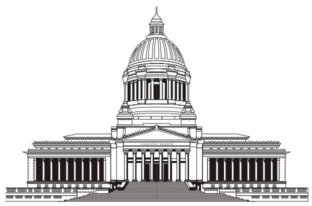
2010 Expedited Tax Preference Performance Reviews

Report 11-5

January 5, 2011



STATE OF WASHINGTON
JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE

STUDY TEAM
Mary Welsh
Dana Lynn
Stacia Hollar
Peter Heineccius

PROJECT SUPERVISOR
Keenan Konopaski

LEGISLATIVE AUDITOR
Keenan Konopaski

Copies of Final Reports and Digests are available on the JLARC website at:
www.jlarc.leg.wa.gov
or contact
Joint Legislative Audit & Review Committee
1300 Quince St SE
Olympia, WA 98504-0910
(360) 786-5171
(360) 786-5180 FAX

REPORT SUMMARY

What Is a Tax Preference?

Tax preferences are 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 nearly 590 tax preferences.

Why a JLARC Review of Tax Preferences?

Legislature Creates a Process to Review Tax Preferences

In 2006, the Legislature expressly 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. The legislation assigns specific roles in the process to two different entities. The Legislature assigns the job of scheduling tax preferences, holding public hearings, and commenting on the reviews to the Citizen Commission for Performance Measurement of Tax Preferences. The Legislature assigns responsibility for conducting the reviews to the staff of the Joint Legislative Audit and Review Committee (JLARC).

Citizen Commission Sets the Schedule

EHB 1069 directs the Citizen Commission for Performance Measurement of Tax Preferences to develop a schedule to accomplish a review of tax preferences at least once every ten years. The legislation directs the Commission to omit certain tax preferences from the schedule such as those required by constitutional law.

The Legislature also directs the Commission to consider two additional factors in developing its schedule. First, the Commission is to schedule tax preferences for review in the order in which the preferences were enacted into law, except that the Commission must schedule tax preferences that have a statutory expiration date before the preference expires. This means that Washington's longest-standing tax preferences are evaluated first.

The Commission has identified three categories of review, based on each tax preference's estimated biennial fiscal impact:

1. Full reviews (over $10 million)
2. Expedited reviews (between $2 million and $10 million)
3. Expedited light reviews ($2 million or less)

However, at their discretion, the Commission may elect to subject a tax preference with a fiscal impact of $2 million or less to the expedited review process.

In October 2009, the Commission adopted its fourth ten-year schedule for the tax preference reviews. The schedule for 2010 includes a total of 58 tax preferences under the business and occupation tax, public utility tax, sales tax, use tax, property tax, motor vehicle fuel tax, special fuel tax, litter tax, real estate excise tax, leasehold excise tax, and the insurance premiums tax. Of these 58 tax preferences, the law allowed 10 tax preferences to have an expedited review process, which are included in this report.

JLARC Staff Conduct the Tax Preference Reviews

JLARC's assignment from EHB 1069 is to conduct the reviews of tax preferences according to the schedule developed by the Commission and consistent with the guidelines set forth in statute. This report presents JLARC's reviews of the 10 tax preferences scheduled by the Commission for expedited review. Ten full tax preference reviews are included in a separate report. A third report contains information on the remaining 38 preferences with a biennial fiscal impact of less than $2 million.

JLARC's Approach to the Tax Preference Reviews

Consistent with the Scope and Objectives for conducting the expedited tax preference reviews, JLARC has evaluated the answers to a set of four questions for each tax preference:

- **Public Policy Objectives:**
  1) What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?
  2) Is there any readily available evidence related to the achievement of any of these public policy objectives?
- **Beneficiaries:**
  3) Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?
- **Revenue and Economic Impacts:**
  4) What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

Methodology

JLARC staff analyzed the following evidence in conducting these expedited reviews: 1) legal and public policy history of the tax preferences; 2) beneficiaries of the tax preferences; 3) government data pertaining to the utilization of these tax preferences and other relevant data; and 4) revenue impacts of the tax preferences.

Staff placed particular emphasis on the legislative history of the tax preferences, researching the original enactments as well as any subsequent amendments. Staff reviewed State Supreme Court, lower court, and Board of Tax Appeals decisions relevant to each tax preference. Staff interviewed the agencies that administer the tax preferences (primarily the Department of Revenue, the Department of Transportation, and the Department of Agriculture). These parties provided data on the value and usage of the tax preference and the beneficiaries. JLARC staff also obtained data from other state and federal agencies to which the beneficiaries are required to report. In a few cases, beneficiaries and other agencies provided additional information.

It is not within the purview of these reviews to resolve or draw definitive conclusions regarding any legal issues discussed within the reviews.

Summary of the Results from JLARC's Reviews

The table beginning on page 5 provides a summary of the recommendations from JLARC's analysis of the tax preferences scheduled for expedited review in 2010. JLARC provides analysis of tax preferences scheduled for full review and expedited light review in 2010 in additional volumes. Of the ten tax preferences included in this volume, this report recommends that the Legislature continue five tax preferences as they are. The expedited report raises issues for the Legislature's consideration for one of the current tax preferences, and recommends that the Legislature allow four tax preferences to expire.

Organization of This Report

This report includes ten separate chapters. Each chapter consists of a review of one or more related tax preferences. Each chapter begins with a summary of the findings and recommendations from JLARC's analysis of the individual tax preferences. Then, each chapter provides additional detail, including additional information supporting the answers to the questions outlined in the approach. The current appendices provide the Scope and Objectives and the text of current law for each preference.

2010 Expedited Reviews

Year Enacted	# of Claimants ($ amount)	JLARC Recommendation	Comments by Citizen Commission for Performance Measurement of Tax Preferences	Related Legislation as of 2010
JLARC recommendation: Legislature should continue the tax preference				
Poultry Used to Produce Poultry and Poultry Products / RCW 82.08.0267; RCW 82.12.0262				
1961	733 $222,000	Continue	Endorses without comment	Unknown until after 2011 session
Farm Machinery Sold to Nonresidents / RCW 82.08.0268				
1961	Unknown $4.6 million	Continue	Endorses without comment	Unknown until after 2011 session
Vehicles Acquired Out-of-State While in the Armed Services / RCW 82.12.0266				
1963	Unknown $2.4 million	Continue	Endorses without comment	Unknown until after 2011 session
Labor and Services for Mining/Sorting/Crushing Sand/Gravel/Rock for Public Road Purposes / RCW 82.08.0275; RCW 82.12.0269				
1965	Unknown $2 million	Continue	Endorses without comment	Unknown until after 2011 session
Conservation and Open Space Lands / RCW 84.36.260; RCW 84.34.220				
1967	58 $1.7 million	Continue	Endorses without comment	Unknown until after 2011 session

2010 Expedited Reviews				
Year Enacted	**# of Claimants ($ amount)**	**JLARC Recommendation**	**Comments by Citizen Commission for Performance Measurement of Tax Preferences**	**Related Legislation as of 2010**
JLARC recommendation: Legislature should re-examine or clarify the intent of the tax preference				
Bailed Tangible Personal Property Consumed in R & D, Experimental, and Testing / RCW 82.12.0265.				
1961	Unknown $4.7 million	Because of the ambiguity of current law, the Legislature should review and clarify the purpose of the preference providing a use tax exemption for bailed tangible personal property consumed in research, development, experimental, and testing activities.	Endorses with comment: The Commission endorses the recommendation that the Legislature should review and clarify the purpose of the preference and further recommends that the Legislature consider whether the interpretation of the existing statute by the Department of Revenue results in fairness or competitive impacts. Rationale: The Commission noted that the Department of Revenue issued an advisory in 2005 explaining that labels provided ("bailed") to salmon labeling companies qualify for this preference. The rationale of this advisory ruling appears to be a technical interpretation of the statue and may not be what the Legislature intended when it established a preference for a use tax exemption for tangible property that is bailed to a person and used in research, development, experimental, and testing activities when the bailed property is entirely consumed during the research, development, experimental, and testing activities, and the party that bails the property was not subject to sales tax or use tax when the party initially purchased or acquired the property.	Unknown until after 2011 session

2010 Expedited Reviews

Year Enacted	# of Claimants ($ amount)	JLARC Recommendation	Comments by Citizen Commission for Performance Measurement of Tax Preferences	Related Legislation as of 2010
JLARC recommendation: Legislature should allow the tax preference to expire				
Fruit and Vegetable Manufacturers / 82.04.4266; 82.04.260(1)(d)				
2005	109 $5 million	Recommendation 1		
		Because the public policy objective of creating and retaining quality jobs is not being fully achieved, and the B&O tax exemption was intended to be temporary, the Legislature should allow the B&O tax exemption for fresh fruit and vegetable processors to expire on July 1, 2012.	Endorses with comment: The Commission endorses the recommendation, but acknowledges that the Department of Agriculture provided correspondence to the Commission indicating they disagreed with the JLARC recommendation.	Unknown until after 2011 session
		Recommendation 2		
		To achieve the public policy objective of providing consistent tax treatment to fresh food processors, the Legislature should continue the preferential tax rate of 0.138 percent that becomes effective on July 1, 2012.	Same as Recommendation 1	Unknown until after 2011 session
Seafood Products Manufacturers / 82.04.4269; 82.04.260(1)(b)				
2006	22 $3.3 million	Recommendation 1		
		Because the implied public policy objective of creating and retaining quality jobs is not being fully achieved, and the B&O tax exemption was intended to be temporary, the Legislature should allow the B&O tax exemption for seafood processors to expire on July 1, 2012.	Endorses with comment: The Commission endorses the recommendation, but acknowledges that the Department of Agriculture provided correspondence to the Commission indicating they disagreed with the JLARC recommendation.	Unknown until after 2011 session
		Recommendation 2		
		To achieve the public policy objective of providing consistent tax treatment to fresh food processors, the Legislature should continue the preferential tax rate of 0.138 percent that becomes effective on July 1, 2012.	Same as Recommendation 1	Unknown until after 2011 session

2010 Expedited Reviews

Year Enacted	# of Claimants ($ amount)	JLARC Recommendation	Comments by Citizen Commission for Performance Measurement of Tax Preferences	Related Legislation as of 2010
Dairy Products Manufacturers / 82.04.4268; 82.04.260(1)(c)				
2006	11 $1.5 million	**Recommendation 1**		
		Although the implied policy objective of creating and retaining quality jobs is being partially achieved, the Legislature should allow the B&O tax exemption for dairy processors to expire on July 1, 2012, because the B&O tax exemption was intended to be temporary.	Endorses with comment: The Commission endorses the recommendation, but acknowledges that the Department of Agriculture provided correspondence to the Commission indicating they disagreed with the JLARC recommendation.	Unknown until after 2011 session
		Recommendation 2		
		To achieve the public policy objective of providing consistent tax treatment to fresh food processors, the Legislature should continue the preferential tax rate of 0.138 percent that becomes effective on July 1, 2012.	Same as Recommendation 1	Unknown until after 2011 session
Fresh Food Processors / 82.74 RCW				
2005	6 $1.1 million	Because the amount of investment in plant and equipment and the number of new jobs are less than expected by the public policy objective, the Legislature should allow the fresh food processors deferral to expire on July 1, 2012.	Endorses with comment: The Commission endorses, but acknowledges that the Department of Agriculture provided correspondence to the Commission indicating they disagreed with the JLARC recommendation and recommended that the deferral be continued.	Unknown until after 2011 session