State of Washington

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Citizen Commission for Performance Measurement of Tax Preferences

November 10, 2014

The Honorable Representative Reuven Carlyle
The Honorable Representative Ross Hunter
The Honorable Senator Andy Hill
The Honorable Representative Terry Nealey
The Honorable Representative Bruce Chandler
The Honorable Senator James Hargrove

Re: 2014 Tax Preference Reviews

I am pleased to forward to you the comments that the Citizen Commission for Performance Measurement of Tax Preferences (Commission) adopted for this year's review of tax preferences.

The attached comments were adopted by the Commissioners at our October 17 meeting. The attachment also includes a minority report from one commissioner related to the package of aerospace tax preferences.

Commissioners encouraged me, in my capacity as Chair, to emphasize to you the importance of the Legislature considering this year's <u>and</u> previous years' recommendations and comments on tax preference statutes, which have undergone rigorous review by the Joint Legislative Audit and Review Committee staff (JLARC), pursuant to legislatively mandated criteria and government auditing standards, and which also have been the subject of public testimony.

This is the eighth year that tax preferences have been reviewed at the direction of the Legislature. As the chairs and ranking minority members of the fiscal committees, I urge your action on these recommendations during the upcoming legislative session.

Tax preference reviews provide a valuable evaluation tool to assist the Legislature in grappling with difficult fiscal issues. Terminating tax preferences that do not appear to be meeting their intended purposes provides the Legislature with the option of using resources for alternative revenue or program purposes. Similarly, continuing effective preferences provides an assurance that the state is getting the value the Legislature expects. And reviewing preferences with an unclear policy purpose and those whose costs or benefits may not be meeting the Legislature's intent provides information and analysis to the Legislature which enables the Legislature to review and clarify those preferences.

During 2014 JLARC staff conducted a full review of 24 preferences. After reviewing JLARC staff's report and receiving public testimony, the Commission has recommended the Legislature should review and clarify the purpose of 20 preferences, continue three preferences, and terminate one preference. Summaries of JLARC staff's analysis and recommendations for these 24 preferences, and Commission comments, are attached to this letter.

Because the availability of JLARC staff resources limits how many tax preferences JLARC staff can evaluate each year, the Commission considers information on a list of "expedited" preferences, which do not receive a JLARC staff evaluation. Many of these expedited preferences have limited revenue impacts, and consideration of some others, in the Commission's judgment, would not benefit from a JLARC staff evaluation. In 2014, the Commission scheduled 62 preferences for "expedited" review. In our call for public testimony, the Commission explicitly solicited public testimony on these expedited preferences as well those that received a JLARC staff evaluation. As a result, we received written testimony on some of the expedited preferences this year.

While these "expedited" preferences are sometimes smaller and did not receive the benefit of a JLARC evaluation, the Commission believes they still merit attention by the Legislature. To further assist the Legislature, the Commission unanimously adopted comments this year on all 62 "expedited" preference reviews. Those comments are also attached to this letter.

The Commission has continued to expand on its process for soliciting public testimony on the preference reviews. Similar to last year, Commissioners requested that stakeholders respond to a set of questions when testifying either in support or in opposition to a tax preference. These questions were posted to our web site, and published along with the agenda for our public hearing. We posed four questions:

1. Is there evidence that the tax preference is achieving its purpose, as noted in the 2014 tax preferences reports? Please provide any relevant evidence.
2. Does the tax preference provide benefits in addition to those stated in its intended or implied purpose?
3. Does the economic activity stimulated by this tax preference exceeds the loss of revenue to the state?
4. Does this preference have negative consequences? For example, were other industries, workers, or the environment harmed by activities stimulated by this tax preference?

In addition to soliciting testimony from the beneficiaries of tax preferences, the Commission also invited and received testimony from other parties. As a result, we also received testimony from individuals who spoke to their views on tax preference effectiveness and accountability. We also solicited and received written testimony, which was posted for the public on our web site.

I believe the work of JLARC staff and the Commission has provided a thoughtful and deliberative forum for highlighting many important performance and policy issues associated with evaluating tax preferences. I encourage you to consider the recommendations of JLARC staff and Commission comments covering the entire eight years of tax preference reviews during the upcoming legislative session.

As Chair of the Citizen Commission for Performance Measurement of Tax Preferences, I would be pleased to discuss the Commission's position and comments with you and any interested legislators. I can be contacted via email at bill@tlff.org.

If you have questions about JLARC staff's performance audits, please feel free to contact the Legislative Auditor, Keenan Konopaski, at 360-786-5187 or keenan.konopaski@leg.wa.gov.

Additional information on all eight years of tax preference reviews can be found at: www.citizentaxpref.wa.gov/reports.htm.

Recordings of this year's public testimony and written testimony we received can be found under the link for the September 19, 2014, meeting at: www.citizentaxpref.wa.gov/meeting.htm.

Sincerely,

William A. Longbrake

William A. Longbrake, Chair
Citizen Commission for Performance Measurement of Tax Preferences

cc: All Legislators
Keenan Konopaski, Legislative Auditor
David Schumacher, Director, Office of Financial Management
Carol Nelson, Director, Department of Revenue
Alex Pietsch, Governor's Office of Aerospace

Attachments

Summary of 2014 Tax Preference Performance Reviews with Commission Comments

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Preferences Related to Aerospace Industry			
Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) RCW 82.04.260(11)			
Provides a preferential B&O tax rate of 0.2904 percent to manufacturers and processors for hire of commercial airplanes and their components and to manufacturers of tooling specifically designed for use in manufacturing aerospace products.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$238.5 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.

Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. The Legislature should establish specific economic development metrics and reporting mechanisms that facilitate determination of whether the intended public policy objectives are being met.

Rationale: The competition for Washington's aerospace firms is intense. Given this intensity, and the state's need to maintain its job base following the Great Recession, these preferences mitigated some near- and medium-term risk for Washington's economy. However, testimony indicated that these preferences suffer from some significant long-run "moral hazard" problems. Moral hazard problems occur when the recipient of an economic benefit is incented to behave in a way inconsistent with the welfare of those granting the benefit. For example, this is common with deposit insurance. Evidence suggests that deposit insurance (an insurance benefit) in the absence of bank examinations (i.e. prudential supervision) encourages banks to take excessive risk since bank owners and depositors are, to varying degrees, insulated from the bank's lending decisions. In effect, without bank examinations, risk is shifted to agents such as the bank's employees, creditors, and ultimately taxpayers.

In the case of the aerospace industry, the lack of verifiable metrics that measure the extent to which the public policy objectives of the tax preference are being met may encourage firms to move employment out of state to gain the benefit of more favorable labor costs, while still benefiting from the tax preferences. However, the establishment of verifiable metrics will need to balance compliance and monitoring costs with the benefits received by the firms. Testimony noted that firms may forego taking advantage of tax preferences with onerous reporting standards, possibly to the detriment of economic development in the state.

In addition to compliance and monitoring costs, it is challenging to determine how to measure whether employment objectives are being met over time. Some employment changes may not be related to the tax preferences. For example, depending upon the industry, technological change can be a significant driver of changes in employment. To isolate the impact of a tax preference on employment levels, changes in technology need to be taken into consideration.

Finally, as with most tax preferences, there is also lack of transparency on how the preferential benefits should be established. Although making all discussions between the state and the industry public is not practical for a variety of reasons, there is still a public interest in additional transparency in how the state and industry determine the preferential benefits. The public should be given information about why a particular preferential benefit structure was chosen. This might include information on costs and competitive pressures faced by an industry, or the influence of competing preferential benefits offered by other states. Given the amounts involved in the aerospace preferences, all of these issues deserve careful consideration by the Legislature. It would be helpful to examine how other states are structuring preferences and performance metrics to achieve public policy objectives.

In addition to Commission comments, one minority report was submitted

Commissioner Bueing voted in opposition to the comment adopted by the Commission and after the meeting provided the following minority report:

Minority Comment: The Legislature should avoid establishing specific economic development metrics to measure progress towards public policy objectives and ensure that reporting mechanisms are targeted and reasonable. The Legislature should revise its definition of "tax preferences" to avoid labeling anomalies under a gross receipts tax as preferences.

Minority Rationale: In an ever evolving marketplace, technological change, market forces and economic trends make it virtually impossible to establish specific economic development metrics. The same specific economic metric cannot reasonably be used to measure the effectiveness of job creation in a growing economy as is used in a recessionary economy. Yet it is impossible for the Legislature to accurately measure the future course of the economy. Instead, rigorous economic analysis is necessary to reasonably and accurately measure the benefit of an incentive. Simplistic, specific economic metrics make the process of measuring progress much easier, but at the expense of creating any useful analysis.

Rigorous economic analysis is also necessary to reasonably and accurately measure the cost of an incentive. Quantification of the costs associated with a "tax preference" is extremely difficult when a reasoned observer must necessarily take into account the potential for relocation of activities. It is also necessary to look at the specific effect of gross receipts tax on a particular industry to accurately measure whether a rate differential is actually a preference or is instead recognition of the unique effects of the Washington B&O tax within a particular industry.

Accordingly, the Legislature should also reconsider and revise its definition of "tax preferences" to recognize the complex realities associated with the Washington B&O tax and allow for accurate analysis of not only the benefit, but also the cost of an incentive.

For example, in the case of manufacturers in the aerospace industry, the Washington B&O tax is an unapportioned tax levied on 100% of the gross receipts from the sale of such manufactured products even though the aerospace products are sold throughout the world. The clear trend in state taxation for the last 30 or more years has been a move to marketplace apportionment. Washington sources virtually all business activity to the place where the product or service is delivered except for manufacturing.

It is no wonder that a highly desirable industry, such as the aerospace industry, that provides significant above average wage jobs would seek relief from an unapportioned gross receipts tax. Instead of relying on a simplistic, overly broad and fictitious definition of "tax preference" the Legislature should direct JLARC to analyze whether deductions, exemptions, deferrals and rate differentials are actually tax preferences or simply necessary adjustments within the context of a gross receipts tax in order to equalize tax burdens between disparate industries and activities.

Summary of 2014 Tax Preference Performance Reviews with Commission Comments

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Aerospace Product Development (B&O Tax) RCW 82.04.290(3)			
Provides a preferential B&O tax rate of 0.9 percent to businesses that research, design, or engineer aerospace products for commercial airplanes for others to manufacture.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$6.5 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.			
Aerospace Product Development Expenditures (B&O Tax) RCW 82.04.4461			
Provides a B&O tax credit equal to 1.5 percent of qualifying expenditures for businesses that develop aerospace products. Qualifying expenditures include wages and benefits, supplies, and computer expenses, but not capital costs and overhead.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$197.9 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.			

Summary of 2014 Tax Preference Performance Reviews with Commission Comments

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Aerospace Product Development Computer Expenditures (Sales and Use Tax) RCWs 82.08.975; 82.12.975			
Provides sales and use tax exemptions for sales of computer hardware, computer peripherals, and software used primarily in developing, designing, and engineering aerospace products and providing aerospace services.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$13.6 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.			
Commercial Airplane Manufacturing – Credit for Taxes Paid (B&O Tax) RCW 82.04.4463			
Provides a B&O tax credit for property taxes or leasehold excise taxes paid on property used exclusively in manufacturing aerospace products or at aviation repair stations. The credit applies to new buildings, the land on which the buildings are located, and on the increase in assessed value from renovations and expansions. The credit is also available for property taxes paid on certain personal property.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$31.6 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.			
Superefficient Airplane Production Facilities (Leasehold Excise Tax) RCW 82.29A.137			
Provides a leasehold excise tax exemption to the manufacturer of a "superefficient airplane" (Boeing 787) for a facility located on port property.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$0 million in the 2015-17 Biennium. Boeing located the 787 facility on private property instead of port property.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.			

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Superefficient Airplane Production Facilities (Property Tax) RCW 84.36.655			
Provides a property tax exemption for all personal property such as equipment and computers to the manufacturer of a "superefficient airplane" (Boeing 787) at a facility located on port property.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$0 million in the 2015-17 Biennium. Boeing located the 787 facility on private property instead of port property.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.			
Commercial Airplane Production Facilities (Sales and Use Tax) RCWs 82.08.980; 82.12.980			
Provides an exemption from sales and use taxes on labor, services, and materials to construct new buildings used exclusively for manufacturing superefficient airplanes. Contingent on the siting of the 777X, the exemption is expanded to new buildings for manufacturing any commercial airplane, the wings, or the fuselage.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$0 million in the 2015-17 Biennium. If the contingency is met, beneficiary savings are estimated at $12.7 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.			

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Certified Aircraft Repair Firms (B&O Tax) RCW 82.04.250(3)			
Provides a preferential tax rate of 0.2904 percent to federally certified aviation repair stations.	The Legislature stated the public policy objectives: • To encourage the continued presence of suppliers and vendors that support the Washington aerospace industry; • To reduce the cost of doing business in Washington for aerospace suppliers and vendors; and • To provide jobs with good wages and benefits for aerospace suppliers and vendors.	$1.3 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired number of jobs would facilitate future reviews of the preference.
Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.			
Commercial Airplane Part Place of Sale (B&O Tax) RCW 82.04.627			
Provides a B&O tax exemption for sales of certain airplane parts made by an out-of-state manufacturer if they are sold to a Washington manufacturer of a commercial airplane.	The Legislature stated the public policy objectives in a larger package of aerospace preferences containing this exemption: • To encourage the continued presence of suppliers and vendors that support the Washington aerospace industry; • To reduce the cost of doing business in Washington for aerospace suppliers and vendors; and • To provide jobs with good wages and benefits for aerospace suppliers and vendors	Unknown because beneficiaries are not required to report amount of exemption claimed.	**Review and clarify:** Because it seems to run counter to the Legislature's stated policy objective of reducing the cost of doing business in Washington compared to locations in other states. In addition, the Legislature may want to consider adding reporting or other accountability requirements that would provide better information on out-of-state manufacturers' use of this preference.
Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.			
Aircraft Part Prototypes (Sales and Use Tax) RCWs 82.08.02566; 82.12.02566			
Provides sales and use tax exemptions for sales of materials incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications.	The Legislature stated the public policy objectives: • To encourage, develop, and expand opportunities for family wage employment in manufacturing industries; • To solidify and enhance the state's competitive position.	$0 million in the 2015-17 Biennium No taxpayers are claiming the preference.	**Terminate:** Because the tax preferences are not being used and have not contributed to the stated public policy objectives.
Commission: Endorse without comment			

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<tr><th>What the Preference Does</th><th>Public Policy Objective</th><th>Est. Beneficiary Savings</th><th>Legislative Auditor Recommendation</th></tr>
<tr><td colspan="4">Preferences Related to Fresh Food Processing</td></tr>
<tr><td colspan="4">Dairy Product Processors – Deduction (B&O Tax) and Dairy Product Ingredient Sales – Deduction (B&O Tax) RCW 82.04.4268</td></tr>
<tr><td>Provides a B&O tax deduction to dairy product processors for:
• Manufacturing activities for certain dairy products;
• Sales of dairy products (wholesale or retail) by the processor to purchasers that receive the products in-state and transport them outside the state; and
• Wholesale sales of dairy products by the processor for use as an ingredient to manufacture dairy products.
Expires July 1, 2015.</td><td>The Legislature did not explicitly state a public policy objective for this preference in 2006 when it enacted the preference or when it extended it in 2012. JLARC staff infer the public policy objective was related to jobs.
In 2013 when the preference was expanded to wholesale dairy product sales for use as an ingredient in manufacturing dairy products, the Legislature specifically stated it intended to provide incentives to create additional jobs in Washington's dairy industry and related dairy-based product manufacturing industry, and specifically to encourage infant formula producers to locate new facilities or expand existing ones in the state.
Additionally, the Legislature noted that the actual fiscal impact of the expanded deduction should substantially conform to the fiscal note estimate.</td><td>$8.9 million in the 2013-15 Biennium.</td><td>Review and clarify: Because the Legislature indicated extension of the expiration date was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should: 1) identify performance targets and metrics for the number and quality of jobs in the dairy processing industry; and 2) establish criteria for when to transition from the deduction to the preferential rate.</td></tr>
<tr><td colspan="4">Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. Although the preference appears to be meeting its public policy objective, the dairy industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.</td></tr>
</table>

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Dairy Product Processors – Preferential Rate (B&O Tax) and Dairy Product Ingredient Sales – Preferential Rate (B&O Tax)			RCW 82.04.260(1)(c)
Effective July 1, 2015, provides a preferential B&O tax rate (0.138 percent) to dairy processors for: • Manufacturing activities for certain dairy products; • Sales of dairy products (wholesale or retail) by the processor to purchasers that receive the products in-state and transport them outside the state; or • Wholesale sales of dairy products by the processor for use as an ingredient to manufacture dairy products. The wholesale sales for use as an ingredient portion of the preference expires July 1, 2023.	When the Legislature first enacted a preferential B&O tax rate for dairy processors prior to establishing an exemption, the stated public policy objective was to provide a tax rate consistent with the rate provided to other fresh food processors. In 2013 when the preference was expanded to wholesale dairy product sales for use as an ingredient in manufacturing dairy products, the Legislature specifically stated it intended to provide incentives to create additional jobs in Washington's dairy industry and related dairy-based product manufacturing industry, and specifically to encourage infant formula producers to locate new facilities or expand existing ones in the state. Additionally, the Legislature noted that the actual fiscal impact of the expanded deduction should substantially conform with the fiscal note estimate.	$9.1 million in the 2015-17 Biennium.	**Review and clarify:** To clarify, before the preference takes effect, whether the Legislature intends there to be parity among all the different food processor manufacturing and processor manufacturing and sales activities.
Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. Although the preference appears to be meeting its public policy objective, the dairy industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.			

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Fruit and Vegetable Processors – Exemption (B&O Tax) RCW 82.04.4266			
Provides a B&O tax exemption to fruit and vegetable processors for: • Manufacturing activities for fresh fruit and vegetable products, or • Wholesale sales of fruit or vegetable products by the processor to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference in 2005 when it first enacted the preference or when it extended it in 2012. JLARC staff infer the public policy objective was related to jobs.	$39.3 million in the 2013-15 Biennium.	**Review and clarify:** Because the Legislature indicated extension of the expiration date was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should: 1) identify performance targets and metrics for the number and quality of jobs in the fruit and vegetable processing industry; and 2) establish criteria for when to transition from the deduction to the preferential rate.
Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. Although the preference appears to be meeting its public policy objective, the fruit and vegetable industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.			
Fruit and Vegetable Processors – Preferential Rate (B&O Tax) RCW 82.04.260(1)(d)			
Effective July 1, 2015, provides a preferential B&O tax rate (0.138 percent) to fruit and vegetable processors for: • Manufacturing activities for fresh fruit and vegetable products, or • Wholesale sales of fruit or vegetable products by the processor to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference. JLARC staff infer the policy objective is to treat fruit and vegetable processors consistently with other fresh food processors.	$30.8 million in the 2015-17 Biennium.	**Review and clarify:** To clarify, before the preference takes effect, whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.
Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. Although the preference appears to be meeting its public policy objective, the fruit and vegetable industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.			

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Seafood Product Processors and Certain Sellers – Exemption (B&O Tax) RCW 82.04.4269			
Provides a B&O tax exemption to the seafood industry for: • Manufacturing activities for certain seafood products; or • Sales of certain seafood products (retail or wholesale) to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference. JLARC staff infer that the policy objective was related to jobs.	$4.4 million in the 2013-15 Biennium.	**Review and clarify:** Because the Legislature indicated extension of the expiration date was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should: 1) identify performance targets and metrics for the number and quality of jobs in the seafood processing industry; and 2) establish criteria for when to transition from the deduction to the preferential rate.
Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. Although the preference appears to be meeting its public policy objective, the seafood product industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.			
Seafood Product Processors and Certain Sellers – Preferential Rate (B&O Tax) RCW 82.04.260(1)(b)			
Effective July 1, 2015, provides a preferential B&O tax rate (0.138 percent) to the seafood industry for: • Manufacturing activities for certain seafood products; or • Sales of certain seafood products (retail or wholesale) to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference. JLARC staff infer the policy objective is to treat seafood processors consistently with other fresh food processors.	$3.5 million in the 2015-17 Biennium.	**Review and clarify:** To clarify, before the preference takes effect, whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.
Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. Although the preference appears to be meeting its public policy objective, the seafood product industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.			

Summary of 2014 Tax Preference Performance Reviews with Commission Comments

<table>
<tr><th>What the Preference Does</th><th>Public Policy Objective</th><th>Est. Beneficiary Savings</th><th>Legislative Auditor Recommendation</th></tr>
<tr><td colspan="4">Miscellaneous Preferences</td></tr>
<tr><td colspan="4">Electric Power Exported or Resold (Public Utility Tax) and Electricity Sales for Resale (B&O Tax) RCWs 82.16.050(11); (82.04.310(2)</td></tr>
<tr><td>These two preferences provide:
Public utility tax deductions for four types of electricity sales made by light and power (L&P) businesses:
• Direct (to end user) sales delivered out-of-state;
• Wholesale sales between L&P businesses delivered in-state;
• Wholesale sales to non-L&P businesses delivered in-state; and
• Wholesale sales delivered out-of-state.
B&O tax exemptions for non-L&P businesses for wholesale electricity sales delivered in-state and out-of-state.</td><td>The Legislature did not state the public policy objectives for the public utility tax (PUT) deductions to L&P businesses for four types of electricity sales or the B&O tax exemptions for non-L&P businesses for two types of electricity sales. JLARC staff infer the public policy objectives were
PUT deductions:
• Direct sales delivered out-of-state – to ensure the state complied with federal limitations on taxing goods in interstate commerce.
• In-state wholesale sales between L&P businesses – to ensure the PUT did not pyramid, while facilitating transfers of electricity between L&P companies to help meet customer demand.
• In-state wholesale sales to non-L&P companies – to provide consistent PUT treatment for wholesale sales by L&P companies regardless of the purchaser.
• Out-of-state wholesale sales – to provide consistent tax treatment with wholesale sales delivered in-state to comply with federal requirements.
B&O tax exemptions:
• In-state sales – to provide similar tax treatment to wholesale electricity sales by non-L&P businesses as to L&P businesses, and to keep electricity marketers from moving outside the state; and
• Out-of-state wholesale sales – to provide consistent tax treatment for wholesale electricity delivered in-state and out-of-state to comply with federal requirements.</td><td>PUT deductions:
$111.9 million in the 2015-17 Biennium
B&O tax exemptions:
Cannot be reliably estimated</td><td>PUT deductions:
Continue: Because the preference is achieving the inferred public policy objectives.
B&O tax exemptions:
Review and clarify: Because: 1) the Legislature may want to consider adding reporting or other accountability requirements to provide better information on use of the preference; 2) it is unclear whether the preference is still needed to keep electricity marketers from moving out-of-state due to 2010 changes in how service businesses calculate their taxable income; and 3) it is unclear whether the Legislature intended the preference to apply to commission or fee income from electricity brokering.</td></tr>
<tr><td colspan="4">Commission: Endorse without comment.</td></tr>
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What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
International Investment Management (B&O Tax)	RCW 82.04.290(1)		
Provides a preferential B&O tax rate (0.275 percent) to businesses conducting international investment management services.	The Legislature did not state the public policy objective for this preference. JLARC staff infer the preferential B&O tax rate has two public policy objectives: 1) To reduce a perceived competitive disadvantage for IIMS businesses located in Washington; and 2) To attract new international trade and finance business to the state.	$26.6 million in the 2015-17 Biennium.	**Review and clarify:** To determine if the preference is still necessary, since Washington's 2010 adoption of an economic nexus and apportionment standard has reduced the competitive disadvantage for international investment management businesses located in-state as compared to those located out-of-state. If the Legislature determines it wants to maintain this tax preference, then the Legislature should consider clarifying the law to identify which businesses qualify for the preference and what income is subject to the preferential rate.

Commission Comment: The Commission endorses the Legislative Auditor recommendation for this preference. The Legislature in its review of this preference should take into consideration the Department of Revenue's findings from its review of approximately 70 refund requests, which will take some time to complete. In addition, the Legislature should consider the financial and competitive impact this preference has on beneficiaries resulting from the typical business structure involving use of multiple affiliates in the international investment management services business.

Rationale: The Department of Revenue issued an Excise Tax Advisory on International Management Services on February 28, 2014, which clarifies the Department's position on eligibility and what income is taxable. The Department is currently reviewing approximately 70 refund requests and has completed one-third of these reviews. It will take additional time to complete the remaining reviews and determine the viability of these refunds under existing rules. The conclusions reached by the Legislative Auditor based on the existence of these refunds and the timing of the economic nexus and single sales factor apportionment standards are premature given the status of the current refund request reviews. While the Excise Tax Advisory addresses many of the issues revolving around who is eligible for the preferential rate and the Department of Revenue has a position on what income is taxable, not all taxpayers agree.

The Commission received testimony from a beneficiary that described how the B&O tax, which applies both to inter-affiliate transactions as well as to the gross receipts of the parent company, poses an undue tax burden compared to taxation methodologies in other states. This burden arguably could be reduced by merging affiliates; however, the affiliate business structure is a standard feature of businesses involved in international investment management services that is generally required by state and federal securities regulations. In states that tax income rather than receipts, the income of the parent is typically taxed, not the income of each individual affiliate. This issue arises from the structure of the B&O tax and is not unique to the international investment management services business. However, the B&O tax structure frequently results in a larger B&O tax burden for international investment services businesses located in Washington than for such businesses located outside of Washington.

Summary of 2014 Tax Preference Performance Reviews with Commission Comments

What the Preference Does	Public Policy Objective	Est. Beneficiary Savings	Legislative Auditor Recommendation
Sales Subject to Public Utility Tax (Sales Tax) and Electricity and Steam (Sales and Use Tax)		RCWs 82.08.0252, 82.08.950, 82.12.950	
Two tax preferences provide: • A sales tax exemption for any income from activities specifically taxed under public utility tax (applies to electricity, water, and natural or manufactured gas); and • A more narrow sales and use tax exemption for sales of steam, electricity, or electrical energy.	The Legislature did not state the public policy objective for this preference. JLARC staff infer: • The public policy objective for the sales tax exemption was to avoid double taxation by ensuring that sales or distribution of items defined as "tangible personal property" that are taxed under public utility tax are not also subject to sales tax. • The public policy objective for the more narrow sales and use tax preference was to ensure Washington tax law conformed with National Streamlined Sales and Use Tax Agreement.	$1.85 billion in the 2015-17 Biennium.	**Continue:** Because the preferences are meeting the inferred public policy objectives of avoiding double taxation and ensuring Washington tax statutes conform with the National Streamlined Sales and Use Tax Agreement.
Commission: Endorse without comment.			

Citizen Commission Comments on 2014 Expedited Tax Preferences

Biodiesel and Alcohol Fuel Production Facilities (Leasehold Excise Tax / Property Tax)	
Commission Comment: The Legislature should determine whether these preferences continue to meet their public policy objective. If they do, the Legislature should modify the expiration date; if they do not, the Legislature should allow the preferences to expire.	
Wood Biomass Fuel Production Facilities (Leasehold Excise Tax / Property Tax)	
Commission Comment: Because there are no beneficiaries, the Legislature should determine whether these preferences continue to meet their public policy objective. If they do, the Legislature should modify the expiration date; if they do not, the Legislature should allow the preferences to expire.	
Aluminum Master Alloy Producers (B&O Tax)	
Commission Comment: Because there are no beneficiaries, the Legislature should determine whether this preference continues to meet its public policy objective. If it does not, the Legislature should terminate this preference.	
Bad Debts (Fuel Tax)	
Commission Comment: The Legislature should consider whether this preference continues to serve its purpose, and if not, let it expire. No public testimony covering this preference was submitted.	
Multi-Unit Urban Housing (Property Tax); Nonprofit Developmentally Disabled Housing (Property Tax); and Prewritten Computer Software (Property Tax)	
Commission Comment: The Legislature could review whether these preferences are meeting their public policy objectives. If any of them is not, the Legislature should consider modifying or terminating the preference because other taxpayers are bearing the tax burden if the preference is continued.	
Second Narrows Bridge (Leasehold Excise Tax / Property Tax / Public Utility Tax / Real Estate Excise Tax)	
Commission Comment: These preferences were enacted in 1998 and anticipated the possibility of private funding, ownership, or lease of the bridge. These preferences are inoperative because that possibility was not pursued. For this reason the Legislature could consider terminating them.	
Multiple Activities Credit (B&O Tax)	
The Commission recommends the Legislature continue this preference. **Commission Comment:** This preference is a structural provision of the B&O tax necessary to comply with a ruling of the U.S. Supreme Court interpreting the U.S. Constitution.	
Natural Gas Subject to Public Utility Tax (Use Tax)	
The Commission recommends the Legislature continue this preference. **Commission Comment:** The preference is meeting its public policy objective.	
Baseball Stadiums (Leasehold Excise Tax); Football Stadiums (Leasehold Excise Tax); and Football Stadium and Exhibition Center Parking (Sales Tax)	
The Commission recommends the Legislature review and clarify these preferences. **Commission Comment:** The baseball stadium preference was enacted in 1995 as part of a comprehensive package to finance construction of Safeco Field and the football stadium preference was enacted in 1997 as part of a comprehensive package to finance construction of CenturyLink Field. Both of these involved public and private investment. Because nearly 20 years has passed, the Legislature should consider reviewing these preferences to determine whether they are continuing to meet their public policy objectives.	

Citizen Commission Comments on 2014 Expedited Tax Preferences

<table>
<tr><th colspan="2">All Other Tax Preferences</th><th>General Commission Comment</th></tr>
<tr><td rowspan="13">B&O</td><td>Academic Transcripts</td><td rowspan="44"> The Citizen Commission solicited public testimony for all 2014 expedited preferences. No public testimony was submitted for any of these expedited preferences. Tax revenue is a public asset that should be utilized in the best overall interests of citizens of Washington State. The Commission requested beneficiaries to provide responses to the following four questions: Is there evidence that the tax preference achieved its purpose, as noted in the 2014 tax preferences reports? Please provide any relevant evidence.
Does the preference provide benefits in addition to those stated in its intended or implied purpose?
Does the economic activity stimulated by this tax preference exceed the loss of revenue to the state?
Does this preference have negative consequences? For example, were other industries, workers, or the environment harmed by activities stimulated by this tax preference? The Commission encourages the Legislature to examine these preferences and gather responses to the four questions posed by the Commission from beneficiaries and then determine whether to continue, modify, or terminate each preference. </td></tr>
<tr><td>Child Care</td></tr>
<tr><td>Church Child Care</td></tr>
<tr><td>Discount Program Membership</td></tr>
<tr><td>Fish Cleaning</td></tr>
<tr><td>International Services</td></tr>
<tr><td>Mental Health Services</td></tr>
<tr><td>Natural Gas Surplus Sales</td></tr>
<tr><td>Nonprofit Camps and Conference Centers</td></tr>
<tr><td>Nonprofit Fund Raising</td></tr>
<tr><td>Second Narrows Bridge</td></tr>
<tr><td>Trade Shows</td></tr>
<tr><td>Wholesale Auto Auctions</td></tr>
<tr><td rowspan="17">Sales/Use</td><td>Academic Transcripts</td></tr>
<tr><td>Air Pollution Control Facilities</td></tr>
<tr><td>Coal for Thermal Generating Plants</td></tr>
<tr><td>Commuter Airplanes</td></tr>
<tr><td>Football Stadiums</td></tr>
<tr><td>Film and Video Production Equipment</td></tr>
<tr><td>Gravitational Wave Observatory</td></tr>
<tr><td>Gun Safes</td></tr>
<tr><td>Nonprofit Camps and Conference Centers</td></tr>
<tr><td>Nonprofit Fund Raising</td></tr>
<tr><td>Public Records Copies</td></tr>
<tr><td>Second Narrows Bridge</td></tr>
<tr><td>Truck Auxiliary Power-Batteries and Infrastructure</td></tr>
<tr><td>Truck Auxiliary Power-Enabling Parked Operation</td></tr>
<tr><td>Vending Machine Sales</td></tr>
<tr><td>Vessel Use by Manufacturers or Dealers</td></tr>
<tr><td>Wax and Ceramic Materials to Create Molds</td></tr>
<tr><td rowspan="5">Property</td><td>Air Pollution Control Facilities</td></tr>
<tr><td>Custom Computer Software</td></tr>
<tr><td>Habitat and Water Quality Improvements</td></tr>
<tr><td>Historic Property</td></tr>
<tr><td>Low Value Parcels</td></tr>
<tr><td rowspan="9">Other Taxes</td><td>Boats Under 16 Feet (Watercraft Excise Tax)</td></tr>
<tr><td>Emergency Medical Air Transport (Aircraft Fuel Tax)</td></tr>
<tr><td>Inmate Employment Programs (Leasehold Excise Tax)</td></tr>
<tr><td>Microbrewers (Beer Tax)</td></tr>
<tr><td>Nonresident Keeping Aircraft In-State (Aircraft Excise Tax)</td></tr>
<tr><td>Products Shipped Out-of-State (Litter Tax)</td></tr>
<tr><td>Racing Fuel (Fuel Tax)</td></tr>
<tr><td>Sewerage Processing and Disposal (Public Utility Tax)</td></tr>
<tr><td>Tuna, Mackerel, and Jack Fish (Enhanced Food Fish Tax)</td></tr>
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