

Proposed Final Report

2016 Tax Preference Performance Reviews

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Joint Legislative Audit & Review Committee

December 2016



2006 legislative mandate: conduct performance audits of tax preferences

Legislature (Chapter 43.136 RCW):

- **Created** the Citizen Commission for Performance Measurement of Tax Preferences
- **Specified** JLARC to review preferences over 10-year cycle
- **Outlined** specific questions for JLARC staff to answer
- **Required** audit recommendation
- **Key questions:** public policy objective stated?
Achieved?

Steps in process repeated each year

In 2015, Commission determined 10-year review schedule and preferences for JLARC staff review

July 2016: Staff presented to JLARC Committee

Aug: Staff presented to Citizen Commission

Sept: Commission took public testimony

Oct: Commission adopted comments

Dec: JLARC hears final report

Jan 2017: Joint fiscal committee hearing

Focus on 12 of this year's reviews

4 where we suggest the Legislature review **structural** issues

3 where we suggest **future review or clarification** by Legislature helpful

1 analyzing if **initiative's goals were met is complex**

4 where analysis raised **fiscal issues**

Structural issues

1. Fuel used by mint growers

2. Rural electric cooperative

3. Syrup tax

4. Solar energy

Fuel Used by Mint Growers

(expires July 1, 2017)

Sales and Use Tax



Unclear if preference is achieving stated public policy objective

Stated objective	Objective met?
Incentivize mint growers to transition from diesel to cleaner burning fuels	? Unclear <ul style="list-style-type: none">• Evidence suggests preference not enough to spur remaining diesel stills to convert• Growers using natural gas do not benefit from preference



Legislative Auditor recommends allow to expire

Expire

The preference is **likely not providing enough of an incentive** for mint growers **to convert** the remaining stills from diesel fuel

Citizen Commission **endorsed** without comment

Consider

If Legislature wants to incentivize remaining stills to convert, it may want to consider a **different preference** that applies to **both**



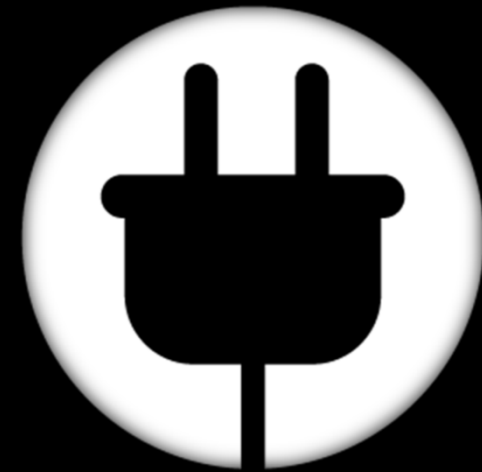
Rural Electric Cooperative Finance Organizations

(expires July 1, 2017)

B&O Tax



REA CO-OPS ARE MEMBER-OWNED AND CONTROLLED



Unclear if Legislature's objectives are being achieved

Stated objective	Objective met?
<p>Provide tax relief to customers of WA rural electric cooperatives</p>	<p>? Unclear Tax relief provided to finance co-op; no evidence that relief was seen by rural electric customers</p>
Add'l legislative intent	Intent met?
<p>Actual revenue impact substantially conform with DOR fiscal estimate</p>	<p>? Unclear</p> <ul style="list-style-type: none"> • DOR fiscal estimate not disclosable • Actual FY15 fiscal impact 27% above \$ amount industry rep provided in 2013 legislative hearings



Legislative Auditor recommends modify the preference

Modify

As currently structured, there is **no guarantee** that the **savings realized by finance organizations** will be **passed on** to Washington rural electric **cooperatives** and their **customers**, as the Legislature intended



Citizen Commission does not endorse Legislative Auditor's recommendation

Continue

- Beneficiary is federally chartered organization created to provide **cost effective financing** to rural electric co-ops
- **Savings likely passed on** to all rural utility customers across U.S. through electric rates
- Ensuring benefit is solely received by WA co-ops and their customers is **unnecessary**



Syrup Tax Paid

B&O Tax



Inferred public policy objective not being achieved

Inferred objective	Objective met?
<p>Provide tax relief to the restaurant industry while maintaining funding via the \$1 per gallon syrup tax for the Violence Reduction and Drug Enforcement (VRDE) account</p>	<p>— No</p> <ul style="list-style-type: none">• Preference not providing tax relief to all restaurants that pay syrup tax<ul style="list-style-type: none">○ 40% of B&O credit available not claimed each year• Objective to maintain VRDE funding no longer relevant<ul style="list-style-type: none">○ VRDE account eliminated in 2009○ Syrup tax now deposited in General Fund



Legislative Auditor recommends repeal syrup tax and associated B&O tax credit

Eliminate syrup tax

Would achieve objective of **providing tax relief**

Since 2009, syrup tax revenues **no longer fund violence & drug enforcement account**

Repeal preference

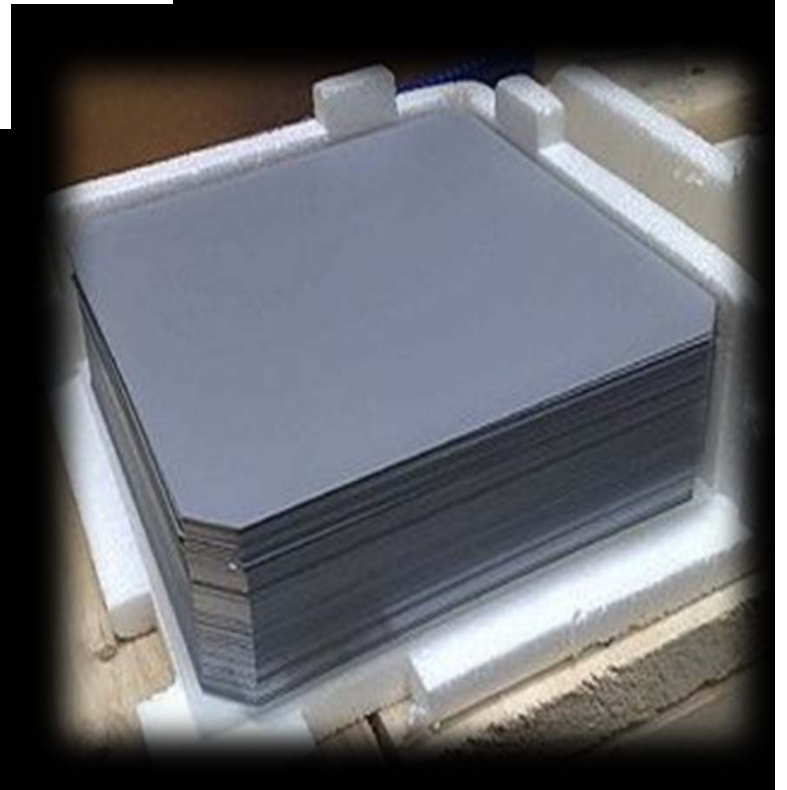
B&O preference unnecessary if syrup tax repealed. Preference **not providing all the intended tax relief** to businesses paying syrup tax

Citizen Commission **endorsed** Legislative Auditor recommendation to repeal B&O tax credit and underlying syrup tax

Solar Energy and Silicon Product Manufacturers

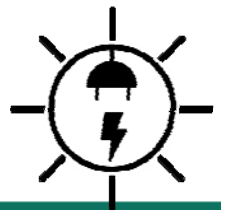
(expires June 30, 2017)

B&O Tax



Unclear if stated objective is being met

Stated objective	Objective met?
Maintain and grow jobs in the solar silicon industry	? Unclear <ul style="list-style-type: none">• “Solar silicon industry” not defined<ul style="list-style-type: none">○ Narrower than qualifying businesses• No job or wage targets<ul style="list-style-type: none">○ Employment has fluctuated



Legislative Auditor recommends review and clarify

Clarify

Intent statement **appears narrower** than businesses that qualify

Unclear whether jobs have been retained and expanded

Inform

Provide performance statement and relevant metrics such as a jobs target

Citizen Commission endorsed without comment



Clarification or review

1. Customer-generated power

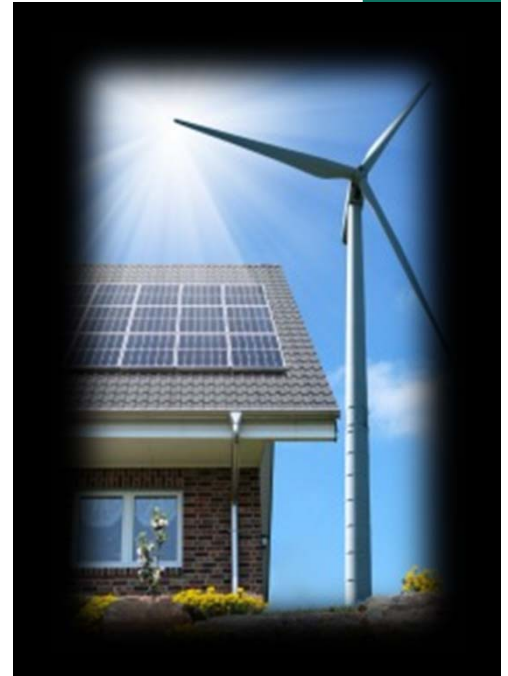
2. Semiconductors

3. Timber and wood products (B&O)



Customer-Generated Power

(expires June 30, 2021)

Public Utility Tax

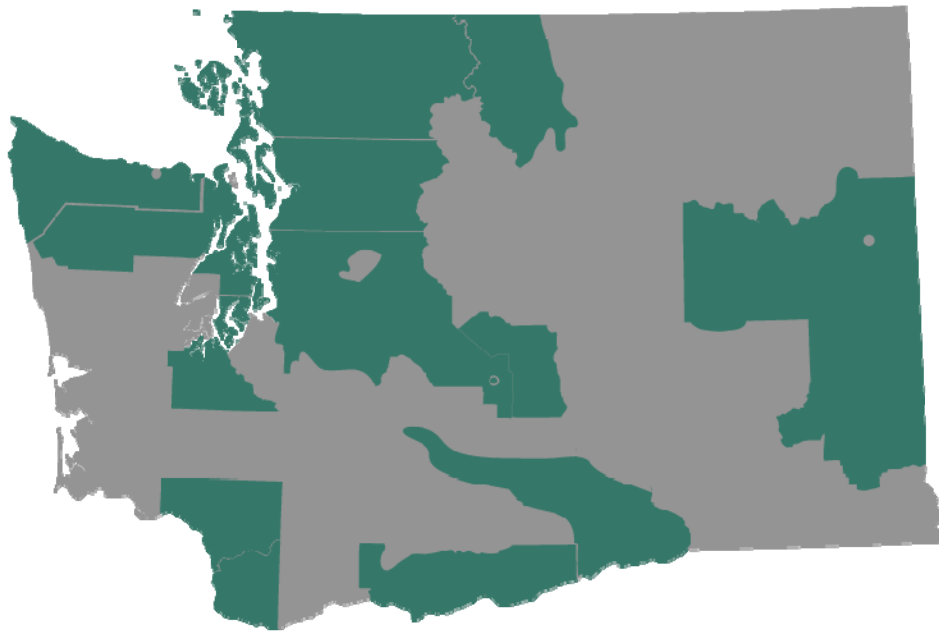


Achievement of two stated public policy objectives is mixed

Stated objective	Objective met?
Greater use of locally created renewable energy technologies	 Yes <ul style="list-style-type: none">• More systems installed, more of those systems made in Washington• Growth is all from solar, wind has decreased
Support and retain existing local industries, create new opportunities for industries	 Unclear <ul style="list-style-type: none">• Installation of Washington-made systems has increased• Growth concentrated in solar, three companies



Utilities reaching limits for providing incentive



**16 utilities – serving
71% of WA utility
customers – reached
the statutory cap**

6 reduced payments, 10
closed program to new
participants

Legislative Auditor recommends review and clarify the preference

Clarify

Use of locally made systems has grown

Growth is concentrated in solar, small number of manufacturers

Inform

Include targets for number of systems, how much power generating capacity, specify which local industries



Citizen Commission endorses the Legislative Auditor's recommendation

Review and clarify

More **clearly define targets** for installations and generation

Include targets for **residential, commercial, and community solar**

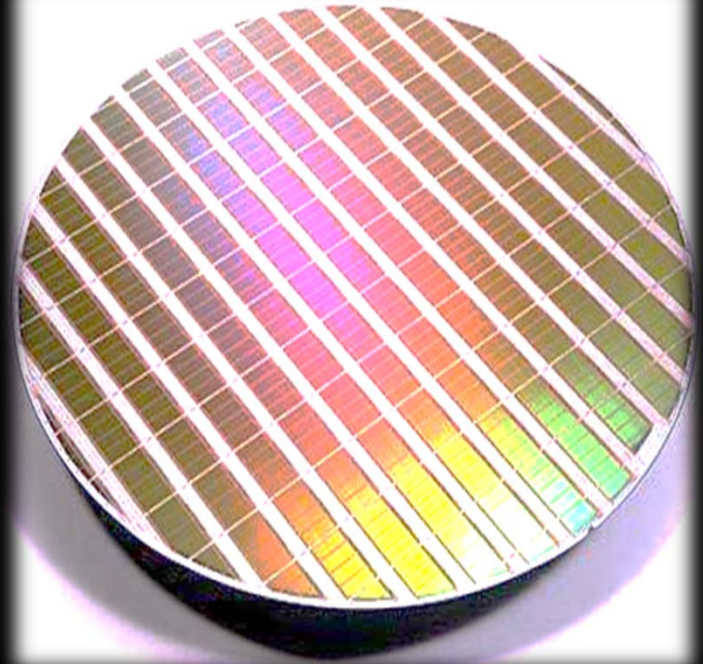
Consider **utilities' administrative costs** related to managing customer-installed solar panels






Semiconductor Materials Manufacturing

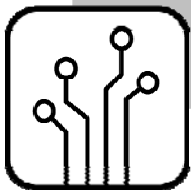
(expires December 1, 2018)

Multiple Taxes



Mixed achievement of stated public policy objectives (preferences in use)

Stated objective	Objective met?
Induce significant construction projects	 Yes <ul style="list-style-type: none"> At least one significant construction project in 2006
Retain, expand and attract semiconductor businesses	 Unclear <ul style="list-style-type: none"> Businesses in the sector have increased, beneficiary businesses have decreased
Create family wage jobs	 Unclear <ul style="list-style-type: none"> Sector employment increased, beneficiary employment decreased 53% of employees below \$20 per hour



Legislative Auditor recommends review and clarify (preferences in use)

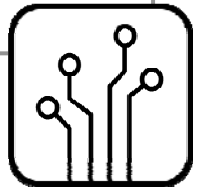
Clarify

Unclear what **employment outcomes** the Legislature wants to achieve

Number of beneficiary businesses and employees has decreased

Inform

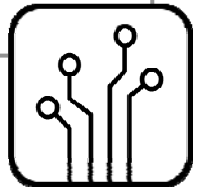
Add **uniform reporting requirements** and targets for employment growth and wages



Legislative Auditor recommends terminate (preferences not in use)

Terminate

The **six preferences** not in effect **have not been used** in the thirteen years since they were enacted



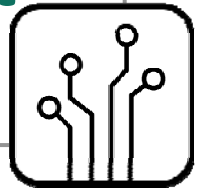
Citizen Commission endorses Legislative Auditor recommendations with comment

Clarify

Congressional Research Service reports 87% of fabrication located **outside** the U.S., employment has **fallen 38%**

- Shift of production to **outside the U.S.**;
- **Increasing automation** of production facilities;
- Shift in favor of **semiconductor design work**

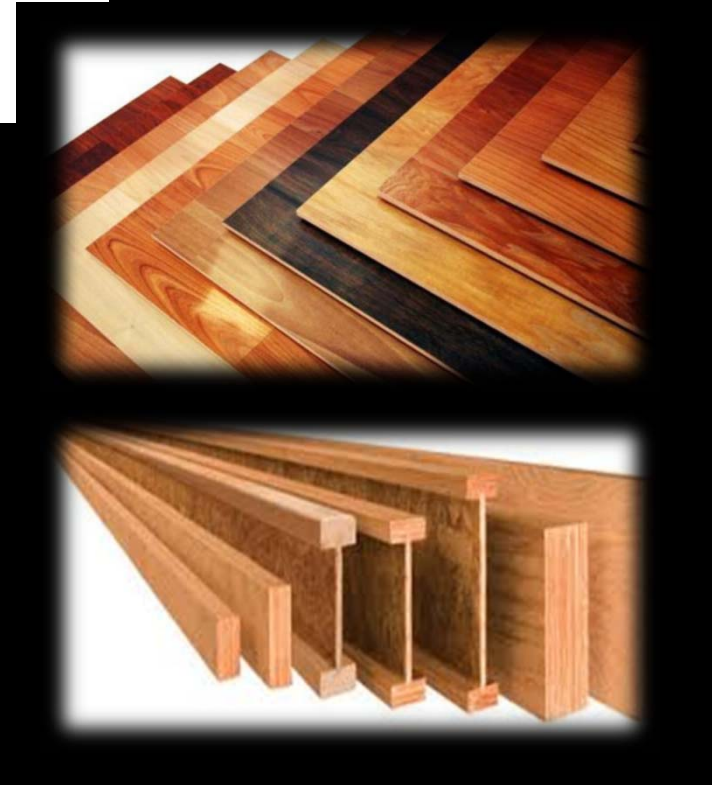
Trends suggest that the current set of preferences will be, for the foreseeable future, **underutilized or not utilized**





Timber and Wood Products

(expires July 1, 2024)

B&O Tax



Unclear if inferred public policy objectives achieved

Inferred objectives	Objectives met?
Reduce cost of doing business for the timber industry	 Yes
Help retain good paying jobs in rural areas (especially manufacturing jobs)	 Unclear Evidence is mixed <ul style="list-style-type: none"> • 30% drop in timber jobs since 2002 • Rural counties had less job loss than non-rural counties (23% vs 41%) • While jobs are down, productivity has increased in WA
Help timber industry compete nationally and internationally	



Legislative Auditor recommends review and clarify

Review

While it is **reducing the cost of business**, it is **unclear** how the preference is **impacting employment and competitiveness**



Clarify

Legislature should provide a **performance statement identifying the public policy objectives** and **providing targets and metrics** to measure if objectives achieved

Citizen Commission endorses Legislative Auditor recommendation

Review and clarify

- Preference may **help offset environmental costs** not borne by foreign competitors
- Legislature should provide **more measurable performance statement** and also **measure the tax burden** of this extractive and manufacturing industry to consider if B&O tax creates a **disproportionate burden** not faced by competitors based elsewhere

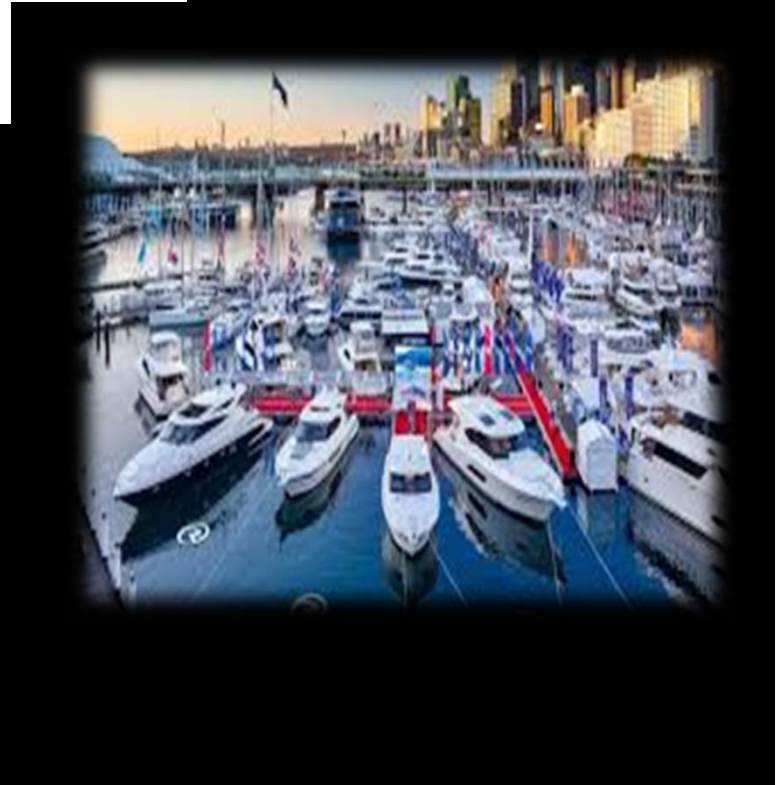


Initiative's goals

1. Trade-ins

Trade-Ins

Sales and Use Tax



Preference enacted by initiative mixed in achieving objectives

Stated and inferred objectives achieved

Reduce amount on which sales tax paid by excluding trade-in value



Yes

Make WA consistent with other states



Yes

40 of 45 states with sales tax

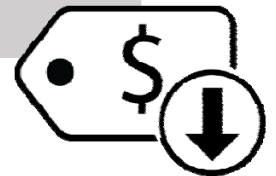
Inferred objective not achieved

Stimulate sales to offset loss of revenue due to the preference



No

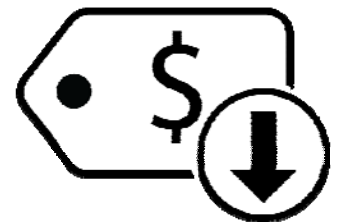
Additional sales generated by preference **do not offset loss**



Legislative Auditor recommends review and clarify

Clarify

While the preference is reducing consumers' taxes and making Washington's tax treatment consistent with other states, it is **not achieving** the inferred objective of **stimulating enough additional sales to replace lost revenue**



Citizen Commission endorses Legislative Auditor recommendation

Review

- This preference is similar to trade-in tax treatment in many other states
- JLARC staff's review concludes the **\$182 million** associated with automobile sales is estimated to **only generate \$31 million** in new sales, causing a **net loss of \$151 million in tax revenue**



Fiscal issues

1. Data centers

2. Nonresident large airplanes

3. Clay targets



4. Flavor-imparting items

Data Center Equipment

Sales & Use Tax



Legislature stated public policy objectives

Stated objective	Objective met?
<p>Improve industry competitiveness through increased investment in data centers</p>	<p> Yes</p> <ul style="list-style-type: none"> • More businesses invest in data centers & claim exemption • Beneficiaries: assessed values grew \$1.2 billion, property taxes paid grew \$13 million during 2011-2015
<p>Create family-wage jobs</p> <ul style="list-style-type: none"> • Permanent/full-time • At the data center • 150% of county per-capita income 	<p> Too early to tell</p> <ul style="list-style-type: none"> • Beneficiaries have 6 years to meet job creation requirements • Only one beneficiary has reached the deadline by May 2016



Legislative Auditor recommends continue

Continue

The stated public policy objective of increased rural property values and rural property taxes from investment in data center construction in rural Washington counties is being achieved.

Tax preference performance statement:

“[T]he Legislature **intends to extend** the expiration date of the tax preference if a review finds that the rural county **tax base is increased** as a result of the construction of data centers eligible for the tax preference.”



Citizen Commission endorses Legislative Auditor recommendation with comment

Continue

- The **Legislature should periodically evaluate** whether the economic **benefits** of the data centers really **exceed the cost** of the tax incentives required over the long term to attract them.
- Other regions offering tax incentives admit uncertainty whether the long-run benefits exceed the costs.
- Local pressure to **increase employment** may override the ability of policy makers to pause to consider longer-run cost issues.

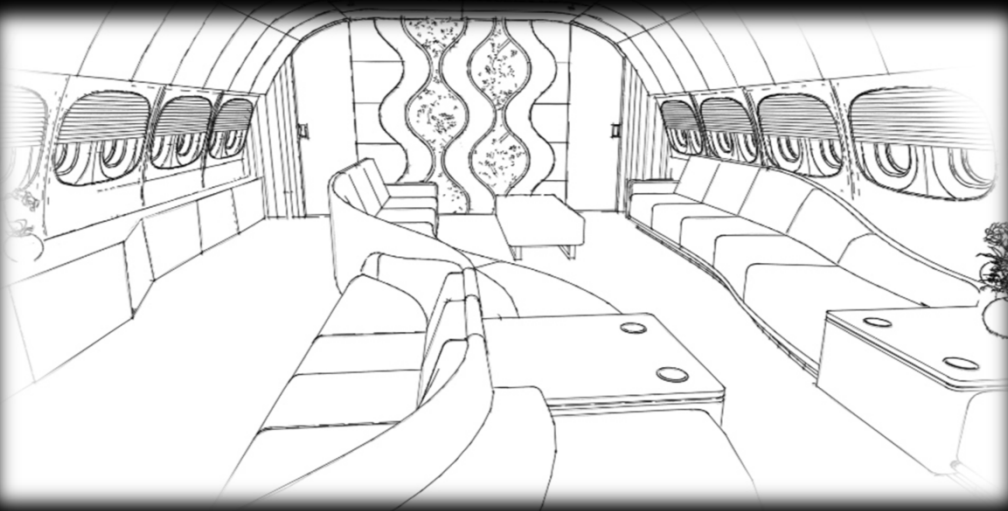


Nonresident Large, Private Airplanes


(expires July 1, 2021)



Sales and Use Tax



Legislature stated public policy objective

Stated objective	Objective met?
<p>Promote economic dev. of WA aerospace cluster and increase tax revenues by promoting competitive marketplace to store and modify private aircraft</p>	<p>? Too early to determine</p> <ul style="list-style-type: none"> As of March 2016, no evidence that preference had been used In late fall, 2 companies contacted JLARC staff indicating they were doing qualifying work
Add'l legislative directive	Results?
<ul style="list-style-type: none"> Estimate net impact of tax preference Estimate job growth resulting from tax preference 	<p>? Too early to determine</p> <p>No reported records of the extent of work or amount of related beneficiary savings</p> 

Legislative Auditor recommends review prior to 2021 expiration

Review before expiration

Prior to July 2021 expiration date, JLARC staff will review again:

- To **determine extent of use** and **economic impact**
- To **provide** the Legislature **accurate information** to help determine if preference is achieving stated public policy objectives



Citizen Commission states preference should be continued

Continue

The Legislature should continue the preference at this time. The Commission defers a conclusion on the expiration date until it is reviewed again in 2019.



Clay Targets

(expires July 1, 2017)

Sales and Use Tax



Legislative Auditor recommends review and clarify

Review

While the preference is **meeting inferred objective** of **providing tax relief** to nonprofit gun clubs, it is **unclear** if the **actual fiscal impact reasonably conforms** to the 2013 fiscal estimate



Citizen Commission endorsed Legislative Auditor recommendation

Review

As the Legislature reviews this related to the actual fiscal impact, should **also review** if nonprofit gun clubs are facing **financial distress**. If not, the preference may **no longer be necessary**



Flavor-Imparting Items

(expires July 1, 2017)

Sales and Use Tax



Legislative Auditor recommends review and clarify

Review

While the preference is **achieving** the stated public policy objective of **providing tax relief** to restaurants, it is **unclear** if the actual fiscal impact **substantially conforms** with the fiscal estimate



Citizen Commission endorsed Legislative Auditor recommendation

Review

While the stated objective was to provide tax relief, it also **avoided a tax dispute** between DOR and taxpayers regarding the ingredients sales tax exemption. As the Legislature reviews preference's actual fiscal impact, should also **consider continuing** as a **clarification** of longstanding sales tax principles



Preferences meeting desired public policy objectives

1. Custom software

2. Self-service laundry

3. Standing timber (REET)

2017-2026 ten-year schedule adopted

Each year focuses on specific groups of industries, such as energy, agriculture, aerospace

As authorized by statute, Commission identified 132 as ***critical to the tax structure***, likely will not be reviewed. Examples include:

- Interest from state and municipal obligations (B&O)
- Growing crops (Property)
- Income of employees (B&O)

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