

## Levy Swap: Tax Increases, Tax Reductions, Unanswered Questions

### Briefly

- Levy swap: court-required state funding to replace local dollars to finance basic k-12 education.
- A state property tax increase to fund a levy swap is proposed by Sen. Dammeier, Rep. Hunter.
- A uniform statewide property tax hike to replace local levies would bring higher taxes in some areas.
- Capital gains tax revenues dedicated to education could be a levy swap funding source.
- Capital gains tax's volatility makes it a dubious ongoing source for funding education.
- Senators Ranker and Rolfes have capital gains tax proposals that target only the very wealthy.
- Legislature unlikely to pass a capital gains tax, an initiative next year is possible.
- The consequences of increasing state funding to replace local education levies are not clear.

There has been a convergence of two policy elements being proposed in Olympia this session. The capital gains tax first floated by Governor Jay Inslee has new life as Senate Democrats connect the proposal's additional revenue potential with the second element that will need new state revenue: the reduction of local levies currently funding education. The state Supreme Court's

McCleary decision requires the state to provide higher funding levels for basic education. However, the justices have made clear that the McCleary problem concerns not just the absolute level of funding for basic education but also the source of those funds. Local property tax levies cannot be used to meet the state's constitutional obligation to fully fund basic education.

### Levy Swap

How a pure property tax "levy swap" might work:

Increase state property tax rate to \$3.50 per \$1,000 assessed value in 2019. The 2015 rate is \$2.19/\$1,000. (2) Distribute this revenue to local school districts. (3) Reduce each district's local levy authority by the amount gained in state funding. The average local rate would be \$1.25/\$1,000 in 2019, compared to \$2.64/\$1,000 in 2015.

On average the sum of the state and local school rates would be slightly lower in 2019, \$4.75/\$1,000, than in 2015, \$4.83/\$1,000. However, the net result varies across districts. For Seattle, which is "property rich," the rise in the state rate would exceed the fall in the local rate and the sum of rates would rise to \$5.26/\$1,000 in 2019 from \$3.71/\$1,000 in 2015. For Pasco, which is "property poor" the rate would fall to \$5.09/\$1,000 in 2019 from \$6.61 in 2015.

The levy swap, substituting state property taxes for local school district maintenance and operation (M&O) levies to fund basic education, is seen by some to be the natural remedy for this portion of the McCleary problem. House and Senate bills sponsored by key legislators seek to move forward with the levy swap idea.

Meanwhile, Senate Democrats have proposed a capital gains tax with revenues dedicated to education to provide funds to reduce local M&O levies and lessen pressure on legislators to utilize an in-

Table 1: Capital Gains Tax Proposals

	Rate	Standard Deduction	Principal Residence, Lived in Two of Past Five Years	Principal Residence, Owned for 20 Years, Lived in for 10 Years	Other Residences	Number of Tax Returns Affected
HB 1484 Inslee	7%	\$25,000 for an Individual, \$50,000 for a Couple	Federal Deduction: \$250,000 for an Individual, \$500,000 for a Couple	Totally Exempt	Taxed	32,000
HB 2224 Carlyle	5%	\$25,000 for an Individual, \$50,000 for a Couple	Federal Deduction: \$250,000 for an Individual, \$500,000 for a Couple	No Special Exemption	Taxed	32,000
SB 6102 Ranker SB 6104 Rolfes	7%	\$250,000 for an Individual, \$500,000 for a Couple	Totally Exempt	Totally Exempt	Totally Exempt	5,000

created state property tax to carry the whole burden of replacement funding.

Senate Democrats' proposals are contained in a series of three bills:

*SB 6102.* Sen. Kevin Ranker would tax capital gains over \$250,000 for an individual and \$500,000 for a couple at 7 percent. Personal residences, retirement funds, agriculture, and timber lands and harvests would be exempted. Funds would be dedicated to education. It is estimated that only about 5,000 taxpayers would be affected by this tax in any year, as opposed to 32,000 for Gov. Inslee's capital gains tax. Several powerful interest groups and a majority of people exposed under previous proposals would no longer need to be in opposition, with a small, and very affluent group left to provide revenues.

*SB 6103.* Sen. Jim Hargrove is proposing a step-down of local school district M&O levy authority beginning in 2018, with

the funds to be replaced by state monies specifically allocated for salary enhancements. The bill is silent on a new revenue source.

*SB 6104.* Sen. Christine Rolfes combines several proposals—including convening a working group to determine how to reduce local levies, a new compensation plan, funding of Initiative 1351 class size reductions—with a high-earners capital gains tax.

Capital gains proposals are not likely to pass the Senate but may provide impetus for a high wage earner proposal that could be seen on the ballot as an initiative next year. However, House Finance committee Chair Reuven Carlyle's capital gains bill is part of the House budget and will be taken into negotiations with the Senate, possibly with alterations stemming from the Senate proposals. The Carlyle proposal calls for a 5 percent rate, compared to the Governor's initial ask of 7 percent. It dedicates revenue to education funding and attempts to address the inherent volatility of a capital gains tax by banking funds in a dedicated account in years when revenues are extraordinarily high.

Levy swap proposals are advanced by two bills:

Sen. Bruce Dammeier, in the Senate majority caucus, has introduced SB 6109, which would reduce local levies and re-

Table 2: Proposals to Reduce Local M&O Taxes

SB 6103 Hargrove	By 2023 maximum local M&O rate is \$1.00 per \$1,000 of assessed value
SB 6104 Rolfes	OFM is to convene a working group to devise a plan for reducing local M&O levies
SB 6109 Dammeier	By 2020 maximum local rate is \$1.25 per \$1,000 assessed value
HB 2239 Hunter	The 2017 legislature is instructed to enact appropriate limitations on local M&O levies

place those funds for schools by increases in the state property tax, and seek savings through a new employee compensation plan, and a state takeover of school employee health care benefits. His bill will likely be part of negotiations between the houses, and provides an alternative to a capital gains tax.

HB 2239 has been introduced by House Appropriations Chair Ross Hunter. It would create a working group to specifically develop a new compensation plan, a local levy reduction plan, and increases in the state property tax. Like Dammeier's approach to creating a levy swap, this one will be on the negotiating table as legislators seek to hammer out a deal..

### **Discussion**

In a time of dramatically rising property values, tying the imposition of a capital gains tax to cuts in local property tax levies allows supportive lawmakers to offer

a transfer of tax burden from property owners to a small group of rich taxpayers. This strengthens both proposals politically. It gives capital gains taxation a specific rationale in the always popular, and now court-mandated, education category. It avoids raising property taxes in more prosperous areas (as would happen under a levy swap)—giving these areas a property tax cut instead.

None of the capital gains tax bills deal meaningfully, if at all, with the problem of volatility, a significant issue if such a tax is to become a core component of basic education funding statewide. It is difficult to see how the House and Senate majorities can come together on a capital gains tax. The mechanics and consequences of swapping local for state funds on such a large scale are also not clear. The next moves in the legislative chess game should be very interesting.

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