

No. 100769-8

IN THE SUPREME COURT OF THE STATE OF
WASHINGTON

CHRIS QUINN, an individual; CRAIG LEUTHOLD, an individual; SUZIE BURKE, an individual; LEWIS and MARTHA RANDALL, as individuals and the marital community comprised thereof; RICK GLENN, an individual; NEIL MULLER, and individual; LARRY and MARGARET KING, as individuals and the marital community comprised thereof; and KERRY COX, an individual,

Respondents,

vs.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE an agency of the State of Washington, and VIKKI SMITH, in her official capacity as Director of the Department of Revenue,

Appellants,

EDMONDS SCHOOL DISTRICT, TAMARA GRUBB, ADRIENNE STUART, MARY CURRY, and WASHINGTON EDUCATION ASSOCIATION,

Intervenors.

APRIL CLAYTON, an individual; KEVIN BOUCHEY, an individual; RENEE BOUCHEY, an individual; JOANNA

CABLE, an individual; ROSELLA MOSBY, and individual;
BURR MOSBY, an individual; CHRISTOPHER SENSKE, an
individual; CATHERIN SENSKE, an individual; MATTHEW
SONDEREN, an individual; JOHN MCKENNA, an individual;
WASHINGTON FARM BUREAU; WASHINGTON STATE
TREE FRUIT ASSOCIATION;
WASHINGTON STATE DAIRY FEDERATION,
Respondents,

vs.

STATE OF WASHINGTON, DEPARTMENT OF
REVENUE, an agency of the State of Washington, and
VIKKI SMITH, in her official capacity as Director of the
Department of Revenue,

Appellants,

EDMONDS SCHOOL DISTRICT, TAMARA GRUBB,
ADRIENNE STUART, MARY CURRY, and WASHINGTON
EDUCATION ASSOCIATION,

Intervenors.

**BRIEF OF AMICI CURIAE
ASSOCIATION OF WASHINGTON BUSINESS,
TECHNOLOGY NETWORK,
CITIZEN ACTION DEFENSE FUND, and
ETHNIC CHAMBER OF COMMERCE COALITION,**

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I. INTRODUCTION

The Association of Washington Business (“AWB”), Technology Network (“TechNet”), The Citizen Action Defense Fund (“CADF”), and the Ethnic Chamber of Commerce Coalition (“ECCC”) ask this Court to affirm the superior court’s order that found the tax created by the Washington State Legislature, when it passed ESSB 5096, to be unconstitutional. ESSB 5096 creates two problems. First, it discourages local investment in Washington businesses. The members of AWB, TechNet, CADF, and ECCC include a substantial number of businesses that are owned by individuals who are Washington residents and non-residents alike. The tax created by ESSB 5096 affects those Washington businesses by making it more difficult to raise capital from anyone who may not see an adequate return on investment if they must pay this tax. Second, ESSB 5096 presents a risk of double taxation that is prohibited under the U.S. Constitution. This Court should affirm that the tax is invalid and unenforceable as a matter of law.

Not only is this law unconstitutional, it is bad public policy for all Washington residents and Washington businesses. This law, if allowed to stand, will create a negative business investment environment that discourages local investment in the community and disproportionately harms small business. In fact, this law would encourage Washington owners to move business operations and personal residency out of our state.

The legislature, when it passed ESSB 5096, would have this Court endorse a legal fiction and ignore Article VII of the Washington Constitution. This Court has found in the past that state income taxes are not constitutional if they are not uniform. Without a constitutional amendment, the law must be voided and declared unconstitutional. The members of AWB, TechNet, CADF, and ECCC members rely on the clear, consistent judicial precedent that has determined that an income tax (in this case, masquerading as an excise tax on capital gains) is unconstitutional on its face and must be overturned.

II. IDENTITY AND INTEREST OF AMICUS CURIAE

The Association of Washington Business (“AWB”) is Washington State’s principal representative of the state’s business community. AWB is the state’s oldest and largest general business membership federation, representing the interests of approximately 7,000 Washington companies who, in turn, employ over 700,000 employees, approximately one-quarter of the state’s workforce. AWB serves as both the state’s Chamber of Commerce and a manufacturing and technology association. AWB members are located throughout Washington, represent a broad array of industries, and range from sole proprietors to large Washington-based corporations that do business across the country and around the world. While its membership includes major employers, 90 percent of AWB members employ fewer than 100 people, and more than half of AWB’s members employ fewer than ten. AWB members include all types of employers that conduct business both within and outside Washington.

Technology Network (“TechNet”) is a corporation organized under the laws of California. TechNet is the national, bipartisan network of technology CEOs and senior executives that promotes the growth of the innovation economy by advocating a targeted policy agenda at the federal and fifty-state levels. TechNet’s diverse membership includes dynamic American businesses ranging from startups to the most iconic companies on the planet, representing over five million employees and countless customers. TechNet supports tax policies that promote innovation and foster an economic climate that enables companies to compete, thrive, invest, and expand in the United States and around the globe.

The Citizen Action Defense Fund (“CADF”) is an independent, nonprofit organization based in Washington State that supports and pursues strategic, high-impact litigation in cases to advance free markets, restrain government overreach or defend constitutional rights. The government watchdog nonprofit files lawsuits, represents affected parties and

intervenes in cases when the state enacts laws that violate the state or federal constitutions, when government officials take actions that infringe upon the First Amendment or other constitutional rights, or when agencies promulgate rules in violation of state law.

The Ethnic Chamber of Commerce Coalition (“ECCC”) was formed in 2016 by seven ethnic chambers of commerce in the Greater Seattle area to provide a unified voice and increase cooperation on issues impacting small business owners in their communities. The ECCC came together because separately their voices, representing the interests of an estimated 39,000 small businesses in the Seattle MSA, were not being heard. Among those interests are tax and regulatory stability, as the ECCC’s members are directly and negatively affected by increased taxes – including taxes on their owners – and by higher regulatory burdens. The capital gains tax will make it harder and more expensive for small businesses to raise needed capital in Washington state, and will penalize their owners when they sell

their stakes in their companies upon retirement. For many small business owners, including the ECCC's members, the equity they build in their companies represents their retirement nest egg. For these owners' employees, the companies represent their livelihood and their families' economic future. The capital gains tax threatens their future by burdening their companies with higher capital costs, slowing their growth.

The members of AWB, TechNet, CADF, and ECCC have a vested interest in the outcome of this case. Investment by individual entrepreneurs in Washington is critical to a vibrant economy. The members of AWB, TechNet, CADF, and ECCC members have invested their personal resources in developing businesses that provide jobs to hundreds of thousands of individuals throughout the state. Without these investments the state and local economies will suffer. The legislature through the adoption of ESSB 5096 has undermined this core investment.

The members of AWB, TechNet, CADF, and ECCC members rely on the consistent application of laws and the

Washington Constitution when establishing and maintaining businesses in the state of Washington. The proponents of ESSB 5096 would have this Court ignore legal precedent and the plain words of the state constitution without regard for the disruptions it would cause the local business community. Failure to adhere to these principles in this case undermines citizens' faith that they may rely on consistent interpretation of laws in conducting their business and trust in the institutions of government to act within constitutional limits.

III. ISSUES OF CONCERN TO AMICI CURIAE

The amici are concerned about the impact this tax will have on businesses and business owners in Washington if the tax is upheld. Amici members should not be subject to a substantial disruption of the state's tax system because the legislature decided to ignore the plain meaning of the Washington Constitution and nearly a century of judicial precedent regarding income taxes in Washington. The members of AWB, TechNet and CADF respectfully asks this Court to affirm the trial court

decision that declared the tax unconstitutional and unenforceable as a matter of law.

IV. STATEMENT OF FACTS

The members of AWB, TechNet, CADF, and ECCC adopt and join in the Statement of the Case in the Answer to Statements of Grounds for Direct Review filed by Respondents. *See* Resp. Quinn Op. Br., pp. 5-11 and Resp. Clayton Op. Br., pp. 6-13.

V. ARGUMENT

It is not surprising that the tax system in Washington State is very complicated. Most tax systems are complex. For purposes of helpful background that forms the foundation for amici's following analysis, and amici want the Court to understand that Washington is a high-cost state for employers. As this new tax shows, legislators continue to debate new taxes and new regulations that will only make it harder to do business in our state. Employers in Washington already face a higher tax and regulatory burden than many states. The cost to do business in Washington has been going up for years, but legislators continue

to propose and pass laws that increase the tax burden on Washington employers. Over the last three legislative sessions, lawmakers have passed 22 tax increases raising \$40 billion over 10 years in addition to the revenue raised by the tax system that existed prior to the new tax laws.¹ These taxes directly impact businesses, their owners, and the owners' ability to attract local investments from Washington residents for the reasons explained hereafter. Allowing ESSB 5096 to be upheld will stifle local business ownership and investment in Washington businesses.

¹ The Washington Economic and Revenue Forecast Council forecasts an additional \$1.4 billion for the 2021-23 and 1.30 billion for the 2023-25 biennia. Some of this increase is from increases in Revenue Act taxes. *See* Exhibit A, Revenue Review (February 16, 2022), (un-numbered bullet 5), p. 002. The second graphs appearing on pp. 004 -005 shows the tremendous growth of revenue since 2013. No doubt the recent increase in revenue is partially explained by inflation, it is equally doubtless true that since 2013, much of the increased revenue is the increased tax burden.

A. Allowing ESSB 5096 to be upheld will stifle local business ownership and investment by Washington residents.

The Washington economy relies on the ability of individuals to invest in the local economy. It is vital that our system encourages local investment by Washington residents. When an individual lives in a community served by small businesses, that individual is more likely to invest in that business and consequently, in their community. ESSB 5096 creates an unfavorable investment market for individuals who reside in Washington State, as well as distorts investment incentives for both non-residents and residents. The new law discourages non-residents to invest in Washington businesses. At the same time, it encourages Washington residents to choose investments that the new capital gains tax will not reach (e.g., real estate). Stated differently, this tax discourages both state residents and non-residents from owning Washington businesses. While, non-resident owners may not be as sensitive to local concerns as resident owners who live and do business in

their communities, the impact of the loss of their investment will still be great.²

Non-resident owners are not as sensitive to local concerns as resident owners who live and do business in their communities.³ While this may result in a short-term increase in investment from outside our state, it ultimately will result in reduced capital investment from within the state.

The recent pandemic has highlighted this concern. The last two years have shown that many individuals do not need to reside in the state where they are doing business. This law would encourage more individuals to reside outside the state and avoid investing in local business ownership to avoid the unfair and unconstitutional new tax crated by ESSB 5096.

When there is no personal tie to a community motivating investment there, an individual's investment in the local

² You do not have to look back too far to see a local business choosing to leave the state. The loss of the Seattle Sonics is one example.

economy declines for the same reason that investors buy tax-free municipal bonds instead of investing in companies that pay a taxable dividend: minimizing and avoiding taxes becomes a primary consideration, as opposed to loyalty to the community.

ESSB 5096's negative impacts on in-state businesses will reverberate throughout the economy and affect all Washington residents. When financial resources are less available for a local business, then that burden typically flows down to the employees who shoulder lagging wages and fewer benefits, or worse, the loss of their jobs. Local businesses create jobs. ESSB 5096 is a job killer and will trade short-term revenue gains for long-term losses in local investment. It is bad for business and bad for Washington's families and workers. If ESSB 5096 is enforced, local businesses and ownership, their employees, and their communities will be the losers. Ultimately, these effects result in lower revenues from B&O and sales taxes, the principal engines of state revenue.

Ninety-nine and a half percent of Washington businesses are small businesses; Women make up 46.0 percent of workers and own 46.0 percent of businesses; Veterans make up 6.5 percent of workers and own 7.8 percent of businesses; Hispanics make up 12.1 percent of workers and own 6.2 percent of businesses; and racial minorities make up 20.7 percent of workers and own 15.1 percent of businesses.⁴ Yet these minority and women-owned businesses face the most challenging business environment in the country. Washington's business failure rate is the highest in the nation.⁵

Minority-owned businesses have the potential to create more jobs and revitalize distressed communities. Many members of minority communities create businesses as a last resort when they feel locked out of traditional jobs. The lack of social capital,

⁴ <https://cdn.advocacy.sba.gov/wp-content/uploads/2022/08/30121340/Small-Business-Economic-Profile-WA.pdf> (last checked on December 12, 2022)

⁵ <https://advisorsmith.com/data/small-business-failure-rate/#state> (last checked December 12, 2022);

poor educational systems, broken transportation systems, or systemic issues motivate these entrepreneurs to create businesses out of necessity. Despite the rise in minority businesses, they still lag significantly when it comes to access to capital. Restricting capital investment, whether intra-state or inter-state, to Washington businesses, harms these entrepreneurs and their communities.

B. ESSB 5096 is Not Enforceable as an Excise Tax, Because It Could Result in Double Taxation.

Amici agree with the superior court that the capital gains tax imposed by ESSB 5096 is labeled an excise tax but is an income tax in all other respects. If it is held to be an excise tax, however, it creates the risk of double taxation. This Court should not condone double taxation as a matter of law or of policy.

ESSB 5096 purports to tax the sale or exchange of a capital asset, but if this tax were truly an excise tax, then the taxable event would be the *transaction* -- the sale or exchange of a capital asset -- not realization of net income from the transaction. Under

settled federal constitutional principles, the State can only tax a transaction that has a sufficient nexus with the state, i.e., occurs within its jurisdiction.⁶ For example, if the sale or exchange takes place in New York City (e.g., sale of publicly traded stock), the transaction should not be taxable in Washington, because the transaction did not occur in Washington. Washington lacks any nexus with the transaction; only New York has a transactional nexus with the sale or exchange of a share of stock.

ESSB 5096's sponsors understood that rule but wanted to reach net income arising from most sales or exchanges of tangible and intangible capital assets, regardless of where the transaction occurred, which by definition is a tax on income. So, in RCW 82.87.100(1)(b), they altered that "inconvenient" rule of law by sourcing capital gain from the transactions to the domicile of the owner or beneficial owner of the capital asset. If the bill's drafters did not make this change, then tax could not apply to

⁶ *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995).

sales or exchanges that take place in other states or countries. The corollary is that ESSB 5096 does not reach capital gains from a sale of intangible assets occurring in Washington if the owner is not domiciled here. The new law thus defies and violates the fundamental rules governing state jurisdiction to levy excise taxes, turning universally accepted law governing state excises on its head.

Consequently, under ESSB 5096, transfer of intangible capital assets, regardless of where the transaction occurs, is taxable in Washington if the owner or beneficial owner is a Washington domiciliary and realizes net income from the transaction. In contrast, transfers of intangible capital assets that occur in Washington are not taxable if the owner is not domiciled here. It is this reality that creates the problem explained in the preceding section regarding encouraging out-of-state investment at the expense of local investment and encouraging individuals to move out of state.

This Court should be mindful not to conflate *in personam* nexus over the taxpayer (via residency or domiciliary) with transactional nexus; the former is jurisdiction over the taxpayer and the other is jurisdiction over the transaction. ESSB 5096 treats *in personam nexus* as the equivalent of transactional nexus when it requires taxation when only *in personam* nexus exists but transactional nexus is missing. This is flawed reasoning, and it indicates that the tax does not intend to tax the transaction as in an excise tax, but to tax the legal or beneficial owner who realizes the capital gains, as in an income tax.

The flaw is also evident after reviewing judicial interpretations of the Commerce Clause (U.S. Const., Art. 1, Sec. 8, Cl. 3) and the Department of Revenue's administrative rule. The United States Supreme Court draws this nexus distinction,⁷ and Washington's application of the gross receipts tax employs

⁷ *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 165, 103 S. Ct. 2933, 2940, 77 L. Ed. 2d 545 (1983).

that distinction. For example, in 2014, WAC 458-20-193⁸ explained that a transaction occurred in Washington if delivery of goods (transactional nexus) occurred in Washington:

(7) Inbound sales. ... There must be both the receipt of the goods in Washington by the purchaser and the seller must have nexus for the B&O tax to apply to a particular sale. The B&O tax will not apply if one of these elements is missing.

Because states must apply the internal consistency test⁹ to assess the constitutionality of their tax laws for Commerce Clause purposes under the U.S. Constitution, we must assume that the reverse is true as well: both nexus with the seller and the transaction must be present for out-of-state sales for the tax to meet its federal constitutional requirements. This capital gains tax fails to do that, because it substitutes *in personam* nexus in lieu

⁸ The Department of Revenue revised WAC 458-20-193 in 2015 and this exact language no longer exists in the rule. The revised rule still recognizes the principal in WAC 458-20-193(203)(b), noting in example 10 that the B&O tax does not apply to goods received out of state in that the sale ... where the sale occurs ... is sourced out of state.

⁹ *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987).

of transactional nexus when such transactional nexus is missing. This creates a double-taxation risk. For example, if a Washington resident sold or exchanged a tangible capital asset in New York, then Washington could tax the sale or exchange because of *in personam* nexus over the resident under ESSB 5096. Because the sale or exchange occurred in New York, New York could also tax it because of transactional nexus. Under *Jefferson Lines*, only one state should tax that single, taxable transaction. Both states could tax income of a single transaction (and avoid multiple taxation with sound credits or apportionment), but they cannot both tax a single transaction as an excise tax, because a transaction can only be taxed in one state according to *Jefferson Lines*, *Container Corp.*, and *Tyler Pipe*. ESSB 5096 violates this constitutional principle. Thus, even if ESSB 5096 is understood to be an excise tax, the disregard of transactional nexus creates risks of multiple taxation. ESSB 5096 should be struck down.

VI. CONCLUSION

For the reasons stated above, the amici urge this Court to affirm the trial court's ruling finding that the capital gains tax is unconstitutional and not enforceable.

This document contains 2859 words, excluding the parts of the document exempted from the word count by RAP 18.17.

RESPECTFULLY SUBMITTED this 12th day of December, 2022.



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CERTIFICATE OF SERVICE

I hereby certify that I caused the foregoing document to be served on counsel for all other parties in this matter via this Court's e-filing platform.

DATED: December 12, 2022

By



ROBERT A. BATTLES WSBA # 22163

EXHIBIT A

Selected pages from the Economic and Revenue Forecast Council, dated February 16, 2022.

Complete review found at:

<https://erfc.wa.gov/sites/default/files/public/documents/meetings/rev20220216.pdf> meeting
materials (wa.gov)

<https://erfc.wa.gov/sites/default/files/public/documents/meetings/rev20220216.pdf> meeting materials (wa.gov)

EMBARGOED

*until February 16, 2022, 9:00 am PDT when it will be published at
www.erfc.wa.gov*

Revenue Review

February 16, 2022



WASHINGTON STATE
ECONOMIC AND REVENUE FORECAST COUNCIL

the same average growth rate expected in the November forecast. Employment growth is expected to slow to an average rate of 0.8% per year in 2026 and 2027. Our forecast for nominal personal income growth this year is 2.9%, up from 1.9% in the November forecast. Personal income growth will be weak this year as the extraordinary stimulus of the last two years is withdrawn. Our new forecast for nominal personal income growth in 2023 through 2025 averages 5.5% per year compared to 5.2% in the November forecast. Personal income growth is expected to grow at an average rate of 5.1% per year in 2026 and 2027.

Revenue

- State taxable activity has once again been much stronger than expected. Cumulative major General Fund-State (GF-S) collections from November 11, 2021 through February 10, 2022 came in \$452 million (5.9%) above the November forecast.
- Most of the collections in excess of the forecast were Revenue Act taxes (the main category of GF-S taxes including retail sales and use, business and occupation (B&O), public utility and non-cigarette tobacco products). Cumulative Revenue Act collections came in \$286 million (5.5%) higher than forecasted in November.
- The February economic forecast featured increases in personal income, construction employment and housing permits, all of which are conducive to revenue growth. Combining those factors with the recent strength in collections, forecasted Revenue Act receipts have been increased by \$1.0 billion in the 2021-23 biennium and \$1.1 billion in the 2023-25 biennium.
- The property market has also continued to be stronger than expected. Real estate excise tax (REET) collections came in \$133 million higher than forecasted. Both commercial and residential real estate have exceeded expectations. REET collections for the 2021-23 biennium are now expected to be \$283 million higher than previously forecasted. The REET forecast was increased by \$93 million for the 2023-25 biennium.
- Including the increases in Revenue Act taxes, REET and other sources, the GF-S forecast has been increased by \$1.40 billion in the 2021-23 biennium and \$1.31 billion in the 2023-25 biennium.
- Forecasted GF-S revenue is now \$58.919 billion for the 2021-23 biennium and \$62.175 billion for the 2023-25 biennium. This is the first forecast that also includes the 2025-27 biennium. Forecasted GF-S revenue is \$66.532 billion for that biennium.
- The forecast of Education Legacy Trust Account (ELTA) revenue was increased by \$56 million in the 2021-23 biennium and \$2 million in the 2023-25 biennium. Forecasted ELTA revenue is now \$1.743 billion for the 2021-23 biennium and \$2.084 billion for the 2023-25 biennium. Forecasted ELTA revenue is \$2.305 billion for the 2025-27 biennium.
- The forecast of revenue dedicated to the Opportunity Pathways Account (OPA) was decreased by \$10 million in the 2021-23 biennium and increased

by \$2 million in the 2023-25 biennium. Forecasted OPA revenue is now \$345 million for the 2021-23 biennium and \$356 million for the 2023-25 biennium as well. Forecasted OPA revenue is \$357 million for the 2025-27 biennium.

- Forecasted revenue dedicated to the Workforce Education Investment Account (WEIA) has been increased by \$6 million in the 2021-23 biennium and \$5 million in the 2023-25 biennium. Forecasted WEIA revenue is now \$684 million for the 2021-23 biennium and \$753 million for the 2023-25 biennium. Forecasted WEIA revenue is \$831 million for the 2025-27 biennium.
- Summing the changes to the GF-S, ELTA, OPA and WEIA forecasts, total state revenue subject to the budget outlook process is expected to increase by \$1.453 billion in the 2021-23 biennium and \$1.320 billion in the 2023-25 biennium.
- The forecasted total of GF-S, ELTA, OPA and WEIA revenue for the 2021-23 biennium is \$61.691 billion, an increase of 16.1% over 2019-21 biennial revenue, and forecasted total revenue for the 2023-25 biennium is \$65.368 billion, an increase of 6.0% over expected 2021-23 biennial revenue. Forecasted total revenue for the 2025-27 biennium is \$70.025 billion, an increase of 7.1% over expected 2023-25 biennial revenue.



WA housing permits average 1,100 units higher in 2022 – 2025 compared to November



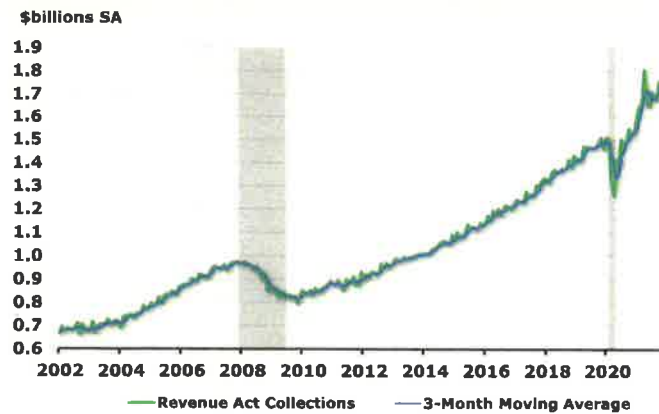
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Source: ERFC February 2022 forecast; historical data through 2021

WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



Revenue Act collections remain strong; year over year growth 10.1% for December activity



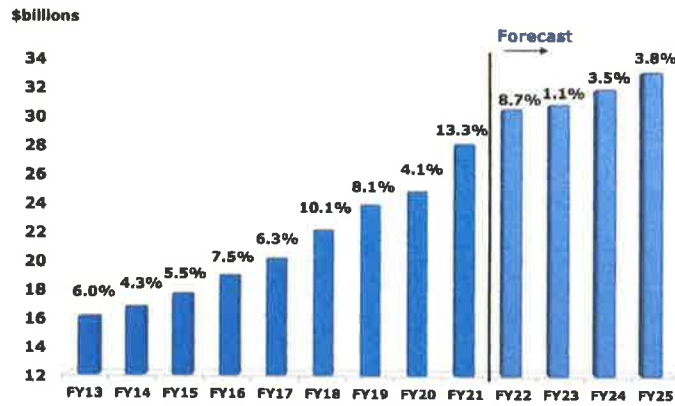
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* Adjusted for large one-time transactions, amnesty payments, reporting frequency change and deferred 2020 payments, current definition of Revenue Act
Source: DOR and ERFC; monthly data through December 2021 activity

WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



Forecast of funds subject to the budget outlook process* by fiscal year



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*Funds subject to the budget outlook process are General Fund-State plus Education Legacy Trust, Washington Opportunities Pathway and Workforce Education Investment Accounts
Source: ERFEC forecast, February 2022

WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



Conclusion

- U.S. GDP, employment forecasts similar to November; inflation, oil prices higher in 2022 - 2025
- WA personal income growth forecast slightly higher than Nov. forecast; residential construction forecast revised up
- COVID, inflation, geopolitics pose forecast risks
- Total state revenues are expected to grow 16.1% between the 2019-21 and 2021-23 biennia and 6.0% between the 2021-23 and 2023-25 biennia

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