State of Washington

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Citizen Commission for Performance Measurement of Tax Preferences

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Meeting Minutes

October 9, 2012
John A. Cherberg Bldg.,
Senate Hearing Rm. 3
Olympia, WA

Members Present:

William A. Longbrake	Stephen Miller
James Bobst	Ruta Fanning
Paul Guppy	Sen. Craig Pridemore

Members Absent:

Brian Sonntag

Staff:

Keenan Konopaski	John Woolley
Mary Welsh	Dana Lynn
Peter Heineccius	Suzanne Kelly
Curt Rogers	Matt Stoutenburg
Stacia Hollar, AG Staff	

WELCOME AND INTRODUCTIONS

Commission Chair Bill Longbrake welcomed those in attendance and called the meeting to order at 2:03 p.m. Keenan Konopaski, Legislative Auditor, introduced a new Joint Legislative Audit and Review Committee (JLARC) staff member, Matt Stoutenburg.

APPROVAL OF MEETING MINUTES

A motion was made to approve the September 14, 2012, meeting minutes.

The motion was seconded and carried.

(See TVW recording at 00:01:36)

ADOPTION OF 2013 COMMISSION MEETING SCHEDULE

The Commission discussed the four proposed Commission meetings scheduled for 2013.

A motion was made to adopt the 2013 Commission meeting schedule.

The motion was seconded and carried.

(See TVW recording at 00:01:58)

DISCUSSION AND APPROVAL OF COMMISSION COMMENTS ON 2012 TAX PREFERENCE REVIEWS

Chair Longbrake reviewed the process to approve Commission comments on the 2012 Tax Preference Reviews. The Chair noted the written comments submitted by Commissioners and solicited any additional proposals or comments from the Commissioners. The Commission discussed the 2012 Tax Preference Reviews, as well as three reviews completed in 2010. (See TVW recording at 00:04:11)

MOTION: The Commission acknowledges receipt of the 2012 JLARC Tax Preference Reviews of: **Annuities (Insurance Premiums Tax)**; **Business Inventories (Property Tax)**; **Condominium and Homeowner Maintenance Fees (Business & Occupation [B&O] Tax)**; **Health Insurance by State Pool (Insurance Premiums Tax)**; **Insurance Guaranty Funds (Insurance Premiums Tax)**; **Leases Under $250 per Year and Short Term Leases (Leasehold Excise Tax)**; **Natural and Manufactured Gas (Sales and Use Tax)**; **Special Fuel Use Exemptions (Fuel Tax)**; and **Urban Passenger Transit Fuel (Sales and Use Tax)**. 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 2012 JLARC reports related to these preferences.

The motion was seconded and carried.

(See TVW recording at 00:05:25)

MOTION: The Commission acknowledges receipt of the 2012 JLARC Tax Preference Review of **Ferry Boats (Sales and Use Tax)**. 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 and provides the following additional comments.

Commission Comment: The Commission does not endorse the recommendation to continue the preference and encourages the Legislature to review and clarify the public policy intent of the preference.

Rationale: The JLARC staff study infers the public policy objective is to support state and local governments by reducing the cost of building and repairing ferry vessels owned and operated by state or local government entities. The principal beneficiary of this preference is Washington State Ferries. If the preference were terminated, state and local government entities that operate ferries in Washington would have to pay sales and use tax, which presumably would be a burden on state and local entities' finances. However, because state and local entities that operate ferries charge fees to users of ferries, it would be possible for those entities to raise user fees to recover the amount of sales and use tax. Thus, in effect, this preference is a subsidy that reduces the fees paid by users of ferries. The Commission recommends that the Legislature review and clarify the public policy objective of this preference and determine whether the intent of the preference is to subsidize public use of ferries. If that is not the public policy intent, the Legislature should consider terminating this preference.

The motion was seconded and carried.

(See TVW recording at 00:07:55)

MOTION: The Commission acknowledges receipt of the 2012 JLARC Tax Preference Reviews of: **Fish Tax Differential Rates (Enhanced Food Fish Tax)**; **Precious Metals and Bullion (B&O Tax)**; **Precious Metals and Bullion (Sales and Use Tax)**; and **Solar Energy and Silicon Product Manufacturers (B&O Tax)**. The Commission has provided a forum for discussion and public comment on these reviews. The Commission endorses the JLARC recommendations for these reviews, and does not have additional comments.

The motion was seconded and carried.

(See TVW recording at 00:14:08)

MOTION: The Commission acknowledges receipt of the 2012 JLARC Tax Preference Review of **Biotechnology Manufacturing (Sales and Use Tax)**. 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 and provides the following additional comments.

Commission Comment: The Commission does not endorse the recommendation that the Legislature should review and clarify this tax preference and recommends that the Legislature take no action and allow this preference to expire in 2017, as scheduled.

Rationale: The JLARC audit staff was unable to determine the impact, if any, this preference has had on encouraging investment and creating jobs. Additionally, there is no evidence that this industry needs this preference for unique competitive conditions. No testimony was provided by beneficiaries in support of continuing this tax preference.

The motion was seconded and carried.

(See TVW recording at 00:15:38)

MOTION: The Commission acknowledges receipt of the 2012 JLARC Tax Preference Review of **Commuting Programs (Multiple Taxes)**. 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 and provides the following additional comments.

Commission Comment: The Commission does not endorse the recommendation that the Legislature should review and clarify the public policy objective of the preference and determine whether it is necessary any longer to encourage trip reduction activities. The Commission recommends that the Legislature allow the preference to expire as scheduled on June 30, 2013.

Rationale: The Legislature did not specify a public policy purpose for this preference. JLARC staff inferred from the record that the implied public policy purpose is to encourage businesses to provide financial incentives to their employees who participate in commute trip reduction programs. This preference may no longer be essential to achieve the implied public policy objective because many businesses offer trip reduction financial incentives to employees as a standard component of their employee benefit programs. In 1994, the Department of Revenue stated that many firms already had commute trip reduction programs in place and tax credits were not expected to generate significantly higher participation in such programs. The Commission believes that expiration of this preference would be unlikely to result in a material reduction in businesses' provision of trip reduction financial incentives to employees.

The motion was seconded and carried.

(See TVW recording at 00:20:34)

MOTION: The Commission acknowledges receipt of the 2012 JLARC Tax Preference Reviews of **High Technology R&D (Sales and Use Tax)** and **High Technology R&D (B&O Tax)**. The Commission has provided a forum for discussion and public comment on these reviews. The Commission does not endorse the JLARC recommendation for this review and provides the following additional comments.

Commission Comment: The Commission does not endorse the recommendation that the Legislature review and clarify this tax preference and recommends that the Legislature allow the B&O tax credit and sales and use tax deferral/waiver to expire in 2015, as scheduled.

Rationale: The JLARC audit staff study provided substantive evidence that these tax preferences created approximately 454 new jobs between 2004 and 2009 at an overall cost in terms of foregone tax revenue of approximately $20.5 million per year or $45,000 per job. However, new earnings per job were estimated to amount to $25,000. Even allowing for measurement errors, it is clear that the cost of these preferences greatly exceeds the estimated benefits. Industry representatives provided general information in support of these tax preferences. However, they did not provide tangible evidence to refute the findings of the JLARC staff study nor did they provide alternative evidence of a direct link between these tax preferences and significant job creation.

Industry representatives testified that competition from other states to attract high technology R&D companies is intense, but provided no evidence that investment in high technology R&D would decline meaningfully if this tax preference were terminated.

An industry representative testified that these preferences are important for industry profitability. However, since most participants in this industry are neither fledgling nor facing unique short-term competitive pressures, financially supporting the industry through these tax preferences appears to be of little or no value.

The Legislature's objective to create "quality" employment opportunities in the state might be achieved more cost effectively in other ways such as partnering with the high technology R&D industry to provide educational and training programs that develop human resources skills needed by the industry.

The motion was seconded and carried.

(See TVW recording at 00:29:20)

MOTION: The Commission acknowledges receipt of the 2012 JLARC Tax Preference Review of **Insurance Producers, Title Insurance Agents, and Surplus Line Brokers (B&O Tax)**. The Commission has provided a forum for discussion and public comment on this review. The Commission endorses the JLARC recommendation for this review and provides the following additional comments.

Commission Comment: The Commission endorses the recommendation that the Legislature should review and clarify the public policy purpose of the preference and unless there is a compelling reason for a differential rate, the Legislature should increase the tax rate to provide equivalent tax treatment with businesses with similar agent/sub-agent relationships.

Rationale: The JLARC staff study documents numerous changes in this tax preference between its initiation in 1935 and the most recent change in 2009. Beginning in 1995 the Legislature has reduced the tax rate on insurance commissions from 1.172% of insurance commissions to 0.484%. The Legislature provided no economic or competitive rationale for the reductions in the tax rate. Over the same time period, the Legislature has reduced the tax rate on real estate commissions from 2.13% to 1.80%. It should be noted that pyramiding of B&O taxes applies to insurance agents but not to real estate agents, pursuant to a 1992 state Supreme Court case that ruled that insurance agents are not entitled to the same exemption that removed tax pyramiding for real estate agents. Adjusting the current insurance commissions tax rate for pyramiding results in a combined B&O tax rate of 0.726% compared to 1.80% for real estate services. In public testimony, representatives of insurance agents pointed out that commission rates are established by insurance companies. Thus, there are limitations on how agents can recover costs directly from policyholders if there is an increase in the insurance commissions B&O tax rate. However, no evidence was provided for why a lower tax rate relative to similar agent/sub-agent relationships in other industries is appropriate.

The motion was seconded and carried.

(See TVW recording at 00:36:33)

MOTION: The Commission acknowledges receipt of the 2012 JLARC Tax Preference Reviews of **Stevedoring (B&O Tax)** and **International Charter and Freight Brokers (B&O Tax)**. The Commission has provided a forum for discussion and public comment on these reviews. The Commission does not endorse the JLARC recommendations for these reviews and provides the following additional comments.

Commission Comment: The Commission does not endorse the JLARC staff recommendation to review and clarify these two preferences and recommends that the Legislature should terminate both of these preferential tax rates.

Rationale: The apparent original intent of providing a preferential tax rate in 1979 was to maintain an equivalent tax burden after a U.S. Supreme Court decision eliminated the tax exemption of certain stevedoring activities. While the industry has argued that the preferential rate is justified for competitive reasons, the industry has never provided substantiation for this claim. In testimony provided to the Commission by a representative of these industries, no substantive evidence was provided that elimination of this preference would harm the competitiveness of Washington's ports materially. In response to a question during public testimony, an industry representative acknowledged no competing west coast ports in the U.S. receive a similar tax break. The JLARC staff study indicated that it is unclear that the preferential B&O tax rate has had any role in making Washington's ports more competitive. Therefore, the Commission recommends that the Legislature stop supporting these industries financially by terminating the preferential tax rates.

The motion was seconded and carried.

(See TVW recording at 00:39:50)

MOTION: The Commission acknowledges receipt of the 2012 JLARC Tax Preference Review of **Travel Agents and Tour Operators (B&O Tax)**. 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 and provides the following additional comments.

Commission Comment: The Commission does not endorse the JLARC audit staff recommendation to review and clarify the preference and recommends that the Legislature terminate the preferential tax rate for travel agents and tour operators.

Rationale: JLARC audit staff documented that circumstances in the travel industry have changed since this preference was established. Based on the JLARC staff analysis, it appears there are no longer competitive reasons to continue the preference and thus retention of the preference simply increases commissions for travel agents. Moreover, administrative considerations, which prompted the Department of Revenue to request the Legislature extend the preference to tour operators, no longer exist. Because there is no apparent compelling reason any longer for preferential tax treatment, the Legislature should terminate this preference.

The motion was seconded and carried.

(See TVW recording at 00:44:11)

MOTION: The Commission acknowledges receipt of the 2012 JLARC Tax Preference Review of **Minor Final Assembly Completed in Washington (B&O Tax)**. The Commission has provided a forum for discussion and public comment on this review. The Commission endorses the JLARC recommendation for this review, and does not have additional comments.

The motion was seconded and carried.

(See TVW recording at 00:47:11)

MOTION: *NOTE: During consideration of this item, Commissioner Bobst declared a conflict of on this issue because his employer operates an interstate trucking company.*

A motion was made to append an additional comment to the Commission's previous comments on the 2010 JLARC Tax Preference Reviews of:
Interstate Transportation - Through Freight (Public Utility Tax);
Interstate Transportation - In-State Portion (Public Utility Tax); and
Interstate Transportation - Shipments to Ports (Public Utility Tax).

2012 Additional Commission Comment: The Commission notes that the Legislature took no action on the Commission's recommendation, and notes that the fiscal impact of these preferences exceeds $100 million per biennium. The Commission therefore recommends that the Legislature mandate JLARC to conduct an economic impact study of the preferences and appropriate sufficient resources to conduct this study. After the 2013 session, if the Legislature has taken no action the Commission will consider whether to schedule these preferences for further review.

The motion was seconded and carried.

(See TVW recording at 00:49:03)

The Commission also discussed making comments of a more general nature, not related to specific tax preferences.

MOTION: The Commission will incorporate the Legislative Auditor's responses to the Commission Chair's questions regarding the Pew Center's report into JLARC's 2012 report to the Legislature.

The motion was seconded and carried.

(See TVW recording at 01:36:52)

The Commission discussed and deferred further consideration of proposed suggestions to improve the effectiveness of using tax preferences. (See TVW recording at 01:38:56)

MOTION: The Commission endorses the JLARC staff recommendations to the Department of Revenue and the Office of Financial Management contained in the 2012 Tax Preferences report.

The motion was seconded and carried.

(See TVW recording at 02:02:48)

PUBLIC COMMENT

No members of the public signed up to testify. (See TVW recording at 02:05:20)

PRESENTING COMMISSION COMMENTS TO THE LEGISLATURE

John Woolley, JLARC staff, informed Commissioners that their comments would be incorporated into the final version of the 2012 Tax Preference Reviews, which will then be presented at the January 2013 JLARC meeting, as well as at a joint House and Senate fiscal committee meeting during session.

In addition to distributing the report and comments to the Legislature, the Commission discussed the possibility of meeting with individual legislators to communicate the Commission's comments. At the request of Chair Longbrake, Commissioner Fanning agreed to work with staff to request meetings with legislators. (See TVW recording at 02:05:31)

Chair Longbrake adjourned the meeting at 4:12 p.m.