Summary of Commission Comments on 2016 Tax Preference Reviews

At its October 14, 2016 meeting, the Citizen Commission for Performance Measurement of Tax Preferences determined whether it wanted to endorse the Legislative Auditor's recommendations or take a different position.

In summary, the Commission took the same position for 14 of the Legislative Auditor's recommendations and took a different position on one.

In addition, the Commission elected to adopt a comment to continue the preference for Grocery Distribution Co-ops. This preference was an expedited review that was not evaluated by the JLARC staff. Further, Commissioner Miller submitted minority report comments on three other expedited preferences.

Preference	*Legislative Auditor Recommendation*	*Commission Position*
Clay Targets Sales and Use Tax	The Legislature should **review and clarify** the sales and use tax exemption for clay targets for nonprofit gun clubs because while the preference is meeting the inferred objective of providing tax relief to nonprofit gun clubs, it is unclear if the actual fiscal impact reasonably conforms to the 2013 fiscal estimate.	**Endorse** the Legislative Auditor's recommendation. As the Legislature reviews this preference related to the actual fiscal impact, they should also review whether non-profit gun clubs are facing financial distress. If not, the tax preference may no longer be necessary. The rationale for most tax preferences can be linked to clear instances of industry stress, competition, or tax structure issues. No such stresses or issues were identified by the preference or the JLARC staff.
Custom Software Sales and Use Tax	The Legislature should **continue** the custom software tax preference because it is achieving the stated public policy objective of making the tax treatment of software clear and certain for developers, programmers, and consumers.	**Endorse** the Legislative Auditor's recommendation without comment.
Customer Generated Power Public Utility Tax	The Legislature should **review and clarify** the preference because while there has been growth in locally made systems and associated opportunities for businesses, this growth is concentrated in a small number of solar energy system manufacturers. As part of the clarification, the Legislature should include targets for how many new local renewable energy systems it hopes to create and how much power capacity it hopes to generate through the use of this preference, as well as which local industries it would like to support.	**Endorse** the Legislative Auditor's recommendation. The Legislature should more clearly define targets for installations and generation. This would include targets for both residential, commercial, and community solar installations. In addition, based on written testimony from Inland Power and Light (a cooperative headquartered in Spokane County), the Legislature may want to consider a utility's administrative costs related to managing customer-installed solar panels. The testimony from Inland Power and Light indicates administrative costs are not fully compensated under the current tax preference.

Preference	*Legislative Auditor Recommendation*	*Commission Position*
Data Center Equipment Sales and Use Tax	The Legislature should **continue** the data center sales and use tax exemption because the stated public policy objectives of increased rural property values and rural property taxes from investment in data center construction in rural Washington counties are being achieved.	**Endorse** the Legislative Auditor's recommendation. JLARC staff's research confirms that this preference is currently meeting its intent. However, in light of competition to attract this industry, the Legislature should periodically evaluate whether the economic benefits of the data centers really exceed the cost of the tax incentives required over the long term to attract them. Other regions offering competing tax incentives admit uncertainty regarding whether or not the long-run benefits exceed the costs. However, local pressure to increase employment in the face of weak economic growth may override the ability of policy makers to pause to consider longer-run cost issues.
Flavor-Imparting Items Sales and Use Tax	The Legislature should **review and clarify** the sales and use tax exemption for flavor-imparting items because while the preference is achieving the stated public policy objective of providing tax relief to restaurant owners, it is unclear if the actual fiscal impact substantially conforms with the 2013 fiscal estimate.	**Endorse** the Legislative Auditor's recommendation. While the stated objective of this preference was to provide tax relief, it also avoided a tax dispute between the Washington Department of Revenue and taxpayers regarding the application of the ingredients exemption to the retail sales tax. As the Legislature reviews the actual fiscal impact of this preference, it should also consider continuing it as a clarification of longstanding sales tax principles.
Fuel Used by Mint Growers Sales and Use Tax	The Legislature should allow the sales and use tax exemption for propane and natural gas used by mint growers to **expire** as scheduled on July 1, 2017, because it is likely not providing enough of an incentive for mint growers to convert the remaining six stills from diesel fuel. If the Legislature wants to create an incentive for the remaining six mint stills to convert to one of the cleaner fuels, it may want to consider different types of tax preferences that can apply to both propane and natural gas.	**Endorse** the Legislative Auditor's recommendation without comment.

Preference	*Legislative Auditor Recommendation*	*Commission Position*
Nonresident Large Airplanes Sales and Use Tax	The Legislature should **review** prior to expiration in 2021. It is not yet possible for JLARC staff to estimate the impact of this preference. There are no formal records of the use of this preference. However, after this report's initial publication, which included a recommendation to allow the preference to expire in 2021 if it was not being used, and after the Citizen Commission held two meetings seeking testimony, two companies contacted JLARC staff indicating they are conducting work that would qualify for this exemption. Therefore, prior to its July 2021 expiration date, the JLARC staff should review this preference again to determine the extent of its use and economic impact. The Legislature will then have more complete information to help determine whether the preference is achieving the stated public policy objectives.	The Legislature should **continue** the preference. While it appears the preference has not been used to date, it provides an opportunity for local companies to better compete on future bids for this type of work. The Commission believes the preference should continue at this time and defers a conclusion on the expiration date until it is reviewed again in 2019.
Rural Electric Cooperative Finance Organization Business and Occupation Tax	The Legislature should **modify** the B&O tax preference for rural electric cooperative finance organizations because, as currently structured, there is no guarantee that the savings realized by finance organizations will be passed on to Washington rural electric cooperatives and their customers, as the Legislature intended.	**Do not endorse** the Legislative Auditor's recommendation. The Legislature should **continue** the preference. The organization to which this exemption applies is a federally chartered organization created to provide cost effective financing to rural electric cooperatives. Savings due to the preference are likely passed on to all rural utility customers across the nation through electric rates. To assure that the benefit of the exemption is solely received by Washington based cooperatives, such cooperatives must bear the cost of this tax from which they are otherwise exempted by this law. Accordingly, such a clarification is unnecessary, would force the cooperative to amend its bylaws and rules for no reason, and will undoubtedly create undue confusion.

Preference	*Legislative Auditor Recommendation*	*Commission Position*
Self-Service Laundry Facilities Sales and Use Tax	The Legislature should **continue** the sales and use tax exemptions for self-service laundry facilities because it is achieving the inferred public policy objectives of providing consistent tax treatment to all self-service laundry facilities and helping people with low incomes who may be more likely to use these facilities.	**Endorse** the Legislative Auditor's recommendation. Testimony from owners of coin-operated laundry operations noted that there is an increasing bias towards low-income individuals using their services. That is, because laundry hookups are now standard in many upper- and middle-income apartment units, fewer of these apartment residents need coin-operated laundromats. This has shifted the customer base to a larger share of low-income individuals. As a result, the number of coin-operated laundromats has significantly fallen.
Semiconductor Materials Manufacturing: Multiple Taxes	For the six preferences not currently in effect, the Legislature should **terminate** the preferences because they have not been used in the thirteen years since they were enacted. The Legislature should **review and clarify** the two preferences currently in effect because while there has been one significant construction project, it is unclear what employment outcomes the Legislature wants to achieve. As part of the clarification, the Legislature should add uniform reporting requirements and targets for employment growth and wages to facilitate future reviews.	**Endorse** the Legislative Auditor's recommendation. In addition to JLARC staff's research, a recent research paper released by the Congressional Research Service (CRS) on the U.S. semiconductor industry highlights some important points. First, the CRS study finds that about 87% of fabrication is located outside of the U.S. with little evidence this will change significantly in the future. Second, between 2001 and 2015 U.S. employment in semiconductor manufacturing has fallen 38%. Third, the decline in employment reflects both the shift of production to outside of the U.S.; increasing automation of production facilities; and a shift in favor of U.S. employment focused on semiconductor design work. The trends laid out by the CRS paper suggest that the current set of preferences will be, for the foreseeable future, underutilized or not utilized.
Solar Energy and Silicon Product Manufacturers Business and Occupation Tax	The Legislature should **review and clarify** the B&O tax preference for solar energy and silicon product manufacturers because the intent statement appears narrower than the types of businesses that qualify for the preference. In clarifying, the Legislature should provide a performance statement and relevant metrics such as a jobs target to measure the preference's effectiveness.	**Endorse** the Legislative Auditor's recommendation without comment.

Preference	*Legislative Auditor Recommendation*	*Commission Position*
Standing Timber Real Estate Excise Tax	The Legislature should **continue** the real estate excise tax exemption for standing timber sales because it is achieving the inferred objective of helping Washington's wood products and timber businesses adjust to structural changes in the industry.	**Endorse** the Legislative Auditor's recommendation without comment.
Syrup Taxes Paid Business and Occupation Tax	The Legislature should **repeal the syrup tax and the associated B&O tax credit** because the syrup tax preference is not providing all of the intended tax relief for businesses that buy syrup; and the Legislature made policy decisions to eliminate the VRDE account and no longer dedicate syrup tax revenues to violence reduction and drug enforcement.	**Endorse** the Legislative Auditor's recommendation. The Commission recommends repealing the B&O tax credit contingent upon also repealing the underlying syrup tax.
Timber and Wood Products Reduced Business and Occupation Tax	The Legislature should **review and clarify** the timber and wood products preferential B&O rate because while it is reducing the cost of business, it is unclear how it is impacting employment and competitiveness. As part of the clarification, the Legislature should provide a performance statement identifying the public policy objectives and providing targets and metrics to measure whether the objectives have been achieved.	**Endorse** the Legislative Auditor's recommendation. The preference for timber and wood products may be helping offset environmental costs not borne by foreign competitors. The Legislature should review and clarify the preference, to provide a more measurable performance statement. As it undergoes this review, the Legislature should also measure the tax burden of this extractive and manufacturing industry and consider whether there is a disproportionate burden of B&O tax that is not faced by other industries or its competitors in other taxing jurisdictions.
Trade-ins Sales and Use Tax	The Legislature should **review and clarify** the sales tax exemption for trade-ins because, while the preference is achieving the inferred objectives of reducing consumers' taxes and making Washington's tax treatment consistent with other states, it is not achieving the inferred objective of stimulating enough additional sales to replace lost revenue.	**Endorse** the Legislative Auditor's recommendation. As the Legislature reviews this preference, the Commission notes that this tax preference is similar to the tax treatment of trade-ins in many other states, due to concerns of double taxation. Additionally, the JLARC staff's review concludes the $182 million associated with automobile sales is estimated to only generate $31 million in new sales, causing a net loss of $151 million in tax revenue.

In addition to adding comments to reviews conducted by JLARC staff, the Commission also adopted a comment to an Expedited Review. Expedited Reviews are completed by commissioners, based on information supplied by the Department of Revenue: they do not contain a Legislative Auditor recommendation.

Grocery Distribution Co-Ops Business and Occupation Tax
Commission comment: The Legislature should continue the preference. This preference is structural and necessary to level the playing field between independent and vertically integrated stores.

In addition, Commissioner Miller added minority report comments to the following expedited preference reviews.

Computers for Publishers (Sales and Use Tax) Commissioner Miller comment: The Legislature should repeal the preference. A unique economic hardship does not exist in the printing and publishing industry to justify the State of Washington supporting the industry through a tax preference. It has been suggested this tax break was put in place to assist newspapers with the rise of internet based media. That trend has been occurring for over 15 years, so it is time for newspapers to compete in the free market without support from Washington state taxpayers.
Nonprofit R&D (Business and Occupation Tax) Commissioner Miller comment: The Legislature should repeal the preference. On the face of it, nonprofit R&D is probably a good investment for Washington State. However, the dollar amount of a tax preference should not be hidden from the taxpayers of Washington State. Repeal would force the recipients of this preference to publicly identify themselves and the amount of the tax preference they receive. This information would be helpful for the Citizen Commission's effort to assess the value of the tax preference.
Public Corporations (Property Tax) Commissioner Miller comment: The Legislature should review and clarify this preference. This tax preference is far too broad. Public housing sites should not be thrown in with convention centers and public transportation. Using such a broad category makes it nearly impossible to assess the impact of the tax preference. The Legislature should break this tax preference into multiple preferences that include similar property use.