Preliminary Report

2018 Tax Preference Performance Reviews

July 2018

Nine preferences reviewed:

- 7 Continue but make changes
- 2 Allow to expire and consider other strategies

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Different process, same JLARC review standards

Legislature:

- Directed JLARC to conduct performance audits of tax preferences
- Identified questions for JLARC staff to address
- Requires recommendations

Citizen Commission:

- Created by Legislature, appointed by four caucuses and Governor
- Creates 10-year schedule for review
- Takes public testimony
- Adopts comments to reports

Preferences Reviewed in 2018

Allow to expire and consider other strategies

- Corporate Headquarters Investment Projects
- Multi-Unit Urban Housing - Mason County

Review sufficiency of outcomes & add metrics

- Investment Projects in High Unemployment Counties and Community Empowerment Zones

Determine whether to continue

Policy decision

- Government-Funded Behavioral Health Services

Continue and clarify

Structural purpose

- Aircraft for Air Ambulances
- Custom Farming & Hauling Farm Products
- Nonprofit & Library Fundraising

Corporate Headquarters Investment Projects

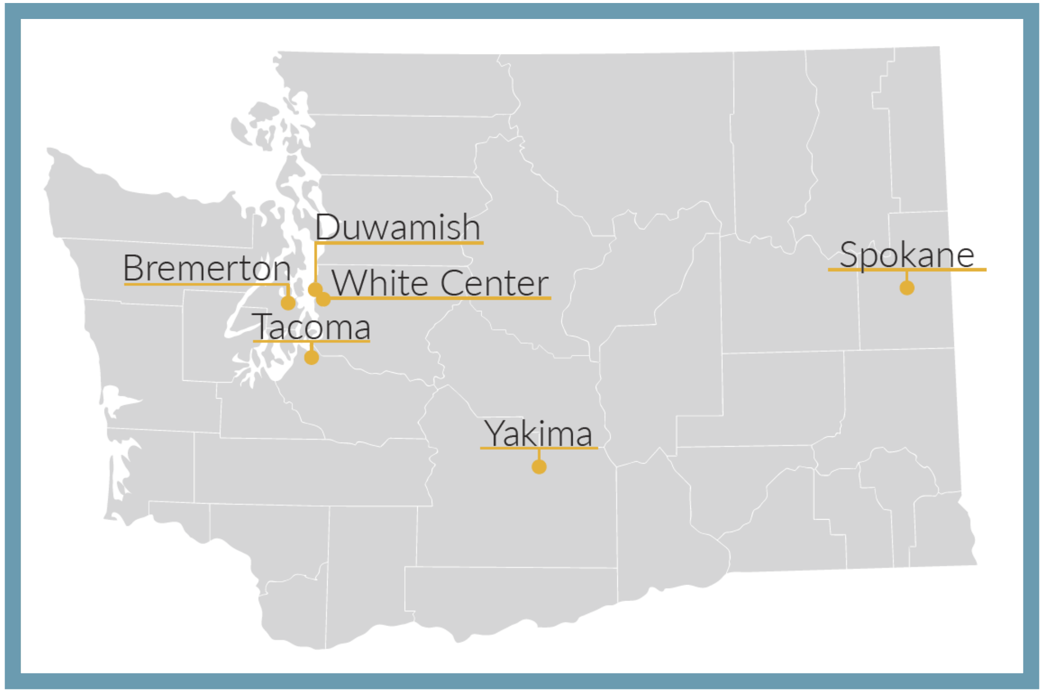
Legislative Auditor's Conclusion

Businesses have not used the tax preference
to locate headquarters in community empowerment zones.

The Legislature may want to consider other strategies to revitalize these areas.

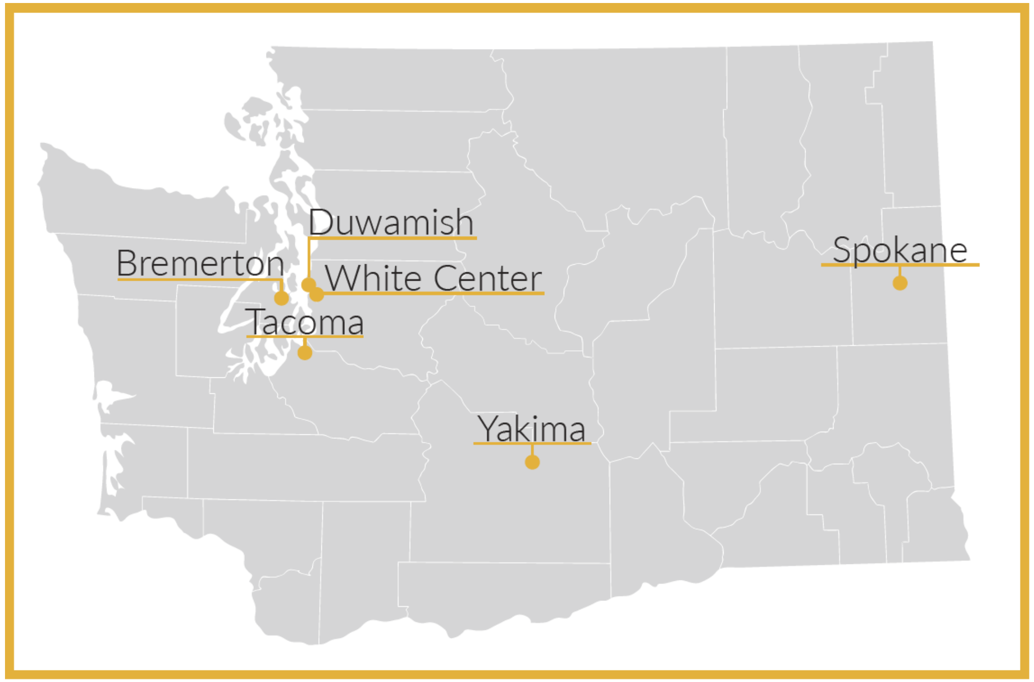
Estimated 2019-21 beneficiary savings: $0

Sales and use tax deferral for corporate headquarters in a Community Empowerment Zone



Low wages	**Limited employment**	**Lack of affordable housing**	**Poor infrastructure**	**Few educational services**

Sales and use tax deferral for corporate headquarters in a Community Empowerment Zone



Operate corporate headquarters

Invest at least $30 million

Provide at least 300 permanent full-time jobs

Deferred taxes waived if project remains eligible for 8 years after construction.

Mixed results for the two inferred public policy objectives

Encourage private sector investment and employment in CEZs

- No businesses have applied since preference was enacted in 2009.

Better compete with Oregon and Idaho for private sector investment

- Removed potential competitive disadvantage with Oregon.
- Idaho repealed a similar preference in 2008.

Research suggests other factors influence location of corporate headquarters

- Ability to attract & retain workforce talent.
- Building the corporate brand/culture.
- Good airport and transportation infrastructure.
- Research and higher education facilities nearby.

Legislative Auditor’s Recommendation

Allow to expire and consider other strategies

The Legislature should allow the preference to expire if no business has applied to use it by December 31, 2020.

The Legislature may want to consider other strategies beyond tax incentives to encourage economic development in CEZs.

Investment Projects in High Unemployment Counties and Community Empowerment Zones

Legislative Auditor's Conclusion

Businesses reported creating **87% fewer jobs** than they originally estimated. The preference likely had a **nominal impact on poverty rates**.

The Legislature should consider adding targets to help determine whether the preference is meeting expectations.

Estimated 2019-21 beneficiary savings: $5.8M

Sales/use tax deferral for qualifying businesses that locate or expand in distressed areas

2019-21 Estimated Beneficiary Savings

$ 5.8 million

Beneficiaries

- **44** businesses in 2016
- DOR estimates **59** businesses for 2017

Program Details

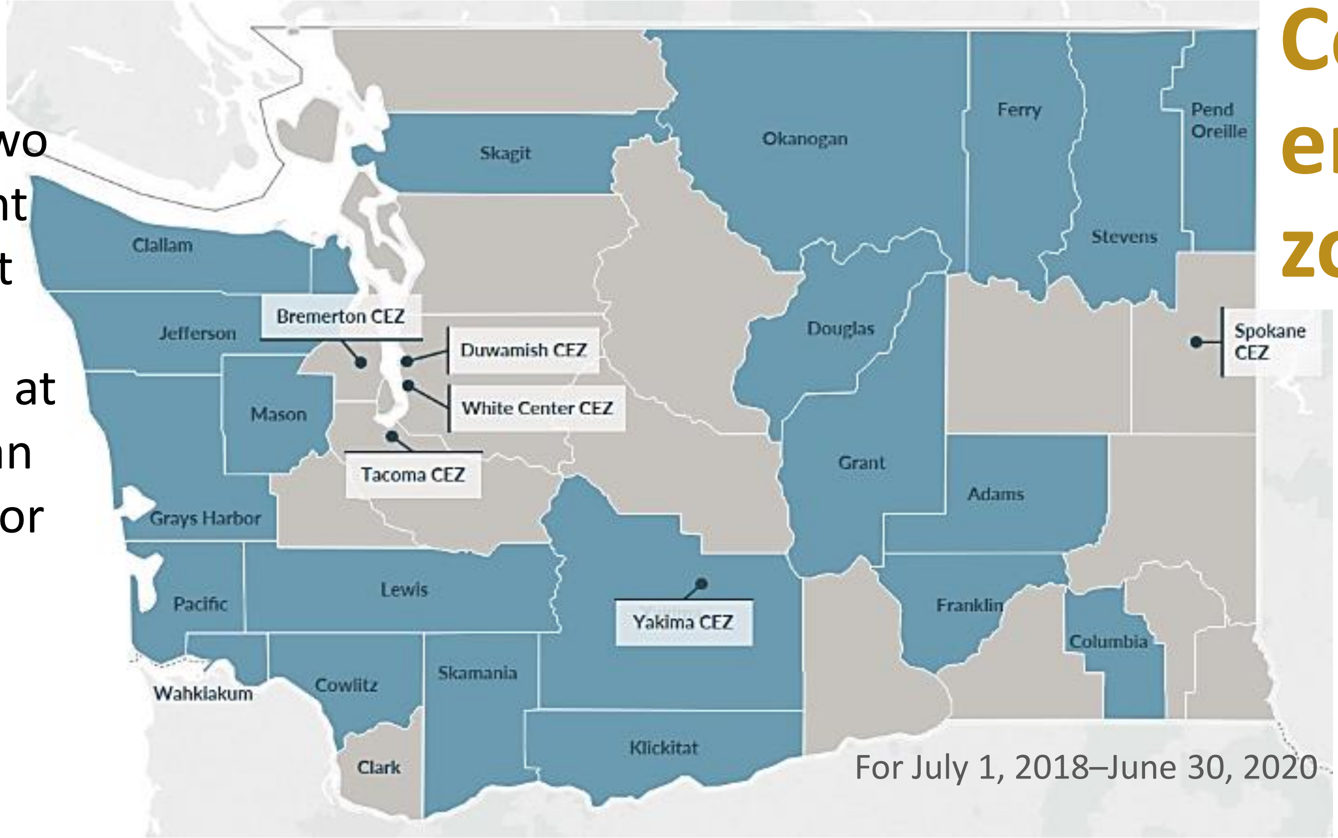
- Invest in facilities, machinery, or equipment in certain distressed areas.
- Manufacturers and certain other activities.
- Deferred taxes waived if project remains eligible for 8 years after completed.
- No deferral certificates issued after June 30, 2020.

2 qualifying distressed areas options

High unemployment counties

Determined every two years by Employment Security Department

Unemployment rate at least 20% higher than state average for prior 3 years



Community empowerment zones

Six established by Department of Commerce

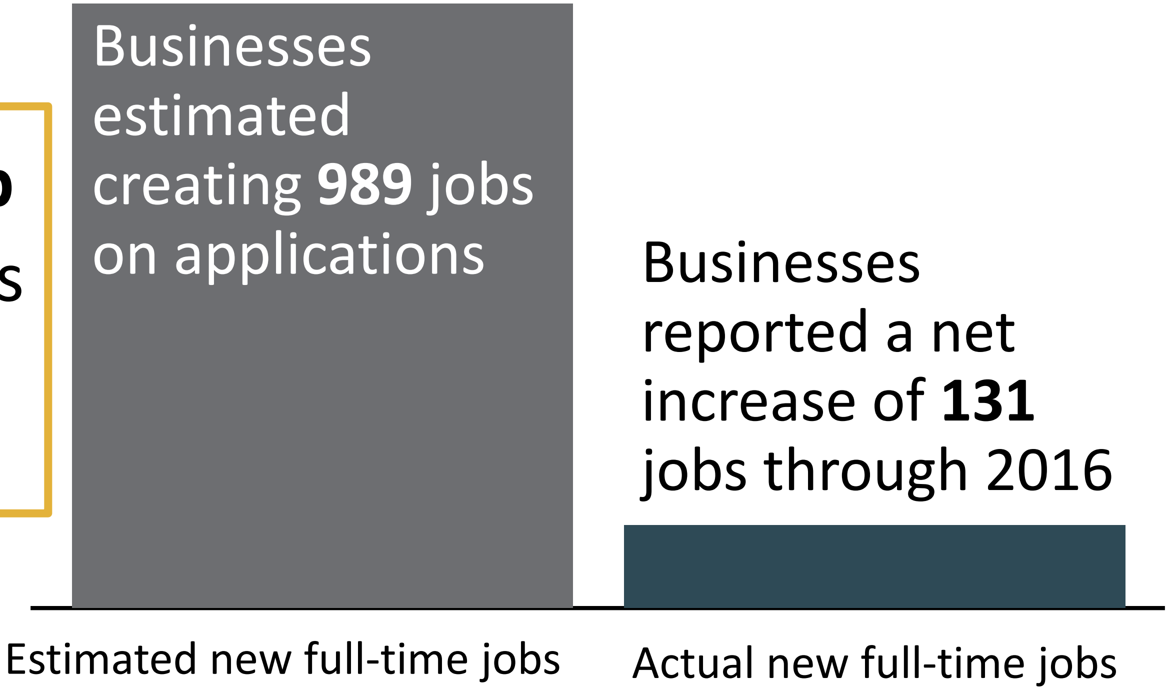
Low wages, limited employment, poor infrastructure, limited services

Mixed results toward achieving first of two stated public policy objectives

1. Stimulate economic development and job growth in distressed areas

Mixed results. Businesses using the preference have created new jobs, but 87% less than they originally estimated.

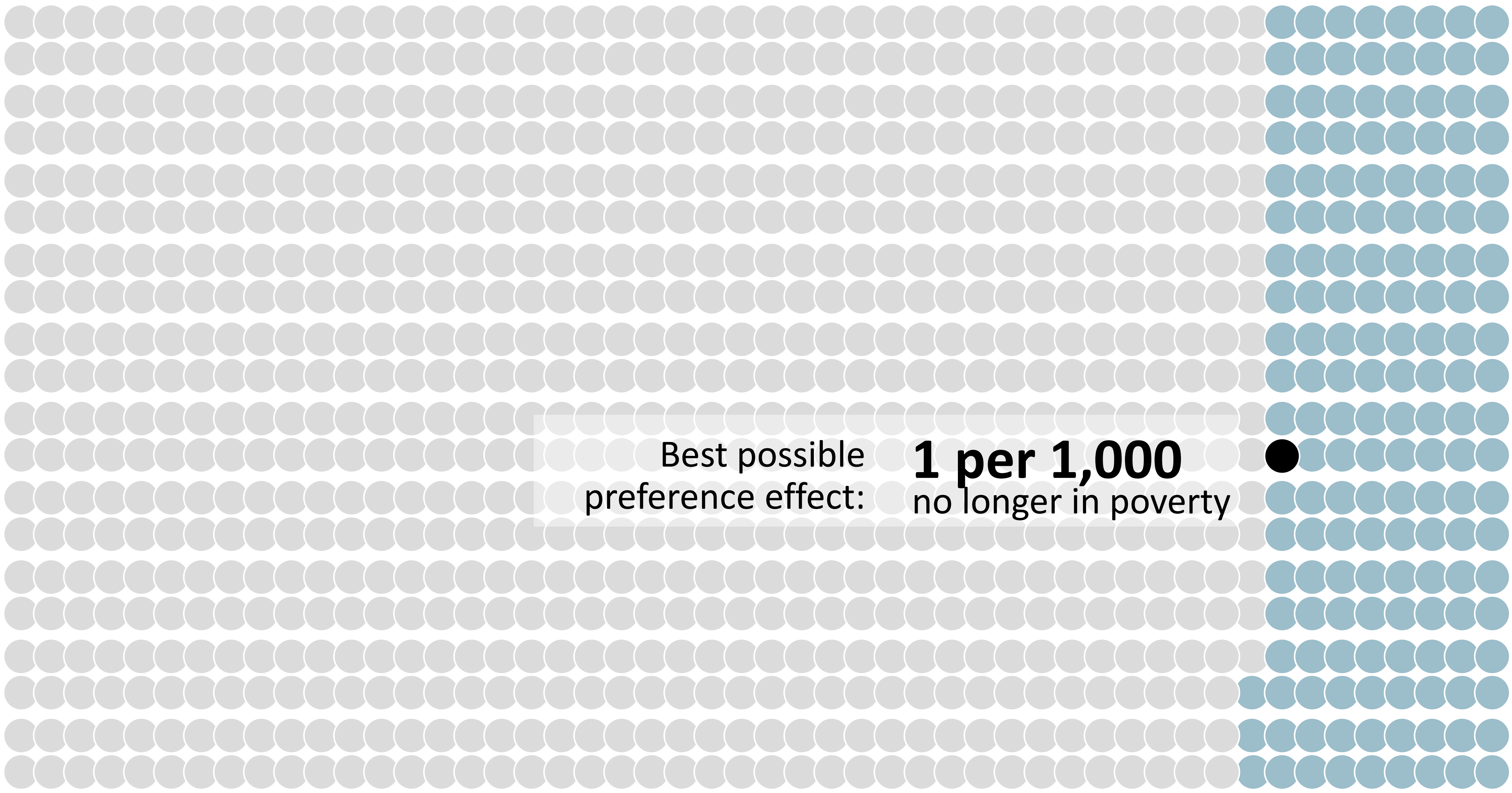
Unclear if **job growth** meets legislative expectations

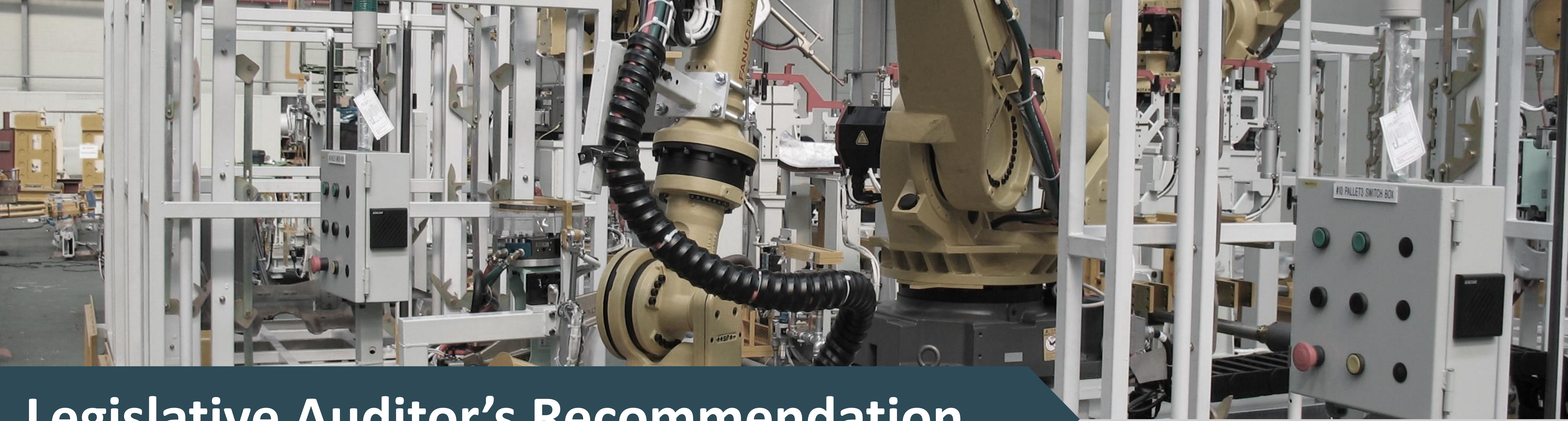


Unclear result toward achieving second stated objective

2. Reduce poverty in distressed areas

Unclear, but likely nominal impact. JLARC staff estimate the potential reduction to the poverty rate is at most 0.07 percent in qualifying areas.


Best possible preference effect:
1 per 1,000
no longer in poverty



Legislative Auditor’s Recommendation

Review sufficiency of outcomes and add metrics

The Legislature should review this preference before July 1, 2020.

While some businesses are using the preference in a few distressed areas, it is unclear if the number of jobs created or potential impact on poverty rates meets legislative expectations. The Legislature should consider adding metrics to reflect its expectations.

Multifamily Housing in Mason County

Legislative Auditor's Conclusion

The preference has not stimulated multifamily housing construction in Mason County.

A review of a similar preference in 2019 may identify some strategies.

Estimated 2019-21 beneficiary savings: $0

Property tax exemption for new, expanded or updated housing

- Application process and reporting by owner and county.
- Must have at least four units.
- 8-year exemption if 20% of units are affordable, 12-year exemption if 50% are affordable.
  - ✓No more than 30% of income
  - ✓Low or moderate income households
- No applications after January 1, 2020.

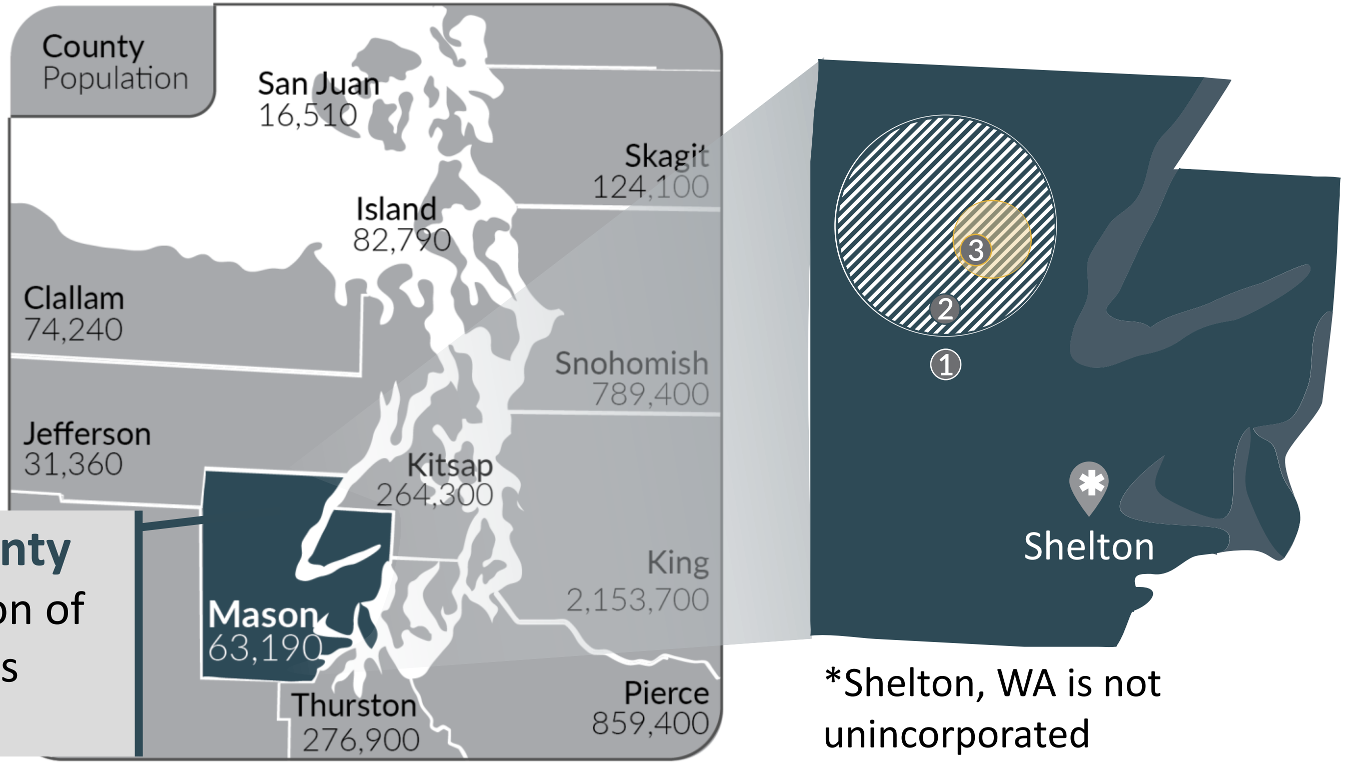
Property tax exemption to stimulate multifamily housing in Mason County

Only Mason County
Meets the definition of rural county for this preference

"Rural County" defined:

- ✓ Population between 50,000 and 71,000
- ✓ Bordering Puget Sound

Property tax exemption to stimulate multifamily housing in Mason County

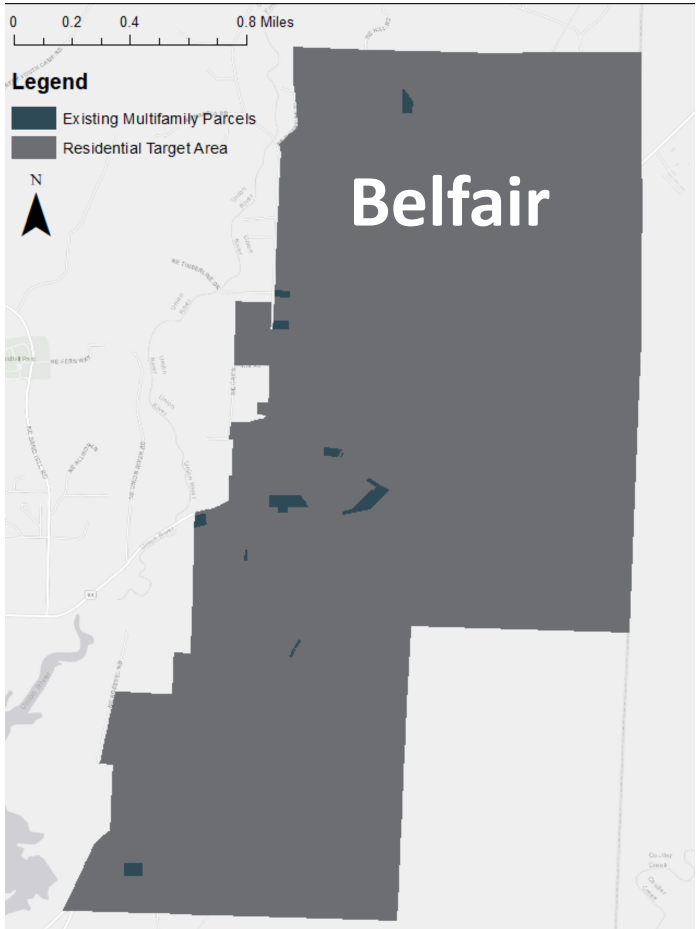


Only Mason County
Meets the definition of rural county for this preference

*Shelton, WA is not unincorporated

Target areas in Mason County must meet 3 criteria

1. Unincorporated
2. In an urban growth area
3. Served by a sewer system



Mason County chose three areas

Unincorporated Shelton

Allyn

Belfair

No multifamily housing built in the county since 2014

Other rural counties report multifamily housing development challenges

3	Three counties had developments with at least four units Farmworker housing – Vacation homes – Religious community
5	Five counties reported no multifamily development in unincorporated areas since 2014

Related preference scheduled for review next year

Multifamily Housing Tax Exemption (MFTE) similar but available in urban areas across the state

No expiration date

Affordability requirements less stringent than for Mason County

Legislative Auditor's Recommendation

Allow to expire and consider other strategies

The Legislature stated it intended to extend the preference if at least **20 percent of new housing** units were occupied by **low or moderate income** households. However, there has been **no new multifamily housing** developed in Mason County since the preference was enacted.

Government-Funded Behavioral Health Services

Legislative Auditor's Conclusion

The preference increases the amount of funding available directly for behavioral health treatment.

With recent changes in the state's management of Medicaid, more providers are likely to use the preference before it expires in 2020.

Estimated 2017-19 beneficiary savings: $10.9M

Behavioral health treatment in Washington

Treatments for mental health and substance use disorders

24-hour crisis services, residential treatment services, group treatment, medication management

85% of government funding is Medicaid

In most regions, behavioral health funding is managed by Behavioral Health Organizations

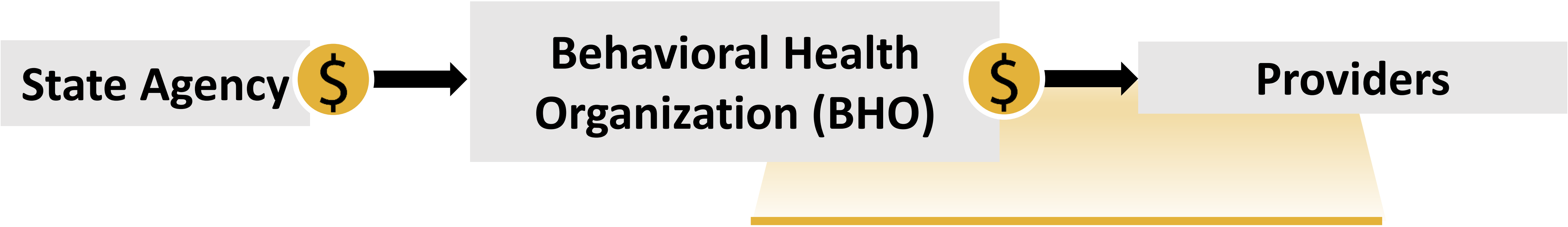
Regional entities that manage public funding for treatment

- 7 are government entities
- 1 is private

When BHOs are government, **some nonprofit providers** can deduct their income from B&O tax

State Agency $ → Behavioral Health Organization (BHO) $ → Providers

Preference reduces taxes, so more money can go directly to behavioral health treatment



Private BHO and qualifying nonprofit providers may deduct the amount the BHO pays for services.

Changes in how Washington manages Medicaid funding will affect how health care providers are taxed

State Agency $ → Different kinds of regional entities for Medicaid and non-Medicaid funding $ → Providers

Most of these new entities are private.

More providers are likely to use preference.

When preference expires in 2020, more government-funded behavioral health treatment will be taxed

Nonprofit providers **will pay tax** on receipts from private entities

Some may claim **other deductions**

Taxed the same as entities providing physical health services

Legislative Auditor’s Recommendation

Determine whether to continue (policy decision)

If the Legislature wants to continue the tax deduction for government-funded behavioral health care, it will **need to take action**. Otherwise, behavioral health will be treated the **same as physical health** and providers will **pay B&O taxes** beginning in 2020.

Aircraft for Air Ambulances

Legislative Auditor's Conclusion

The Legislature should continue the preferences and clarify whether they are intended solely for tax relief.

If so, the Legislature should remove the expiration dates.

Estimated 2019-21 beneficiary savings: $0

Aircraft excise tax exemption and property tax exemption for certain organizations that operate air ambulance services

Nonprofit 501(c)(3) tax-exempt organizations that own aircraft

Aircraft used exclusively for emergency medical transportation

Both preferences expire January 1, 2020.

Inferred objective to provide tax relief achieved

Preference provided tax relief to 1 recipient for 6 years

- Merged with a for-profit company in March 2016, so no longer qualifies

The 5 air ambulance service providers currently operating in Washington **do not qualify**

Legislative Auditor's Recommendation

Continue and clarify (structural purpose - tax relief)

The Legislature should consider:

- Adding performance statements that specify public policy objectives.
- Eliminating expiration dates. While no providers currently qualify to use the preferences, they continue to provide potential tax relief.

Custom Farming and Hauling Farm Products

Legislative Auditor's Conclusion

The Legislature should continue and clarify the two preferences to add performance statements, specify public policy objectives, and eliminate the expiration dates.

Estimated 2019-21 beneficiary savings: $67,500; unknown

B&O tax exemption for:

Public utility tax exemption for:

Custom farming services – using machinery or draft animals to perform activities like planting or harvesting agricultural products.

Performed by a farmer or an entity at least 50% owned by a farmer.

Specific farming services - such as farm management or contract labor.

Performed by a person related to the farmer who receives the services.

Hauling farm machinery, equipment, or agricultural products for a farmer.

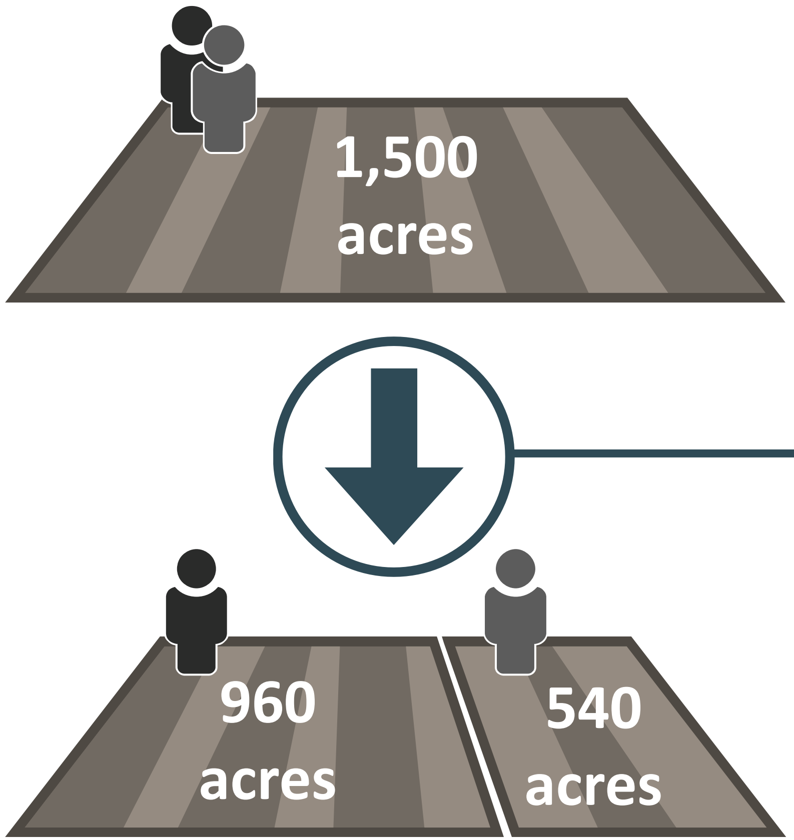
The person who does the hauling must be related to the farmer who receives the service.

“Related” - defined in federal income tax law as family member or organizational relationship, such as a corporation or trust.

Both preferences expire December 31, 2020.

Some WA farmers chose to reorganize their farms in response to federal regulations.

This had potential state tax consequences.



Some owners split their farms among multiple owners.

Often responding to federal regulations limiting irrigation water to **no more than 960 acres.**

They may continue to operate as one farming operation.

These farm ownership changes created an **unintended structural tax issue:** Services provided from one farm owner to another farm owner may be subject to state B&O or public utility tax.

One of the two inferred objectives achieved

B&O tax exemption for custom farming and specific farming services is providing tax relief as intended.

- 2019-21 Estimated beneficiary savings: $67,500
- Five to seven beneficiaries annually

Unclear if the public utility tax exemption is providing tax relief

- No data about use of the preference is available

Legislative Auditor's Recommendation

Continue and clarify (structural purpose – tax relief)

The Legislature should consider:

- Adding performance statements that specify public policy objectives.
- Eliminating expiration dates. If the preferences' objective was to provide tax relief due to a structural issue, it is unclear why an expiration date is needed.

Nonprofit and Library Fundraising

Legislative Auditor's Conclusion

The Legislature should continue and clarify the preference to eliminate the expiration date, add a mechanism to increase the exempt amount over time, and recategorize the preference.

Estimated 2019-21 beneficiary savings: unknown

People who purchase or win items valued at less than $12,000 at nonprofit or library fundraising events do not owe use tax

Qualifying fundraising events must be:

1. Intended to raise money to further the goals of the nonprofit or library
2. Time-limited
3. Exempt from paying B&O tax on income generated from the event

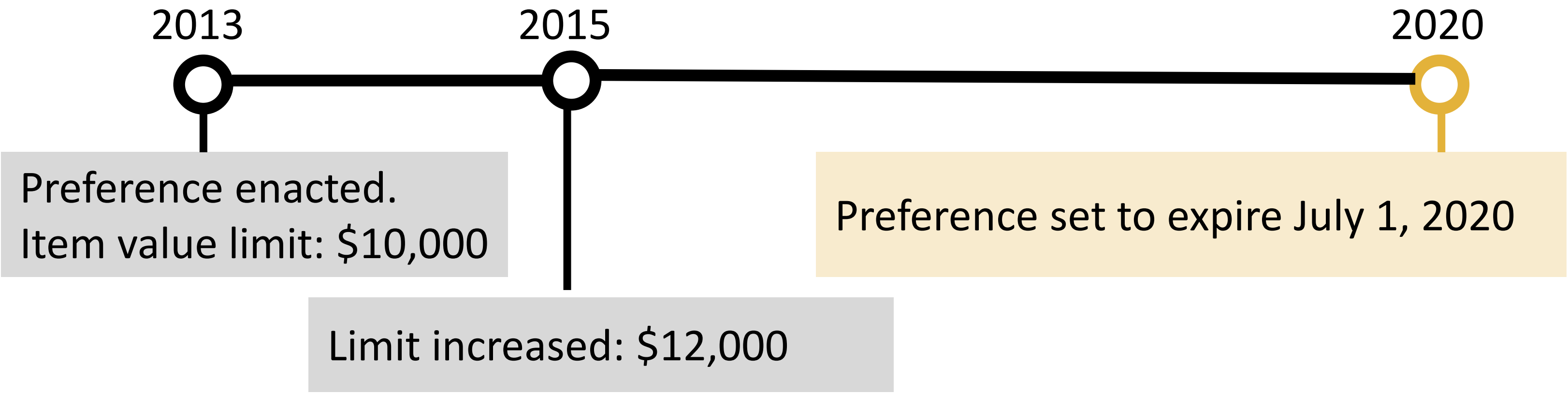
Nonprofit organizations and libraries do not collect sales tax at such fundraising events under a different statute.

Preference scheduled to expire July 1, 2020.

Stated objective met

Preference provides tax relief to people supporting charitable fundraising

Value of exempted items has increased over time



Legislative Auditor's Recommendation

Continue and clarify (structural purpose – tax relief)

If the Legislature continues the preference, it should consider:

- Making the preference permanent.
- Adding a mechanism to increase the exempt value over time.
- Recategorizing as intended to provide tax relief to certain individuals.

Next Steps

Citizen Commission considers report

August – October 2018

Proposed Final Report

December 2018

Joint fiscal committee hearing

January 2019

Full Report

http://leg.wa.gov/jlarc/taxReports/2018/default.html

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