city often dedicates the additional revenue to a specific purpose, such as roads or public safety.

### **Insurance Premiums Taxes**

Insurance premiums are exempt from the B&O tax and are subject to an insurance premiums tax instead. The insurance premiums tax was estimated to generate \$1.3 billion in the 2019-21 biennium and comprise 2.6 percent of general fund revenues.



**Tax Base:**

The tax base includes net premiums received by authorized insurers, except title insurers, after deduction of premiums returned to policyholders. Ocean marine and foreign trade insurers are taxed on their gross underwriting profit.

**Rates:**

The rate of tax is 2.0 percent, except on ocean marine and foreign trade insurance, in which case the tax rate is 0.95 percent.

**Major Exemptions:**

Title insurers; pensions, annuities, and profit-sharing plans; health insurance pool premiums; and fraternal benefit societies.

**Tax Credits:**

Insurance companies that pay an assessment to the Washington Insurance Guaranty Association or the Washington Life and Disability Insurance Guaranty Association for insurance companies that become insolvent after July 27, 1997, receive a tax credit against premium taxes equal to 100 percent of the assessment. The tax credit is taken over five years.

**Distribution of Revenues:**

Revenues are deposited in the general fund with the following exceptions:

- 40 percent of the taxes on fire insurance premiums is deposited into the volunteer firemen's relief and pension fund;
- 25 percent of the taxes on fire insurance premiums is deposited into city firemen's pension funds; and
- 20 percent of the taxes on fire insurance premiums is deposited into the fire service training account.

**Cigarette and Tobacco Products Taxes**

The cigarette and tobacco products taxes are added directly to the price of these goods before the sales tax is applied. The cigarette and tobacco products taxes were estimated to generate \$858.8 million in the 2017-19 biennium and comprise 2.0 percent of state general fund revenues.

**Tax Base:**

Cigarettes and tobacco products sold in Washington.

**Rate:**

- Cigarettes (per pack): \$3.025
- Tobacco products: 95% of the sales price (but no more than \$0.65 per cigar); moist snuff is \$2.5626 per unit or 83.5% of cigarette tax rate

**Major Exemptions:**

Sales to persons in other states, foreign countries, instrumentalities of the United States (U.S.), or to established governing bodies of any Indian tribe recognized as such by the U.S. Department of the Interior. (Sales by Indian tribes to non-Indians are taxable.)

**Distribution of Revenues:**

The revenues are deposited into the state general fund.

## **Vapor Products Tax**

Since October 1, 2019, a tax is imposed on all vapor products in addition to general retail sales and use taxes. The tax is paid by the first person to possess the vapor product in Washington.

**Tax Base:**

All vapor products, including electronic cigarettes, electronic cigars, electronic cigarillos, electronic pipes, or similar products or devices.

Vapor products do not include tobacco cessation products, or marijuana, cigarette, or tobacco products approved by the United States Food and Drug Administration, which are taxed separately.

**Rate:**

There are two vapor products tax rates, depending on the volume of solution and type of the container:

- \$0.09 cents per milliliter of solution for accessible containers of solution greater than five milliliters; or
- \$0.27 cents per milliliter for all other vapor products.

**Distribution of Revenues:**

Revenues from the tax are deposited evenly into the Foundational Public Health Services Account and the Andy Hill Cancer Research Endowment Fund Match Transfer Account.

## **Alcoholic Beverages Taxes**

State liquor taxes are imposed on hard liquor, beer, and wine. For the 2017-19 biennium, it is estimated that \$605.8 million of liquor taxes was distributed to the general fund, comprising 1.4 percent of state general fund revenues.

**Tax Base:**

Taxes on hard liquor or spirits are imposed on a volume and sales tax basis. Taxes on beer and wine are imposed on a volume basis.

**Rates:**Hard Liquor or SpiritsLiquor Liter Tax

- Sales for consumption on premises \$2.4408/liter

- All other liquor sales \$3.7708/liter

### Liquor Sales Tax

- Sales for consumption on premises 13.7 percent
- All other liquor sales 20.5 percent

### Wine:

- Fortified wine excise tax \$0.4536/liter
- Unfortified wine excise tax \$0.2292/liter

### Fermented Apple/Pear Cider:

Wine excise tax \$0.0814/liter (\$9.55 per 31 gallons)

### Beer:

Beer excise tax - large breweries \$8.08 per 31 gallons

Beer excise tax - microbreweries \$4.782 per 31 gallons

### **Major Exemptions:**

Sales to the armed services are exempt.

### **Distribution of Revenues:**

Liquor Liter: Revenues from the tax are deposited into the state general fund.

Liquor Sales: Sixty-five percent of revenues from the liquor sales tax are distributed to the state general fund. The remainder is distributed to counties and cities based on population, with counties receiving 20 percent of remaining funds and cities receiving 80 percent of remaining funds.

Revenue from the surtax and additional taxes are deposited into the state general fund.

Wine Excise/Fermented Apple and Pear Cider: The wine excise tax and the tax on fermented apple and pear cider is split in a complex manner between the state general fund, local law enforcement

programs, counties and cities, Washington State University wine research, the Washington Wine Commission, and youth violence prevention and drug enforcement.

Beer Excise: Revenue from the base tax of \$1.30 per barrel are distributed as follows:

- 0.3 percent to certain border cities and counties for law enforcement costs; and
- The remaining 99.7 percent is distributed to counties and cities based on population, with counties receiving 20 percent of remaining funds and cities receiving 80 percent of remaining funds.

Revenue from the additional tax of \$2.00 per barrel and \$4.78 per barrel are deposited into the state general fund.

Revenue from the \$1.482 tax for barrels exempted from the \$4.78 rate are distributed as follows:

- 97 percent into the state general fund; and
- 3.0 percent to border cities and counties.

### **Cannabis Excise Tax**

The cannabis excise tax (originally called the marijuana excise tax) was created with the passage of Initiative 502 (I-502), which legalized the recreational use of marijuana and marijuana infused products. The initiative imposed an excise tax on each successive sale of recreational marijuana to be paid by the seller. In 2015, the tax was changed so it is imposed only on the final sale to the consumer. Sales of marijuana to the public began in July of 2014. For the 2021-23 biennium, tax collections are estimated to exceed \$1 billion with approximately \$319 million distributed to the state general fund. Of the revenues deposited to the state general fund, up to \$20 million is shared with cities and counties.

**Tax Base:**

The tax is levied on the selling price on each retail sale of cannabis concentrates, useable cannabis, and cannabis-infused products.

**Tax Rate:**

The rate of tax is 37 percent.

**Distribution of Revenues:**

All revenue collected from the cannabis excise tax is deposited into the Dedicated Cannabis Account. Money deposited into the Dedicated Cannabis Account is distributed as follows (on an annualized basis):

1. \$12.5 million to Liquor and Cannabis Board;
2. \$11 million to the Department of Health;
3. \$3 million to the Department of Commerce;
4. \$200,000 to the Health Care Authority;
5. \$25,000 to the University of Washington alcohol and drug abuse institute;
6. \$300,000 to the University of Washington and \$175,000 to the Washington State University for research on the short-term and long-term effects of cannabis;
7. \$550,000 to the Office of the Superintendent of Public Instruction;
8. \$2,423,000 in fiscal year 2023 to the Washington State Patrol;
9. \$290,000 for fiscal year 2023 to the Department of Ecology;
10. \$800,000 for each of fiscal years 2020 through 2023 to the Department of Health for the administration of the cannabis authorization database; and
11. \$635,000 for fiscal year 2023 to the Department of Agriculture.

Distributions 1 through 7 must be adjusted annually based on the United States bureau of labor statistics' consumer price index for the Seattle area.

After the foregoing distributions, remaining cannabis excise tax revenues must be distributed from the Dedicated Cannabis Account as follows:

- Fifty-two percent to the state basic health plan trust account;
- Eleven percent to the health care authority;
- One and one-half percent to counties, cities, and towns where licensed cannabis retailers are physically located;
- Three and one-half percent to counties, cities, and towns ratably on a per capita basis; and
- Thirty-two percent to the state general fund.

### **Estate Tax**

The estate tax applies to transfers of property located in Washington on the death of the owner. The tax was estimated to generate \$359.9 million in the 2017-19 biennium. Estate taxes are not deposited into the state general fund. Revenues are deposited in the education legacy trust account.

#### **Tax Base:**

Transfers of property in Washington at the time of the death of the owner make up the tax base.

#### **Rates:**

The rates range from 10 percent to 20 percent depending on the value of the estate.

#### **Major Exemptions:**

Deductions were allowed for decedents dying in 2013 in the amount of \$2 million. Deductions increase by the consumer price index each year thereafter. A deduction is allowed for qualified farm property including the value of any tangible personal property used primarily for farming purposes if 50 percent of the estate is property used for farming. Qualified family owned business interests up to \$2.5 million are also allowed.

## **Timber Excise Tax**

The timber excise tax is imposed on all timber harvests. The timber excise tax generated \$7.2 million to the state general fund in the 2021-23 biennium. This comprises about 0.01 percent of state general fund revenues.

### **Tax Base:**

The tax is levied on the stumpage value at harvest from all public and private lands.

### **Rate:**

The rate of tax is 5 percent of the harvest value of the logs from public and private lands. A county may impose a 4 percent tax on timber harvested from public and privately-owned land within the county that is credited against the state tax. Therefore, the counties receive 4 percent and the state receives 1 percent.

### **Exemptions:**

There is a simplified method of taxation for small harvesters, who are defined as individuals or companies cutting less than 2.0 million board feet per year. Timber harvested by youth character building organizations from their property-tax-exempt land is exempt from the timber excise tax. In addition, harvesters incurring less than \$50 per quarter in tax liability in any calendar year are also exempt.

### **Credits:**

A credit is allowed against the state tax for any county tax that is imposed.

A credit is allowed against the state tax for any property taxes paid on privately owned timber on state and local lands.

A credit against the state tax is authorized for timber harvested on land subject to enhanced aquatic resources requirements. The credit is



equal to the stumpage value of timber harvested for sale or for commercial or industrial use multiplied by 0.8 percent, except for a small harvester, the credit is equal to 16 percent of the tax otherwise imposed. The credit is reduced by any compensation received from the federal government for reduced timber harvest due to enhanced aquatic resource requirements.

**Distribution of Revenues:**

Both state and county revenues are deposited in the timber tax distribution account. Funds are distributed quarterly to the state and to counties. County receipts are further distributed to taxing districts by a formula which reflects the assessed value of forest land in the respective districts. Districts that have approved excess property tax levies for capital purposes receive funds first. Next, funds are distributed to school districts in relation to their excess levy rates. Any remaining funds in the timber tax distribution account are shared by all local districts.

## **Watercraft Excise Tax**

The watercraft excise tax is an annual tax imposed on watercraft in lieu of a property tax. The tax is estimated to generate approximately \$37 million in the 2021-23 biennium, including approximately 31.6 million for the state general fund. This comprises 0.05 percent of state general fund tax revenues.

### **Tax Base:**

The tax applies to the fair market value of noncommercial boats which are used on Washington waters. Fair market value is the latest purchase price, reduced according to a depreciation schedule adopted by the Department of Revenue.

### **Rate:**

The rate of tax is 0.5 percent of the value.

### **Major Exemptions:**

Boats not required to be registered in Washington, commercial fishing boats, boats under 16 feet in length, government vessels, vessels owned by nonprofit youth organizations, and vessels in dealers' inventories which are not regularly rented are exempt from tax.

### **Distribution of Revenues:**

Receipts are deposited in the state general fund.

## **Capital Gains Tax**

In 2021, the Washington State Legislature created a state tax on the sale or exchange of long-term capital assets if the profits exceed \$250,000 annually. This tax applies to individuals only, though individuals can be liable for the tax as a result of their ownership interest in an entity that sells or exchanges long-term capital assets. It is only applicable to gains allocated to Washington state. The tax takes effect on Jan. 1, 2022, and the first payments are due on or before April 18, 2023.

**Tax Base:** Stocks, bonds, business interests, or other investments, and many tangible assets constituting long-term capital assets under the federal tax code.

**Rate:**

The rate of tax is 7.0 percent of the value of capital assets.

**Major Deductions/Exemptions:**

The following deductions apply:

- \$250,000 per year per individual, married couple, or domestic partnership;
- The long-term capital gain from an individual's sale of all or substantially all of a qualified family-owned small business; and
- Charitable donations in excess of \$250,000 per year per taxpayer, but not to exceed \$100,000 per year, adjusted for inflation.

The following exemptions apply:

- Real estate;
- Interests in a privately-held entity to the extent that the capital gain or loss from such sale or exchange is directly attributable to the real estate owned directly by such entity;
- Assets held in certain retirement accounts;
- Certain livestock related to farming or ranching;
- Assets used in a trade or business to the extent those assets are depreciable or qualify for expensing under the federal tax code;
- Timber, timberlands, and dividends and distributions from real estate investment trusts derived from gains from the sale or exchange of timber or timberlands;
- Commercial fishing privileges; and
- Goodwill received from the sale of a franchised auto dealership.

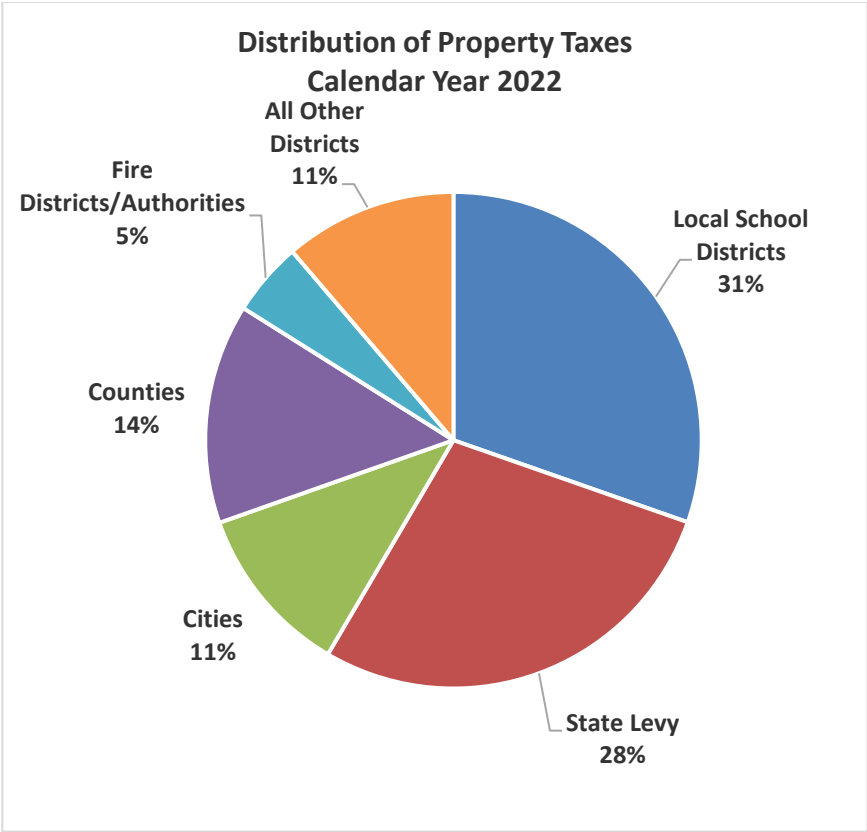
**Distribution of Revenues:** The first \$500 million collected each fiscal year, as adjusted by inflation annually, is deposited into the education legacy trust account. The remainder is deposited into the common school construction account.

## **Property Taxes and In Lieu Property Taxes**

### **How Much Money Does the Property Tax Generate and How is it Spent?**

In 2022, Washington taxpayers paid a total of \$15.9 billion in property taxes to local governments, the state government and school districts. \$9.3 billion, 58 percent, of all property tax revenues are collected in support of K-12 education, with the state’s share being distributed entirely to public schools. Of this \$9.3 billion, \$4.8 billion was collected by the state and \$4.5 billion was collected by local school districts for enrichment purposes, capital expenses, and bonds.

The proportions displayed in the following chart represent the distribution of taxes collected from the “average” individual taxpayer in the state.



Source: Property Tax Statistics 2022, Department of Revenue

Property taxes are the largest source of tax revenue for local governments, generating about \$6.6 billion in 2022 (excluding local school levies).

Local government consists of hundreds of separate taxing districts across the state. In addition to the state (a single taxing district for purposes of collecting the state levy), there are 1,791 other local taxing districts, including 39 counties, 281 cities and towns, 365 fire districts, 190 emergency medical service districts, 77 ports, and 32 library districts.

## **What Property is Taxable?**

Article 7, section 1 of the state Constitution defines property as everything that can be owned, whether tangible or intangible. The property tax is applied annually to the assessed value of all property unless it is specifically exempt by law.

The Constitution requires that taxes be uniform within a class of property. For property tax purposes, there are two broad classes of property, *real* and *personal*. *Real property* consists of land and buildings, structures, or improvements that are affixed to the land.

In general, everything else is referred to as personal property. Because the Legislature has exempted motor vehicles, household goods, and personal effects from the property tax, only personal property used in business is subject to the property tax.

## **What are the Major Exemptions from Property Tax?**

The text of the original state Constitution declares, “[s]uch property as the legislature may by general laws provide shall be exempt.” This provision of the Constitution allows the Legislature to grant property tax exemptions. Note, it allows the Legislature to exempt types of *property*; it does not allow the Legislature to exempt property based on its *owner*.

Any property tax exemption has the effect of increasing the tax rate owners of all other taxable property must pay by reducing the overall base of taxable property. This circumstance of causing one segment of taxpayers’ taxes to increase as a result of exempting the value of property of another segment of taxpayers is commonly referred to as a “*tax shift*.”

There are numerous exemptions from property tax, established either by statute or constitutionally. The largest exemption is for intangible property. This includes money, mortgages, notes, accounts, stocks and

shares of corporations, trademarks, trade names, patents, copyrights, trade secrets, franchise agreements, licenses, etc.

Other exemptions include business inventories, household goods, most personal property, some retired persons, churches, nonprofit hospitals, private schools and colleges, and agricultural products.

### **When Were These Exemptions Granted?**

The exemption for intangible property was originally granted by the Legislature in 1925 and has been amended several times, most recently in 1997. The exemption for business inventories was passed by the Legislature and phased in over 10 years, beginning in 1974. Motor vehicles were exempted from property tax in 1937, when the motor vehicle excise tax was enacted, which has since been replaced by the vehicle license fee. As early as 1871, there were exemptions for household and personal effects, but the expanded exemption that individuals have today was granted in 1935. Churches and hospitals have exemptions that were granted prior to statehood, in 1854 and 1886 respectively. Computer software was exempted in 1991. Exemptions for agricultural products were subject to legislative changes in 1973 through 1984 when the current exemption for all such products was enacted. Private schools and colleges were exempted by the Legislature in 1925.

It is important to note that many of these exemptions were granted in statute by the Legislature. The state Constitution authorized other exemptions, such as exemptions for governmental entities, a \$15,000 exemption from tax on personal property for sole proprietors, and property tax exemptions for some retired persons.

### **What Types of Property Tax Relief are Available to Retired Persons?**

Property tax exemptions for retired persons (defined as seniors, disabled persons, and certain disabled veterans) originated with a

constitutional amendment in 1966 and have been modified by the Legislature many times since, including most recently in 2019. A constitutional amendment was required because exemptions for retired persons are based on the owner of the property, not on the type of property.

Property tax exemptions are available to retired persons who meet income requirements and are retired. Exemptions include total exemptions for excess levies (voter-approved property taxes) or partial exemptions from regular levies.

### **Exemption Program**

To qualify, a person must be 61 years old or retired from employment because of disability; own their principal residence; and have an annual combined disposable income of either (a) \$40,000 or less or (b) 65 percent of the county median income, whichever is greater.

Eligible individuals may qualify for a property tax exemption and a valuation freeze. The amount of property tax exempted is based on the applicant's income, the value of the residence, and the local levy rates. The valuation of the residence of an eligible individual is frozen, for the purpose of calculating property tax liability, at the assessed value of the residence on the later of January 1, 1995, or January 1st of the assessment year in which a person first qualifies for the program.

In 2018, the program provided approximately \$198 million of property tax relief to 114,000 participants in the program.

### **Deferral Program**

A related program allows homeowners at least 60 years of age with household income of either (a) \$45,000 or less or (b) 75 percent of the county median income, whichever is greater, to defer payment of all property taxes. These taxes may be deferred until the sale of the property or until the property ceases to be the permanent residence of



the homeowner or surviving spouse.

Even though the eligibility requirements are broader for the deferral program than for the exemptions, only 508 people took advantage of the available tax deferral in 2017.

## **What Types of Property Tax Relief are Available to Low-Income Persons?**

### **Deferral Program**

During the November 2007 special session, the Legislature created a new property tax deferral program for households with a combined disposable income of \$57,000 or less. This program is similar to the existing property tax deferral program for retired persons, but the new program has no age or retirement due to disability requirement.

Under this new deferral program, eligible homeowners of any age may defer one-half of the property taxes and special assessments imposed on the homeowner's primary residence, if the first-half taxes and assessments are paid by the April 30th due date. To qualify, the homeowner must have owned the residence for at least five years. The total amount of taxes deferred under this program may not exceed 40 percent of the homeowner's equity value in the property.

### **What are “Current Use” Valuations and “Open Space?”**

A Constitutional amendment in 1968 established a *current use* assessment for *open space*, timber, and agricultural lands. Although not a tax exemption in the strict sense of the term, *current use valuations* reduce the tax burden on certain properties. As a result, the reduction “shifts” the tax burden to other taxpayers just as an exemption does.

The taxable value is based on how the property is currently used, rather than the market value (or the “highest and best use”) of the property.

For example, the 2014 market value for all current use properties in the state was \$18.6 billion. The 2014 current use value for these properties is \$5.8 billion, resulting in a 68.8% reduction in overall tax. In 2014, there were 10,056,591 acres in current use classifications.

The *open space* program allows agricultural lands, timberlands, and other “open space” lands to be assessed according to their value as they are currently being used, rather than the market value. This “current use” value is typically much lower than market value and is, therefore, a tax benefit for the property owner.

“*Open space*” lands are lands which conserve natural resources, promote conservation, enhance public value and recreation, preserve visual quality, or have other legislatively identified attributes which are of public benefit. Agricultural and timber lands are subject to various requirements regarding size, use, and income.

When property is removed from the current use valuation program, either by the owner or the assessor due to a change in use, back taxes must be paid.

## **What Types of Restrictions and Limitations are there on Property Taxes?**

The myriad of constitutional and statutory provisions regarding property taxes have served to create an interconnected system of property tax administration and collection. In order to understand the overall system and the rationale for its evolution, it is important to review the restrictions and limitations governing property taxes.

### **Uniformity in Taxation**

Perhaps the most important principle of property taxation in our state is the uniformity of taxation. In the 1853 Organic Act establishing the government of the Washington Territory, the U.S. Congress imposed a strong requirement for uniformity in taxation in order to prevent the

territory's residents from imposing a disproportionate share of taxes on nonresidents. Uniformity of taxation continued as a fundamental principle in the state Constitution adopted in 1889.

The state Constitution includes a uniformity clause, which provides that "taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax.... All real estate shall constitute one class." This means that taxes must be the same on real property of the same market value. Uniformity requires both an equal rate of tax and equality in valuing the property taxed. Many other states have differential tax rates or different value standards that depend upon the separate classifications of property. Such a system would not be constitutional in Washington.

### **One Percent Limit (Ten Dollar Limit)**

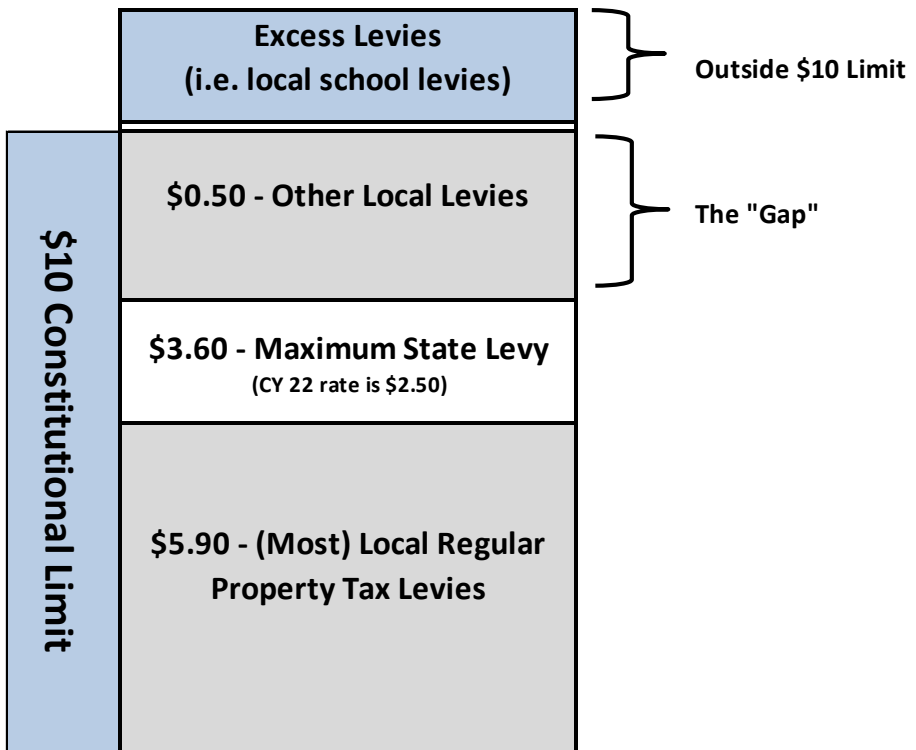
Beyond the principle of uniformity, the Washington property tax system as we know it today really took shape in the early 1970s. In 1972, Washington voters amended the Constitution to limit the annual amount of property taxes that may be imposed on an individual parcel of property to 1 percent of its true and fair value. By law, tax rates are stated in terms of dollars per \$1,000 of value. Therefore, the 1 percent limit is the same as \$10 per \$1,000. Under the constitutional amendment, the 1 percent limit (\$10 constitutional limit) may be exceeded only with the approval of 60 percent of the district's voters, with the exception of school districts and fire protection districts, which may pass a levy with a simple majority vote.

Taxes imposed under this limit are termed "regular" levies, while those outside the limit are "excess" or "special" levies.

For statewide taxes due in 2015, 61.6 percent were regular levies and 38.4 percent were excess voter-approved levies. The majority of excess levies are school district levies.

The \$10 constitutional limit for regular property taxes is effectuated by

a complex series of statutory provisions. These provisions include a \$5.90 cap on the aggregate property tax rate for most local levies. If total local levies exceed this cap, levies are reduced or eliminated according to a statutory hierarchy until the \$5.90 limit is no longer exceeded. Historically, the maximum state property tax rate had been \$3.60. Therefore, that leaves a 50 cent gap before the \$10 constitutional limit is reached. (Because of the impact of the 1 percent limit factor, described in the next section, the actual state rate was less than \$2.00 until it was increased beginning in 2018 to a rate of \$2.70.) Pictorially, the \$10 constitutional limit can be expressed as follows:



## **The Limit (Inflation) Factor**

Local government taxing districts generally determine their property tax levy based on the revenue required to fund their budget for the following year. However, in 1971, the Legislature imposed a statutory limit on annual increases in local governments' revenues from property taxes. Under this limit, revenues from any district's regular property tax levy may not exceed 106 percent of the highest amount of revenue received from any levy in the preceding three years. Added to this is an amount to account for new construction and improvements. The 1979 Legislature extended this limit to the state property tax as well.

In 1997, voters passed Referendum 47, which imposed additional requirements on the 106 percent limit. Under this provision, taxing districts with a population over 10,000 were only allowed to increase the regular levy by the rate of inflation or 6 percent, whichever was smaller. For a district to increase the levy by the full 6 percent, a supermajority vote of the governing body in each district was required. In addition, Referendum 47 limited the growth of assessed values, by averaging large valuation increases over time. This averaging provision was subsequently thrown out by the Washington State Supreme Court in 1998 for being unconstitutional because of the requirement for "uniform" valuation of properties.

In 2000, voters passed Initiative 722, which limited future increases of taxable value to the lesser of inflation, or 2 percent per year. It also limited taxing district increases to 2 percent and rolled back certain property tax increases levied in the year 2000. However, the Supreme Court in 2001 ruled this initiative unconstitutional because it violated the Constitution's requirement that initiatives only involve a single subject. In 2001, voters passed Initiative 747 (effective in 2002), which restricted taxing districts to a property tax increase of the lesser of inflation, or 1 percent. This limit is on the taxes collected and not on the growing value of the property. Thus, under Initiative 747, a taxing district could collect only 1 percent more than the previous year's cumulative total of property taxes assessed within

its jurisdiction.

Initiative 747 was drafted as a change to the 2 percent limit adopted in Initiative 722. In November 2007, the Supreme Court held that since Initiative 747 amended the 2 percent limit in Initiative 722 (which had previously been invalidated by the court), Initiative 747 did not set forth in full the law it amended as the Constitution requires. However, that same month, the Legislature met in special session and passed House Bill 2416, reinstating the 1 percent levy limit established by Initiative 747.

The legislature suspended the revenue limit for four years beginning in 2018 for the state levy as part of legislation modifying school funding. (See Engrossed House Bill 2242)

## How is Assessed Value Determined?

There are three criteria used to value real property: *comparable sales*, *cost*, and *income potential*.

- *Comparable sales*: value is determined or estimated based on multiple sales of similar properties. Most residential property is valued using this method.
- *Cost*: value is determined based on the cost of replacing an existing structure with a similar one that serves the same purpose. This method is used to value new construction.
- *Income*: value is determined based on the income producing potential of the property. This method is often used to value business property.

For many years, assessment practices varied widely across the state, resulting in both constitutional and statutory changes intended to improve adherence to requirements for uniformity. In the early 1950s, with the imposition of the real estate excise tax, the state received more accurate data on actual sales prices of real property. This data revealed significant inequities between the assessed value and the actual market value among taxpayers living in different areas of the state. In 1955, the Legislature adopted a property revaluation cycle, requiring that revaluation occur a minimum of every four years.

Frequent revaluation of property during a time when property values are rapidly increasing improves uniformity, because property assessments more closely reflect the current value. Otherwise, recently revalued property is closer to current market values while property that has not been revalued lags far behind the market value. In addition, less frequent revaluation cycles can create rapid increases in property tax assessments. For example, if a property in a rapidly increasing market is revalued every four years, the assessed value will more dramatically jump after revaluation. To address these inequities, the Legislature passed Substitute Senate Bill 5368 in 2009 which required annual revaluations in all counties by the

year 2014. All 39 counties met the goal of converting to an annual revaluation cycle by 2014.



## How is the Amount of Tax Levied by a Taxing District Determined?

A taxing district levies a property tax in the amount needed to fund its budget for the following year. By November 30th of each year, the amount of taxes to be levied by taxing districts are certified to the county assessor who computes the tax rate necessary to raise that amount of revenue. The county assessor calculates the tax rate necessary by dividing the total levy amount by the amount of taxable property in the district. This number is expressed in terms of a dollar rate per \$1,000 of valuation. For example, a rate of \$0.00025 is expressed as 25¢ per \$1,000 of assessed value. For the state levy (which is dedicated to the support of the common schools), the state Department of Revenue determines the amount of tax to be levied, apportions the tax to the various counties, and certifies the tax to the county assessors.

There are three main components to the property tax; the *levy*, *assessed value*, and *levy rate*.

- The *levy* is the total amount collected from the taxpayers by a taxing district. Currently, the taxing districts are only able to increase their levies by 1 percent per year.
- The *assessed value* and the *levy rate* are the tools that are used to distribute the property tax burden equally to all taxpayers.
- Assessed Value x Levy Rate = *levy*

Since levies are capped at 1 percent, actual property taxes received by a taxing district can only increase that much. The levy rates actually decrease so that the levy itself is limited to a 1 percent increase.

## How are Individual Property Taxes Determined?

The tax on a particular property is calculated by multiplying its assessed value by the tax rate. Once the maximum allowable regular

property tax levy amount is determined for a district under the 1 percent limit factor, the county assessor then calculates the necessary tax rate by dividing the total levy amount by the amount of taxable property (total assessed value) in the district. The rate is expressed in terms of dollars per \$1,000 of assessed value. The rate is multiplied by each \$1,000 in value for each parcel to determine the tax. An individual tax bill is the total of all such calculations for all the individual districts levying tax on the particular property.

For example, for a parcel of property assessed at \$100,000, the tax would be determined as follows, assuming a tax rate of \$11.87:

$$\begin{array}{rclcl}
 \text{Tax Rate (per \$1,000)} & \times & \frac{\text{Assessed Value}}{1,000} & = & \text{Tax Due} \\
 \\ 
 \$11.87 & \times & \frac{\$100,000}{1,000} & = & \$1,187
 \end{array}$$

The Constitution stipulates that property tax is to be levied against the “true and fair” value of property. Property assessment, or *valuation*, is the process by which the “true and fair” value is determined. In order to comply with the provisions of the Constitution, all taxable property must be assessed at 100 percent of its true and fair value unless the law specifically provides otherwise, such as with low-income retired persons. A county assessor makes these assessments for about 97 percent of property in the state. The Department of Revenue makes the remaining 3 percent of the assessments.

**Does Higher Assessed Value Necessarily Mean Higher Property Taxes?**

No. Many individuals have seen rapid growth in their assessed values, but this does not necessarily equate to a rapid increase in their property tax bill. The amount that a local taxing jurisdiction may levy is limited to an increase of 1 percent per year.

With the levy only rising 1 percent per year, the effect of rapidly growing assessed values is a reduction in the levy rate. For example, if each and every parcel of property in a taxing district increased by exactly 30 percent, the actual tax rate due on each parcel of property would still only increase by 1 percent.

A property that does not increase in value as much as the other properties in a district may even see a reduction in taxes or will bear less of the burden of the levy. On the other hand, a property that increases in value at a greater rate than other properties in the district will bear a greater burden of the tax. It is how values grow in relation to other properties in the same district that determines whether the tax on a property increases or decreases.

In a district where values average 30 percent growth, a home with 10 percent value growth would actually see a reduction in taxes. Alternatively, in a district where values average 5 percent growth, a home with 10 percent value growth would likely see a significant increase.

### **How is Property Assessed and the Tax Collected?**

All property, except new construction, is assessed on its value as of January 1st of the assessment year and is listed on the tax rolls by May 31st. For new construction, the value as of July 31st of the tax year is listed on the rolls. Notices of valuation changes are mailed to the owner of the property. If taxpayers disagree, they can appeal the valuation. Appeals of assessed values must be filed with the county board of equalization by July 1st, or 30 days following the mailing of the notice of revaluation, whichever is later. However, the county legislative authority may authorize up to 60 days.

The treasurer in the county where the property is located collects property taxes. The treasurer is required to send each taxpayer a notice which must include the amount of tax owed, the value of both real and personal property, and the name and amount for each taxing district levying a tax. The notice must also separately state the

amount of excess (voter-approved) levies. The county treasurer mails the tax bill to the “taxpayer” listed on the tax rolls, which may be a lending institution in cases where the property owner has provided that taxes are to be paid from a reserve account administered by the lending institution. The treasurers mail tax bills in early to mid-February. The first half of the tax is due by April 30th, and the second half by October 31st. Given the timelines required for revaluation and billing, the taxes due in any particular year are based upon the assessed value from the preceding year.

### **What Does Equalization of Assessments Mean?**

In the 39 counties in Washington, there are differences in revaluation cycles and assessment practices. The state Constitution requires taxes on real estate to be uniform within a district. For the purpose of collecting the state property tax, the state is one district. Since differences in county assessment practices would result in the state property tax being applied non-uniformly across the state, the Department of Revenue estimates, in each county, the relationship between the assessed value and the actual market value.

The Department of Revenue then adjusts the state property tax rate according to the average appraised value for that entire county, but does *not* adjust assessed values for each property. As a result, the effective state property tax rate is different in each county. However, this rate multiplied by the assessed value results in a uniform tax across the entire state. This process is called “*equalization*.”

For example, if a parcel of property sold for \$100,000 (after deducting an amount for any personal property that may have been included in the sale) and its assessed value is \$90,000, the ratio of assessed value to market value would be 90 percent, determined as follows:

$$\begin{array}{rclclcl} \text{Assessed Value} & \div & \text{Market Value} & = & \text{Assessment Ratio} \\ \$90,000 & \div & \$100,000 & = & 90\% \end{array}$$

## **Are Public Schools Funded from the Property Tax?**

The Washington State Constitution established basic education as the state's paramount duty. This duty has been reaffirmed in subsequent statutes and court decisions, which acknowledge that the state must provide sufficient aid to local school districts to fund basic education. Currently, one-half of the state general fund budget is spent for public schools.

As mentioned earlier, the state property tax levy is dedicated for public schools and is frequently called the state school levy. The revenues are paid directly into the general fund, along with all the other tax revenues that go to the general fund.

The state school levy provides about a quarter of the money in the general fund that the state spends on public schools. In addition, revenues from the sales tax, business and occupation tax, real estate excise tax, and other sources support public schools (see the chart on page 4).

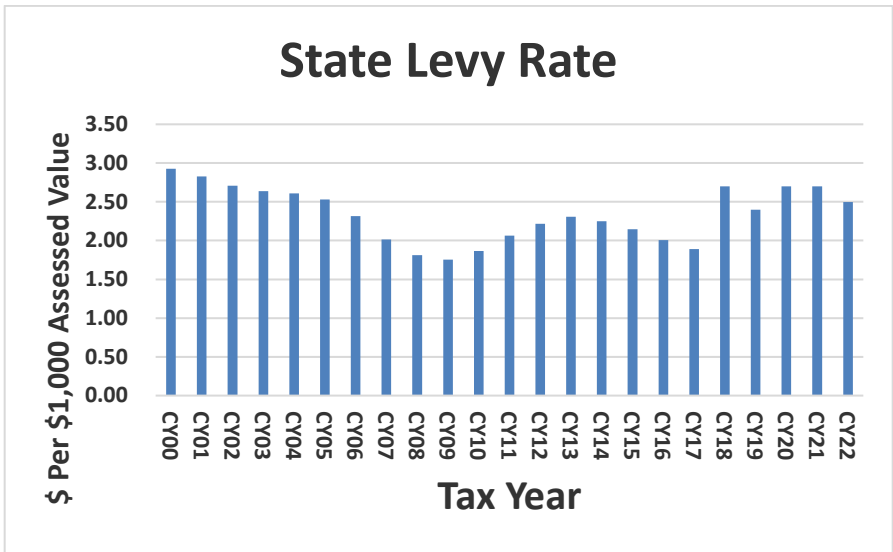
The state school levy as we know it today was enacted in 1975. Prior to 1975, property owners paid a *local regular* school levy of \$3.60 per \$1,000. The local regular levy was replaced by the regular state levy and state aid was increased to replace the lost local revenue.

Over the following few years, the state moved to fully fund basic education from the state general fund. The state levy was increased by approximately 94 cents per \$1,000 of assessed value beginning in calendar year 2018 to a total rate of \$2.70 to provide additional funding for public schools.

## How do Washington State Property Taxes Compare?

This section examines a number of comparative statistics regarding property taxes in Washington, including comparisons with other states and historical comparisons to examine how property taxes have changed over time. The analysis is accomplished largely using a series of graphic presentations.

The following chart shows the recent trends of the state property tax rate. The rate is statutorily limited to \$3.60 per \$1,000 of assessed value; however, it typically fluctuates from year to year due to the interaction between property values and levy limitations. Legislation enacted in 2017 fixes the rate at \$2.70 per \$1,000 in calendar years 2018 through 2021. Legislation enacted in 2018 lowered the 2019 state levy rate by 30 cents for one year to \$2.40 per \$1,000 of assessed value.

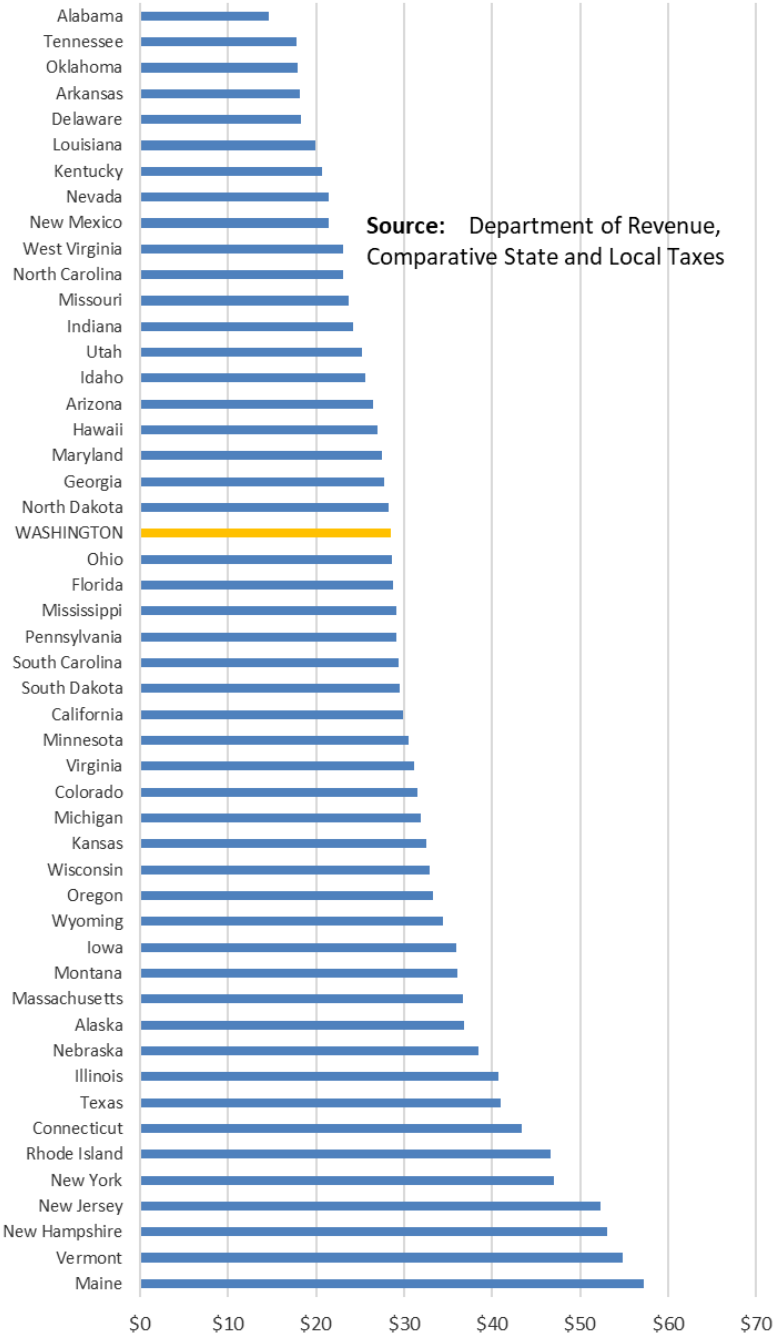


Source: Department of Revenue, State Levy Forecast

The chart on the following page is a comparison among all states of property taxes relative to income. When compared to the other 49

states, state and local property taxes in Washington are in the middle. The most recent national information is from fiscal year 2019, at which time Washington ranked 30th highest in property taxes at \$28.54 per \$1,000 of personal income, below the national average of \$31.27.

**Property Taxes Per \$1000 Personal Income  
Fiscal Year 2019**



**Source:** Department of Revenue,  
Comparative State and Local Taxes



## **What Are Some of the Recent Legislative Changes to the Property Tax?**

### **Subjecting federally recognized Indian tribes to the same conditions as state and local governments for property owned exclusively by the tribe (Engrossed Substitute House Bill 1287, Chapter 207, Laws of 2014)**

Economic development is recognized as an essential government service for purposes of qualifying tribally-owned property for tax-exempt status if the property was owned by the tribe prior to March 1, 2014. A private leasehold interest in tax-exempt tribal property is subject to a leasehold excise tax. A tribe that owns property exempt from tax under state law must make a payment in lieu of taxes if it is used for economic development and there is no leasehold interest in the property.

### **Including the value of solar, biomass, and geothermal facilities in the property tax levy limit calculation (Substitute House Bill 1634 -- Chapter 4, Laws of 2014)**

The property tax revenue limit for a taxing district is increased by the value resulting from new solar, biomass, and geothermal facilities that generate electricity.

### **Providing fairness and flexibility in the payment of property taxes (Substitute House Bill 2309 -- Chapter 13, Laws of 2014)**

A requirement that interest and a 3 percent penalty apply to the full-year amount of delinquent property tax, regardless of amounts paid, is modified. These charges will only apply to the unpaid balance. A county treasurer is authorized to accept partial payment of current and delinquent property taxes, including interest and penalties, by electronic bill presentment and payment. A county treasurer is also authorized to waive interest and penalties on delinquent property taxes when a taxpayer paid an incorrect amount due to apparent

taxpayer error and the taxpayer pays the delinquent tax within 30 days of receiving notice that taxes are due.

**Concerning current use valuation for land primarily used for commercial horticultural purposes (Engrossed Second Substitute House Bill 2493 -- Chapter 125, Laws of 2014)**

It is clarified that land primarily used to grow horticultural plants in pots does qualify for the current use classification as agricultural and farmland under the open space property tax program, with limitations. Additional limitations are provided with regard to qualification for open space property tax rates for growing horticultural plants in pots, as follows: the plants cannot be purchased from other growers for retail sale; the land does not qualify if more than 25 percent of land of less than five acres is used for retail sales to the general public; and the paved portion does not qualify if more than 20 percent of land of any size is paved.

**Consolidating designated forest lands and open space timber lands for ease of administration (Senate Bill 6180 -- Chapter 137, Laws of 2014)**

A county legislative authority is authorized to, at its option, merge the county's open space timber program into its designated forest land program by ordinance. Notice requirements are included for both affected landowners and the Department of Revenue. The removal of land from an open space timber land program as a result of a merger is exempt from tax penalties. The minimum size requirement for land to be designated as forest land is lowered from 20 acres to 5 acres, consistent with the size requirement for open space timber land.

**Promoting affordable housing in unincorporated areas of rural counties within urban growth areas (Engrossed Second Substitute Senate Bill 6330 -- Chapter 96, Laws of 2014)**

Rural counties may offer a property tax exemption for multi-family housing projects within unincorporated urban growth areas. The Joint Legislative Audit and Review Committee must assess the performance of the tax preference with reference to the intent and public policy objective. The property tax exemption for properties located in rural counties expires on January 1, 2020.

**Providing greater consistency in how nonprofit tax-exempt property may be used without jeopardizing the property's tax-exempt status (Senate Bill 6405 -- Chapter 99, Laws of 2014)**

Standardized criteria are established regarding the nonexempt use of tax-exempt property owned by nonprofit organizations.

**Exempting levies imposed by qualifying flood control zone districts from certain limitations upon regular property tax levies (House Bill 1940 -- Chapter 170, Laws of 2015)**

A county-wide flood control zone district located in a county with a population of 775,000, or a county-wide flood control zone district located in the Chehalis River Basin, may protect up to \$0.25 of its property tax levy rate from reduction or elimination under the \$5.90 aggregate rate limit, beginning with taxes levied for collection in 2018.

**Concerning property tax exemptions for service-connected disabled veterans and senior citizens (SSB 5186 -- Chapter 30, Laws of 2015, 3rd Special Session)**

Income thresholds for property tax relief programs for senior citizens and disabled persons are increased by \$5,000 for taxes due beginning in 2016.

**Concerning refunds of property taxes paid as a result of manifest errors in descriptions of property (SSB 5276 -- Chapter 174, Laws of 2015)**

County legislative authorities are permitted to issue property tax refunds more than three years after the due date of the payment for taxes paid as a result of manifest errors in the descriptions of property. County legislative authorities are also permitted to authorize a correction of manifest error in a property value assessment or tax roll more than three years after the error is discovered.

**Providing a property tax exemption for the value of new construction of industrial/manufacturing facilities in target urban areas (ESB 5761 -- Chapter 9, Laws of 2015, 1st Special Session)**

A 10-year property tax exemption is provided on the value of new construction of industrial/manufacturing facilities that create family living wage jobs in certain areas.

**Modifying a property tax exemption for property owned by nonprofit fair associations (ESSB 6057 (Part XX) -- Chapter 6, Laws of 2015, 3rd Special Session)**

The expiration date for the property tax exemption for real and personal property owned by a qualifying nonprofit fair association and used for fair purposes is removed. Since January 1, 2019, if any portion of the exempt property is rented for more than 50 consecutive days during any calendar year, the rental is subject to leasehold excise tax.

**Increasing the state property tax and modifying local school levies (EHB 2242 -- Chapter 13, Laws of 2017, 3rd sp.s.)**

Since 2018, the state property tax rate was increased to \$2.70 per thousand dollars of assessed value and a new formula for the local school district levy lid calculation is provided.

**Providing property tax relief by reducing calendar year 2019 state property taxes and redirecting revenue to the education**

**legacy trust account for fiscal year 2019 (ESSB 6614 -- Chapter 295, Laws of 2018)**

The aggregate state property tax levy rate was reduced from \$2.70 per \$1,000 of assessed value to \$2.40 per \$1,000 of assessed value for taxes levied for collection in calendar year 2019. \$935 million dollars of the additional state levy was redirected to the education legacy trust account in fiscal year 2019.

**Relating to K-12 education funding (ESHB 2140 -- Chapter 411, Laws of 2019)**

All proceeds from the additional state levy was redirected to the education legacy trust account in fiscal year 2019.

**Concerning property tax exemptions for service-connected disabled veterans and senior citizens (ESSB 5160 -- Chapter 453, Laws of 2019)**

The qualifying income thresholds for the property tax exemption program are modified so that they are based on the greater of a percentage of the county median income or the base income threshold, rather base income thresholds that apply statewide.

**Relating to heavy equipment rental property taxation (SSB 5628 -- Chapter 301, Laws of 2020)**

Creates a new heavy equipment rental tax of 1.25% on the rental price, beginning January 1, 2022, which is collected from the consumer, and exempts the equipment from property tax.

## **Public Utility District Privilege Tax**

The public utility district privilege tax applies to the electric generating facilities of public utility districts for the privilege of operating. The tax is in addition to state and local public utility taxes. The tax was estimated to produce \$114.9 million in the 2017-19 biennium for the state general fund. This comprises about 0.25 percent of state general fund revenues.

### **Tax Base:**

The tax is based on the gross revenue derived from the sale of energy, the number of kilowatt-hours sold, and the wholesale value of energy produced in thermal electric generating plants.

### **Rate:**

For hydroelectric dams and other facilities, the rate of tax is 2.14 percent of gross revenues from the sale of power to consumers through the district's distribution system and 5.35 percent of the first \$0.004 per kilowatt-hour a) of the wholesale value of self-generated energy distributed to consumers by a district and b) of revenue obtained from sales of self-generated energy for resale. The rate of tax for thermal electric generating facilities (Hanford) is 1.605% of the wholesale value of energy produced for sale or use.

### **Major Exemptions:**

Net uncollectible amounts.

### **Distribution of Revenues:**

Receipts are distributed through a complex formula to the state, the counties, and local taxing districts.