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Gregoire Presents Book 2 Budget

Briefly

While Governor Gregoire's "Book 2" budget restores $779 million of the spending that was cut in her December supplemental budget proposal, the accompanying revenue package provides only $105 million in additional state funds. For now, she is counting on funds from the federal government to make up the $674 million difference.

In December, Governor Chris Gregoire presented a plan to close the $2.6 billion shortfall in the enacted 2009–11 budget. State law required that this supplemental budget proposal be balanced under current revenue. The December proposal cut $1.6 billion from the enacted spending plan. The remainder of the $2.6 billion gap was closed by transferring $585 million to the NGFS (near general fund-state, which combines the general fund-state and the education legacy trust account) from other state accounts (including $229 million from the budget stabilization account) and accepting a lower projected general fund ending balance (WRC 2009). Governor Gregoire disavowed the plan even as she presented it, saying that it did not reflect her values, and promised to present an alternative proposal in January that would tap additional resources to restore come of the cuts in the initial plan.

Governor Gregoire presented her alternative, *Book 2*, budget proposal on Tuesday. The new proposal restores $779 million of the cuts proposed in December. To partially pay for restoring these cuts, the governor will propose changes to the state's revenue system projected to increase tax collections for the 2009–11 by $105 million beyond the amount forecast by the Economic and Revenue Forecast Council in November. Beyond this $105 million, the governor hopes that additional stimulus monies she expects to be forthcoming from the federal government will be sufficient to restore the cuts.

Spending Restored

Governor Gregoire's Book 2 spending proposal is outlined in a letter to the legislature (Gov. Gregoire 2010a). The $779 million in spending that the governor wishes to restore is equal to 48 percent of the amount cut in her December supplemental proposal.

The table on page 2 lists the 27 specific cuts to be restored. The largest four together account for 71 percent of the $779 million total. They are:

- *K-12 Levy Equalization: $165.0 million.* The December supplemental budget proposed eliminating the levy equalization program. The governor now proposes to continue the program and also to provide addition funds over the next three years during which the cap on the maximum levy rate is to be raised.
- *Basic Health Plan: $160.6 million*. The December proposal terminated Basic Health. The restored funding should be sufficient to support 60,000 enrollees.
- *Higher Education State Need Grant: $146.4 million*. The December proposal reduced Need Grant funding by $146.4 million, reducing the family income eligibility threshold so that 12,000 students would no longer be eligible for a grant and reducing the average grant size for those who remained eligible.

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- *Redesigned General Assistance-Unemployable Program: $84.5 million*. The December proposal eliminated this program. The governor now proposes to continue the program, but to redesign it. Beginning September 1, lifetime access to the program will be limited to 6 months and the monthly cash grant will be reduced to $250.

Additional Revenue

The governor's revenue proposals are less specific than her spending proposals. Her testimony to the Senate and House Ways and Means Committees provides a bit more detail than does her letter to the legislature. In that testimony, Governor Gregoire identified three areas where she was looking to find more revenue: negating through legislation adverse state Supreme Court rulings in cases against the department of revenue; revising the state B&O tax as it applies to services and royalties; and closing loopholes and ending certain exemptions.

Court cases. The governor's revenue package includes legislative "fixes" for two court cases: *Homestreet Bank* and *Agrilink.*

The *Homestreet Bank* case expanded the interpretation of the statutory B&O deduction for interest on certain residential mortgages, while *Agrilink* broadened eligibility for the lower B&O rate of 0.138 percent that applies to processors and wholesalers of perishable meat products. It is estimated that reversing these two rulings would provide $16.4 million for this biennium and $39.2 for 2011–13.

The governor will also seek a fix for a third case, *Dot Foods*. This case, with an estimated revenue impact of $154 million in the current biennium and $191 million in 2011–13, concerns whether Dot qualifies for the statutory B&O tax exemption available to firms that sell products in the state exclusively through a *direct seller's representative*. Because the case is currently under reconsideration, the $154 million revenue loss has not yet been reflected in the official revenue forecast for the 2009–11 biennium, and this revenue loss was not reflected in the balance sheet that accompanied the governor's supplemental budget. OFM does include this $154 million, however, when calculating that the current budget gap is $2.6 billion (WRC 2009a).

Cuts Restored by Governor Gregoire's "Book 2" Proposal

NGFS Dollars in Millions

K-12 Levy Equalization Increases	165.0
Basic Health Plan 160.575	160.6
Higher Education State Need Grant	146.4
Redesigned General Assistance - Unemployable Program	84.5
K-12 All-day Kindergarten, Gifted Program and Reading Corps	42.0
Working Connections Child Care Option	39.5
Maternity Support Services	28.1
Optional Medicaid Services	21.1
Developmental Disabilities/Long Term Care: Housekeeping and Offsite Laundry Services	18.3
Long Term Care/Developmental Disabilities: Homecare Agency Provider Services	14.1
Early Childhood Education Program (ECEAP) for 3-Year-Olds	10.5
Senior Citizens Services Act	7.0
Adult Hospice Care	6.2
Outpatient Drug Treatment and Detox Services	5.4
HIV/AIDS Client Services and AIDSNET Grants	4.9
Foster Care Rates	4.1
Outpatient Community Mental Health Services	4.1
Children's Apple Health Insurance	4.1
Mental Health - Inpatient Hospital	2.9
Developmental Disabilities Individual and Family Services	2.0
Middle School Career and Technical Education program	1.9
Volunteer Chore Services	1.9
Crime Victims Compensation Program	1.5
Jail Services Funding for Mentally Ill Offenders	1.1
Children's Public Health Nurses	0.7
Aging Family Caregiver Support and Respite Care	0.6
Regional Law Enforcement Training	0.3
Total	**778.9**

Revising the B&O for services and royalties. Governor Gregoire's written Ways and Means testimony included this statement:

> We should eliminate tax policies that unfairly benefit out-of-state businesses. During these tough times, we have an even greater obligation to ensure that our state businesses are not at a disadvantage. Businesses that engage in our markets and compete directly with our in-state businesses should pay their fair share of tax. I will be proposing legislation that will level the playing field so that out-of-state businesses are not succeeding to the detriment of Washington businesses. The estimated value this biennium is $73 million and $375 million in 2011–13.

Specific legislation on this matter has yet to be released, so we are not absolutely sure how this will work. As we understand it, however, the idea is to modify in two ways the B&O tax as it applies to the services and royalties categories. The first modification would shift from a physical to an economic standard of nexus. Washington currently collects service and royalty B&O tax only from businesses that have a physical presence in the state. Under the economic nexus standard, Washington would collect service and royalty B&O tax from businesses that had either more than $50,000 in property or more than $50,000 in payroll or more than $500,000 of receipts in the state.

The second modification would change the system of apportionment that applies to multi-state businesses in the services and royalty categories. Currently, service receipts of multi-state businesses are apportioned to Washington either by separate accounting or based on the share of the business's costs that occur in Washington, while royalty receipts are apportioned to Washington only if the business is domiciled here. Under the new system, service and royalty revenue would be apportioned based on sales: Income from transactions when the customer is located in Washington would be subject to the tax, even if the seller is out of state, while income from transactions when the customer is located outside of Washington would be exempt from the tax, even if the seller is located in Washington.

We have been told that 88 percent of the expected gain in revenue would come from financial institutions, with about one-half of that related to credit cards.

Exemptions and Loopholes. In this area, Governor Gregoire hopes to gain $15.7 million in the current biennium and $63.7 million in 2011–13. Exemptions that may be ended include the sales, use and B&O tax exemptions for bouillon and the sales and use tax exemptions for facilities used in livestock nutrient management.

With regard to loopholes, one focus appears to be on strategies that avoid real estate excise tax, sales tax, or use tax on the transfer of high value assets. Suspect strategies include routing transactions through out-of-state affiliates that have no purpose other than avoiding Washington taxes. The Department of Revenue would be given investigate and invalidate such transactions.

Discussion

Some might say that the Governor Gregoire's Book 2 budget is short a couple of chapters.

The revenue package that identified in her written testimony to the Senate Ways and Means Committee provides only $105 million in additional state funds for the current biennium, while her spending package restored $779 million in cuts. For now, she is counting on funds from the federal government to make up the $674 million difference. In several weeks lawmakers may have a better idea as to whether these monies will be forthcoming.

While addition federal money would be good news for the state in the near term, we continue to worry about the sustainability of current spending levels into the 2011–13 biennium.

References

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