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 18, 2013
John A. Cherberg Building
Senate Hearing Room 3
Olympia, WA

Members Present:

William A. Longbrake
Ron Bueing
Lily Kahng
State Auditor Troy Kelley
Stephen Miller
Grant Forsyth
Rep. Kathy Haigh

Members Absent:

Staff:

Keenan Konopaski
Mary Welsh
Peter Heineccius
Suzanne Kelly
Matt Stoutenburg
Jean Wilkinson, AGO
John Woolley
Dana Lynn
Eric Whitaker
Marilyn Richter
Sarah Unbehaun

CALL TO ORDER AND WELCOME

Chair Longbrake welcomed those in attendance and called the meeting to order at 1:00 p.m.

MOTION: A motion was made to approve the September 20, 2013, meeting minutes.

The motion was seconded and carried.

(TVW recording had not started yet)

2014 COMMISSION MEETING SCHEDULE

The Commission discussed the proposed schedule for Commission meetings in 2014.

MOTION: A motion was made to approve the 2014 meeting schedule for the Citizen Commission for Performance Measurement of Tax Preferences.

The motion was seconded and carried.

(See TVW recording at 0:00:05)

Further discussion of the 2014 Commission meeting schedule occurred at the end of the meeting. (See TVW recording at 2:29:02)

DISCUSSION AND ADOPTION OF COMMISSION COMMENTS

Group A

Chair Longbrake asked whether any Commissioners had any proposed comments on the preferences in Group A. The preferences in Group A had received a recommendation of "Continue" by JLARC staff, and no Commissioner had proposed any comments prior to the meeting. No Commissioners had any additional comments on these preferences.

MOTION: The Commission acknowledges receipt of the 2013 JLARC Tax Preference Reviews of **Health Maintenance Organizations (B&O Tax)**; **Medicare and Basic Health Plan Receipts (Insurance Premium Tax)**; **Medical Items, Dietary Supplements, Insulin, and Kidney Dialysis Devices (Sales and Use Tax)**; **Nonprofit Blood and Tissue Banks (B&O Tax, Sales and Use Tax)**; **Tree Trimming Under Power Lines (Sales and Use Tax)**; and **Use Tax on Rental Value (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 2013 JLARC reports related to these preferences.

The motion was seconded and carried.

(See TVW recording at 0:01:45)

Group B

Chair Longbrake asked whether any Commissioners had any proposed comments on the preferences in Group B. The preferences in Group B had received a recommendation of "Review and Clarify" by JLARC staff, and no Commissioner had proposed any comments prior to the meeting. No Commissioners had any additional comments on these preferences.

MOTION: The Commission acknowledges receipt of the 2013 JLARC Tax Preference Reviews of **Fuel Used in Commercial Vessels (B&O Tax)** and **Nonprofit Youth Recreation Services and Local Government Physical Fitness Classes (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 2013 JLARC reports related to these preferences.

The motion was seconded and carried.

(See TVW recording at 0:05:32)

Group C

The Commission discussed the preference in Group C. The preference in Group C had received a recommendation of "Continue" by JLARC staff, and Commissioners had provided proposed comments.

Rob Makin, representing Washington Wholesale Prescription Drug Distributors, testified in response to questions posed by the Commission.

MOTION: The Commission acknowledges receipt of the 2013 JLARC Tax Preference Review of **Prescription Drug Resellers (B&O Tax)**. The Commission has provided a forum for discussion and public comment on these recommendations. The Commission endorses the JLARC recommendation for this preference. The Commission provides the following additional comments to append to the 2013 JLARC report related to this preference.

Comment: The Commission endorses the Legislative Auditor's recommendation to continue the prescription drug resellers preference, but in light of public testimony, the Legislature could consider whether to review this preference.

Rationale: The Legislative Auditor believes the Legislature's inferred public policy objective for the prescription drug resellers B&O preferential tax rate is intended to reduce a competitive disadvantage for drug resellers operating warehouses in Washington relative to businesses that distribute drugs in the state without nexus and that owe no B&O tax. But, the preference is also available to drug resellers operating out-of-state warehouses that have nexus. The Commission received testimony questioning the necessity of this preference, but also received testimony indicating that drug reseller employment in the state has grown 182 percent since the preference was enacted in 1998.

The motion was seconded and carried.

(See TVW recording at 0:06:27)

Group D

The Commission discussed the preferences in Group D. The preferences in Group D had received a recommendation of "Review and Clarify" by JLARC staff, and Commissioners had provided proposed comments.

MOTION: The Commission acknowledges receipt of the 2013 JLARC Tax Preference Review of **Government Payments to Public and Nonprofit Hospitals (B&O Tax)**. The Commission has provided a forum for discussion and public comment on these recommendations. The Commission endorses the JLARC recommendation for this preference. The Commission provides the following additional comments to append to the 2013 JLARC report related to this preference.

Comment: The Commission endorses the Legislative Auditor's recommendation but notes that the Legislature has consistently excluded for-profit hospitals from this preference since 1937 and explicitly omitted for-profit hospitals in its statement of purpose when it amended the preference in 2005.

Rationale: The Legislative Auditor observes that although exclusion of for-profit hospitals from this preference has been long-standing, no rationale for their exclusion is included in the legislative record. Only five percent of government subsidized payments in 2011 went to for-profit hospitals. Thus, if the preference were extended to for-profit hospitals, the reduction in B&O tax receipts would be small. If the Legislature decides to review this preference, it will need to determine whether extending this preference to for-profit hospitals would result in a public benefit. The Commission received no testimony in support of the Legislative Auditor's recommendation.

The motion was seconded and carried.

(See TVW recording at 0:21:40)

MOTION: The Commission acknowledges receipt of the 2013 JLARC Tax Preference Review of **Prescription Drug Administration (B&O Tax)**. The Commission has provided a forum for discussion and public comment on these recommendations. The Commission endorses the JLARC recommendation for this preference. The Commission provides the following additional comments to append to the 2013 JLARC report related to this preference.

Comment: The Commission endorses the Legislative Auditor's recommendation that the Legislature may want to consider adding reporting or other accountability requirements and suggests the Legislature consider how the Affordable Care Act (ACA) impacts incentives to provide services covered by this preference.

Rationale: In light of the Affordable Care Act (ACA), the Legislature may want to track how the ACA impacts incentives to provide the services covered by this preference. Depending on the results of this tracking, alterations in the preference may be appropriate.

The motion was seconded and carried.

(See TVW recording at 0:24:27)

As part of the Commission's discussion of the preferences for Artistic and Cultural Organizations (B&O Tax, Sales and Use Tax), staff responded to questions from the Commission regarding the Commission's statutory mandate.

MOTION: The Commission acknowledges receipt of the 2013 JLARC Tax Preference Reviews of **Artistic and Cultural Organizations (B&O Tax, Sales and Use Tax)**. The Commission has provided a forum for discussion and public comment on these recommendations. The Commission endorses the JLARC recommendation for these preferences. The Commission does not have additional comments to append to the 2013 JLARC reports related to these preferences.

The motion was seconded and carried.

(See TVW recording at 0:25:47)

MOTION: The Commission acknowledges receipt of the 2013 JLARC Tax Preference Review of **Fishing Boat Fuel (Sales and Use Tax)**. The Commission has provided a forum for discussion and public comment on these recommendations. The Commission endorses the JLARC recommendation for this preference. The Commission provides the following additional comments to append to the 2013 JLARC report related to this preference.

Comment: The Commission endorses the Legislative Auditor's recommendation and encourages the Legislature to state an explicit public policy objective for this preference and to structure this preference to be consistent with the stated public policy objective.

Rationale: The Legislative Auditor determined that although the preference removes a possible disincentive for fishing boats to purchase fuel in Washington, the preference is not meeting the inferred public policy objective of providing equitable tax treatment on fuel for Washington commercial deep sea fishing and charter boats when compared to tax treatment on fuel for commercial vessels engaged in interstate and foreign commerce. The Legislature should determine whether this preference serves a public policy objective and, if so, structure the preference to align with an explicitly stated objective.

The motion was seconded and carried.

(See TVW recording at 0:41:25)

MOTION: The Commission acknowledges receipt of the 2013 JLARC Tax Preference Review of **Retailing (B&O Tax)**. The Commission has provided a forum for discussion and public comment on these recommendations. The Commission endorses the JLARC recommendation for this preference. The Commission provides the following additional comments to append to the 2013 JLARC report related to this preference.

Comment: The Commission endorses the recommendation of the Legislative Auditor for the Legislature to review and clarify the retailing preferential B&O tax rate and encourages the Legislature to examine whether the preferential B&O tax rate should be eliminated or be changed to some other amount.

Rationale: The Legislative Auditor believes that the inferred public policy objective of establishing a preferential retailing B&O tax rate was to lessen the impact of a sales tax increase in 1983. Currently, this preferential rate is 0.471 percent, which is not significantly different from the 0.484 percent B&O tax rate that applies to manufacturing and wholesaling. Thus, elimination of the preferential rate would likely have minimal effect. However, public testimony received by the Commission suggested that the B&O tax rate places a competitive disadvantage on retailers who compete with on-line providers who are not subject to comparable sales tax rates. In its review the Legislature could examine whether there would be broad-based public benefits by revising, rather than eliminating, the preferential B&O tax rate.

The motion was seconded and carried.

(See TVW recording at 0:45:09)

MOTION: The Commission acknowledges receipt of the 2013 JLARC Tax Preference Review of **Rural County and CEZ New Jobs (B&O Tax)**. The Commission has provided a forum for discussion and public comment on these recommendations. The Commission endorses the JLARC recommendation for this preference. The Commission provides the following additional comments to append to the 2013 JLARC report related to this preference.

Comment: The Commission endorses the Legislative Auditor's recommendation to determine if new jobs are located where the Legislature intended and if the number of new jobs is what the Legislature intended. In its review the Commission recommends that the Legislature consider whether "rural" rather than "distressed" is the appropriate determinant of eligibility and whether the 15 percent increase in employment requirement is the most appropriate standard for retaining preference benefits.

Rationale: Shifting this preference's emphasis from "distressed" to "rural" has opened the preference to rural counties with relatively healthy economies. As a result, this may be creating an unnecessary loss of tax revenue. Population density is not a direct measure of economic distress. The Legislature should consider returning to economic measures (as opposed to demographic measures) for defining eligibility.

Additionally, under current law, existing firms need to show a 15 percent increase in employment to retain the tax benefits. It is unclear why a 15 percent rate is more appropriate than some other rate, such as ten percent.

The motion was seconded and carried.

(See TVW recording at 0:53:12)

Group E

The Commission discussed the preference in Group E. The preference in Group E had received a recommendation of "Terminate" by JLARC staff, and Commissioners had provided proposed comments.

Molly Nollette, staff with the Office of the Insurance Commissioner (OIC), provided an explanation of the comment her office submitted on the tax preference for Dentistry Prepayments (Insurance Premium Tax).

Pursuant to the Commission's conflict of interest policy, Vice Chair Miller disclosed that he votes on approving the selection of dental benefits for members he represents as an officer of the Washington Education Association.

MOTION: The Commission acknowledges receipt of the 2013 JLARC Tax Preference Review of **Dentistry Prepayments (Insurance Premium 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 to append to the 2013 JLARC report related to this preference.

Comment: The Commission does not endorse the recommendation of the Legislative Auditor to terminate the exemption from the insurance premium tax for health care service contractors on prepayments received for dentistry services. The Commission recommends that the Legislature review and clarify whether this exemption is serving a broad-based public policy objective.

Rationale: Based upon its review the Legislature could determine to terminate the dentistry insurance premium tax exemption, continue it, or establish a preferential insurance premium tax rate. While the 1993 law established a temporary exemption, the exemption became permanent when the part of the 1993 law pertaining to Certified Health Plans was repealed in 1995. There is no public record that the Legislature explicitly intended the temporary exemption to become permanent or whether this was simply the outcome of repealing parts of the 1993 law. The Commission received public testimony that argued that this was an intentional, not an accidental, outcome at the time the Legislature revised the law in 1995.

While the Legislature did not expressly provide a permanent exemption for all health care service contractors providing prepaid dental services in the Health Care Reform Act originally adopted in 1993, the Legislature clearly intended that the tax preference apply for Limited Certified Health Plans for Dental Services. These original intended beneficiaries of the preference continue to enjoy the benefits of this preference along with health care service contractors that would not have had the benefit of this preference for dentistry services under the original 1993 legislation. The 1995 legislation adopted changes to the statute in its current form that extended the tax preference to all health care service contractors. The Legislative Auditor inferred that the absence of any specific reference in the 1995 legislation or in the legislative history of an intent to extend the preference to all health care service contractors was, in effect, an oversight and that the Legislature did not intend to provide the tax preference to all health care service contractors. However, the Commission believes the record is inconclusive as to whether the Legislature simply overlooked the fact that the 1995 legislation converted a temporary exemption into a permanent one or whether the Legislature intended to make the exemption permanent.

The Affordable Care Act (ACA) and its impact may raise a new issue specific to this tax preference. According to public testimony, the industry is facing a two percent tax (instead of 1.5 percent) on insurance obtained in the new ACA-mandated insurance exchange. For pediatric dentistry, the higher tax rate is intended to help pay the costs of running the exchange. The industry argued that increasing the tax from 1.5 percent to two percent (by terminating the tax preference) would lower the amount of dental services provided to vulnerable populations. If this assertion is true, it raises the question of whether the two percent tax on exchange-obtained insurance would result in a similar outcome. The industry did not comment on this possibility.

Furthermore, if the Legislature intended this tax preference to be temporary when enacted in 1993, it is possible the tax preference may have had the unintended consequence of increasing the supply of dental services to vulnerable populations. If so, this may have some social-welfare benefits. The Legislature should request the industry to clarify the specific programs that are at risk if the tax preference is terminated. In response to a commission question during public testimony, the industry was either unable or unwilling to comment on specifics about programs at risk. Finally, there is a question of whether program cuts, if they occur, would be mitigated by increased health insurance coverage generated by the ACA exchanges.

The Legislature may also wish to consider the disparity of tax treatment between the different types of insurance carriers for dental services.

The Commission also received public testimony which indicated that most providers of dentistry services are not-for-profit organizations which engage in substantial public service initiatives. Thus, it is possible that some of the benefits of the tax preference, perhaps a significant portion, are passed on to the public through various educational programs to reduce oral disease and improve overall health.

The motion was seconded and carried.

(See TVW recording at 1:08:39)

Group F

The Commission discussed the preferences in Group F. The preferences in Group F had received an expedited review and no analysis or recommendation by JLARC staff, and Commissioners had provided proposed comments.

The Commission first considered seven expedited review preferences that have not received any previous review by JLARC staff.

After discussion, the Commission decided that it would not comment on the 2013 Expedited Tax Preference Reports for **Baseball Stadiums (Leasehold Excise Tax)**; **Boats Under 16 Feet**

(Watercraft Excise Tax); **Fish Cleaning (B&O Tax)**; **Inmate Employment Programs (Leasehold Excise Tax)**; **Trade Shows (B&O Tax)**; **Tuna, Mackerel, and Jack Fish (Enhanced Food Fish Tax)**; and **Wax and Ceramic Materials To Create Molds (Sales and Use Tax).** The Commission decided to add these preferences to the 2014 expedited review schedule, to allow an opportunity for further discussion about the possibility of adding comments at that time.

Chair Longbrake asked JLARC staff to work with Vice Chair Miller to develop criteria for reviewing expedited preferences at the May 2014 meeting. Chair Longbrake proposed using those criteria to identify any of the 2014 expedited tax preference reviews that the Commission wishes to hear public testimony about at the September 2014 meeting.

(See TVW recording at 1:36:13)

The Commission next considered four expedited review preferences that had previously received a full review by JLARC staff.

Kathy Oline and Gary Grossmann, staff with the Department of Revenue (DOR), responded to questions by the Commission regarding preferences for Wood Biomass Fuel.

Clay Hill, staff with the House Republican Caucus, testified regarding a new wood biomass facility in Okanogan County that might not be included in DOR's 2012 Exemption Report.

After discussion, the Commission decided that it would not comment on the 2013 Expedited Tax Preference Reports for **Biodiesel and Alcohol Fuel Production Facilities (Leasehold Excise Tax)**; **Biodiesel and Alcohol Fuel Production Facilities (Property Tax)**; **Wood Biomass Fuel Production Facilities (Leasehold Excise Tax)**; and **Wood Biomass Fuel Production Facilities (Property Tax)**. The Commission decided to add these preferences to the 2014 expedited review schedule, to allow an opportunity for further discussion about the possibility of adding comments at that time.

(See TVW recording at 2:04:05)

TRANSMITTAL LETTER

The Commission discussed a transmittal letter for the Commission's comments, which would be appended to the final report submitted to the Legislature.

After discussion, the Commission asked that the transmittal letter include the following topics: the specific questions that the Commission asked stakeholders to answer during public testimony; increasing the rigor of the Commission's review of expedited tax preferences; and the public testimony received by the Commission that was of a general nature regarding the broader impact of tax preferences on public services. Chair Longbrake will draft the transmittal letter.

(See TVW recording at 2:22:23)

PUBLIC COMMENT

No members of the public signed up to testify.

Chair Longbrake adjourned the meeting at 3:45.