2014 Tax Preference Performance Reviews

Final Report

December 2014

STATE OF WASHINGTON

JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE

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REPORT SUMMARY

What Is a Tax Preference?

Tax preferences are defined in statute as exemptions, exclusions, or deductions from the base of a state tax; a credit against a state tax; a deferral of a state tax; or a preferential state tax rate. Washington has approximately 600 tax preferences.

Why a Review of Tax Preferences?

Legislature Creates a Process to Review Tax Preferences

In 2006, the Legislature stated that periodic reviews of tax preferences are needed to determine if their continued existence or modification serves the public interest. The Legislature enacted Engrossed House Bill 1069 to provide for an orderly process for the review of tax preferences (now found in Chapter 43.136, Revised Code of Washington). Statute assigns specific roles in the process to two different entities.

- The Citizen Commission for Performance Measurement of Tax Preferences creates a schedule for reviews, holds public hearings, and comments on the reviews.
- Staff to the Joint Legislative Audit and Review Committee (JLARC) conduct the reviews.

Citizen Commission Sets the Schedule

The Legislature directed the Citizen Commission for Performance Measurement of Tax Preferences to develop a schedule to accomplish an orderly review of most tax preferences over ten years. The Commission is directed to omit certain tax preferences from the schedule, such as those required by constitutional law.

The Commission conducts its reviews based on analysis prepared by JLARC staff. In addition, the Commission may elect to rely on information supplied by the Department of Revenue. This volume includes 24 preference reviews (similar preferences may be combined in one chapter) completed by JLARC staff in 2014. Analysis of preferences completed in previous years is found on the Commission's website: http://www.citizentaxpref.wa.gov/

JLARC Staff's Approach to the Tax Preference Reviews

Statute guides the 11 questions typically covered in the reviews.

Public Policy Objectives:

1. What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference? (RCW 43.136.055(b))
2. What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives? (RCW 43.136.055(c))
3. To what extent will continuation of the tax preference contribute to these public policy objectives? (RCW 43.136.055(d))
4. If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment of the tax benefits? (RCW 43.136.055(g))

Beneficiaries:

5. Who are the entities whose state tax liabilities are directly affected by the tax preference? (RCW 43.136.055(a))
6. To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended? (RCW 43.136.055(e))

Revenue and Economic Impacts:

7. What are the past and future tax revenue and economic impacts of the tax preference to the taxpayer and to the government if it is continued? (This includes an analysis of the general effects of the tax preference on the overall state economy, including the effects on consumption and expenditures of persons and businesses within the state.) (RCW 43.136.055(h))
8. If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy? (RCW 43.136.055(f))
9. If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes? (RCW 43.136.055(i))
10. For those preferences enacted for economic development purposes, what are the economic impacts of the tax preference compared to the economic impacts of government activities funded by the tax? (RCW 43.136.055(j))

Other States:

11. Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington? (RCW 43.136.055(k))

Depending on the tax preference, certain questions may be excluded. For instance, question #4 relates to modifying a preference if the public policy is not being fulfilled. If the preference is fulfilling its public policy, this question is skipped.

JLARC Staff's Analysis Process

JLARC staff carefully analyze a variety of evidence in conducting these reviews: 1) the legal and public policy history of the tax preferences; 2) the beneficiaries of the tax preferences; 3) government data pertaining to the utilization of these tax preferences and other relevant data; 4) the economic and revenue impact of the tax preferences; and 5) other states' laws to identify similar tax preferences.

When a preference's public policy objective is identified in statute, staff are able to affirmatively state the public policy objective. This is sometimes found in intent statements or in other parts of statute.

However, for many of the preferences, the Legislature did not state the public policy objective. In such instances, staff may be able to *infer* what the implied public policy objective might be.

To arrive at this inferred policy objective we go through the following step-by-step process:

- Review final bill reports for any statements on the intent or public policy objectives.
- Review bills prior to the final version and legislative action on bills related to the same topic.
- Review bill reports and testimony from various versions of the bill.
- Review records of floor debate.
- Review whether there were court cases that provide information on the objective.
- Review any information available through the Department of Revenue's files on the history of tax preferences, including rules, determinations, appeals, audits, and taxpayer communication.
- Review any press reports during the time of the passage of the bill which may indicate the intention of the preference.
- Review any other historic documents, such as stakeholder statements, that may address the issue addressed by the tax preference.

If there is sufficient information in this evidence to *infer* a policy objective, we state that in our reviews. In these instances, though, the purpose may be a more generalized statement than can be made compared to instances that have explicit statutory language.

JLARC staff also interview the agencies that administer the tax preferences or are knowledgeable of the industries affected by the tax. Agencies may provide data on the value and usage of the tax preference and the beneficiaries. If the beneficiaries of the tax are required to report to other state or federal agencies, JLARC staff will also obtain data from those agencies.

A Change in 2013: Policy Purpose Statement Now Required

Beginning in August 2013, new, extended, or expanded preferences now require a tax preference performance statement. The performance statement is to include a statement of legislative purpose as well as metrics to evaluate the effectiveness of the preference. (RCW 82.32.808). Most of the preferences included in this report were passed before this requirement was established.

Summary of the Results from JLARC Staff's Reviews

The table beginning on page 5 provides a summary of the recommendations from JLARC staff's analysis and includes the Citizen Commission's comments on those recommendations. Of the preferences, JLARC staff recommends the Legislature:

- Terminate one preference;
- Review and clarify the intent of twenty preferences; and
- Continue three preferences.

Organization of this Report

The report begins with JLARC addenda reflecting comments adopted by the Committee, followed by comments of the Citizen Commission. Summary information for each of the 24 preferences is followed by detailed reports.

Since the Commission selected several preferences related to aerospace for JLARC staff to review in 2014, both the summary and detail begin with aerospace related preferences. The appendices provide the Scope and Objectives for the preference reviews and the text of current law for each preference.

In addition to the preferences reviewed in this report, information on 62 other preferences considered by the Commission in 2014 can be found in the 2014 Expedited Tax Preferences report. Information on these preferences was provided by the Department of Revenue.

COMMITTEE ADDENDA

At the December 10, 2014 JLARC meeting, the Committee approved this report for distribution and adopted two addenda to the report.

Aerospace Industry Tax Preferences Addendum

The Committee recommends that the Legislature add language to the aerospace preferences that includes: a) a requirement for five year review as to whether the preference is costing the State more revenue than the incentive generates in revenues from the intended encouraged economic activity; b) a tax incentive statement of intent with measurable goals of job creation or maintenance; and, c) a requirement that businesses claiming a tax preference with the intent to create jobs must certify with the Department of Revenue the number of jobs created from the use of the tax preference, based on measurable employment or other criteria stated in the intent. This will not create onerous new reporting requirements, as employment levels, wages and hours are reported to the State.

International Investment Management Services (IIMS) B&O Preferential Rate Addendum

The Committee recommends continuation of the IIMS tax rate. Further, because we believe this review is premature, we recommend completion of the Department of Revenue's regulatory process that is underway prior to any further review.

CITIZEN COMMISSION LETTER TO THE LEGISLATURE

State of Washington

E-mail: JLARC@leg.wa.gov
www.citizentaxpref.wa.gov

Citizen Commission for Performance Measurement of Tax Preferences

William A. Longbrake, Chair
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Representative Kathy Haigh
Chair, Joint Legislative Audit and Review Committee

Troy Kelley
State Auditor

November 10, 2014

The Honorable Representative Reuven Carlyle
The Honorable Representative Ross Hunter
The Honorable Senator Andy Hill
The Honorable Representative Terry Nealey
The Honorable Representative Bruce Chandler
The Honorable Senator James Hargrove

Re: 2014 Tax Preference Reviews

I am pleased to forward to you the comments that the Citizen Commission for Performance Measurement of Tax Preferences (Commission) adopted for this year's review of tax preferences.

The attached comments were adopted by the Commissioners at our October 17 meeting. The attachment also includes a minority report from one commissioner related to the package of aerospace tax preferences.

Commissioners encouraged me, in my capacity as Chair, to emphasize to you the importance of the Legislature considering this year's and previous years' recommendations and comments on tax preference statutes, which have undergone rigorous review by the Joint Legislative Audit and Review Committee staff (JLARC), pursuant to legislatively mandated criteria and government auditing standards, and which also have been the subject of public testimony.

This is the eighth year that tax preferences have been reviewed at the direction of the Legislature. As the chairs and ranking minority members of the fiscal committees, I urge your action on these recommendations during the upcoming legislative session.

Tax preference reviews provide a valuable evaluation tool to assist the Legislature in grappling with difficult fiscal issues. Terminating tax preferences that do not appear to be meeting their intended purposes provides the Legislature with the option of using resources for alternative revenue or program purposes. Similarly, continuing effective preferences provides an assurance that the state is getting the value the Legislature expects. And reviewing preferences with an unclear policy purpose and those whose costs or benefits may not be meeting the Legislature's intent provides information and analysis to the Legislature which enables the Legislature to review and clarify those preferences.

During 2014 JLARC staff conducted a full review of 24 preferences. After reviewing JLARC staff's report and receiving public testimony, the Commission has recommended the Legislature should

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review and clarify the purpose of 20 preferences, continue three preferences, and terminate one preference. Summaries of JLARC staff's analysis and recommendations for these 24 preferences, and Commission comments, are attached to this letter.

Because the availability of JLARC staff resources limits how many tax preferences JLARC staff can evaluate each year, the Commission considers information on a list of "expedited" preferences, which do not receive a JLARC staff evaluation. Many of these expedited preferences have limited revenue impacts, and consideration of some others, in the Commission's judgment, would not benefit from a JLARC staff evaluation. In 2014, the Commission scheduled 62 preferences for "expedited" review. In our call for public testimony, the Commission explicitly solicited public testimony on these expedited preferences as well those that received a JLARC staff evaluation. As a result, we received written testimony on some of the expedited preferences this year.

While these "expedited" preferences are sometimes smaller and did not receive the benefit of a JLARC evaluation, the Commission believes they still merit attention by the Legislature. To further assist the Legislature, the Commission unanimously adopted comments this year on all 62 "expedited" preference reviews. Those comments are also attached to this letter.

The Commission has continued to expand on its process for soliciting public testimony on the preference reviews. Similar to last year, Commissioners requested that stakeholders respond to a set of questions when testifying either in support or in opposition to a tax preference. These questions were posted to our web site, and published along with the agenda for our public hearing. We posed four questions:

1. Is there evidence that the tax preference is achieving its purpose, as noted in the 2014 tax preferences reports? Please provide any relevant evidence.
2. Does the tax preference provide benefits in addition to those stated in its intended or implied purpose?
3. Does the economic activity stimulated by this tax preference exceeds the loss of revenue to the state?
4. Does this preference have negative consequences? For example, were other industries, workers, or the environment harmed by activities stimulated by this tax preference?

In addition to soliciting testimony from the beneficiaries of tax preferences, the Commission also invited and received testimony from other parties. As a result, we also received testimony from individuals who spoke to their views on tax preference effectiveness and accountability. We also solicited and received written testimony, which was posted for the public on our web site.

I believe the work of JLARC staff and the Commission has provided a thoughtful and deliberative forum for highlighting many important performance and policy issues associated with evaluating tax

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preferences. I encourage you to consider the recommendations of JLARC staff and Commission comments covering the entire eight years of tax preference reviews during the upcoming legislative session.

As Chair of the Citizen Commission for Performance Measurement of Tax Preferences, I would be pleased to discuss the Commission's position and comments with you and any interested legislators. I can be contacted via email at bill@tlff.org.

If you have questions about JLARC staff's performance audits, please feel free to contact the Legislative Auditor, Keenan Konopaski, at 360-786-5187 or keenan.konopaski@leg.wa.gov.

Additional information on all eight years of tax preference reviews can be found at:
www.citizentaxpref.wa.gov/reports.htm.

Recordings of this year's public testimony and written testimony we received can be found under the link for the September 19, 2014, meeting at: www.citizentaxpref.wa.gov/meeting.htm.

Sincerely,

William A. Longbrake

William A. Longbrake, Chair
Citizen Commission for Performance Measurement of Tax Preferences

cc: All Legislators
Keenan Konopaski, Legislative Auditor
David Schumacher, Director, Office of Financial Management
Carol Nelson, Director, Department of Revenue
Alex Pietsch, Governor's Office of Aerospace

Attachments

Summary of Audit Reviews Including JLARC Addenda and Citizen Commission Comments

Summary of 2014 Tax Preference Performance Reviews			
What the Preference Does	**Public Policy Objective**	**Est. Beneficiary Savings**	**Legislative Auditor Recommendation**
Aerospace Industry Preferences			
A Commercial Airplane Products and Services B&O Tax Preferential Rates			
Commercial Airplane Manufacturing – Preferential Rate (B&O Tax)	RCW 82.04.260(11)		Detail begins on page 32
Provides a preferential B&O tax rate of 0.2904 percent to manufacturers and processors for hire of commercial airplanes and their components and to manufacturers of tooling specifically designed for use in manufacturing aerospace products.	The Legislature stated the public policy objectives: • To encourage the continued presence of the aerospace industry in Washington; • To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and • To provide jobs with good wages and benefits.	$238.5 million in the 2015-17 Biennium.	**Review and clarify:** Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.
JLARC Addendum: The Committee recommends that the Legislature add language to the aerospace preferences that includes: a) a requirement for five year review as to whether the preference is costing the State more revenue than the incentive generates in revenues from the intended encouraged economic activity; b) a tax incentive statement of intent with measurable goals of job creation or maintenance; and, c) a requirement that businesses claiming a tax preference with the intent to create jobs must certify with the Department of Revenue the number of jobs created from the use of the tax preference, based on measurable employment or other criteria stated in the intent. This will not create onerous new reporting requirements, as employment levels, wages and hours are reported to the State.			
Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. The Legislature should establish specific economic development metrics and reporting mechanisms that facilitate determination of whether the intended public policy objectives are being met. **Rationale:** The competition for Washington's aerospace firms is intense. Given this intensity, and the state's need to maintain its job base following the Great Recession, these preferences mitigated some near- and medium-term risk for Washington's economy. However, testimony indicated that these preferences suffer from some significant long-run "moral hazard" problems. Moral hazard problems occur when the recipient of an economic benefit is incented to behave in a way inconsistent with the welfare of those granting the benefit. For example, this is common with deposit insurance. Evidence suggests that deposit insurance (an insurance benefit) in the absence of bank examinations (i.e. prudential supervision) encourages banks to take excessive			

Summary of 2014 Tax Preference Performance Reviews

risk since bank owners and depositors are, to varying degrees, insulated from the bank's lending decisions. In effect, without bank examinations, risk is shifted to agents such as the bank's employees, creditors, and ultimately taxpayers.

In the case of the aerospace industry, the lack of verifiable metrics that measure the extent to which the public policy objectives of the tax preference are being met may encourage firms to move employment out of state to gain the benefit of more favorable labor costs, while still benefiting from the tax preferences. However, the establishment of verifiable metrics will need to balance compliance and monitoring costs with the benefits received by the firms. Testimony noted that firms may forego taking advantage of tax preferences with onerous reporting standards, possibly to the detriment of economic development in the state.

In addition to compliance and monitoring costs, it is challenging to determine how to measure whether employment objectives are being met over time. Some employment changes may not be related to the tax preferences. For example, depending upon the industry, technological change can be a significant driver of changes in employment. To isolate the impact of a tax preference on employment levels, changes in technology need to be taken into consideration.

Finally, as with most tax preferences, there is also lack of transparency on how the preferential benefits should be established. Although making all discussions between the state and the industry public is not practical for a variety of reasons, there is still a public interest in additional transparency in how the state and industry determine the preferential benefits. The public should be given information about why a particular preferential benefit structure was chosen. This might include information on costs and competitive pressures faced by an industry, or the influence of competing preferential benefits offered by other states. Given the amounts involved in the aerospace preferences, all of these issues deserve careful consideration by the Legislature. It would be helpful to examine how other states are structuring preferences and performance metrics to achieve public policy objectives.

In addition to Commission comments, one minority report was submitted

Commissioner Bueing voted in opposition to the comment adopted by the Commission and after the meeting provided the following minority report:

Minority Comment: The Legislature should avoid establishing specific economic development metrics to measure progress towards public policy objectives and ensure that reporting mechanisms are targeted and reasonable. The Legislature should revise its definition of "tax preferences" to avoid labeling anomalies under a gross receipts tax as preferences.

Minority Rationale: In an ever evolving marketplace, technological change, market forces and economic trends make it virtually impossible to establish specific economic development metrics. The same specific economic metric cannot reasonably be used to measure the effectiveness of job creation in a growing economy as is used in a recessionary economy. Yet it is impossible for the Legislature to accurately measure the future course of the economy. Instead, rigorous economic analysis is necessary to reasonably and accurately measure the benefit of an incentive. Simplistic, specific economic metrics make the process of measuring progress much easier, but at the expense of creating any useful analysis.

Rigorous economic analysis is also necessary to reasonably and accurately measure the cost of an incentive. Quantification of the costs associated with a "tax preference" is extremely difficult when a reasoned observer must necessarily take into account the potential for relocation of activities. It is also necessary to look at the specific effect of gross receipts tax on a particular industry to accurately measure whether a rate differential is actually a preference or is instead recognition of the unique effects of the Washington B&O tax within a particular industry.

Summary of 2014 Tax Preference Performance Reviews
Accordingly, the Legislature should also reconsider and revise its definition of "tax preferences" to recognize the complex realities associated with the Washington B&O tax and allow for accurate analysis of not only the benefit, but also the cost of an incentive. For example, in the case of manufacturers in the aerospace industry, the Washington B&O tax is an unapportioned tax levied on 100% of the gross receipts from the sale of such manufactured products even though the aerospace products are sold throughout the world. The clear trend in state taxation for the last 30 or more years has been a move to marketplace apportionment. Washington sources virtually all business activity to the place where the product or service is delivered except for manufacturing. It is no wonder that a highly desirable industry, such as the aerospace industry, that provides significant above average wage jobs would seek relief from an unapportioned gross receipts tax. Instead of relying on a simplistic, overly broad and fictitious definition of "tax preference" the Legislature should direct JLARC to analyze whether deductions, exemptions, deferrals and rate differentials are actually tax preferences or simply necessary adjustments within the context of a gross receipts tax in order to equalize tax burdens between disparate industries and activities.

<table>
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<tr><th>What the Preference Does</th><th>Public Policy Objective</th><th>Est. Beneficiary Savings</th><th>Legislative Auditor Recommendation</th></tr>
<tr><td colspan="4">Aerospace Product Development (B&O Tax) RCW 82.04.290(3) Detail begins on page 32</td></tr>
<tr><td>Provides a preferential B&O tax rate of 0.9 percent to businesses that research, design, or engineer aerospace products for commercial airplanes for others to manufacture.</td><td>The Legislature stated the public policy objectives:
• To encourage the continued presence of the aerospace industry in Washington;
• To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and
• To provide jobs with good wages and benefits.</td><td>$6.5 million in the 2015-17 Biennium.</td><td>Review and clarify: Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.</td></tr>
<tr><td colspan="4">JLARC Addendum: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.</td></tr>
<tr><td colspan="4">Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.</td></tr>
<tr><td colspan="4">B Aerospace Product Development Expenditures B&O Tax Credit</td></tr>
<tr><td colspan="4">Aerospace Product Development Expenditures (B&O Tax) RCW 82.04.4461 Detail begins on page 32</td></tr>
<tr><td>Provides a B&O tax credit equal to 1.5 percent of qualifying expenditures for businesses that develop aerospace products. Qualifying expenditures include wages and benefits, supplies, and computer expenses, but not capital costs and overhead.</td><td>The Legislature stated the public policy objectives:
• To encourage the continued presence of the aerospace industry in Washington;
• To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and
• To provide jobs with good wages and benefits.</td><td>$197.9 million in the 2015-17 Biennium.</td><td>Review and clarify: Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.</td></tr>
<tr><td colspan="4">JLARC Addendum: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.</td></tr>
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<tr><td colspan="4">C Aerospace Product Development Computer Expenditures Sales and Use Tax Exemptions</td></tr>
<tr><td colspan="4">Aerospace Product Development Computer Expenditures (Sales and Use Tax) RCWs 82.08.975; 82.12.975 Detail begins on page 32</td></tr>
<tr><td>Provides sales and use tax exemptions for sales of computer hardware, computer peripherals, and software used primarily in developing, designing, and engineering aerospace products and providing aerospace services.</td><td>The Legislature stated the public policy objectives:
• To encourage the continued presence of the aerospace industry in Washington;
• To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and
• To provide jobs with good wages and benefits.</td><td>$13.6 million in the 2015-17 Biennium.</td><td>Review and clarify: Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.</td></tr>
<tr><td colspan="4">JLARC Addendum: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.</td></tr>
<tr><td colspan="4">Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.</td></tr>
<tr><td colspan="4">D Aerospace B&O Tax Credit for Property/Leasehold Excise Taxes Paid and Superefficient Airplane Facility Leasehold Excise Tax/Property Tax Exemptions</td></tr>
<tr><td colspan="4">Commercial Airplane Manufacturing – Credit for Taxes Paid (B&O Tax) RCW 82.04.4463 Detail begins on page 32</td></tr>
<tr><td>Provides a B&O tax credit for property taxes or leasehold excise taxes paid on property used exclusively in manufacturing aerospace products or at aviation repair stations. The credit applies to new buildings, the land on which the buildings are located, and on the increase in assessed value from renovations and expansions. The credit is also available for property taxes paid on certain personal property.</td><td>The Legislature stated the public policy objectives:
• To encourage the continued presence of the aerospace industry in Washington;
• To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and
• To provide jobs with good wages and benefits.</td><td>$31.6 million in the 2015-17 Biennium.</td><td>Review and clarify: Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.</td></tr>
<tr><td colspan="4">JLARC Addendum: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.</td></tr>
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<tr><td colspan="4">Superefficient Airplane Production Facilities (Leasehold Excise Tax) RCW 82.29A.137 Detail begins on page 32</td></tr>
<tr><td>Provides a leasehold excise tax exemption to the manufacturer of a "superefficient airplane" (Boeing 787) for a facility located on port property.</td><td>The Legislature stated the public policy objectives:
• To encourage the continued presence of the aerospace industry in Washington;
• To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and
• To provide jobs with good wages and benefits.</td><td>$0 million in the 2015-17 Biennium.
Boeing located the 787 facility on private property instead of port property.</td><td>Review and clarify: Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.</td></tr>
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<tr><td colspan="4">Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.</td></tr>
<tr><td colspan="4">Superefficient Airplane Production Facilities (Property Tax) RCW 84.36.655 Detail begins on page 32</td></tr>
<tr><td>Provides a property tax exemption for all personal property such as equipment and computers to the manufacturer of a "superefficient airplane" (Boeing 787) at a facility located on port property.</td><td>The Legislature stated the public policy objectives:
• To encourage the continued presence of the aerospace industry in Washington;
• To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and
• To provide jobs with good wages and benefits.</td><td>$0 million in the 2015-17 Biennium.
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<tr><td colspan="4">Commercial Airplane Production Facilities (Sales and Use Tax) RCWs 82.08.980; 82.12.980 Detail begins on page 32</td></tr>
<tr><td>Provides an exemption from sales and use taxes on labor, services, and materials to construct new buildings used exclusively for manufacturing superefficient airplanes.
Contingent on the siting of the 777X, the exemption is expanded to new buildings for manufacturing any commercial airplane, the wings, or the fuselage.</td><td>The Legislature stated the public policy objectives:
• To encourage the continued presence of the aerospace industry in Washington;
• To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and
• To provide jobs with good wages and benefits.</td><td>$0 million in the 2015-17 Biennium.
If the contingency is met, beneficiary savings are estimated at $12.7 million in the 2015-17 Biennium.</td><td>Review and clarify: Because providing additional detail in the tax preference performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences.</td></tr>
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<tr><td colspan="4">Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.</td></tr>
<tr><td colspan="4">Other Aerospace</td></tr>
<tr><td colspan="4">Certified Aircraft Repair Firms (B&O Tax) RCW 82.04.250(3) Detail begins on page 65</td></tr>
<tr><td>Provides a preferential tax rate of 0.2904 percent to federally certified aviation repair stations.</td><td>The Legislature stated the public policy objectives:
• To encourage the continued presence of suppliers and vendors that support the Washington aerospace industry;
• To reduce the cost of doing business in Washington for aerospace suppliers and vendors; and
• To provide jobs with good wages and benefits for aerospace suppliers and vendors.</td><td>$1.3 million in the 2015-17 Biennium.</td><td>Review and clarify: Because providing additional detail in the tax preference performance statement such as a measure of the desired number of jobs would facilitate future reviews of the preference.</td></tr>
<tr><td colspan="4">Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.</td></tr>
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<tr><td colspan="4">Commercial Airplane Part Place of Sale (B&O Tax) RCW 82.04.627 Detail begins on page 75</td></tr>
<tr><td>Provides a B&O tax exemption for sales of certain airplane parts made by an out-of-state manufacturer if they are sold to a Washington manufacturer of a commercial airplane.</td><td>The Legislature stated the public policy objectives in a larger package of aerospace preferences containing this exemption:
• To encourage the continued presence of suppliers and vendors that support the Washington aerospace industry;
• To reduce the cost of doing business in Washington for aerospace suppliers and vendors; and
• To provide jobs with good wages and benefits for aerospace suppliers and vendors</td><td>Unknown because beneficiaries are not required to report amount of exemption claimed.</td><td>Review and clarify: Because it seems to run counter to the Legislature's stated 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.</td></tr>
<tr><td colspan="4">Commission Comment: Same as Commercial Airplane Manufacturing – Preferential Rate (B&O Tax) above.</td></tr>
<tr><td colspan="4">Aircraft Part Prototypes (Sales and Use Tax) RCWs 82.08.02566; 82.12.02566 Detail begins on page 83</td></tr>
<tr><td>Provides sales and use tax exemptions for sales of materials incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications.</td><td>The Legislature stated the public policy objectives:
• To encourage, develop, and expand opportunities for family wage employment in manufacturing industries;
• To solidify and enhance the state's competitive position.</td><td>$0 million in the 2015-17 Biennium
No taxpayers are claiming the preference.</td><td>Terminate: Because the tax preferences are not being used and have not contributed to the stated public policy objectives.</td></tr>
<tr><td colspan="4">Commission: Endorse without comment</td></tr>
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Summary of 2014 Tax Preference Performance Reviews			
What the Preference Does	**Public Policy Objective**	**Est. Beneficiary Savings**	**Legislative Auditor Recommendation**
Fresh Food Processing Preferences			
Dairy Product Processors–Deduction (B&O Tax) and Dairy Product Ingredient Sales - Deduction (B&O Tax)		RCW 82.04.4268	Detail begins on page 89
Provides a B&O tax deduction to dairy product processors for: • Manufacturing activities for certain dairy products; • Sales of dairy products (wholesale or retail) by the processor to purchasers that receive the products in-state and transport them outside the state; and • Wholesale sales of dairy products by the processor for use as an ingredient to manufacture dairy products. Expires July 1, 2015.	The Legislature did not explicitly state a public policy objective for this preference in 2006 when it enacted the preference or when it extended it in 2012. JLARC staff infer the public policy objective was related to jobs. In 2013 when the preference was expanded to wholesale dairy product sales for use as an ingredient in manufacturing dairy products, the Legislature specifically stated it intended to provide incentives to create additional jobs in Washington's dairy industry and related dairy-based product manufacturing industry, and specifically to encourage infant formula producers to locate new facilities or expand existing ones in the state. Additionally, the Legislature noted that the actual fiscal impact of the expanded deduction should substantially conform with the fiscal note estimate.	$8.9 million in the 2013-15 Biennium.	**Review and clarify:** Because the Legislature indicated extension of the expiration date was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should: 1) identify performance targets and metrics for the number and quality of jobs in the dairy processing industry; and 2) establish criteria for when to transition from the deduction to the preferential rate.
Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. Although the preference appears to be meeting its public policy objective, the dairy industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.			

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<tr><td colspan="4">Dairy Product Processors – Preferential Rate (B&O Tax) and
Dairy Product Ingredient Sales - Preferential Rate (B&O Tax) RCW 82.04.260(1)(c) Detail begins on page 89</td></tr>
<tr><td>Effective July 1, 2015, provides a preferential B&O tax rate (0.138 percent) to dairy processors for:
• Manufacturing activities for certain dairy products;
• Sales of dairy products (wholesale or retail) by the processor to purchasers that receive the products in-state and transport them outside the state; or
• Wholesale sales of dairy products by the processor for use as an ingredient to manufacture dairy products.
The wholesale sales for use as an ingredient portion of the preference expires July 1, 2023.</td><td>When the Legislature first enacted a preferential B&O tax rate for dairy processors prior to establishing an exemption, the stated public policy objective was to provide a tax rate consistent with the rate provided to other fresh food processors.
In 2013 when the preference was expanded to wholesale dairy product sales for use as an ingredient in manufacturing dairy products, the Legislature specifically stated it intended to provide incentives to create additional jobs in Washington's dairy industry and related dairy-based product manufacturing industry, and specifically to encourage infant formula producers to locate new facilities or expand existing ones in the state. Additionally, the Legislature noted that the actual fiscal impact of the expanded deduction should substantially conform with the fiscal note estimate.</td><td>$9.1 million in the 2015-17 Biennium.</td><td>Review and clarify: To clarify, before the preference takes effect, whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.</td></tr>
<tr><td colspan="4">Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. Although the preference appears to be meeting its public policy objective, the dairy industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.</td></tr>
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<tr><td colspan="4">Fruit and Vegetable Processors – Exemption (B&O Tax) RCW 82.04.4266 Detail begins on page 107</td></tr>
<tr><td>Provides a B&O tax exemption to fruit and vegetable processors for:
• Manufacturing activities for fresh fruit and vegetable products, or
• Wholesale sales of fruit or vegetable products by the processor to purchasers that receive the products in-state and transport them outside the state.</td><td>The Legislature did not explicitly state a public policy objective for this preference in 2005 when it first enacted the preference or when it extended it in 2012. JLARC staff infer the public policy objective was related to jobs.</td><td>$39.3 million in the 2013-15 Biennium.</td><td>Review and clarify: Because the Legislature indicated extension of the expiration date was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should: 1) identify performance targets and metrics for the number and quality of jobs in the fruit and vegetable processing industry; and 2) establish criteria for when to transition from the deduction to the preferential rate.</td></tr>
<tr><td colspan="4">Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. Although the preference appears to be meeting its public policy objective, the fruit and vegetable industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.</td></tr>
<tr><td colspan="4">Fruit and Vegetable Processors – Preferential Rate (B&O Tax) RCW 82.04.260(1)(d) Detail begins on page 107</td></tr>
<tr><td>Effective July 1, 2015, provides a preferential B&O tax rate (0.138 percent) to fruit and vegetable processors for:
• Manufacturing activities for fresh fruit and vegetable products, or
• Wholesale sales of fruit or vegetable products by the processor to purchasers that receive the products in-state and transport them outside the state.</td><td>The Legislature did not explicitly state a public policy objective for this preference. JLARC staff infer the policy objective is to treat fruit and vegetable processors consistently with other fresh food processors.</td><td>$30.8 million in the 2015-17 Biennium.</td><td>Review and clarify: To clarify, before the preference takes effect, whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.</td></tr>
<tr><td colspan="4">Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. Although the preference appears to be meeting its public policy objective, the fruit and vegetable industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.</td></tr>
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Summary of 2014 Tax Preference Performance Reviews			
What the Preference Does	**Public Policy Objective**	**Est. Beneficiary Savings**	**Legislative Auditor Recommendation**
Seafood Product Processors and Certain Sellers – Exemption (B&O Tax)		RCW 82.04.4269	Detail begins on page 127
Provides a B&O tax exemption to the seafood industry for: • Manufacturing activities for certain seafood products; or • Sales of certain seafood products (retail or wholesale) to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference. JLARC staff infer that the policy objective was related to jobs.	$4.4 million in the 2013-15 Biennium.	**Review and clarify:** Because the Legislature indicated extension of the expiration date was directly related to jobs but has not yet identified job-related performance metrics, the Legislature should: 1) identify performance targets and metrics for the number and quality of jobs in the seafood processing industry; and 2) establish criteria for when to transition from the deduction to the preferential rate.
Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. Although the preference appears to be meeting its public policy objective, the seafood product industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.			
Seafood Product Processors and Certain Sellers – Preferential Rate (B&O Tax)		RCW 82.04.260(1)(b)	Detail begins on page 127
Effective July 1, 2015, provides a preferential B&O tax rate (0.138 percent) to the seafood industry for: • Manufacturing activities for certain seafood products; or • Sales of certain seafood products (retail or wholesale) to purchasers that receive the products in-state and transport them outside the state.	The Legislature did not explicitly state a public policy objective for this preference. JLARC staff infer the policy objective is to treat seafood processors consistently with other fresh food processors.	$3.5 million in the 2015-17 Biennium.	**Review and clarify:** To clarify, before the preference takes effect, whether the Legislature intends there to be parity among all the different food processor manufacturing and sales activities.
Commission Comment: The Commission endorses the Legislative Auditor recommendations for these preferences. Although the preference appears to be meeting its public policy objective, the seafood product industry is subject to technological change that reduces the need for labor. Therefore, the Legislature should not limit its review to the number of jobs created, but should also consider other factors such as locational choice.			

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<tr><td colspan="4">Miscellaneous Preferences</td></tr>
<tr><td colspan="2">Electric Power Exported or Resold (Public Utility Tax) and Electricity Sales for Resale (B&O Tax)
RCWs 82.16.050(11) 82.04.310(2)</td><td colspan="2">Detail begins on page 145</td></tr>
<tr><td>These two preferences provide:
Public utility tax deductions for four types of electricity sales made by light and power (L&P) businesses:
• Direct (to end user) sales delivered out-of-state;
• Wholesale sales between L&P businesses delivered in-state;
• Wholesale sales to non-L&P businesses delivered in-state; and
• Wholesale sales delivered out-of-state.
B&O tax exemptions for non-L&P businesses for wholesale electricity sales delivered in-state and out-of-state.</td><td>The Legislature did not state the public policy objectives for the public utility tax (PUT) deductions to L&P businesses for four types of electricity sales or the B&O tax exemptions for non-L&P businesses for two types of electricity sales. JLARC staff infer the public policy objectives were
PUT deductions:
• Direct sales delivered out-of-state – to ensure the state complied with federal limitations on taxing goods in interstate commerce.
• In-state wholesale sales between L&P businesses – to ensure the PUT did not pyramid, while facilitating transfers of electricity between L&P companies to help meet customer demand.
• In-state wholesale sales to non-L&P companies – to provide consistent PUT treatment for wholesale sales by L&P companies regardless of the purchaser.
• Out-of-state wholesale sales – to provide consistent tax treatment with wholesale sales delivered in-state to comply with federal requirements.
B&O tax exemptions:
• In-state sales – to provide similar tax treatment to wholesale electricity sales by non-L&P businesses as to L&P businesses, and to keep electricity marketers from moving outside the state; and
• Out-of-state wholesale sales – to provide consistent tax treatment for wholesale electricity delivered in-state and out-of-state to comply with federal requirements.</td><td>PUT deductions:
$111.9 million in the 2015-17 Biennium
B&O tax exemptions:
Cannot be reliably estimated</td><td>PUT deductions:
Continue: Because the preference is achieving the inferred public policy objectives.
B&O tax exemptions:
Review and clarify: Because: 1) the Legislature may want to consider adding reporting or other accountability requirements to provide better information on use of the preference; 2) it is unclear whether the preference is still needed to keep electricity marketers from moving out-of-state due to 2010 changes in how service businesses calculate their taxable income; and 3) it is unclear whether the Legislature intended the preference to apply to commission or fee income from electricity brokering.</td></tr>
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<tr><td colspan="4">International Investment Management (B&O Tax) RCW 82.04.290(1) Detail begins on page 163</td></tr>
<tr><td>Provides a preferential B&O tax rate (0.275 percent) to businesses conducting international investment management services.</td><td>The Legislature did not state the public policy objective for this preference. JLARC staff infer the preferential B&O tax rate has two public policy objectives:
1) To reduce a perceived competitive disadvantage for IIMS businesses located in Washington; and
2) To attract new international trade and finance business to the state.</td><td>$26.6 million in the 2015-17 Biennium.</td><td>Review and clarify: To determine if the preference is still necessary, since Washington's 2010 adoption of an economic nexus and apportionment standard has reduced the competitive disadvantage for international investment management businesses located in-state as compared to those located out-of-state.
If the Legislature determines it wants to maintain this tax preference, then the Legislature should consider clarifying the law to identify which businesses qualify for the preference and what income is subject to the preferential rate.</td></tr>
<tr><td colspan="4">JLARC Addendum: The Committee recommends continuation of the IIMS tax rate. Further, because we believe this review is premature, we recommend completion of the Department of Revenue's regulatory process that is underway prior to any further review.</td></tr>
<tr><td colspan="4">Commission Comment: The Commission endorses the Legislative Auditor recommendation for this preference. The Legislature in its review of this preference should take into consideration the Department of Revenue's findings from its review of approximately 70 refund requests, which will take some time to complete. In addition, the Legislature should consider the financial and competitive impact this preference has on beneficiaries resulting from the typical business structure involving use of multiple affiliates in the international investment management services business.

Rationale: The Department of Revenue issued an Excise Tax Advisory on International Management Services on February 28, 2014, which clarifies the Department's position on eligibility and what income is taxable. The Department is currently reviewing approximately 70 refund requests and has completed one-third of these reviews. It will take additional time to complete the remaining reviews and determine the viability of these refunds under existing rules. The conclusions reached by the Legislative Auditor based on the existence of these refunds and the timing of the economic nexus and single sales factor apportionment standards are premature given the status of the current refund request reviews. While the Excise Tax Advisory addresses many of the issues revolving around who is eligible for the preferential rate and the Department of Revenue has a position on what income is taxable, not all taxpayers agree.

The Commission received testimony from a beneficiary that described how the B&O tax, which applies both to inter-affiliate transactions as well as to the gross receipts of the parent company, poses an undue tax burden compared to taxation methodologies in other states. This burden arguably could be</td></tr>
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reduced by merging affiliates; however, the affiliate business structure is a standard feature of businesses involved in international investment management services that is generally required by state and federal securities regulations. In states that tax income rather than receipts, the income of the parent is typically taxed, not the income of each individual affiliate. This issue arises from the structure of the B&O tax and is not unique to the international investment management services business. However, the B&O tax structure frequently results in a larger B&O tax burden for international investment services businesses located in Washington than for such businesses located outside of Washington.

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What the Preference Does	**Public Policy Objective**	**Est. Beneficiary Savings**	**Legislative Auditor Recommendation**
Sales Subject to Public Utility Tax (Sales Tax) and Electricity and Steam (Sales and Use Tax)	RCWs 82.08.0252, 82.08.950, 82.12.950		Detail begins on page 173
Two tax preferences provide: • A sales tax exemption for any income from activities specifically taxed under public utility tax (applies to electricity, water, and natural or manufactured gas); and • A more narrow sales and use tax exemption for sales of steam, electricity, or electrical energy.	The Legislature did not state the public policy objective for this preference. JLARC staff infer: • The public policy objective for the sales tax exemption was to avoid double taxation by ensuring that sales or distribution of items defined as "tangible personal property" that are taxed under public utility tax are not also subject to sales tax. • The public policy objective for the more narrow sales and use tax preference was to ensure Washington tax law conformed with National Streamlined Sales and Use Tax Agreement.	$1.85 billion in the 2015-17 Biennium.	**Continue:** Because the preferences are meeting the inferred public policy objectives of avoiding double taxation and ensuring Washington tax statutes conform with the National Streamlined Sales and Use Tax Agreement.
Commission: Endorse without comment.			