



City Budget Office

Subject: Seattle Income Tax Threshold Information Sheet

Date: June 30, 2017

Proposal

The City of Seattle is proposing to levy an income tax on high-income households. The City defines a high-income household as one with total income in excess of \$250,000 per year for single filers and \$500,000 per year for joint filers. The tax rate for Seattle households with total income above these thresholds will be two percent. Based on 2014 Federal Income Tax data, the City estimates that its proposed income tax would generate about \$125 million per year. The findings and data presented below indicate that the City's proposed income tax will reasonably be assessed only on high-income households.

Background

Washington state has one of the most regressive state and local tax structures in the nation. A regressive tax structure is one in which taxpayers with relatively low incomes pay a higher share of their income in taxes than do higher income taxpayers. The City of Seattle's tax structure is regressive because it receives about 45 percent of General Fund revenue from retail sales and property taxes, both of which are very regressive taxes. The City is seeking to use a tax on high-income households to reduce the regressive nature of its tax system.

To implement a tax on high-income households, the City needed to determine what incomes might reasonably be considered high. The City's intent is to tax households whose incomes are well in excess of what is considered to be a comfortable standard of living. Three methodologies were used to assess the reasonableness of the City's high-income thresholds of \$250,000 for single filers and \$500,000 for joint filers: 1) the distribution of incomes in Seattle, 2) household expenditure data for the Seattle area, and 3) basic cost-of-living indices.

Income Distribution

Internal Revenue Service (IRS) data on adjusted-gross incomes (AGI) shows that Seattle residents filed 418,512 federal tax returns with the IRS in 2014. The City's proposal is to tax total income, a slightly broader tax base (by approximately 1.5%) than AGI, but AGI is a good proxy for income distribution in the city. Ignoring less common filing statuses such as Head of Household returns, 67 percent filed single tax status returns and 33 percent filed joint tax status returns. To be in the top 5 percent of their respective filing status a single filer had to have AGI above \$125,000 and a joint filer needed AGI above \$400,000. The median, or mid-point, of all household income in Seattle was \$80,349 in 2015 – half of households were higher and half were lower.

Using the thresholds proposed by the City for a tax on high-income households, 8,493 tax filers would be affected, which is about two percent of all filers. In 2014, 1.4 percent of single filers had AGI above the \$250,000 threshold, which is over three times higher than median household income. Similarly, 3.3

percent of all joint filers had an AGI above the \$500,000 threshold, which is over six times the median household income.

The City's proposal is designed to tax both wages and salaries as well as unearned income, which is typically defined as income from investments like dividends, interest, and capital gains. For all returns with AGI lower than \$100,000, 82 percent of AGI was from wages and salaries. For returns with AGI above \$200,000, only 53 percent of AGI came from wages and salaries. The IRS data indicate that as incomes rise households receive an increasingly larger share of their income from unearned sources.

For additional insight into what constitutes a high income, the City looked at actions taken by the Federal government. For the Affordable Care Act, the Obama administration and Congress adopted high-income thresholds of \$200,000 and \$250,000, respectively, for single and joint tax filers. The Bush administration tax cuts, put into place in 2001, were made permanent in 2012 for single filers earning less than \$400,000 of AGI and \$450,000 for joint filers. For taxpayers above those thresholds, tax rates returned to 39.6 percent.

Household Expenditures

Information on actual expenditures for the Seattle metropolitan area are available from the U.S. Bureau of Labor Statistics' Consumer Expenditure Survey. The most recent data indicate that in 2014-2015 the average annual expenditure (excluding taxes) for consumer units¹ was \$69,017. The largest expenditure was for housing, which accounted for one-third of total spending. Expenditures by major category are:

\$69,017	Average annual expenditures
8,929	Food
23,768	Housing
2,405	Apparel and services
9,767	Transportation
4,635	Healthcare
3,673	Entertainment
7,961	Personal insurance and pensions
7,879	Other

The \$250,000 threshold for taxing single filers is 3.6 times greater than the average annual expenditure of \$69,017. The joint filer threshold of \$500,000 is 7.2 times greater.

Cost-of-Living Indices

Two cost-of-living indices provide additional context for assessing the reasonableness of the City's income thresholds. The first cost-of-living index is the Massachusetts Institute of Technology's Living Wage Calculator. It defines a living wage as the amount of income needed to meet a family's basic needs while maintaining self-sufficiency. It excludes "luxuries" such as restaurant meals and vacations. For 2016, the living wage for King County ranged from \$27,672 for a single adult household to \$88,027 for a household with two working adults and three children.

¹ A consumer unit consists of any of the following: (1) all members of a household who are related by blood, marriage, adoption, or other legal arrangements; (2) a person living alone; (3) a person sharing a household with others but who is financially independent; or (4) two or more unrelated persons living together who use their incomes to make joint expenditure decisions.

The second cost-of-living index is the Self-Sufficiency Standard developed by Diana Pearce at the University of Washington. This index identifies the amount of income necessary to meet basic needs, including taxes, without public subsidies or private/informal assistance, such as shared housing or free babysitting. The Self-Sufficiency Standard has been calculated for a wide range of household types for the City of Seattle for 2014. For a single adult, the Self-Sufficiency Standard is \$25,440. It rises to \$103,346 for a family with two adults, an infant, a preschooler, and a school age child. For a mid-size family with one adult, a school-age child and a teenager the standard is \$48,865.

The two cost-of-living indices measure the cost to live at a basic level. The tax thresholds have been set so that they are well above a comfortable standard of living. If we assume that a comfortable standard of living is some multiple of a basic standard of living, e.g. double, then the thresholds are still well above a comfortable standard of living.

Conclusion

Although there is no single accepted definition of high income, measures of income distribution, average household expenditures, and cost-of-living standards in Seattle serve to establish a framework for identifying levels of income that reasonable people would consider to be high. The high-income thresholds are three to nine times that of median household income, self-sufficiency standards, and average household expenditures. Those who would be subject to the tax have incomes in the top three percent of all Seattle households. At these levels, the City of Seattle is confident that those subject to the tax would be high-income households.