

2014 Tax Preference Performance Review – Proposed Final Report

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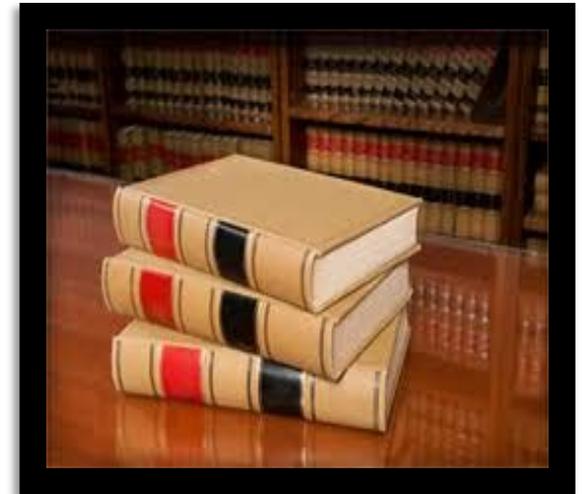
Joint Legislative Audit & Review Committee

December 2014



2006 Legislative Mandate: Conduct Performance Audits of Tax Preferences

- Created the Citizen Commission for Performance Measurement of Tax Preferences
- Specified JLARC to review preferences over 10-year cycle
- In 2014, JLARC staff reviewed 24 preferences
- Statute directs common set of questions: what, why, who, how much?
- Today's focus: preferences where the Citizen Commission added comments



Steps in Process Repeated Each Year

In 2013, Commission determined 10-year review schedule – which preferences JLARC staff to review

JLARC staff prepared analysis

July, Aug 2014: Staff presented to JLARC and Citizen Comm

Sept: Citizen Commission took public testimony

Oct: Commission adopted comments

Dec: JLARC hears proposed final report

Jan 2015: Joint fiscal committee hearing

Aerospace Industry Tax Preference Package

- Preferential B&O tax rates
- Product development tax credits
- Sales & use tax exemptions
- Tax credits for spending on facilities & equipment
- B&O tax exemptions for out-of-state parts manufacturers



Legislature Stated Public Policy Objectives:

1

To encourage the continued presence of the aerospace industry in Washington

2

To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states

3

To provide jobs with good wages and benefits

Legislature added an objective in 2013:

To maintain and grow WA's aerospace workforce

Legislative Auditor Recommends Review and Clarify

Aerospace industry package:

- Adding performance statement such as a measure of the desired increase in jobs would facilitate future reviews of these preferences

Aircraft part place of sale (out-of-state manufacturers):

- Preference seems to run counter to the stated objective of reducing the cost of doing business for WA compared to locations in other states

Citizen Commission Endorsed Legislative Auditor Recommendations

The Legislature should establish specific economic development metrics and reporting mechanisms that facilitate determination of whether the intended public policy objectives are being met.

Summary of Commission's comment rationale:

- Preferences mitigated some risks to Washington's economy.
- Lack of metrics may encourage firms to move jobs out of state and still benefit from the preference.
- Recognition that developing metrics will be challenging.

Commissioner Bueing Submitted Minority Report

Commissioner Bueing did not agree with Commission and included the following minority comment

Legislature should avoid establishing specific economic development metrics to measure progress toward 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.

Fresh Food Processor Preferences

B&O Deductions, Exemptions, and Preferential Rates for:

- **Dairy Product Processors**
- **Fruit and Vegetable Processors**
- **Seafood Processors and Certain Sellers**



Public Policy Objectives

Inferred

B&O Exemptions/Deductions

Related to jobs

B&O Preferential Rate

Provide tax treatment consistent with other food processors

Stated

2013 Dairy Ingredient Sales Deduction/ Preferential Rate

To encourage infant formula producers to locate new or expand current facilities in Washington

Legislative Auditor Recommends Review and Clarify Exemption

- To identify performance targets and metrics for the number and quality of jobs in these industries, because the Legislature indicated extension of the expiration date in 2012 was directly related to jobs, but has not yet identified job-related metrics.
- To establish criteria for when to transition from an exemption/deduction to the preferential rate.

Legislative Auditor Recommends Review and Clarify Preferential Rate

To clarify whether the Legislature intends there to be parity among all food processor manufacturing and sales activities. While the preferential rate will make B&O tax rates for several food product *manufacturing* activities conform, it will not bring parity to food product *sales* activities.

Citizen Commission Endorsed Legislative Auditor Recommendation

Although the preferences appear to be meeting their public policy objectives, these industries are subject to technological changes that reduce 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.

International Investment Management Services

B&O Tax Preferential Rate



Inferred Public Policy Objectives

1

To reduce a perceived competitive disadvantage for international investment management service businesses located in Washington vs. businesses located outside Washington.

2

To attract new international trade/finance businesses to Washington.

Legislative Auditor Recommends Review and Clarify

- To determine if changes in the state's tax laws since 1995 regarding how out-of-state transactions are taxed impact the inferred public policy objectives.
- To clarify the law to identify which businesses and what income qualify.

Citizen Commission Endorsed Legislative Auditor Recommendation

The Legislature in its review of this preference should take into consideration DOR'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.

Other 2014 JLARC Staff Reviews: Commission Concurs, No Additional Comments

JLARC Auditor recommends continue

Electricity and Steam (Sales/Use Tax)

Electric Power Exported and Resold (Public Utility Tax)

Sales Subject to Public Utility Tax (Sales Tax)

JLARC Auditor recommends review and clarify

Electricity Sales for Resale (B&O Tax)

JLARC Auditor recommends terminate

Aircraft Part Prototypes (Sales/Use Tax)

Agency Responses on 2014 Tax Preference Reviews

OFM and DOR had no specific comments, noting that continuous review of state tax preferences is important to help Washington maintain a fair and equitable tax system.

Commission's Expedited Tax Preference Reviews



Citizen Commission Considered 62 “Expedited” Preferences As Well

- Based on DOR supplied information
- Requested beneficiaries provide evidence preference achieving its public policy objective (answers to four specific questions)
- Focusing on many where there was no public testimony, the Commission:

“...encourages the Legislature to examine these preferences and gather responses to the four questions...and determine whether to continue, modify, or terminate each preference.”

Summary of Commission's Four Questions

1. Provide evidence of meeting the public policy objective?
2. Benefits other than those stated in purpose?
3. Stimulated economic activity exceed the loss of revenue to the state?
4. Negative consequences? (e.g., other industries, workers, or the environment harmed)

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