State of Washington

Citizen Commission for Performance Measurement of Tax Preferences

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Citizen Commission for Performance Measurement of Tax Preferences
Meeting Minutes

October 11, 2011
John A. Cherberg Bldg.,
Senate Hearing Rm. 3
Olympia, WA

Members Present:

William A. Longbrake
Paul Guppy
Stephen Miller
Sen. Craig Pridemore

Members Absent:

Lily Kahng
James Bobst
Brian Sonntag

Staff:

Keenan Konopaski
Mary Welsh
Peter Heineccius
Cindy Evans
John Woolley
Dana Lynn
Suzanne Kelly
Lisa Hennessy

WELCOME / INTRODUCTIONS

Commission Chair Bill Longbrake welcomed those in attendance and called the meeting to order at 2:00 p.m.

APPROVAL OF MEETING MINUTES

MOTION: A motion was made to approve the September 23, 2011, meeting minutes.

The motion was seconded and carried.

STAFF REPORTS

John Woolley presented the Scope and Objectives for the 2012 Tax Preference Reviews.

Mr. Woolley also discussed the nonresident sales tax exemption with respect to comments made at the September 23, 2011, Commission meeting by the representative of the Washington State Budget & Policy Center.

2012 COMMISSION MEETING SCHEDULE

A draft 2012 Commission meeting schedule was presented. John Woolley explained agenda items and a new timeline and process for finalizing the next 10-year tax preference review schedule.

MOTION: A motion was made to approve the 2012 meeting schedule.

The motion was seconded and carried.

DISCUSSION / APPROVAL OF COMMISSION COMMENTS ON 2011 TAX PREFERENCE REVIEWS

Chair Longbrake reviewed the process to approve Commission comments on the 2011 Tax Preference Reviews. The Commission agreed to include statements of rationale as official parts of the record. The Commission discussed the 2011 Tax Preference Reviews.

MOTION: A motion was made to acknowledge receipt of the 2011 JLARC Tax Preference Reviews of **boat sales to nonresidents and foreign residents; church camps; display items for trade shows; interest from state/municipal obligations; interstate bridges; investment of businesses in related entities; laundry for nonprofit health care facilities; nonprofit blood and tissue banks; nonprofit day care centers; open space compensating tax; real estate excise tax exemptions; sales or use tax paid in another state; and state chartered credit unions**. The Commission has provided a forum for discussion and public comment on these recommendations. The Commission endorses the JLARC recommendations for these preferences. The Commission does not have additional comments to append to the 2011 JLARC reports related to these preferences.

The motion was seconded and carried.

MOTION: The Commission acknowledges receipt of the 2011 JLARC Tax Preference Review of **sales of goods to certain nonresidents for use out-of-state**. The Commission has provided a forum for discussion and public comment on this review. The Commission does not endorse the JLARC recommendation for this review because there is ambiguity about the Legislature's public policy objective and the economic benefits and costs; the Legislature should review and clarify the public policy objective and evaluate the economic impacts of this preference.

Rationale: The Legislature has not stated an explicit public policy objective for this preference. However, based on various commentaries and patterns of practice, JLARC staff determined that the "implied" public policy objective is to remove a disincentive for nonresidents to purchase goods in Washington. The beneficiaries are businesses that have greater sales than otherwise might be the case, thus benefiting the state's economy. However, it is possible that many of the purchases of goods benefiting from this preference would have occurred in the absence of this preference. To the extent that this has occurred, the state is sacrificing revenue without realizing any offsetting economic benefits. For example, it is possible that purchase of high value items could decline in the absence of this preference while the impact on purchase of low value items might be limited. While it would be difficult and expensive to conduct a thorough analysis of costs and benefits of this preference, it would be useful for the Legislature to consider the benefits and consequences that might stem from limiting the items and geographies covered by this preference.

The motion was seconded and carried.

MOTION: A motion was made to acknowledge receipt of the 2011 JLARC Tax Preference Reviews of **municipal sewer charges, and extracted fuel**. The Commission has provided a forum for discussion and public comment on these recommendations. The Commission endorses the JLARC recommendations for these preferences. The Commission does not have additional comments to append to the 2011 JLARC reports related to these preferences.

The motion was seconded and carried.

MOTION: The Commission acknowledges receipt of the 2011 JLARC Tax Preference Review of **aircraft fuel, exports, and commercial use**. The Commission has provided a forum for discussion and public comment on this review. The Commission endorses the JLARC recommendation for this review, and encourages the Legislature to state the public policy objectives of the preference and narrow the scope of the preference commensurate with the stated public policy objectives.

Rationale: The JLARC staff study indicates that there are two implied public policy objectives for this preference. The first is that parties benefiting from the expenditure of aircraft fuel tax receipts were the ones that paid the tax. This implied public policy objective is not being met. The second implied public policy objective was to comply with U.S. Constitutional prohibitions on taxing goods in interstate commerce. However, in many instances the tax could be levied and comply with the U.S. Constitution provided that credit was provided for taxes paid in other states.

The motion was seconded and carried.

MOTION: The Commission acknowledges receipt of the 2011 JLARC Tax Preference Review of **interest on real estate loans**. The Commission has provided a forum for discussion and public comment on this review. The Commission endorses the recommendation that the Legislature should review and clarify the public policy objective of the preference and should consider whether the preference is essential to maintaining competitive residential lending capability for state-domiciled residential real estate lenders.

Rationale: The Legislature did not specify a public purpose for this preference. JLARC staff inferred from the record that the implied public policy purpose was to encourage Washingtonians to buy homes by making loans more available and less expensive. However, if the deduction were to be removed, the holder of the residential mortgage loan would bear the full burden rather than the borrower, unless the elimination of the deduction applied only to loans originated or purchased after the effective date of the repeal of the deduction. On a prospective basis the portfolio lender could attempt to recoup the cost of the B&O tax by charging a higher interest rate to the borrower; however, the mortgage market is national in scope, which virtually makes it impossible to charge interest-rate differentials on a geographic basis.

As is often the case when the B&O gross receipts tax is involved in a preference, another unstated public policy purpose may be to assure competitive balance with similarity situated business firms in other states subject to other types of tax regimes. The Commission received testimony that removal of the deduction would place a burden on state-domiciled residential mortgage lenders that retain the loans they originate in their portfolios.

The motion was seconded and carried.

MOTION: The Commission acknowledges receipt of the 2011 JLARC Tax Preference Review of the **limited income property tax deferral**. The Commission has provided a forum for discussion and public comment on this review. The Commission endorses the recommendation that the Legislature should clarify the preference to define "families in economic crisis" and, if the Legislature determines to continue the preference, identify measurable evaluation criteria; however, the Commission notes that costs to administer the program are considerable relative to the participation rate and, as such, it might be appropriate to terminate the preference unless the preference can be restructured in a way that assures cost effective achievement of the public policy objectives.

Rationale: To date only 181 out of an estimated 425,000 potential participants have taken advantage of the preference. Participant benefits in the 2009-11 biennium were $270,891 while costs to administer the preference were $350,184 for fiscal years 2009, 2010, and 2011. JLARC staff recommends that the Legislature clarify the definition of "families in economic crisis". While this might result in increasing the participation rate, it is possible that the low participation rate also results from the eligibility criteria and the design of the program. Furthermore, it is not clear that the preference, as designed, is serving a critical public policy purpose of helping families in economic crisis. If the Legislature determines that is the case, the Commission believes it would be better to terminate the preference and save the state costs of administering the program.

The motion was seconded and carried.

MOTION: The Commission acknowledges receipt of the 2011 JLARC Tax Preference Review of **meat processors**. The Commission has provided a forum for discussion and public comment on this review. The Commission endorses the recommendation that the Legislature should review and clarify the public policy purpose of the preference and further recommends that the Legislature determine whether the tax differential provides approximate competitive parity with state tax rates and geography-based differences in other business costs for meat processors domiciled in other states.

Rationale: Meat processing is a highly competitive, low margin business. This means that small differentials in state tax rates and other costs of business, such as transportation expenses, can have significant impacts on profitability and impact locational decisions. Public testimony provided to the Commission argued that the preferential tax rate for meat processors is comparable to the maximum corporate tax rate in other western states.

The motion was seconded and carried.

MOTION: The Commission acknowledges receipt of the 2011 JLARC Tax Preference Review of **nonprofit sheltered workshops**. The Commission has provided a forum for discussion and public comment on this review. The Commission endorses the recommendation that the Legislature should review and clarify the public policy objective of the preference and further recommends that the Legislature evaluate whether the preference is necessary any longer to encourage employment of persons with disabilities.

Rationale: Although the statute does not state a public policy purpose, the implied purpose was to encourage employment of persons with disabilities in sheltered workshops. Since the enactment of this preference in 1970 the Federal government enacted the Americans with Disabilities Act in 1990. In response, over time employers have made efforts to employ persons with disabilities, frequently with beneficial economic results. In addition, the state has taken initiatives, beginning in 1992, to encourage employment of persons with disabilities. Thus, the need for sheltered workshops to employ persons with disabilities has diminished since enactment of the preference. While the preference clearly benefits established sheltered workshops, it is no longer clear that this preference is necessary to assure employment of persons with disabilities.

The motion was seconded and carried.

MOTION: The Commission acknowledges receipt of the 2011 JLARC Tax Preference Review of **shared real estate commissions**. The Commission has provided a forum for discussion and public comment on this review. The Commission endorses the recommendation that the Legislature should clarify the B&O tax preference for shared real estate commissions and further recommends that the Legislature align B&O tax treatment of real estate brokers and agents to brokers and agents in other industries unless there is a compelling reason for differential treatment.

Rationale: The standard approach to applying the B&O tax to commissions received by brokers and agents is that the broker is taxed on the full amount of the commission and the agent, if any, who receives a portion of the broker's commission, must pay an additional B&O tax on the amount he/she receives. This approach is the standard for all but real estate brokers and agents in which case real estate agents are exempted from paying B&O tax. The Legislature did not specify a public policy objective for differential treatment between real estate agents and agents in other industries, such as insurance and investment services. The Washington Realtors, in a letter to the Commission, presented information which may be pertinent to the Legislature's consideration of this preference; however, this information also appears to be pertinent to brokers and agents in other industries and, as such, does not address the issue of differential treatment.

The motion was seconded and carried.

MOTION: A motion was made to acknowledge receipt of the 2011 JLARC Tax Preference Review of **renewable energy machinery**. The Commission has provided a forum for discussion and public comment on this review. The Commission endorses the JLARC recommendation for this preference. The Commission does not have additional comments to append to the 2011 JLARC reports related to this preference.

The motion was seconded and carried.

MOTION: The Commission acknowledges receipt of the 2011 JLARC Tax Preference Review of **hog fuel to produce energy**. The Commission has provided a forum for discussion and public comment on this review. The Commission does not endorse the recommendation that the Legislature should allow the sales and use tax exemptions for hog fuel to expire because it is unclear that the Legislature intended the exemptions in this preference to be temporary. The Commission recommends that the Legislature review available evidence before determining whether to let the preference expire. Further, if the Legislature determines to extend the preference, the Commission recommends a two year extension, and that performance goals (public policy objectives) be specified and reporting be required to enable subsequent assessment of the benefits and costs of the preference.

Rationale: Although the Legislature did not specify a public policy objective for this preference, public testimony provided to the Commission argued that the public purpose was summarized in testimony on SB 5442, which was a precursor to SB 6170, which included the hog fuel tax preference: "*The forestry industry is facing an economic crisis, and this bill will help preserve jobs, promote healthy forest, and ensure CO2-neutral energy by encouraging the use of woody biomass. The forestry industry in eastern and western Washington is distressed, which is stressing rural local governments and social programs. This bill will help preserve the forestry industry and thereby rural economies."*

As the JLARC study points out part of the rationale for the hog fuel tax preference may have been because hog fuel was less competitive during a time of declining oil prices. Because the price of oil since enactment has risen, presumably the economic disadvantage no longer exists. However, public testimony provided to the Commission asserted that the more relevant alternative fuel price is natural gas rather than oil and, further, because of significant structural changes in the market for natural gas the price of natural gas has declined significantly since the hog fuel preference was enacted. Public testimony also pointed out that since hog fuel must be transported, diesel fuel costs, which are subject to tax, have risen along with oil prices, and this has exacerbated hog fuel's price competitiveness relative to natural gas.

Hog fuel is a low-cost raw material (LCRM). Utilizing this LCRM produced at sawmills and chipping facilities creates a low cost energy source for those who burn it to produce green energy. Utilizing the LCRM prevents the need to stockpile mountains of this material on property which creates safety issues such as fire hazards. Burning LCRM for the production of energy is the primary way to deal with this material on a large-scale basis. Relying on the LCRM to produce energy would significantly reduce dependence on fossil fuels.

Public testimony suggested that the Legislature extend the hog fuel tax preference for two years subject to collection of sufficient data to evaluate the public policy merits of this preference.

The motion was seconded and carried.

MOTION: A motion was made to include the following general comment in the 2011 Tax Preference Reports:

"The Legislature frequently specifies an expiration date when it enacts a tax preference statute. JLARC staff and the Citizens Commission for Performance Measurement of Tax Preferences (Commission) have had difficulty in discerning the Legislature's intent for some preferences. An expiration date could simply mean that the Legislature intends to review experience with the preference before determining whether to extend it. Or, the Legislature can intend the preference to be temporary in response to short-term economic or industry conditions with the expectation that the preference will not be extended. Absence of explicit legislative guidance on the intended meaning of "expiration date" led JLARC staff to conclude that the Hog Fuel to Produce Energy preference should be allowed to expire because the Legislature intended the exemptions to be temporary. This interpretation was disputed in public testimony provided to the Commission. Accordingly, the Commission recommends that the Legislature either clarify directly in a tax preference statute the intent of an expiration date or provide commentary in the legislative record that clarifies the intent of an expiration date."

The motion was seconded and carried.

OTHER COMMISSION BUSINESS

The Commission discussed distributing a letter outlining the work of the Commission and urging Legislative action on recommendations made regarding tax preference reviews. The Commission agreed to draft a letter to the Legislature and possibly an op-ed piece for local newspapers.

PUBLIC COMMENT

Pat Holm provided public comment supporting the work of the Commission.

Robert Whitlock, from the Olympia Fellowship of Reconciliation, provided public testimony pertaining to the work of the Commission and the process of tax preference reviews.

With no further public comment Chair Longbrake adjourned the meeting at 3:45 p.m.