

State of Washington
Citizen Commission for Performance Measurement of Tax Preferences

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October 30, 2019

The Honorable Representative Timm Ormsby
The Honorable Representative Drew Stokesbary
The Honorable Representative Cindy Ryu
The Honorable Representative Bill Jenkin
The Honorable Representative Zack Hudgins
The Honorable Representative Norma Smith
The Honorable Representative Gael Tarleton

The Honorable Representative Ed Orcutt
The Honorable Senator Patty Kuderer
The Honorable Senator Hans Zeiger
The Honorable Senator Mark Mullet
The Honorable Senator Lynda Wilson
The Honorable Senator Christine Rolfes
The Honorable Senator John Braun

Re: 2019 Tax Preference Reviews

Dear Senators and Representatives,

I am pleased to forward to you the comments that the Citizen Commission for Performance Measurement of Tax Preferences unanimously adopted for this year's review of tax preferences. The Citizen Commission consists of five voting members, with a member appointed by each of the four caucuses and the Governor's office. Notably, reviews this year included the \$569M aerospace preferences that were expanded and extended in 2013, as well as a \$262M preference to encourage development of multifamily and affordable housing.

We adopted positions similar to the Legislative Auditor for eight of the nine recommendations issued this year. I would like to call your attention to a recommendation from the Citizen Commission to the Legislature to form a taskforce to improve the information available to the Legislature on the use and consistency of the multifamily tax preference.

The full text of our Commissioner recommendations, summaries of the JLARC staff's analysis and recommendations, and brief video summaries of each preference are available on the 2019 Tax Preference Reviews overview page linked [here](#).

Tax preference reviews provide valuable information as the Legislature considers whether specific preferences are meeting the Legislature's policy objectives. With this year's report, there are now 13 years of tax preference evaluations available to the Legislature, comprising over 296 individual reviews.

I urge you to consider this year's and previous years' recommendations and comments on tax preference statutes in the upcoming legislative session. An interactive summary of legislative action on prior reviews is available [here](#).

As Chair of the Citizen Commission, I would be pleased to discuss the Commission's position and comments with you and any interested legislators. Please feel free to contact me (grant.forsyth@leg.wa.gov) or the Legislative Auditor, Keenan Konopaski (keenan.konopaski@leg.wa.gov or 360-786-5187).

Sincerely,



Grant D. Forsyth, Chair
Citizen Commission for Performance Measurement of Tax Preferences

Citizen Commission for Performance Measurement of Tax Preferences

Commission Comments Adopted on 10/9/2019

1. Aerospace Tax Preferences (Business & Occupation Tax, Sales and Use Tax, Leasehold Excise Tax, Property Tax)

Legislative Auditor (LA) recommendation: Clarify

The Legislature should clarify its expectations for the level of aerospace industry employment. Providing additional detail in the tax preference performance statement, such as a baseline level of employment, would facilitate future reviews of these preferences.

Commission Comment	Endorse LA recommendation with comment.	<p>The tax preference continues to meet the majority of stated objectives. However, the employment objectives are ambiguous. The commission recommends the Legislature clarify its position on employment levels.</p> <p>Regardless of how the Legislature clarifies this issue, the Legislature must be very cautious in how it interprets and responds to employment changes as a factor in the preference's efficacy. The industry, like manufacturing in general, are rapid adopters of new technology that enhances productivity. This has the potential to significantly lower the labor input over time. Also, business cycle events, which are outside the industry's control, may lead to significant declines in employment that can persist for several years. In addition, the Legislative Auditor's research and aerospace industry testimony shows that the industry provides above-average investment spending, wages and benefits, and workforce training. None of these areas can be captured by an analysis of changes in employment.</p> <p>Given the above, employment changes by themselves are insufficient for evaluating the preference's efficacy. Therefore, the commission recommends that the Legislature continues to evaluate the preference on a regular cycle using a range of objectives, with employment levels being only one of the considerations. The current JLARC process, based on multiple objectives, provides the most transparent and valid method for determining the degree to which the majority of objectives are met and whether or not the Legislature needs to adjust the preference.</p>
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2. Aircraft Part Prototypes (Sales & Use Tax)

Legislative Auditor recommendation: Terminate

The Legislature should terminate the sales and use tax exemption for prototypes for aircraft parts, auxiliary equipment, and modifications because the tax preference is not being used and has not contributed to the state public policy objectives.

The Legislature may wish to consider other strategies beyond this tax incentive to accomplish the public policy objectives.

Commission Comment	Endorse LA recommendation without comment.	
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Citizen Commission for Performance Measurement of Tax Preferences

Commission Comments Adopted on 10/9/2019

3. Commercial Airplane Parts: Place of Sale (Business & Occupation Tax)

Legislative Auditor recommendation: Review and Clarify

The Legislature should review and clarify the preferential tax treatment provided to out-of-state manufacturers because it seems to run counter to the Legislature’s state 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	Endorse LA recommendation with comment.	The tax preference addresses what had previously been an area of significant dispute between taxpayers and the Department of Revenue on sourcing of sales where final inspection of the products for FAA purposes occurs outside of Washington. The Legislature should clarify this by continuing the preference and re-stating that its purpose is to define the place of sale as opposed to reducing Washington’s cost of business. Doing so will avoid further disputes and will not require further reporting for this structural clarification.
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4. Commuter Air Carriers (Property Tax)

Legislative Auditor recommendation: Modify

The preference is meeting one of two inferred objectives. While it is simplifying reporting for one taxpayer and the Department of Revenue, it is not providing an alternative to property tax that results in a similar amount of tax paid.

The Legislature should modify the preference to:

- Provide a method to equalize commuter air carrier excise tax fees on airplanes with property taxes over time.
- Clarify why the preference is limited to commuter air carriers primarily located on private property.
- Provide a performance statement with stated objectives and metrics to determine if the objectives are met.

Commission Comment	Endorse LA recommendation with comment.	Extensive calculations by the Legislative Auditor suggests that current tax methodology is not revenue neutral relative to the older, more complicated methodology. The Legislature should be aware that the lack of neutrality is not the fault of industry; it’s an unintended consequence of much needed tax simplification. Because the new methodology has been in place since 2014, the industry has already budgeted in the current tax going forward. Therefore, should the Legislature decide to adjust the tax, it should be done in a way that increases the burden very gradually. Industry testimony indicates they operate with narrow margins and abrupt changes in costs can be difficult to absorb. The ability to absorb tax changes is an important consideration given that industry testimony and the Legislative Auditor’s research shows the industry provides unique transportation services to residents in remote parts of the state.
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Citizen Commission for Performance Measurement of Tax Preferences

Commission Comments Adopted on 10/9/2019

5. Commuter Air Carrier (Sales and Use Tax)

Legislative Auditor recommendation: Clarify expectations for levels of service and locations served

The Legislature should clarify its expectations for this preference by adding a performance statement that clearly states the public policy objectives and metrics to determine whether the objectives have been met. The Legislature should clarify what it hopes to achieve in terms of frequency of flights and locations served.

<p>Commission Comment</p>	<p>Endorse LA recommendation with comment.</p>	<p>It would be helpful for future reviews for the Legislature to clarify its expectations for this tax preference by adding a performance statement. However, public testimony suggests that any performance metrics must be chosen carefully so as not to be overly burdensome to firms that provide an important service in a low-margin industry. Also, in many cases, economics unrelated to the tax preference will dictate a specific route's viability and optimal flight frequency. Therefore, metrics related to specific routes and frequency may not accurately reflect the preference's impact on industry performance. In particular, although the preference likely improves industry viability by lowering costs, linking the preference's impact to route changes may be difficult and/or overly burdensome to the industry.</p>
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6. Financial Institutions' Income from Certain Airplane Loans (Business and Occupation Tax)

Legislative Auditor recommendation: Clarify the intent and duration

The Legislature should clarify the intent and duration of the tax preference. If the preference is intended to provide targeted financial relief to Washington-based airlines, the Legislature should add a performance statement and determine whether the relief is meant to be permanent or time-limited.

<p>Commission Comment</p>	<p>Continue and clarify intent only.</p>	<p>Given the Legislature did not add an expiration date in 2010, it can be inferred the tax preference was not intended to be time limited. However, the Legislature should add an explicit performance statement. This would bring it in line with the Legislature's current requirement that similar tax arrangements have an explicit performance statement. Such a statement would aid future reviews by removing any ambiguity about the Legislature's intent.</p>
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Citizen Commission for Performance Measurement of Tax Preferences

Commission Comments Adopted on 10/9/2019

7. Hog Fuel to Produce Energy (Sales and Use Tax)

Legislative Auditor recommendation: Continue if facilities keep achieving the 75% job retention goal

The Legislature should continue the preference because the statutory employment goal is being met.

The Legislature should monitor facility employment levels through 2023 to determine if they continue to meet statutory goal.

- If employment levels continue to meet the statutory goal, then the Legislature will need to decide in the 2024 legislative session whether to extend the preference and re-state or update employment goals.
- If employment levels do not continue to meet the statutory goal, then the Legislature should allow the preference to expire on June 30, 2024.

Commission Comment	Endorse LA recommendation with comment.	If employment goals are not met at any time, the Legislature should analyze whether the tax preference should be continued based on a differing set of goals. The jobs protected by this tax provision are often located in rural parts of the state that continue to struggle with good job opportunities for its citizens.
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8. Modifying Large Private Airplanes Owned by Nonresidents (Sales and Use Tax)

Legislative Auditor recommendation: Continue and clarify the objective

The Legislature should continue the preference by extending the expiration date before it is scheduled to expire on July 1, 2021.

Since the preference was enacted, several large private airplanes have been modified, or are currently being modified, in Washington. This work was not conducted in Washington prior to the preference. This work has created new jobs and increased economic activity in Moses Lake and elsewhere in the state.

The preference has had a negligible impact on Washington's broader aerospace manufacturing industry. The Legislature should clarify whether the objective of growing the broader aerospace manufacturing industry is relevant.

If the preference is allowed to expire, the modification activity would likely cease.

Commission Comment	Endorse LA recommendation with comment.	The tax preference should not be linked to an objective of growing broader aerospace manufacturing industry. Public testimony suggests that the preference is promoting economic development and offering highly-paid, skilled employment in a very specialized segment of the aerospace industry. The evidence further suggests that this segment would likely relocate outside of Washington without the preference.
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Citizen Commission for Performance Measurement of Tax Preferences

Commission Comments Adopted on 10/9/2019

9. Property Tax Exemption for Multifamily Housing in Urban Areas (Property Tax)

Legislative Auditor recommendation: Modify

The Legislature should modify the preference to direct cities to include analysis of profitability as a consideration in offering or approving exemptions.

The Department of Commerce should report annually to JLARC and the relevant policy committees on city compliance with the requirements, as well as the metrics in statute and affordability measures.

The Department of Revenue should report to JLARC and the relevant policy committees on which statutory ambiguities can be resolved through guidance and which require statutory changes.

<p>Commission Comment</p>	<p>Endorse LA recommendation with comment.</p>	<p>The Legislature should pay particular attention to reporting guidelines as it applies to low-income units and residents. In particular, the lack of reporting means the actual number of low-income units and associated rents are difficult to identify. This makes it impossible to analyze how the tax preference is impacting the low-income housing supply. Testimony regarding the City of Olympia’s use of the preferences strongly highlights the current reporting problems.</p> <p>The Legislature may want to review how rent limits for low-income households are set. In particular, the Legislature may want to include in the formula an adjustment for a low-income household’s actual income, rather than relying only on a county’s median income.</p> <p>Finally, public testimony raised the important question of whether the introduction of MFTEs in Washington communities has had the unanticipated consequence of increasing rental costs and squeezing out existing affordable housing. More research is needed to investigate the impacts of this preference on housing affordability in Washington.</p> <p>While the commission endorses the intent of the Legislative Auditor’s recommendations to Commerce and Revenue to improve reporting and clarify ambiguities, both departments did not concur and cite resource and authority issues to act on this without further legislative action. However, without improvements in clarity and allowable use, the Legislature will continue having difficulty determining the preference’s success. The commission suggests the Legislature could begin with a workgroup to provide options to improve reporting and consistency of use.</p>
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