

2012 Tax Preference Performance Reviews

Proposed Final Report

JLARC Staff

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Joint Legislative Audit & Review Committee

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JLARC

2006 Legislative Mandate: Conduct Performance Audits of Tax Preferences

Statute (Chapter 43.136 RCW):

- Created a Citizen Commission for Performance Measurement of Tax Preferences (Tax Preference Commission)
- Specified JLARC to review preferences over 10 year cycle
- Outlined specific questions for JLARC auditors to answer in reviews



Statute Directs Audit Questions and Calls for Audit Recommendations

- Questions include:
 - ♦ Current law and legal history?
 - ♦ Public policy objective(s)?
 - ♦ Achieving objective(s)?
 - ♦ Beneficiaries?
 - ♦ Beneficiary savings?
 - ♦ Effects on the economy (as applicable)?
- Types of recommendations:
 - ♦ Continue
 - ♦ Review/clarify
 - ♦ Terminate

Steps in Process Repeated Each Year

In 2011 Commission determined 10-year audit schedule: which preferences for JLARC to audit

JLARC staff conducted audits

July 2012: Staff presented to JLARC

Aug: Staff presented to Citizen Commission

Sep: Commission took public testimony

Oct: Commission adopted comments

Feb 2013: JLARC hears final report; joint hearing in Legislature

158 Preferences Reviewed by JLARC Staff Since 2007

| Auditor Recommendation to Legislature | Number of Preferences | Beneficiary Savings Est. |
|---------------------------------------|-----------------------|--------------------------|
| Terminate | 7 | \$ 98.0 million |
| Allow to Expire | 12 | \$ 63.0 million |
| Review/Clarify | 40 | \$ 1.6 billion |
| Continue | 99 | \$ 57.4 billion |
| Total | 158 | \$ 59.2 billion |

Information provided by DOR on other preferences is also available.

23 Preferences Reviewed by JLARC Staff in 2012

| Auditor Recommendation to Legislature | Number of Preferences | Beneficiary Savings Est. |
|---------------------------------------|-----------------------|--------------------------|
| Terminate | 1 | \$ 0 |
| Review/Clarify | 12 | \$ 223.0 million |
| Continue | 10 | \$ 1.9 billion |
| Total | 23 | \$ 2.1 billion |

*Today we focus on reviews where the Citizen Commission **commented on or did not concur with** Auditor recommendations.*

Auditors Recommended that the Legislature...

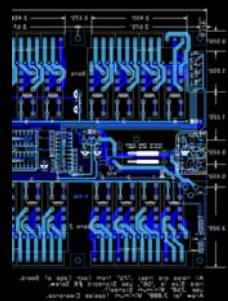
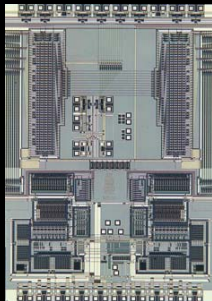
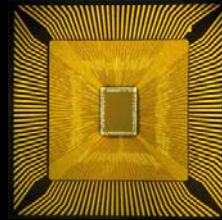
| | |
|---------------------------|--|
| Terminate | Minor Final Assembly (<i>B&O Tax</i>) |
| Review and Clarify | <p>Biotech Mfg Deferral/Waiver (<i>Sales/Use Tax</i>) Commuting Programs (<i>B&O and PUT Tax</i>) Fish Tax Differential Rates (<i>Fish Tax</i>) High Technology Deferral (<i>Sales/Use and B&O Tax</i>) Insurance Producers (<i>B&O Tax</i>) Int'l Charter, Freight Brokers, & Stevedoring (<i>B&O Tax</i>) Precious Metal and Bullion (<i>Sales/Use and B&O Tax</i>) Solar Energy & Silicon Product Mfg (<i>B&O Tax</i>) Travel Agents (<i>B&O Tax</i>)</p> |

Auditors Recommended that the Legislature...

| | |
|-----------------|---|
| Continue | <p>Annuities (Insurance Premium Tax) Business Inventories (Property Tax) Condominium Maintenance Fees (B&O Tax) Ferry Boats (<i>Sales/Use Tax</i>) Health Insurance by State Pool (Insurance Premium Tax) Insurance Guarantee Funds (Insurance Premium Tax) Leases Under \$250 Per Year (Leasehold Excise Tax) Natural and Manufactured Gas (Sales/Use Tax) Special Fuel Use Exemptions (Fuel Tax) Urban Transit Fuel (Sales/Use Tax)</p> |
|-----------------|---|

High Technology

Sales & Use Tax
Deferral/Waiver
B&O Tax Credit

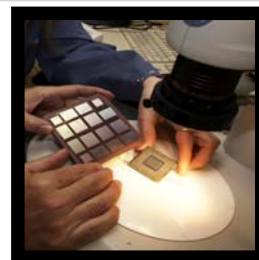


High Technology (Sales and Use Tax Deferral/Waiver and B&O Tax Credit)

Public Policy Objective?

Legislature stated intent to:

- Create “quality” job opportunities.
- Encourage expenditures in research and development (R&D) as the sector develops new technologies and products.



Auditor Concludes

| | |
|---------------------------|------------------|
| Number of Jobs | 454 |
| Economy-Wide New Earnings | \$25,000 per job |
| Tax Credit Taken | \$45,000 per job |

High Technology (Sales and Use Tax Deferral/Waiver and B&O Tax Credit)

Auditor Recommendation

Review and Clarify

To determine if progress toward its high technology R&D objectives is sufficient and to consider identifying targets for investment and employment.



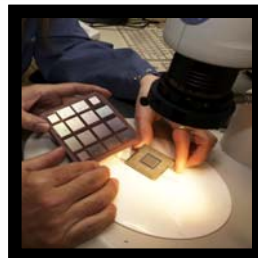
High Technology (Sales and Use Tax Deferral/Waiver and B&O Tax Credit)

Citizen Commission

Does Not Endorse and Recommends

The Legislature should allow the B&O tax credit and sales and use tax deferral/waiver to expire in 2015, as scheduled;

It is clear that the cost exceeds the estimated benefits.



Biotechnology Manufacturing

Sales & Use Tax Deferral/Waiver

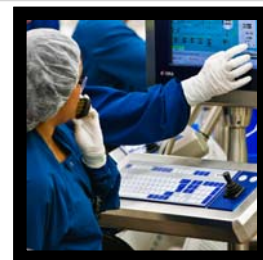


Biotechnology Manufacturing (Sales & Use Tax Deferral/Waiver)

Public Policy Objective?

Legislature stated intent to:

- Encourage expenditures in commercial biotechnology operations.
- Develop employment opportunities in biotechnology manufacturing.



Audit Conclusion

JLARC staff is unable to isolate what impact, if any, this tax preference had on investment.

Biotechnology Manufacturing (Sales & Use Tax Deferral/Waiver)

Auditor Recommendation

Review and Clarify

To determine if progress toward biotechnology manufacturing objectives is sufficient, and to consider identifying targets for investment and employment.



Biotechnology Manufacturing (Sales & Use Tax Deferral/Waiver)

Citizen Commission

Does Not Endorse and Recommends

The Legislature should take no action and allow this preference to expire in 2017, as scheduled;

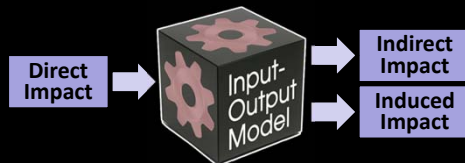
JLARC staff was unable to determine the impact, if any, this preference had on investment and jobs.



Supplement to High Technology and Biotechnology Reviews

Enhancements Are Needed in the Annual Taxpayer Survey and the Washington Input-Output Model

| | |
|-----|------|
| 01 | 0.61 |
| 02 | 0.62 |
| 03 | 0.63 |
| 04 | 0.64 |
| 05 | 0.65 |
| 06 | 0.66 |
| 07 | 0.67 |
| 08 | 0.68 |
| 09 | 0.69 |
| 10 | 0.70 |
| 11 | 0.71 |
| 12 | 0.72 |
| 13 | 0.73 |
| 14 | 0.74 |
| 15 | 0.75 |
| 16 | 0.76 |
| 17 | 0.77 |
| 18 | 0.78 |
| 19 | 0.79 |
| 20 | 0.80 |
| 21 | 0.81 |
| 22 | 0.82 |
| 23 | 0.83 |
| 24 | 0.84 |
| 25 | 0.85 |
| 26 | 0.86 |
| 27 | 0.87 |
| 28 | 0.88 |
| 29 | 0.89 |
| 30 | 0.90 |
| 31 | 0.91 |
| 32 | 0.92 |
| 33 | 0.93 |
| 34 | 0.94 |
| 35 | 0.95 |
| 36 | 0.96 |
| 37 | 0.97 |
| 38 | 0.98 |
| 39 | 0.99 |
| 40 | 1.00 |
| 41 | 1.01 |
| 42 | 1.02 |
| 43 | 1.03 |
| 44 | 1.04 |
| 45 | 1.05 |
| 46 | 1.06 |
| 47 | 1.07 |
| 48 | 1.08 |
| 49 | 1.09 |
| 50 | 1.10 |
| 51 | 1.11 |
| 52 | 1.12 |
| 53 | 1.13 |
| 54 | 1.14 |
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| 57 | 1.17 |
| 58 | 1.18 |
| 59 | 1.19 |
| 60 | 1.20 |
| 61 | 1.21 |
| 62 | 1.22 |
| 63 | 1.23 |
| 64 | 1.24 |
| 65 | 1.25 |
| 66 | 1.26 |
| 67 | 1.27 |
| 68 | 1.28 |
| 69 | 1.29 |
| 70 | 1.30 |
| 71 | 1.31 |
| 72 | 1.32 |
| 73 | 1.33 |
| 74 | 1.34 |
| 75 | 1.35 |
| 76 | 1.36 |
| 77 | 1.37 |
| 78 | 1.38 |
| 79 | 1.39 |
| 80 | 1.40 |
| 81 | 1.41 |
| 82 | 1.42 |
| 83 | 1.43 |
| 84 | 1.44 |
| 85 | 1.45 |
| 86 | 1.46 |
| 87 | 1.47 |
| 88 | 1.48 |
| 89 | 1.49 |
| 90 | 1.50 |
| 91 | 1.51 |
| 92 | 1.52 |
| 93 | 1.53 |
| 94 | 1.54 |
| 95 | 1.55 |
| 96 | 1.56 |
| 97 | 1.57 |
| 98 | 1.58 |
| 99 | 1.59 |
| 100 | 1.60 |



Supplement to High Tech and Biotech Reviews

Auditor Recommendations

The Department of Revenue Should

Convene a work group to address how to improve reliability and accuracy of the information collected in the annual survey and reported to the Legislature and the public.

The Office of Financial Management Should

Estimate cost of including state and local government as separate sectors in the Washington Input-Output model.

Both the Department of Revenue and OFM concur with the recommendations.



Insurance Producers, Title Insurance Agents, and Surplus Line Brokers



Preferential B&O Tax Rate



Insurance Producers, Title Insurance Agents, and Surplus Line Brokers (B&O Tax)

Public Policy Objective?

Legislature did not state. JLARC staff infers the original objectives were to:

- Reduce the impact of B&O surtaxes on insurance contractors because they are unable to raise commissions to cover tax increases in the short term.
- Provide some equity for insurance businesses following the removal of pyramiding for real estate businesses.
- Simplify the tax code by consolidating B&O tax rates.



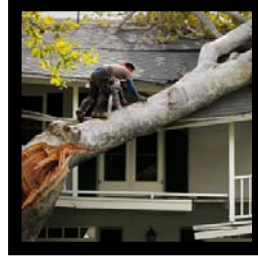
Insurance Producers, Title Insurance Agents, and Surplus Line Brokers (B&O Tax)

Auditor Recommendation

Review and Clarify Because

Unclear why different tax treatment provided to businesses with similar agent/sub agent relationships.

Inferred objectives related to inability of passing on rate increases and consolidating rates may no longer apply.



Insurance Producers, Title Insurance Agents, and Surplus Line Brokers (B&O Tax)

Citizen Commission

Endorses and Adds

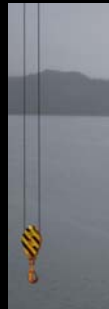
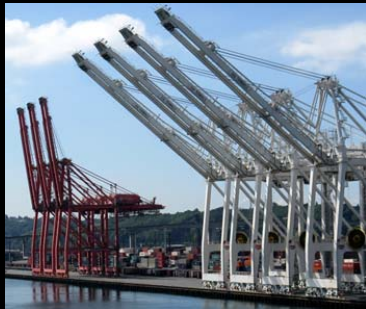
Unless there is a compelling reason for a differential B&O tax rate, the Legislature should increase the tax rate to provide equivalent tax treatment with businesses with similar agent/sub-agent relationships;

No evidence provided for why differential rate is appropriate.



Stevedoring and International Charter/ Freight Brokers

Preferential B&O Tax Rate



Stevedoring and International Charter and Freight Brokers (B&O Tax)

Public Policy Objective?

Stevedoring

Legislature did not state. JLARC staff infers to keep WA's ports and port-related businesses competitive.

International Charter & Freight Brokers

Legislature did not state. JLARC staff could not determine.

1998 Rate Reduction

Stated objective was to simplify the tax code by consolidating B&O tax rates.



Stevedoring and International Charter and Freight Brokers (B&O Tax)

Auditor Recommendation

Review and Clarify Because

- 1) The public policy objective for why the Legislature chose the particular current preferential tax rate for stevedoring activities is unclear;
- 2) The objective for providing the preferential tax rate for international charter and freight brokers is unclear; and
- 3) The objective to consolidate B&O tax rates and classifications may no longer apply.



Stevedoring and International Charter and Freight Brokers (B&O Tax)

Citizen Commission

Does Not Endorse and Recommends

Terminate preferential tax rates; industry has provided no substantial proof that preferential rates are needed to remain competitive and there is no substantive evidence that eliminating the preferences would materially harm Washington's ports.



Travel Agents and Tour Operators

Preferential B&O Tax Rate



Travel Agents and Tour Operators (B&O Tax)

Public Policy Objective?

Legislature did not state. JLARC staff infers to:

- Reduce the financial impact of DOR's 1975 rule change on travel agents by reducing their tax rate in proportion to commissions earned from arranging interstate air travel;
- Provide equitable tax treatment between travel agents and air carriers;
- Achieve administrative simplicity by taxing tour operators at the same rate as travel agents.



Travel Agents and Tour Operators (B&O Tax)

Auditor Recommendation

Review and Clarify Because

It is unclear whether the inferred policy objective of reducing the financial impact of DOR's 1975 rule change, providing equitable tax treatment with air carriers, and achieving administrative simplicity still apply in light of industry changes.



Travel Agents and Tour Operators (B&O Tax)

Citizen Commission

Does Not Endorse and Recommends

Terminate the preferential tax rate for travel agents/tour operators; there no longer appears to be a compelling reason to provide a preferential rate.



Commuting Programs

B&O Tax or Public Utility Tax Credit



Commuting Programs (B&O Tax, PUT)

Public Policy Objective?

Legislature did not state.

JLARC staff infers the objective is to encourage businesses to provide financial incentives to their employees who participate in commute trip reduction (CTR) programs that reduce single occupancy vehicle travel.



Commuting Programs (B&O Tax, PUT)

Auditor Recommendation

Review and Clarify Because

While it provides a credit to businesses providing financial incentives to their employees who participate in CTR activities, it is unclear whether the preference is meeting the broader public policy objective of increasing participation in CTR programs.



Commuting Programs (B&O Tax, PUT)

Citizen Commission

Does Not Endorse and Recommends

Allow to expire as scheduled on June 30, 2013; eliminating the credit unlikely to materially reduce the amount of financial incentives provided by businesses.



Ferry Boats

Sales and Use Tax Exemption



Ferry Boats (Sales and Use Tax)

Public Policy Objective?

Legislature did not state.

JLARC staff infers the objective is to support state and local governments by reducing the cost of building and repairing ferry vessels owned and operated by state and local government entities.



Ferry Boats (Sales and Use Tax)

Auditor Recommendation

Continue Because

It is meeting the inferred objective of reducing state and local governments' costs to build, maintain, and repair ferry vessels they own and operate.



Ferry Boats (Sales and Use Tax)

Citizen Commission

Does Not Endorse and Adds

Review/clarify the public policy objective; if it is not to subsidize public use of ferries, the Legislature should consider terminating the preference.



Commission Updated Comments to Three 2010 Tax Preference Reviews

- In 2010, JLARC staff reviewed three public utility tax preferences involving interstate commerce.
- Commission recommended Legislature direct OFM, DOR, or Economic and Revenue Forecast Council to conduct economic impact study by 12/31/2011 on impacts if preferences were terminated.

Additional Comment (2012)

Legislature has not acted on 2010 recommendation. Legislature should mandate JLARC staff to conduct economic impact study and appropriate sufficient resources. If no action after 2013 session, Commission may schedule preferences for further review.

Agency Comments on 2012 Reviews

Department of Revenue and Office of Financial Management reviewed the preliminary 2012 Tax Preference Performance Reviews and had no comments.

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