JLARC Preliminary Report: 2017 Tax Preference Performance Reviews

Overview

JLARC staff reviewed 16 tax preferences in 2017, which are organized into 13 reports below.

View a more detailed summary of all the preferences **here**.

The Citizen Commission for Performance Measurement of Tax Preferences also considers preferences based on information provided by the Department of Revenue. View the 2017 expedited preference report **here** (PDF).

Click the preference below for details	One Page Overview	Estimated Biennial Beneficiary Savings	Legislative Auditor Recommendation	Commissioner Recommendation *Available October 2017*
Alternative Fuel Vehicles		$14.8 million	Review	
Automotive Adaptive Equipment For Veterans and Service Members With Disabilities		$194,000	Clarify	
Coal-Fired Power Plant Preferences		$6.1 - 16.6 million; $0; $2.2 million	Continue	
Cogeneration Facilities and Renewable Resources		$0	Terminate	
Electric Power Sold in Rural Areas		$1.68 million	Continue	
Electric Vehicle Batteries and Charging Stations		$0; $1.8 - $3.4 million; Unknown	Clarify	
Electricity for Electrolytic Processors		$1.3 million	Clarify	
International Banking Facilities		$208,000	Review and Clarify	
Manufactured Home Communities		$105,000	Continue	
Standard Financial Information		$3.1 million	Clarify	

Click the preference below for details	One Page Overview	Estimated Biennial Beneficiary Savings	Legislative Auditor Recommendation	Commissioner Recommendation *Available October 2017*
State-Chartered Credit Unions		$47.9 million	Clarify	
Vessel Deconstruction		$184,000	Review and Clarify	
Wood Biomass Fuel Manufacturing		$0	Terminate	

How We Do Reviews

What Is a Tax Preference?

Tax preferences are defined in statute (RCW **43.136.021**) as 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 approximately 600 tax preferences.

Why a Review of Tax Preferences?

Legislature Creates a Process to Review Tax Preferences

In 2006, the Legislature 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 (RCW **43.136**).

Statute assigns specific roles in the process to two different entities.

- The Citizen Commission for Performance Measurement of Tax Preferences ("The Commission") creates a schedule for reviews, holds public hearings, and comments on the reviews.
- Staff to the Joint Legislative Audit and Review Committee (JLARC) conduct the reviews.

Citizen Commission Sets the Schedule

The Legislature directed the Commission to develop a schedule to accomplish an orderly review of most tax preferences over ten years. The Commission is directed to omit certain tax preferences from the schedule, such as those required by constitutional law. The Commission may also exclude preferences from review that the Commission determines are a critical part of the tax structure.

The Commission conducts its reviews based on analysis prepared by JLARC staff. In addition, the Commission may elect to rely on information supplied by the Department of Revenue.

In 2017, JLARC staff completed 16 preference reviews (similar preferences may be combined into one report). The Commission's website includes analysis of preferences completed in previous years: See **http://www.citizentaxpref.wa.gov/**.

JLARC Staff's Approach to the Tax Preference Reviews

Statute guides the 11 questions typically covered in the reviews.

Public Policy Objectives:

1. What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference? (RCW 43.136.055(b))
2. What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives? (RCW 43.136.055(c))

3. To what extent will continuation of the tax preference contribute to these public policy objectives? (RCW 43.136.055(d))
4. If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment of the tax benefits? (RCW 43.136.055(g))

Beneficiaries:

5. Who are the entities whose state tax liabilities are directly affected by the tax preference? (RCW 43.136.055(a))
6. To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended? (RCW 43.136.055(e))

Revenue and Economic Impacts:

7. What are the past and future tax revenue and economic impacts of the tax preference to the taxpayer and to the government if it is continued? (This includes an analysis of the general effects of the tax preference on the overall state economy, including the effects on consumption and expenditures of persons and businesses within the state.) (RCW 43.136.055(h))
8. If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy? (RCW 43.136.055(f))
9. If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes? (RCW 43.136.055(i))
10. For those preferences enacted for economic development purposes, what are the economic impacts of the tax preference compared to the economic impacts of government activities funded by the tax? (RCW 43.136.055(j))

Other States:

11. Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington? (RCW 43.136.055(k))

Depending on the tax preference, certain questions may be excluded. For instance, question #4 relates to modifying a preference if the public policy is not being fulfilled. If the preference is fulfilling its public policy, this question is skipped.

JLARC Staff's Analysis Process

JLARC staff carefully analyze a variety of evidence in conducting these reviews:

- Legal and public policy history of the tax preferences.
- Beneficiaries of the tax preferences.
- Government and other relevant data pertaining to the utilization of these tax preferences.
- Economic and revenue impact of the tax preferences.
- Other states' laws to identify similar tax preferences.

Key: Understanding the Purpose

The Legislature now requires that when it creates a new preference, or expands or extends an existing preference, a tax preference performance statement is to be included. The performance statement is to include a statement of legislative purpose as well as metrics to evaluate the effectiveness of the preference. (RCW **82.32.808**).

When a preference's purpose or objective is identified in statute, staff are able to affirmatively state the public policy objective. If not in a tax preference performance statement, the objective may be found in intent statements or in other parts of statute.

However for many preferences passed before 2013 the Legislature did not state the public policy objective. In such instances, staff may be able to infer what the implied public policy objective might be. To arrive at this inferred policy objective staff review the following:

- Legislative history, including
    - Final bill reports for any statements on the intent or public policy objectives
    - Bills prior to the final version and legislative action on bills related to the same topic
    - Bill reports and testimony from various versions of the bill
    - Records of floor debate
- Relevant court cases that provide information on the objective.
- Department of Revenue information on the history of tax preferences, including rules, determinations, appeals, audits, and taxpayer communication.
- Press reports during the time of the passage of the bill which may indicate the intention of the preference.
- Other historic documents, such as stakeholder statements, that may address the issue addressed by the tax preference.

JLARC staff also interview the agencies that administer the tax preferences or are knowledgeable of the industries affected by the tax. Agencies may provide data on the value and usage of the tax preference and the beneficiaries. If the beneficiaries of the tax are required to report to other state or federal agencies, JLARC staff will also obtain data from those agencies.

If there is sufficient information in this evidence to *infer* a policy objective, JLARC staff state that in the reviews. In these instances, the purpose may be a more generalized statement than can be made compared to instances that have explicit statutory language.

About This Year's Reviews

Contact

Authors of these Reviews

Dana Lynn, Research Analyst, 360-786-5177

Eric Whitaker, Research Analyst, 360-786-5618

Rachel Murata, Research Analyst, 360-786-5293

Pete van Moorsel, Research Analyst, 360-786-5185

John Woolley, Audit Coordinator

Keenan Konopaski, Legislative Auditor

Audit Authority

The Joint Legislative Audit and Review Committee (JLARC) works to make state government operations more efficient and effective. The Committee is comprised of an equal number of House members and Senators, Democrats and Republicans.

JLARC's non-partisan staff auditors, under the direction of the Legislative Auditor, conduct performance audits, program evaluations, sunset reviews, and other analyses assigned by the Legislature and the Committee.

The statutory authority for JLARC, established in **Chapter 44.28 RCW**, requires the Legislative Auditor to ensure that JLARC studies are conducted in accordance with Generally Accepted Government Auditing Standards, as applicable to the scope of the audit. This study was conducted in accordance with those applicable standards. Those standards require auditors to plan and perform audits to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on the audit objectives. The evidence obtained for this JLARC report provides a reasonable basis for the enclosed findings and conclusions, and any exceptions to the application of audit standards have been explicitly disclosed in the body of this report.

Members: Citizen Commission for Performance Measurement of Tax Preferences

Voting Members

Dr. Grant D. Forsyth

Ronald L. Bueing

Diane Lourdes Dick

Dr. Justin Marlowe

Andi Nofziger-Meadows

Non-voting Members

John Braun, JLARC Chair
Pat McCarthy, State Auditor

JLARC Members on Publication Date

Senators	Representatives
Randi Becker	Jake Fey
John Braun, *Chair*	Larry Haler
Bob Hasegawa	Vicki Kraft
Mark Mullet, *Assistant Secretary*	Christine Kilduff
Rebecca Saldaña	Ed Orcutt, *Secretary*
Dean Takko	Gerry Pollet
Lynda Wilson	Derek Stanford, *Vice Chair*
	Drew Stokesbary

Scope & Objectives

Why a JLARC Study of Tax Preferences?

In 2006, the Legislature established the Citizen Commission for Performance Measurement of Tax Preferences and directed it to develop a schedule for periodic review of the state's tax preferences. The Legislature directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct the periodic reviews. (Chapter 43.136 RCW).

Background

Tax preferences include: exemptions, exclusions, or deductions from the base of a state tax; credits against a state tax; deferrals of a state tax; or preferential state tax rates.

Recognizing the need to assess the effectiveness of these tax preferences through an orderly process, the Legislature established the Citizen Commission for Performance Measurement of Tax Preferences. One of the Commission's roles is to develop a schedule for the orderly review of the state's 600+ tax preferences at least once every ten years. The Commission meets this requirement through the development of a ten-year review schedule, which can be revised annually if needed.

Omitted from review are several categories of tax preferences identified by statute (e.g., tax preferences required by constitutional law). Any tax preference the Commission determines is critical to the structure of the tax system may also be omitted. Additionally, the Commission may recommend an expedited process for any tax preference.

JLARC staff are to review tax preferences according to the schedule developed by the Commission. For each tax preference the Commission selects for a performance review, JLARC staff are to provide a recommendation to either: (1) continue; (2) allow to expire; (3) continue and modify the expiration date; (4) review and clarify; or (5) terminate the preference.

Study Scope

With the 2017 reviews, the Commission will enter into the second decade of reviews. Based on the experiences of the past ten years, the Commission choose, as permitted in statute, to organize the ten-year schedule primarily by industry groupings. For 2017, the focus is on alternative energy, energy, finance, and maritime.

The Citizen Commission selected the following tax preferences for a performance review by JLARC staff in 2017:

Brief Description and Tax Type	RCW Citation	Year Enacted

1.	*Renewable Energy Machinery (Sales and Use Tax)*	*During the 2017 third special legislative session, this preference was substantially narrowed. JLARC staff suspended the 2017 review and the Citizen Commission may consider it for review in the future.*	
2.	Alternative Fuel Vehicles (Sales and Use Tax)	82.08.809; 82.12.809	2005
3.	*Solar Energy Machinery and Equipment (Sales and Use Tax)*	*During the 2017 third special legislative session, this preference was substantially narrowed. JLARC staff suspended the 2017 review and the Citizen Commission may consider it for review in the future.*	
4.	Standard Financial Information (Sales and Use Tax)	82.08.207; 82.12.207	2013
5.	Vessel Deconstruction (Sales and Use Tax)	82.08.9996; 82.12.9996	2014
6.	Disabled Veterans Adaptive Vehicle Equipment (Sales and Use Tax)	82.08.875; 82.12.875	2013
7.	Electric Vehicle Battery Charging Stations (Sales and Use Tax)	82.08.816; 82.12.816	2009
8.	Electric Vehicle Infrastructure (Leasehold Excise Tax)	82.29A.125	2009
9.	Manufactured Home Communities (Real Estate Excise Tax))	82.45.010(3)(r	2008
10.	Electricity for Electrolyte Firms (Public Utility Tax)	82.16.0421	2009
11.	Cogeneration Facilities and Renewable Resources (Public Utility Tax)	82.16.055	1980
12.	Wood Biomass Fuel Manufacturing (B&O Tax)	82.04.260(1)(f)	2003
13.	Coal for Thermal Generating Plants (Sales and Use Tax)	82.08.811; 82.12.811	1997
14.	Electric Power Sold in Rural Areas (Public Utility Tax)	82.16.053	1994
15.	Domestic Use (Petroleum Products Tax)	82.23A.030(2)	1989

The Citizen Commission also identified the following additional tax preferences for a performance review by JLARC staff in 2017, if staff resources are available.

	Brief Description and Tax Type	RCW Citation	Year Enacted
14.	Financial Institution Affiliates Income (B&O Tax)	82.04.645; 82.04.080(2)	2010

	Brief Description and Tax Type	RCW Citation	Year Enacted
15.	Credit Unions – State Chartered (B&O Tax)	82.04.405	1970
16.	Financial Institution Investment Conduit or Securitization Entity Income (B&O Tax)	82.04.650; 82.04.080(2)	2010
17.	International Banking Facilities (B&O Tax)	82.04.315	1982
18.	Interest on Agricultural Loans (B&O Tax)	82.04.4294	1970
19.	Trust Accounts (B&O Tax)	82.04.392	1997
20.	Forfeiture of Interest in a Sales of Real Property (Real Estate Excise Tax)	82.45.010(3)(d)	1955
21.	Ferry Boats (Sales and Use Tax)	82.08.0285; 82.12.0279	1977
22.	Boats Under 16 Feet (Watercraft Excise Tax)	82.49.020(3)	1983
23.	Fuel for State or County Ferries (Sales and Use Tax)	82.08.0255(1)(d)-(e); 82.12.0256(2)(e)-(f)	2011

In addition, the Commission will consider the following tax preferences, using an expedited process. The expedited process is primarily based on information published by the Department of Revenue in its most recent statutorily required tax exemption study.

	Brief Description and Tax Type	RCW Citation	Year Enacted
1.	Boats Sold to Nonresidents (Sales and Use Tax)	82.08.700; 82.12.700	2007
2.	Vessel Use by Manufacturers or Dealers (Use Tax)	82.12.800, 801, 802	1997
3.	Historic Vessels (Property Tax)	84.36.080(2)	1986
4.	Vessels Under 65 Feet in Length (Public Utility Tax)	82.16.020(1)(e)	1935
5.	Ships Under Construction (Property Tax)	84.36.079	1959
6.	Foreclosure or Deed in Lieu of Foreclosure (Real Estate Excise Tax)	82.45.010(3)(j)	1951
7.	Multi-unit Urban Housing (Property Tax)	84.14.020	1995
8.	Subsidized Housing (Leasehold Excise Tax)	82.29A.130(3)	1976
9.	Mortgage Insurers (Real Estate Excise Tax)	82.45.010(3)(k)	1951
10.	Used Mobile Homes (Sales and Use Tax)	82.08.033; 82.12.033	1979
11.	Used Floating Homes (Sales and Use Tax)	82.08.034; 82.12.034	1984
12.	Used Park Model Trailers (Sales and Use Tax)	82.08.032; 82.12.032	2001
13.	Mortgage or Other Security Interest (Real Estate Excise Tax)	82.45.010(3)(i)	1951
14.	Public Employee Housing (Leasehold Excise Tax))	82.29A.130(5	1976
15.	Homes Pending Destruction (Leasehold Excise Tax)	82.29A.130(10)	2009
16.	Mobile Homes in Dealer Inventory (Property Tax)	84.36.510	1985
17.	Mobile Homes Possessed by Landlords (Property Tax)	84.56.335(2)	2013
18.	Housing Finance Commission (B&O Tax)	82.04.408	1983

Study Objectives

In response to the legislative directive, each performance review may answer questions relevant to the tax preference from the following list of questions.

Public Policy Objectives:

1. What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference? (RCW **43.136.055(b)**)
2. What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives? (RCW **43.136.055(c)**)
3. To what extent will continuation of the tax preference contribute to these public policy objectives? (RCW **43.136.055(d)**)
4. If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment of the tax benefits? (RCW **43.136.055(g)**)

Beneficiaries:

5. Who are the entities whose state tax liabilities are directly affected by the tax preference? (RCW **43.136.055(a)**)
6. To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended? (RCW **43.136.055(e)**)

Revenue and Economic Impacts:

7. What are the past and future tax revenue and economic impacts of the tax preference to the taxpayer and to the government if it is continued? (This includes an analysis of the general effects of the tax preference on the overall state economy, including the effects on consumption and expenditures of persons and businesses within the state.) (RCW **43.136.055(h)**)
8. If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy? (RCW **43.136.055(f)**)
9. If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes? (RCW **43.136.055(i)**)
10. For those preferences enacted for economic development purposes, what are the economic impacts of the tax preference compared to the economic impact of government activities funded by the tax? (This analysis involves conducting an economic impact study using OFM's input-output model.) (RCW **43.136.055(j)**)

Other States:

11. Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington? (RCW **43.136.055(k)**)

Timeframe for the Study

A preliminary audit report will be presented at the July 2017 JLARC meeting and at the August 2017 meeting of the Commission. A final report will be presented to JLARC in December 2017.

Alternative Fuel Vehicles

One Page Overview

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A sales and use tax exemption on the first $32,000 of a sale or lease agreement for qualifying new clean alternative fuel vehicles with a manufacturer's suggested retail price of $42,500 or less for the lowest price base model. The preference is scheduled to expire when one of the following occurs: • The total number of qualifying vehicles titled on or after July 15, 2015, reaches 7,500. • July 1, 2019.	**Sales and Use** RCWs 82.08.809; 82.12.809	$14.8 million

Public Policy Objective

The Legislature stated it wanted to increase the use of qualifying clean alternative fuel vehicles by reducing the price of such vehicles.

Recommendations

Legislative Auditor's Recommendation

Review: The Legislature should review the preference in the 2019 legislative session if the number of qualifying vehicles titled in Washington has not reached 7,500 by July 1, 2019.

Commissioner Recommendation: Available in October 2017.

Automotive Adaptive Equipment For Veterans and Service Members With Disabilities

One Page Overview

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A sales and use tax exemption for veterans or service members with disabilities for purchases, installations, or repairs of qualifying automotive adaptive equipment. The preference is scheduled to expire July 1, 2018.	**Sales and Use** RCWs 82.08.875; 82.12.875	$194,000

Public Policy Objective

The Legislature stated the public policy objectives were to:

- Provide specific financial relief for severely injured veterans and service members.
- Offset a competitive disadvantage for Washington businesses.

Recommendations

Legislative Auditor's Recommendation

Clarify: The Legislature should clarify the preference because, while it provides financial relief and removes a perceived competitive disadvantage, the estimated beneficiary savings have exceeded the 2013 fiscal note estimate for the past three fiscal years.

Commissioner Recommendation: Available in October 2017.

Coal-Fired Power Plant Preferences

One Page Overview

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A sales and use tax exemption for purchases of coal used in electric generation.	**Sales and Use Tax** RCWs 82.08.811, 82.12.811	$6.1-16.6 million in the 2017-19 biennium
A sales and use tax exemption for purchases of air pollution control equipment.	**Sales and Use Tax** RCWs 82.08.810, 82.12.810	$0 in the 2017-19 biennium
A property tax exemption for the assessed value of air pollution control equipment.	**Property Tax** RCW 84.36.487	$2.2 million in the 2017-19 biennium

Public Policy Objective

The Legislature's stated public policy objectives:

1. Update coal plant air pollution control equipment.
2. Abate pollution.
3. Play a long-term economic role in the communities where the plant is located.

Recommendations

Legislative Auditor's Recommendation

Continue: The Legislature should continue the three tax preferences until the coal-fired boilers at the plant are decommissioned. The three tax preferences are meeting the stated public policy objectives of helping Washington's only coal-fired power plant to update air pollution control equipment, abate pollution, and play an economic role in its community through 2025.

Commissioner Recommendation: Available in October 2017.

Cogeneration Facilities and Renewable Resources

One Page Overview

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A public utility tax deduction to utilities based on the cost to produce electricity from cogeneration or renewable energy resources.	**Public utility tax** RCW 82.16.550	$0

Public Policy Objective

The Legislature stated it wanted to encourage efficient energy use and a reliable supply of energy based on renewable energy resources.

Recommendations

Legislative Auditor's Recommendation

Terminate: The Legislature should add an expiration date to terminate this preference because it is not currently being used and there will be no remaining eligible utilities within a few years.

Commissioner Recommendation: Available in October 2017.

Electric Power Sold in Rural Areas

One Page Overview

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A public utility tax deduction for utilities with fewer than 17 customers per mile of power line and retail power rates above the statewide average.	**Public utility tax** RCW 82.16.053	$1,680,000

Public Policy Objective

JLARC staff infer the public policy objective was to provide tax relief to utilities and their customers in rural areas where retail power rates exceed the statewide average.

Recommendations

Legislative Auditor's Recommendation

Continue: The Legislature should continue the preference because it is meeting its inferred objective of providing tax relief to rural utilities with higher electricity costs and their customers. In continuing the preference, the Legislature should consider stating the public policy objective in statute.

Commissioner Recommendation: Available in October 2017.

Electric Vehicle Batteries and Charging Stations

One Page Overview

The Preferences Provide	Tax Type	Estimated Biennial Beneficiary Savings
A **sales and use tax exemption** for: • Electric vehicle (EV) battery purchases, installations, and repairs. • EV charging stations and component parts, and labor and services to install, repair, and improve them. A **leasehold excise tax (LET) exemption** for private use of publicly owned property for installing, maintaining, or operating EV charging stations. The preferences are scheduled to expire on January 1, 2020.	**Sales and Use** RCWs 82.08.816; 82.12.816 **Leasehold Excise** RCW 82.29A.125	Sales and Use Tax for EV Batteries: Limited use and impact Sales and Use Tax for EV Charging Stations: range between $1.8 - $3.4 million LET for EV Charging Stations: Unknown

Public Policy Objective

The Legislature stated the public policy objectives:

- Encourage transition to greater use of EVs; and
- Develop convenient, cost-effective EV infrastructure in Washington.

Recommendations

Legislative Auditor's Recommendation

Before the January 1, 2020, expiration date, the Legislature should:

- **Review and clarify the electric vehicle battery tax preference** to determine if the use matches legislative expectations for the preference.
- **Review and clarify the electric vehicle charging station** components, construction, installation, and repair tax preference to set a target for the number of new EV charging stations.
- **Clarify the leasehold excise tax preference** for private use of publicly owned property for electric vehicle infrastructure to require direct beneficiaries to report their use of the preference.

Commissioner Recommendation: Available in October 2017.

Electricity for Electrolytic Processors

One Page Overview

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A public utility tax exemption for sales of electricity to businesses that use electrolysis to make chemicals. The preference is scheduled to expire June 30, 2019.	**Public Utility Tax** RCW 82.16.0421	$1 million in the 2017-19 biennium.

Public Policy Objective

JLARC staff infer the public policy objectives are to:

- Retain family-wage jobs.
- Allow the electrolytic processors to continue production in Washington so that the industries will remain competitive and be positioned to preserve and create new jobs.

Recommendations

Legislative Auditor's Recommendation

Clarify: The Legislature should review and clarify the tax preference because the law no longer includes public policy objectives and the metric for jobs may not reflect current employment levels in the industry.

Commissioner Recommendation: Available in October 2017.

International Banking Facilities

One Page Overview

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A business and occupation tax exemption for the gross receipts of international banking facilities.	**Business and Occupation Tax** RCW 82.04.315	$208 thousand in the 2017-19 biennium

Public Policy Objective

JLARC staff infer the public policy objective is to encourage the establishment of international banking facilities in Washington.

Recommendations

Legislative Auditor's Recommendation

Review and Clarify: The Legislature should review and clarify the B&O tax exemption for international banking facilities to provide an explicit public policy objective and metrics to determine if the objective has been achieved.

The Legislature may also want to review the relevance of the preference given changes to Washington's apportionment laws.

Commissioner Recommendation: Available in October 2017.

Manufactured Home Communities

One Page Overview

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
An exemption for sellers from real estate excise tax when they sell a mobile or manufactured home community to an organization for the purpose of preserving the community.	**Real Estate Excise Tax** RCWs 82.45.010(r), 59.20.030	$96,000

Public Policy Objective

The Legislature stated the public policy objectives were to encourage and facilitate preservation of existing manufactured and mobile home communities, and involve community tenants or eligible organizations representing their interests in preservation.

Recommendations

Legislative Auditor's Recommendation

Continue: The Legislature should continue the preference because it is meeting its stated public policy objective of facilitating the preservation of existing manufactured and mobile home communities.

Commissioner Recommendation: Available in October 2017.

Standard Financial Information

One Page Overview

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A sales and use tax exemption for buyers of standard financial information. The preference is scheduled to expire July 1, 2021.	**Sales and Use Tax** RCWs 82.08.207; 82.12.207	$3.1 million in the 2017-19 biennium

Public Policy Objective

The Legislature stated the public policy objectives were to:

- Exempt standard financial information purchased by international investment management companies from sales and use tax.
- Provide the exemption with a minimal fiscal impact.

Recommendations

Legislative Auditor's Recommendation

Clarify: The Legislature should clarify the sales and use tax exemption for standard financial information because, while the preference is meeting the stated objective of exempting sales of standard financial information, it is unclear if the actual fiscal impact reasonably conforms to the 2013 fiscal estimate.

Commissioner Recommendation: Available in October 2017.

State-Chartered Credit Unions

One Page Overview

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A B&O tax exemption for gross income earned by state-chartered credit unions.	**B&O** RCW 82.04.405	$47.9 million

Public Policy Objective

The Legislature did not state a public policy objective. JLARC staff infer two:

- To keep state-chartered credit unions under state regulation by removing an incentive for them to switch to a federal charter.
- To continue support for credit unions, which were originally formed to provide financial services for low-income groups underserved by commercial banks.

Recommendations

Legislative Auditor's Recommendation

Clarify: The Legislature should clarify the preference to identify public policy objectives because none are stated in statute. As part of the clarification, the Legislature should provide a performance statement that provides targets and metrics to measure whether the objectives have been achieved.

Commissioner Recommendation: Available in October 2017.

Vessel Deconstruction

One Page Overview

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A sales and use tax exemption for vessel deconstruction services when done at either a qualified vessel deconstruction facility or over the water in an area permitted under federal law. The preference is scheduled to expire on January 1, 2025.	**Sales and Use** RCWs 82.08.9996; 82.12.9996	$184,000

Public Policy Objective

The Legislature stated the public policy objective was to decrease the number of abandoned and derelict vessels by providing incentives to increase vessel deconstruction.

Recommendations

Legislative Auditor's Recommendation

The Legislature should review and clarify the preference because:

- The average cost is lower, but it is unclear if it leads to an increase in vessel removals.
- Other factors, such as available DVRP funds, removal costs, and size and condition of the vessel, may impact vessel removals as much or more than reduced deconstruction costs.

When reviewing the preference, the Legislature may want to consider:

1. **Adopting a metric** other than the number of vessels removed to measure if the public policy objective has been achieved.
2. **Re-categorizing the purpose** of the preference as intended to provide tax relief rather than intended to induce a certain behavior.

Commissioner Recommendation: Available in October 2017.

Wood Biomass Fuel Manufacturing

One Page Overview

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A preferential business and occupation tax rate (0.138 percent) for manufacturers that create liquid fuel from wood biomass.	**Business and Occupation Tax** RCW 82.04.260(1)(f)	$0 in 2017-19 biennium.

Public Policy Objective

JLARC staff infer the public policy objectives are to:

- Encourage the production of wood biomass fuel in Washington.
- Reduce air pollution and greenhouse gas emissions by promoting the production of wood biomass fuel.
- Increase demand for wood biomass.

Recommendations

Legislative Auditor's Recommendation

Terminate: The Legislature should terminate the tax preference because the preference is not being used and other tax preferences directed at wood biomass fuel manufacturing are no longer in effect.

Commissioner Recommendation: Available in October 2017.

Alternative Fuel Vehicles

JLARC Staff 2017 Tax Preference Performance Evaluation — Sales and Use Tax Preference

Objectives (stated)	Results
Increase use of clean alternative fuel vehicles by reducing the price.	**Mixed.** Preference has reduced price but the extent that it is impacting sales is unknown.
End preference by July 2019 or when 7,500 qualifying alternative fuel vehicles are titled, whichever is first.	**On pace.** At current trend, target will be met before July 2019 expiration date.

Buyers do not pay sales/use tax on the first $32,000 of the sale or lease for qualifying vehicles

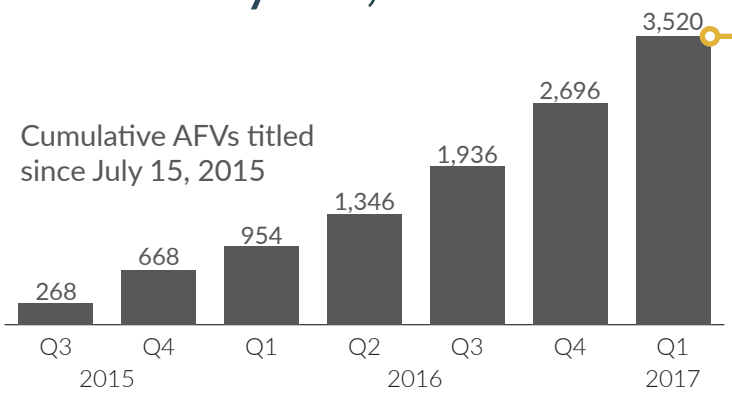
Qualifying vehicles' base model must cost $42,500 or less **and be either:**

- Powered by natural gas, propane, hydrogen, or electricity.

or

- Plug-in hybrid that can travel at least 30 miles on only battery power.

3,520 qualifying vehicles titled in Washington since July 15, 2015



About halfway towards 7,500 target for new titles as of March 31, 2017.

If trend continues, will meet target before July 2019 expiration date.

Source: Department of Licensing (DOL) title data as reported to Department of Revenue.

Preference one of many factors that may influence vehicle purchasing decisions

- **Purchase prices** for electric vehicles **tend to be higher** than for conventional fuel vehicles.
- Consumer concerns about the **cost and range of EV batteries.**
- Overall **driving costs lower for electric** than conventional vehicles.
- **Access** to charging stations.

Legislative Auditor recommendation: **Review**

Legislature should review the preference in the 2019 legislative session if the target for vehicle titles is not met.

The complete report is on the JLARC web site.

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
(360) 786-5187 keenan.konopaski@leg.wa.gov

Alternative Fuel Vehicles | Sales and Use Tax

Click here for One Page Overview

Summary of this Review

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A sales and use tax exemption on the first $32,000 of a sale or lease agreement for qualifying new clean alternative fuel vehicles with a manufacturer's suggested retail price of $42,500 or less for the lowest price base model. The preference is scheduled to expire when one of the following occurs: • The total number of qualifying vehicles titled on or after July 15, 2015, reaches 7,500. • July 1, 2019.	**Sales and Use** RCWs 82.08.809; 82.12.809	$14.8 million

Public Policy Objective
The Legislature stated it wanted to increase the use of qualifying clean alternative fuel vehicles by reducing the price of such vehicles.

Recommendations
Legislative Auditor's Recommendation **Review:** The Legislature should review the preference in the 2019 legislative session if the number of qualifying vehicles titled in Washington has not reached 7,500 by July 1, 2019. **Commissioner Recommendation:** Available in October 2017.

Details on this Preference

1. What is the preference?

Sales and use tax exemption for purchases or leases of new vehicles that use clean alternative fuel

Purpose

The Legislature passed this sales and use tax preference with the stated purpose to increase the use of clean alternative fuel vehicles in Washington.

Clean alternative fuel vehicles are powered by electricity, natural gas, propane, or hydrogen and must meet specific emission standards.

Exemption applies to the first $32,000 of a sale for vehicles with base model priced at $42,500 or less

Individuals are exempt from paying sales or use tax on the first $32,000 of a sale or lease agreement for vehicles with a manufacturer's suggested retail price of $42,500 or less for the lowest base model.

Qualifying vehicles must be either **exclusively powered by a clean alternative fuel** or **plug-in hybrids** that use electricity as at least one power source, and can travel at least 30 miles using only battery power.

The sales and use tax exemption has three components: the 6.5 percent state sales tax, an additional 0.3 percent sales tax for motor vehicle sales, and the applicable local sales tax.

Legislature set two potential expiration dates for the sales and use tax preference

The preference expires as soon as one of the following occurs:

- The **cumulative number** of qualifying vehicles titled in Washington on or after July 15, 2015, **reaches 7,500.**
- **July 1, 2019**.

2. Legal History

Legislature has modified sales and use tax preference over time to encourage more use of clean alternative fuel vehicles

The first sales and use tax preference, passed in 2005, took effect January 1, 2009, when the first alternative fuel vehicles (AFVs) were expected to be on the market.

Since then, the Legislature has continued to modify the preference to encourage more use of qualifying AFVs.

2005: Legislature passed sales and use tax exemptions for new, clean AFVs and hybrids effective in 2009

The Legislature passed two sales and use tax exemptions for sales and leases of qualifying new passenger cars, light duty trucks, and medium duty passenger vehicles. Qualifying vehicles had to be powered by a clean alternative fuel or by hybrid technology with highway mileage ratings of at least 40 miles per gallon. There were no price limitations for qualifying vehicles.

The preferences were scheduled to expire January 1, 2011.

2009: Legislature repealed preference for new hybrid vehicles after 8 months, but left the preference for AFVs in place

The Legislature repealed the sales and use tax exemption for new hybrid technology vehicles with highway mileage ratings of at least 40 miles per gallon.

The Legislature did not change the preference for sales and leases of new vehicles powered only by clean alternative fuel.

2010: Legislature extended and expanded tax preference to include some used, modified AFVs

The Legislature expanded the preference to apply to qualifying **used** vehicles that were part of a fleet of five or more vehicles all owned by the same person. The used vehicles had to be modified after their initial purchase to run exclusively on a clean alternative fuel and meet other qualifying criteria.

The Legislature also extended the expiration date from January 1, 2011, to July 1, 2015.

2015: Legislature allowed preference to expire, then replaced with a modified version

After the existing tax preference expired on July 1, 2015, the Legislature passed a new, modified preference that took effect July 15, 2015.

The new exemption applied to sales and leases for the following vehicles with a **sales or lease price of $35,000 or less**:

- **"Plug-in hybrid vehicles" -** vehicles that use at least one power source that can be recharged by an external electricity source and can travel at least 30 miles using only battery power.
- **Qualifying alternative fuel vehicles** which are powered exclusively by natural gas, propane, hydrogen, or electricity.

The exemption **no longer applied** to sales or leases of **used, modified vehicles**.

The Legislature established a July 1, 2019, expiration date.

2016: Legislature revised current preference to include higher priced vehicles but lowered amount eligible for exemption

Effective July 1, the preference applies to the **first $32,000 of a vehicle's sales price or lease agreement** on new qualifying vehicles with a **manufacturer's suggested retail price of $42,500 or less for the lowest base model.**

The preference expires as soon as one of the following occurs:

- The total number of qualifying vehicles titled in Washington on or after July 15, 2015, reaches 7,500.
- July 1, 2019.

3. Other Relevant Background

Other tax credits, exemptions, and Governor's goals focus on increasing use of alternative fuel vehicles and clean fuel

The sales and use tax exemption is one of many tools used to encourage the use of alternative fuel vehicles and clean fuel.

Federal income tax credit up to $7,500 for plug-in electric vehicles

A federal income tax credit is currently available to people who purchase new, qualifying plug-in electric vehicles (PEVs). For vehicles purchased after December 31, 2009, the minimum credit is $2,500 and the maximum is $7,500. The credit amount is determined by the vehicle's battery capacity and gross weight. The credit will phase out when a manufacturer's cumulative sales reach 200,000 vehicles.

Governor's Results Washington program established other clean transportation goals in 2011

Governor Inslee's "Results Washington" program set a goal to increase the number of PEVs registered in Washington to 50,000 by 2020. This includes all PEVs, not just those that are exempt from sales and use tax.

Washington has passed other tax preferences for clean alternative vehicles, fuels, and infrastructure

In addition to the sales and use tax preference, the Legislature has passed several other preferences related to clean alternative fuel vehicles and related infrastructure.

Exhibit 3.1: Additional preferences for clean alternative fuel vehicles and related infrastructure

Preference	Description
Clean Alternative Fuel Commercial Vehicle B&O or Public Utility Tax (PUT) Credit	Credits for businesses purchasing or leasing a clean alternative fuel commercial vehicle or modifying a vehicle to use clean fuel.
EV Battery and Charging Station Sales and Use Tax Exemption ***Click here*** *for 2017 JLARC review.*	Exemption for purchases of batteries, component parts of EV infrastructure, and labor and services to install and repair batteries or infrastructure.
EV Leasehold Excise Tax (LET) Exemption ***Click here*** *for 2017 JLARC review.*	Exemption for private leases of public land to construct, install, or operate EV infrastructure.
EV Supply Equipment (EVSE) Return on Utility Investment Incentive	Utilities and Transportation Commission may approve an additional 2% to the standard return rate if the utility installs EVSE on a fully regulated basis like other capital investments.
Biodiesel Feedstock Sales and Use Tax Exemption	Exemptions for purchases of waste vegetable oil (cooking oil) from restaurants or commercial food processors that is used to produce biodiesel for personal use.
Alternative Fuel and Hybrid Electric Vehicle (HEV) Emissions Inspection Exemption	Exemption from state emissions control inspections on dedicated electric, natural gas, and propane vehicles, and HEVs with an EPA fuel economy rating of at least 50 MPG (city driving).
Natural Gas Used in Transportation - Various Preferences	Five preferences for the manufacturers and sellers of natural gas used for transportation.

Source: JLARC staff analysis of tax statutes, DOR tax incentives web site, and U.S. Department of Energy Alternative Fuels Data Center web site.

Exhibit 3.2: Vehicles Qualifying for Sales and Use Tax Preference as of March 1, 2017

Electric

- BMW i3
- BMW i3 Range Extender
- Chevrolet Bolt
- Chevrolet Spark EV
- Fiat 500e
- Ford Focus Electric
- Honda Fit EV 2014
- Kia Soul Electric
- Mercedes-Benz B250e
- Mercedes-Benz B-class
- Mercedes-Benz Smart for Two
- Mitsubishi i-MiEV
- Nissan Leaf
- Tesla Model 3
- Volkswagen e-Golf

Plug-in hybrid electric

- 2017 Chrysler Pacifica Hybrid
- Chevrolet Volt

Neighborhood electric

- Canadian Electric Vehicles Might-E Truck
- E-ride EXV2 and EXV4
- Electro Bubble Buddy LSV 8 Passenger Roadsters Low Speed
- Polaris GEMs (e2, e4, e6, eL XD, and eM 1400 LSV)
- Vantage trucks (EVX1000 and EVR1000) and passenger vans (EVC1000 and EVP1000)
- Xtreme Green Police Pro ATV
- Eco Truck and Eco Van

Natural gas

- Chevrolet Silverado 2500HD
- Chevrolet 2500 25 4x2 HD 1WT CNG
- Chevrolet Express Cargo 2500
- Chevrolet Express Cargo 3500
- GMC Savana Cargo 2500
- GMC 3500 4X2 4x2 35 SLE DRW CNG

Source: JLARC staff analysis of Department of Licensing list of qualifying vehicles, as posted March 1, 2017.

4. Public Policy Objectives

Legislature stated public policy objective in its performance statement

The Legislature stated it wanted to increase the use of qualifying clean alternative fuel vehicles by reducing the price of such vehicles.

Stated objective: Increase use of clean alternative fuel vehicle by reducing the price

The Legislature categorized the sales and use tax preference as intending to induce certain behaviors. The stated public policy objective was to:

> ". . . . **increase the use** of clean alternative fuel vehicles in Washington . . . **by extend[ing]** the **existing sales and use tax exemption** on **certain clean alternative fuel vehicles** in order to reduce the price charged to customers for clean alternative fuel vehicles."

Legislature provided metric for JLARC review

In 2016, the Legislature directed JLARC to report on the **number of** clean alternative fuel vehicles **titled in the state** to measure the effectiveness of the tax preference.

Legislature set two potential targets for when preference should end

The Legislature identified two targets for when the sales and use tax preference should expire. The preference will end when the first of these is reached:

1. 7,500 qualifying new vehicles are titled in Washington on or after July 15, 2015.
2. July 1, 2019.

5. Are Objectives Being Met?

Preference has reduced prices for qualifying vehicles but it is unknown the extent it is impacting sales

The preference has reduced the purchase and lease price of qualifying new clean alternative fuel vehicles (AFVs). Prices are reduced by the applicable sales tax rate for the first $32,000 of the sale or lease agreement.

Exhibit 5.1: How does the AFV preference work?

	Price without preference	Price with preference	Savings with Preference
Vehicle purchase price from dealer	$42,500	$42,500	
Cap on exemption		($32,000)	
Taxable amount	$42,500	$10,500	
Sales tax owed (Average rate – 9.3%)	$3,953	$977	
Total price paid	$46,453	$43,477	$2,976

Source: JLARC staff analysis of tax preference.

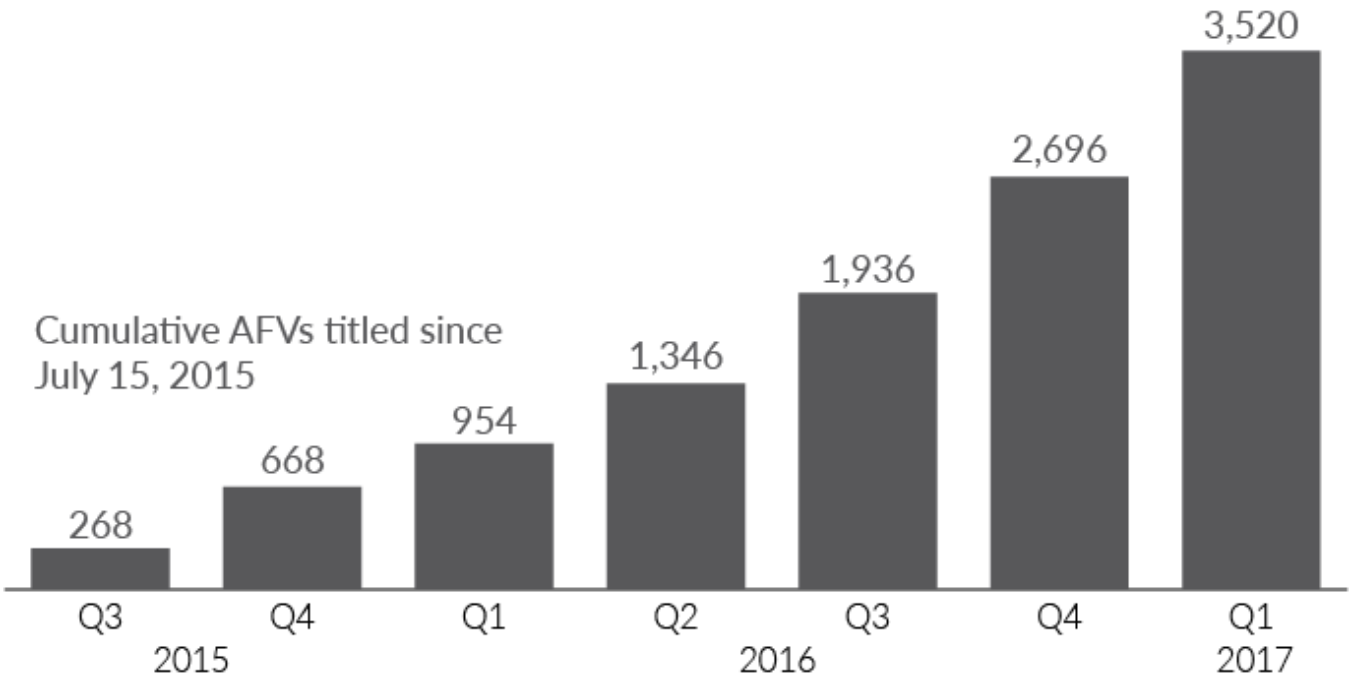
New AFV titles about halfway to 7,500 target

The Department of Licensing has issued **3,520 titles** for qualifying vehicles since July 15, 2015. This represents 47 percent progress toward the 7,500 target. To reach 7,500 titles before the final expiration date of July 1, 2019, an additional 3,980 qualifying AFVs must be titled between April 1, 2017, and July 1, 2019. This equates to 442 per quarter.

Since July 1, 2016, the number of new titles per quarter has exceeded 442 and has increased each successive quarter. If this trend continues, the 7,500 target will be met before the final expiration date.

Throughout this period, the federal income tax credit for purchases of new, qualifying plug-in electric vehicles (PEVs) has remained in place.

Exhibit 5.2: AFV titles about halfway to 7,500 target as of March 31, 2017



Note: Quarter 3, 2015 begins July 15, 2015.

Source: Department of Revenue detail per Department of Licensing reports. Detail from July 15, 2015 through March 31, 2017.

New clean AFV titles less than 1% of all new titled vehicles in Washington

Department of Licensing data indicates that clean AFVs accounted for just 0.5 percent of new titles for vehicles of the same class in Fiscal Year 2016.

During the first five months of Fiscal Year 2017 (July through November 2016, the latest data available when this report was published), the share of AFVs increased to 0.9 percent of new vehicle titles for similar classes of vehicles.

Majority of new qualifying AFV titles are in Puget Sound region

Sixty percent of the newly titled qualifying alternative fuel vehicles were in King County between July 2015 and November 2016. Snohomish County and Pierce County were the second and third top counties for total number of new AFV titles.

Many other factors impact vehicle purchases

Continuing the tax preference beyond the expiration date will provide a reduction in the sale or lease price of qualifying vehicles for up to $32,000. While this may encourage people to purchase qualifying vehicles, other issues also influence vehicle purchasing decisions. These include:

- Purchase price of electric vehicles tend to be higher than conventional vehicles.
- High battery costs and concerns about battery range for electric vehicles.
- Average driving costs are lower for electric vehicles than gas-powered vehicles—The U.S. Department of Energy reports that it costs about one-half as much on average to drive an electric vehicle using electricity the same distance as a similar vehicle fueled by gasoline. The estimate uses national averages for gasoline and electricity prices.
- Access to charging stations.
- Washington and nine other states charge additional registration fees on AFVs.

6. Beneficiaries

Preference benefits buyers, lessees, and sellers of clean alternative fuel vehicles

Tax preferences have direct beneficiaries (entities whose state tax liabilities are directly affected) and may have indirect beneficiaries (entities that may receive benefits from the preference, but are not the primary recipient of the benefit).

Direct Beneficiaries

The direct beneficiaries are individuals, businesses, and public or private entities that purchase or lease a qualifying clean alternative fuel vehicle (AFV) in Washington.

The purchaser or lessee does not pay sales or use tax on up to $32,000 of the qualifying vehicle's sale or lease agreement. Qualifying vehicles include:

- Vehicles powered exclusively by natural gas, propane, hydrogen, or electricity.
- Plug-in hybrids powered partly by an external electricity source that can travel at least 30 miles using only battery power.

Between July 15, 2015, and March 31, 2017, there have been **3,520 titles issued to individuals and other entities** that **have benefited from the preference**.

Indirect Beneficiaries

Indirect beneficiaries are automobile dealers who sell or lease qualifying vehicles. The tax preference reduces the price of vehicles, especially when paired with available federal tax credits and other manufacturer or dealer offers.

7. Revenue and Economic Impacts

Estimated beneficiary savings in 2017-19 Biennium are $14.8 million

JLARC staff estimate direct beneficiary savings of $3.9 million in Fiscal Year 2016 and $14.8 million for the 2017-19 Biennium.

The preference is currently scheduled to expire when the first of these occur: 7,500 qualifying vehicles are titled in Washington, since July 15, 2015, or July 1, 2019.

JLARC staff estimated the beneficiary savings using Department of Licensing data on qualifying new titles. It is unclear if the savings will increase or continue at the pace they did for the first nine months of Fiscal Year 2017.

If they do continue at the same pace, the total number of new titles could reach the 7,500 target to end the preference by the middle of Fiscal Year 2019.

Exhibit 7.1: Estimated direct beneficiary savings

Biennium	Fiscal Year	Qualifying Vehicle Sales	State Sales Tax (includes 0.3% vehicles sales tax)	Local Sales Tax	Beneficiary Savings
2015-17 *7/1/15-6/30/17*	2016	$41,412,000	$2,816,000	$1,088,000	$3,904,000
	2017	$78,879,000	$5,364,000	$2,039,000	$7,403,000
2017-19 *7/1/17-6/30/19*	2018	$78,879,000	$5,364,000	$2,039,000	$7,403,000
	2019	$78,879,000	$5,364,000	$2,039,000	$7,403,000
2017-19 Biennium		**$157,758,000**	**$10,728,000**	**$4,078,000**	**$14,806,000**

Note: Fiscal Year 2016 began July 15, 2015.

Source: JLARC staff analysis of: Department of Revenue tax return deduction detail for clean alternative vehicles, Fiscal Years 2015; Department of Licensing new AFV title data FY 2016 and July 1 – March 31, 2017. No estimated growth in 2018 or 2019 due to uncertainty in marketplace.

Without the tax preference, beneficiaries would pay sales or use tax, but impact on AFV use is uncertain

If the tax preference was allowed to expire, purchasers of qualifying AFVs and plug-in hybrids would pay sales or use tax on the full cost of the vehicle.

The impact of the preference on sales of qualifying vehicles is unknown. Many other issues influence whether consumers decide to purchase these vehicles.

8. Other States with Similar Preference?

States offer varying types of incentives to encourage use of clean alternative fuels and vehicles

Most states and the District of Columbia provide incentives to encourage use of alternative fuels and vehicles. The U.S. Department of Energy maintains an **Alternative Fuel Data Center**, tracking incentive programs offered in each state.

Only **Washington** and **New Jersey** provide sales and use tax exemptions for new purchases and leases of clean alternative fuel vehicles (AFVs).

States use a variety of other tools to encourage AFV adoption, including: income tax credits, rebates, grants, low interest loans, HOV lane access, free parking, reduced or exempted vehicle registrations, and emissions test exemptions.

9. Applicable Statutes

RCW 82.08.809

Exemptions—Vehicles using clean alternative fuels and electric vehicles, exceptions—Quarterly transfers. (Contingent expiration date.)

(1)(a) Except as provided in subsection (4) of this section, the tax levied by RCW 82.08.020 does not apply to sales of new passenger cars, light duty trucks, and medium duty passenger vehicles, which (i) are exclusively powered by a clean alternative fuel or (ii) use at least one method of propulsion that is capable of being reenergized by an external source of electricity and are capable of traveling at least thirty miles using only battery power.

(b) Beginning with sales made or lease agreements signed on or after July 1, 2016, the exemption in this section is only applicable for up to thirty-two thousand dollars of a vehicle's selling price or the total lease payments made plus the selling price of the leased vehicle if the original lessee purchases the leased vehicle before the expiration of the exemption as described in subsection (6) of this section.

(2) The seller must keep records necessary for the department to verify eligibility under this section.

(3) As used in this section, "clean alternative fuel" means natural gas, propane, hydrogen, or electricity, when used as a fuel in a motor vehicle that meets the California motor vehicle emission standards in Title 13 of the California code of regulations, effective January 1, 2005, and the rules of the Washington state department of ecology.

(4)(a) A sale, other than a lease, of a vehicle identified in subsection (1)(a) of this section made on or after July 15, 2015, and before July 1, 2016, is not exempt from sales tax as described under subsection (1) of this section if the selling price of the vehicle plus trade-in property of like kind exceeds thirty-five thousand dollars.

(b) A sale, other than a lease, of a vehicle identified in subsection (1)(a) of this section made on or after July 1, 2016, and before the expiration of the exemption as described in subsection (6) of this section, is not exempt from sales tax as described under subsection (1)(b) of this section if, at the time of sale, the lowest manufacturer's suggested retail price, as determined in rule by the department of licensing pursuant to chapter 34.05 RCW, for the base model is more than forty-two thousand five hundred dollars.

(c) For leased vehicles for which the lease agreement was signed before July 1, 2015, lease payments are exempt from sales tax as described under subsection (1)(a) of this section regardless of the vehicle's fair market value at the inception of the lease.

(d) For leased vehicles identified in subsection (1)(a) of this section for which the lease agreement is signed on or after July 15, 2015, and before July 1, 2016, lease payments are not exempt from sales tax if the fair market value of the vehicle being leased exceeds thirty-five thousand dollars at the inception of the lease. For the purposes of this subsection (4), "fair market value" has the same meaning as "value of the article used" in RCW 82.12.010.

(e) For leased vehicles identified in subsection (1)(a) of this section for which the lease agreement is signed on or after July 1, 2016, and before the expiration of the exemption as described in subsection (6) of this section, lease payments are not exempt from sales tax as described under subsection (1)(b) of this section if, at the inception of the lease, the lowest manufacturer's suggested retail price, as determined in rule by the department of licensing pursuant to chapter 34.05 RCW, for the base model is more than forty-two thousand five hundred dollars.

(f) The department of licensing must maintain and publish a list of all vehicle models qualifying for the sales tax exemption under this section until the expiration of the exemption as described in subsection (6) of this section.

(5) On the last day of January, April, July, and October of each year, the state treasurer, based upon information provided by the department, must transfer from the multimodal transportation account to the general fund a sum equal to the dollar amount that would otherwise have been deposited into the general fund during the prior calendar quarter but for the exemption provided in this section. Information provided by the department to the state treasurer must be based on the best available data, except that the department may provide estimates of taxes exempted under this section until such time as

retailers are able to report such exempted amounts on their tax returns. For purposes of this section, the first transfer for the calendar quarter after July 15, 2015, must be calculated assuming only those revenues that should have been deposited into the general fund beginning July 1, 2015.

(6)(a) The exemption under this section expires, effective with sales of vehicles delivered to the buyer or leased vehicles for which the lease agreement was signed, after the last day of the calendar month immediately following the month the department receives notice from the department of licensing under subsection (7)(b) of this section. All leased vehicles that qualified for the exemption before the expiration of the exemption must continue to receive the exemption as described under subsection (1)(b) of this section on lease payments due through the remainder of the lease.

(b) Upon receiving notice from the department of licensing under subsection (7)(b) of this section, the department must provide notice as soon as is practicable on its web site of the expiration date of the exemption under this section.

(c) For purposes of this subsection, even if the department of licensing provides the department with notice under subsection (7)(b) of this section before the end of the fifth working day of the month notice is required, the notice is deemed to have been received by the department at the end of the fifth working day of the month notice is required.

(d) If, by the end of the fifth working day of May 2019, the department has not received notice from the department of licensing under subsection (7)(b) of this section, the exemption under this section expires effective with sales of vehicles delivered to the buyer or leased vehicles for which the lease agreement was signed after June 30, 2019.

(e) Nothing in this subsection (6) may be construed to affect the validity of any exemption properly allowed by a seller under this section before the expiration of the exemption as described in (a) of this subsection and reported to the department on returns filed after the expiration of the exemption.

(f) Nothing in this subsection (6) may be construed to allow an exemption under this section for the purchase of a qualifying vehicle by the original lessee of the vehicle after the expiration of the exemption as provided in (a) of this subsection.

(7)(a) By the end of the fifth working day of each month, until the expiration of the exemption as described in subsection (6) of this section, the department of licensing must determine the cumulative number of qualifying vehicles titled on or after July 15, 2015, and provide notice of the cumulative number of these vehicles to the department.

(b) The department of licensing must notify the department once the cumulative number of qualifying vehicles titled in the state on or after July 15, 2015, equals or exceeds seven thousand five hundred.

(8) By the last day of July 2016, and every six months thereafter until the expiration of the exemption as described in subsection (6) of this section, based on the best available data, the department must report the following information to the transportation committees of the legislature: The cumulative number of qualifying vehicles titled in the state on or after July 15, 2015, as reported to it by the department of licensing; and the dollar amount of all state retail sales and use taxes exempted on or after July 15, 2015, under this section and RCW 82.12.809.

(9) For purposes of this section, "qualifying vehicle" means a vehicle qualifying for the exemption under this section or RCW 82.12.809 in which the sale was made or the lease agreement was signed on or after July 15, 2015.

[2016 1st sp.s. c 32 § 2; 2015 3rd sp.s. c 44 § 408; 2010 1st sp.s. c 11 § 2; 2005 c 296 § 1.]

NOTES:

Effective date—2016 1st sp.s. c 32: "This act takes effect July 1, 2016." [2016 1st sp.s. c 32 § 4201

Tax preference performance statement—2016 1st sp.s. c 32: "This section is the tax preference performance statement for the tax preferences contained in sections 2 and 3 of this act. The performance statement is only intended to be used for subsequent evaluation of the tax preference. It is not intended to create a private right of action by any party or be used to determine eligibility for preferential tax treatment.

(1) The legislature categorizes the tax preference as one intended to induce certain designated behavior by taxpayers, as indicated in RCW 82.32.808(2)(a).

(2) It is the legislature's specific public policy objective to increase the use of clean alternative fuel vehicles in Washington. It is the legislature's intent to extend the existing sales and use tax exemption on certain clean alternative fuel vehicles in order to reduce the price charged to customers for clean alternative fuel vehicles.

(3) To measure the effectiveness of the tax preferences in sections 2 and 3 of this act in achieving the public policy objectives described in subsection (2) of this section, the joint legislative audit and review committee must evaluate the number of clean alternative fuel vehicles titled in the state.

(4) In order to obtain the data necessary to perform the review in subsection (3) of this section, the department of licensing must provide data needed for the joint legislative audit and review committee analysis. In addition to the data source described under this subsection, the joint legislative audit and review committee may use any other data it deems necessary." [2016 1st sp.s. c 32 § 1.]

Tax preference performance statement—2015 3rd sp.s. c 44 §§ 408 and 409: "This section is the tax preference performance statement for the tax preferences contained in sections 408 and 409 of this act. The performance statement is only intended to be used for subsequent evaluation of the tax preference. It is not intended to create a private right of action by any party or be used to determine eligibility for preferential tax treatment.

(1) The legislature categorizes the tax preference as one intended to induce certain designated behavior by taxpayers, as indicated in RCW 82.32.808(2)(a).

(2) It is the legislature's specific public policy objective to increase the use of clean alternative fuel vehicles in Washington. It is the legislature's intent to extend the existing sales and use tax exemption on certain clean alternative fuel vehicles in order to reduce the price charged to customers for clean alternative fuel vehicles.

(3) To measure the effectiveness of the tax preferences in sections 408 and 409 of this act in achieving the public policy objectives described in subsection (2) of this section, the joint legislative audit and review committee must evaluate the number of clean alternative fuel vehicles registered in the state.

(4) In order to obtain the data necessary to perform the review in subsection (3) of this section, the department of licensing must provide data needed for the joint legislative audit and review committee analysis. In addition to the data source described under this subsection, the joint legislative audit and review committee may use any other data it deems necessary." [2015 3rd sp.s. c 44 § 407.]

Effective date—2005 c 296: "This act takes effect January 1, 2009." [2005 c 296 § 5200

RCW 82.12.809

Exemptions—Vehicles using clean alternative fuels and electric vehicles, exceptions—Quarterly transfers.

(1)(a) Except as provided in subsection (4) of this section, the provisions of this chapter do not apply in respect to the use of new passenger cars, light duty trucks, and medium duty passenger vehicles, which (i) are exclusively powered by a clean alternative fuel or (ii) use at least one method of propulsion that is capable of being reenergized by an external source of

electricity and are capable of traveling at least thirty miles using only battery power.

(b) Beginning with purchases made or lease agreements signed on or after July 1, 2016, the exemption in this section is only applicable for up to thirty-two thousand dollars of a vehicle's purchase price or the total lease payments made plus the purchase price of the leased vehicle if the original lessee purchases the leased vehicle before the expiration of the exemption as described in RCW 82.08.809(6).

(2) The definitions in RCW 82.08.809 apply to this section.

(3) A taxpayer is not liable for the tax imposed in RCW 82.12.020 on the use, on or after the expiration of the exemption as described in RCW 82.08.809(6), of a passenger car, light duty truck, or medium duty passenger vehicle that is exclusively powered by a clean alternative fuel or uses at least one method of propulsion that is capable of being reenergized by an external source of electricity and is capable of traveling at least thirty miles using only battery power, if the taxpayer used such vehicle in this state before the expiration of the exemption as described in RCW 82.08.809(6), and the use was exempt under this section from the tax imposed in RCW 82.12.020.

(4)(a) For vehicles identified in subsection (1)(a) of this section purchased on or after July 1, 2016, and before the expiration of the exemption as described in RCW 82.08.809(6), or for leased vehicles identified in subsection (1)(a) of this section for which the lease agreement was signed on or after July 1, 2016, and before the expiration of the exemption as described in RCW 82.08.809(6), a vehicle is not exempt from use tax as described under subsection (1)(b) of this section if, at the time the tax is imposed for purchased vehicles or at the inception of the lease for leased vehicles, the lowest manufacturer's suggested retail price, as determined in rule by the department of licensing pursuant to chapter 34.05 RCW, for the base model is more than forty-two thousand five hundred dollars.

(b) For vehicles identified in subsection (1)(a) of this section purchased on or after July 15, 2015, and before July 1, 2016, or for leased vehicles identified in subsection (1)(a) of this section for which the lease agreement was signed on or after July 15, 2015, and before July 1, 2016, a vehicle is not exempt from use tax if the fair market value of the vehicle exceeds thirty-five thousand dollars at the time the tax is imposed for purchased vehicles, or at the inception of the lease for leased vehicles.

(c) For leased vehicles for which the lease agreement was signed before July 1, 2015, lease payments are exempt from use tax as described under subsection (1)(a) of this section regardless of the vehicle's fair market value at the inception of the lease.

(5) On the last day of January, April, July, and October of each year, the state treasurer, based upon information provided by the department, must transfer from the multimodal transportation account to the general fund a sum equal to the dollar amount that would otherwise have been deposited into the general fund during the prior calendar quarter but for the exemption provided in this section. Information provided by the department to the state treasurer must be based on the best available data. For purposes of this section, the first transfer for the calendar quarter after July 15, 2015, must be calculated assuming only those revenues that should have been deposited into the general fund beginning July 1, 2015.

(6)(a) The exemption provided under this section does not apply to the use of new passenger cars, light duty trucks, and medium duty passenger vehicles, or lease payments due on such vehicles, if the date of sale of the vehicle from the seller to the buyer occurred or the lease agreement was signed after the expiration of the exemption as provided in RCW 82.08.809(6).

(b) All leased vehicles that qualified for the exemption before the expiration of the exemption must continue to receive the exemption as described under subsection (1)(b) of this section on lease payments due through the remainder of the lease.

(c) Nothing in this subsection (6) may be construed to allow an exemption under this section for the purchase of a qualifying vehicle by the original lessee of the vehicle after the expiration of the exemption.

[2016 sp.s. c 32 § 3; 2015 3rd sp.s. c 44 § 409; 2010 1st sp.s. c 11 § 3; 2005 c 296 § 3.]

NOTES:

Effective date—Tax preference performance statement—2016 sp.s. c 32: See notes following RCW 82.08.809.

Effective date—2015 3rd sp.s. c 44: See note following RCW 46.68.395.

Tax preference performance statement—2015 3rd sp.s. c 44 §§ 408 and 409: See note following RCW 82.08.809.

Effective date—2005 c 296: See note following RCW 82.08.809.

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends reviewing the tax preference before the final expiration date if the target for vehicle titles is not yet met

The Legislature should review the sales and use tax preference for clean alternative fuel vehicles in the 2019 legislative session if the number of qualifying vehicles titled in Washington has not reached 7,500.

The preference reduces the price of the sale or lease agreement for qualifying new alternative fuel vehicles. However, it is unknown the extent the preference is impacting sales. Other factors also influence vehicle purchasing decisions.

As of March 31, 2017, 3,520 qualifying vehicles were titled, which is 47 percent of the 7,500 target. If this trend continues, the target will be met before the final expiration date. If that target is not met, the preference will expire on July 1, 2019.

Legislation required: To be determined (preference expires July 1, 2019).

Fiscal impact: Depends on legislative action.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, available December 2017.

Automotive Adaptive Equipment

For Veterans and Service Members with Disabilities

JLARC Staff 2017 Tax Preference Performance Evaluation | Sales and Use Tax Preference

Objectives (stated)	Results
Provide **financial relief** for severely injured veterans and service members.	**Met.** Disabled veterans and service members do not pay sales or use tax on automotive adaptive equipment purchases.
Offset a **competitive disadvantage** for Washington's businesses.	**Met.** The preference removes the sales tax. Oregon has no sales tax.
Foregone revenues "**reasonably**" conform to fiscal note estimate.	**Not met.** Estimate of foregone revenue at least 267% higher than 2013 estimate.

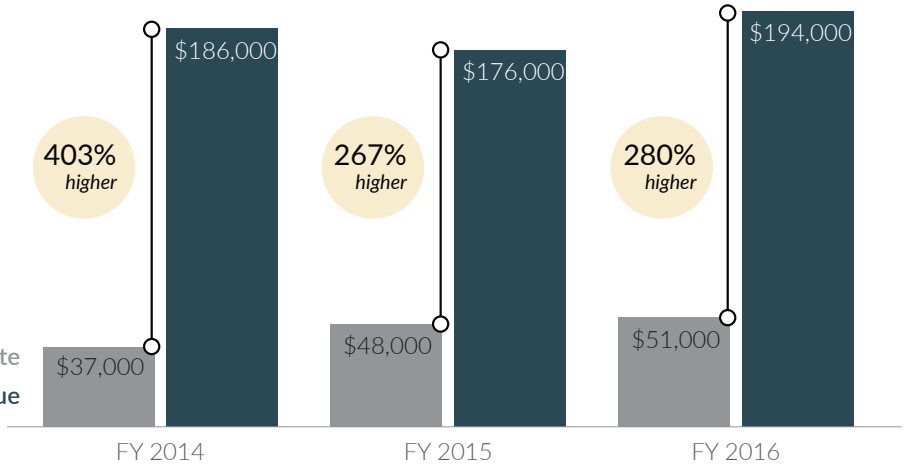
Preference provides financial relief and removes a perceived competitive disadvantage

Removes sales and use tax for disabled veterans and service members buying automotive adaptive equipment.

Neighboring state Oregon has no sales tax.

Estimates of foregone revenue exceeded 2013 fiscal note estimate in past three fiscal years

Legislature intended to reexamine this preference to compare foregone revenues to what was "reasonably assumed" in the 2013 fiscal note.



Source: Estimated foregone revenues are based on actual beneficiary savings from Department of Revenue tax return data.

Legislative Auditor recommendation: **Clarify**

The Legislature should clarify what revenue impact is "reasonable." While it provides financial relief and removes a perceived competitive disadvantage, the estimated foregone revenue has exceeded the 2013 fiscal note estimate for the past three fiscal years.

The complete report is on the JLARC web site.

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
(360) 786-5187 ● keenan.konopaski@leg.wa.gov

July 2017

Automotive Adaptive Equipment For Veterans and Service Members With Disabilities | Sales and Use Tax

Click **here** for One Page Overview

Summary of this Review

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A sales and use tax exemption for veterans or service members with disabilities for purchases, installations, or repairs of qualifying automotive adaptive equipment. The preference is scheduled to expire July 1, 2018.	**Sales and Use** RCWs 82.08.875; 82.12.875	$194,000

Public Policy Objective
The Legislature stated the public policy objectives were to: • Provide specific financial relief for severely injured veterans and service members. • Offset a competitive disadvantage for Washington businesses.

Recommendations
Legislative Auditor's Recommendation **Clarify:** The Legislature should clarify the preference because, while it provides financial relief and removes a perceived competitive disadvantage, the estimated beneficiary savings have exceeded the 2013 fiscal note estimate for the past three fiscal years. **Commissioner Recommendation:** Available in October 2017.

Details on this Preference

1. What is the Preference?

Sales and use tax exemption for automotive adaptive equipment purchased by veterans and service members with disabilities

Purpose

The Legislature passed this preference with the stated purpose to:

- Provide financial relief for severely injured veterans and service members.
- Offset a competitive disadvantage for Washington businesses when compared to businesses in states without a sales and use tax.

Sales and use tax exemption for purchase, installation, and repair costs of automotive adaptive equipment

Veterans and service members with disabilities do not pay sales or use tax on equipment used to assist in entering, exiting, or safely operating a motor vehicle. This exemption also applies to installation and repair costs. The equipment is known as add-on automotive adaptive equipment, or AAE.

To qualify, the adaptive equipment must be:

- Prescribed by a physician.
- Paid for fully or in part by the U.S. Department of Veterans Affairs (VA) or another federal agency.
- Obtained through a direct payment between the federal government and the equipment seller.
- Installed by someone other than the automobile manufacturer.

Examples of AAE include vehicle ramps and steering devices, as shown in the pictures below, as well as other equipment listed in the **Other Relevant Background** tab.

Exhibit 1.1: Qualifying AAE examples

Source: JLARC staff analysis of RCWs 82.08.875, 82.12.875.

Veterans' and service members' disabilities do not need to be connected to their military service to qualify for the preference.

The preference took effect August 1, 2013, and is set to expire July 1, 2018.

2. Legal History

Inconsistent application of tax for adaptive equipment preceded sales and use tax preference

Before 2013, Washington law required that businesses charge sales tax on purchases of any automotive adaptive equipment (AAE) added to a vehicle. This meant that veterans and service members with disabilities were required to pay sales tax on their purchases of AAE, even if the federal government paid the seller for the equipment.

Federal law prohibits states from taxing the federal government. However, in this case, the veterans and service members **are the purchasers**, not the federal government.

2011 – 2012: DOR issued draft advisory requiring sales tax on AAE purchases

During a routine audit, the Department of Revenue (DOR) discovered that a business selling AAE to veterans with disabilities had not been charging sales tax. The audit found that the U.S. Department of Veteran's Administration (VA) paid for the AAE on behalf of veterans with disabilities. The veterans had to apply for the funding, and were designated as the purchasers even though the VA paid for the equipment. As purchasers, the veterans were responsible for paying the sales tax owed.

Upon further investigation, DOR found other AAE businesses in Washington had not been consistently charging or collecting sales tax for similar transactions.

In October 2012, DOR posted a draft advisory to its web site regarding purchases of automotive adaptive equipment. The advisory specified that veterans and service members with disabilities were subject to sales tax on their AAE purchases, even if the federal government paid for the equipment.

2013: Legislature enacted this preference

The Legislature enacted this preference, providing veterans and service members with disabilities a sales and use tax exemption for purchases, installation, and repair of prescribed AAE.

The Legislature noted that veterans who have been severely injured often need customized, accessible transportation to be self-sufficient. The Legislature stated these individuals with disabilities:

- Are three times more likely to be at or below the national poverty level.
- Often cannot afford the sales or use tax owed on the extensive adaptive equipment they require.
- Sometimes purchase the equipment in neighboring states that do not impose a sales tax. This puts Washington businesses at a competitive disadvantage.

The preference is scheduled to expire July 1, 2018.

3. Other Relevant Background

State law defines eligible equipment, while federal VA sets reimbursement criteria

Definitions and examples

Add-on automotive adaptive equipment (AAE): equipment installed in, and modifications made to, a motor vehicle that are necessary to assist physically challenged persons to enter, exit, or safely operate a vehicle. These do not include motor vehicles or equipment installed by the vehicle manufacturer. Add-on adaptive equipment may include:

- Chest and shoulder harnesses
- Digital driving systems
- Dual battery systems
- Hand controls
- Left foot gas pedals
- Lowered floors or raised roofs
- Parking brake extensions
- Power door openers
- Raised doors
- Ramps under vehicles lifts
- Reduced and zero effort steering and braking
- Steering devices
- Voice-activated controls
- Wheelchair lifts or restraints

Federal funding for AAE purchases

According to the U.S. Department of Veterans Affairs (VA), veterans and service members with disabilities are eligible for AAE for up to two vehicles in a four-year period. The VA establishes criteria for allowable AAE reimbursements, but there is no lifetime limit on AAE for qualified veterans and service members with disabilities.

4. Public Policy Objectives

Legislature stated public policy objectives in its intent statement

The Legislature stated its objectives were to:

- **Provide specific financial relief** for severely injured veterans and service members.
- **Offset a competitive disadvantage for Washington's** automotive adaptive equipment **businesses** when compared to similar businesses in states without a sales and use tax.

The Legislature also stated its intent **to reexamine the preference in five years.**

Provide specific financial relief to veterans and service members with disabilities

The Legislature noted that severely injured veterans and service members:

- "…often need customized, accessible transportation to be self-sufficient and to maintain a high quality of life."
- "Are three times more likely to be at or below the national poverty level."
- "Often times cannot afford the tax due to the substantial amount of adaptive equipment required in such customized vehicles."

The prime sponsor testified that the preference would be used by about 20 to 25 people each year.

Adaptive equipment costs vary depending on the level of disability:

- 2013 House Finance staff estimated the *average* cost for adaptive automotive equipment (AAE) was $9,000. This would make the combined state and local sales taxes $800 on average.
- Stakeholders indicated that simple hand controls to operate the gas and brake might cost $2,000. Additional state and local sales taxes would be $180 on average.
- Stakeholders also noted that a more extensive adaptation that provides wheelchair access to an automobile and voice command controls could cost over $40,000. State and local sales taxes would cost an additional $3,600 on average.

Offset a competitive disadvantage of Washington's tax structure

The Legislature stated that the financial burden of owing sales tax had the "unintended effect" of encouraging veterans and service members with disabilities to purchase automotive adaptive equipment outside of Washington. Neighboring states, such as Oregon, have no sales tax. While Washington residents are required to pay use tax on items purchased in Oregon, compliance is low.

Reexamine preference performance and cost

The Legislature also stated it wanted to reexamine the preference in five years to:

- Determine if the preference **mitigated the competitive disadvantage** stemming from Washington's tax structure.
- **Compare the cost of the preference** in foregone state revenue **with what was "reasonably assumed" in the 2013 fiscal note estimate**.

For the purposes of this review, JLARC staff used estimated beneficiary savings to determine foregone revenues.

5. Are Objectives Being Met?

Preference provides financial relief and removes competitive disadvantage, but estimated beneficiary savings exceed fiscal note estimate

Provides specific financial relief

The preference is providing financial relief to Washington's veterans and service members with disabilities on their purchases of prescribed automotive adaptive equipment (AAE). Department of Revenue (DOR) records show that Washington businesses are selling tax-exempt AAE. The preference reduces the amount owed by veterans and service members with disabilities by an average of 9.0 percent of the equipment's total cost.

Offsets a competitive disadvantage of Washington's tax structure

The preference eliminates a perceived competitive disadvantage for Washington businesses. There is no data available to determine if Washington veterans and service members with disabilities are purchasing more equipment in state because of the preference.

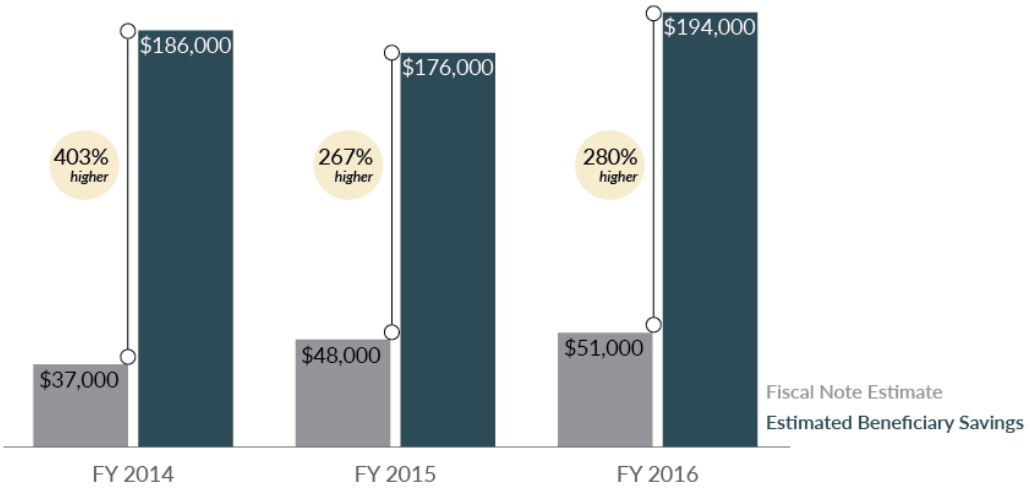
Estimated beneficiary savings exceed fiscal note estimate

JLARC staff did not quantify foregone revenue, which requires determining or assuming changes in taxpayer purchasing behavior. Instead, JLARC staff estimated the beneficiary savings for this preference based on qualifying sales and services reported to DOR by Washington's AAE businesses from August 2013 through June 2016 .

JLARC staff found the estimated beneficiary savings from this preference exceed what was "reasonably assumed" in the 2013 fiscal note by at least 267 percent in each fiscal year since the preference was enacted.

The fiscal note estimate indicated an average of 20 taxpayers would qualify for the preference each year. The Department of Veterans Affairs reports that it processed 185 applications from Washington residents in Calendar Year 2016, and 75 in Calendar Year 2015.

Exhibit 5.1: Estimated beneficiary savings consistently exceeds the 2013 fiscal note estimate



Source: Fiscal note estimates from SSB 5072; actual beneficiary savings from Department of Revenue tax return deduction line 0149, Fiscal Years 2014-2016.

Continuing the preference reduces costs to veterans and service members with disabilities and removes perceived competitive disadvantage

The preference is scheduled to expire on July 1, 2018. Continuing the tax preference will provide financial relief to Washington's veterans and service members with disabilities who purchase AAE and related repair and installation services. It also removes a perceived competitive disadvantage for Washington businesses selling and servicing AAE.

6. Beneficiaries

Veterans and service members with disabilities and Washington businesses benefit from this preference

Tax preferences have direct beneficiaries (entities whose state tax liabilities are directly affected) and may have indirect beneficiaries (entities that may receive benefits from the preference, but are not the primary recipient of the benefit).

Direct Beneficiaries

Direct beneficiaries of the tax preference are veterans and service members with disabilities. The U.S. Department of Veterans Affairs reports that it processed 185 applications for automobile adaptive equipment (AAE) from Washington residents in Calendar Year 2016. There were 75 applications submitted in Calendar Year 2015.

Indirect Beneficiaries

Indirect beneficiaries of the tax preference are Washington businesses that sell and service AAE. In 2013 testimony, an AAE business owner indicated that there were four or five AAE businesses in Washington. More recent data shows that there still are four or five Washington businesses selling and servicing AAE.

7. Revenue and Economic Impacts

Estimated beneficiary savings in Fiscal Year 2016 are $194,000

JLARC staff estimate the direct beneficiary savings at $194,000 in Fiscal Year 2016 and $194,000 for the 2017-19 biennium. The preference is currently scheduled to expire on July 1, 2018, midway through the 2017-19 Biennium.

JLARC staff estimated the beneficiary savings using qualifying sales reported to the Department of Revenue by businesses selling and servicing automobile adaptive equipment (AAE) to veterans and service members with disabilities.

Exhibit 7.1: Estimated direct beneficiary savings

Biennium	Fiscal Year	Total Exempt	State Sales Tax	Local Sales Tax	Total Estimated Beneficiary Savings
2013-15 *(7/1/13-6/30/15)*	2014	$2,073,000	$135,000	$51,000	$186,000
	2015	$1,954,000	$127,000	$49,000	$176,000
2015-17 *(7/1/15-6/30/17)*	2016	$2,152,000	$140,000	$54,000	$194,000
	2017	$2,152,000	$140,000	$54,000	$194,000
2017-19 *(7/1/17-6/30/18)*	2018	$2,152,000	$140,000	$54,000	$194,000
	2019	Preference expires effective July 1, 2018			
	Total 2017-19 Estimated Savings	**$2,152,000**	**$140,000**	**$54,000**	**$194,000**

Source: JLARC staff analysis for Fiscal Years 2014-2016 based on Department of Revenue tax return deduction detail. Future value in fiscal years 2017 and 2018 estimated on average of three years of prior deductions and not grown due to fluctuation in amounts reported for previous years.

Absent the tax preference, beneficiaries would pay sales or use tax

If the tax preference were terminated or allowed to expire as scheduled, veterans and service members with disabilities would pay sales or use tax on the cost of purchasing, repairing, and installing AAE on their vehicles. The preference reduces the amount they owe by an average of 9.0 percent of the total cost of their equipment.

Washington businesses may be at a competitive disadvantage with businesses in states that do not have a sales tax.

8. Other States with Similar Preference?

Washington and four other states exempt AAE purchases for veterans with disabilities, 32 other states exempt AAE purchases for all individuals with disabilities

JLARC staff reviewed the 45 states and the District of Columbia that impose sales and use taxes and found:

- **Five states** provide a specific exemption for veterans with disabilities who purchase automotive adaptive equipment (AAE). They are: Washington, Arkansas, Georgia, Massachusetts, and Tennessee.
- **32 states** provide an exemption for all individuals with disabilities (not just veterans) who purchase AAE or mobility enhancing equipment that can be used in vehicles.
- For **nine states and the District of Columbia**, JLARC staff were unable to determine if a similar tax exemption is in place.

9. Applicable Statutes

RCW 82.08.875

Exemptions—Automotive adaptive equipment. (Expires July 1, 2018.)

(1) The tax imposed by RCW 82.08.020 does not apply to sales to eligible purchasers of prescribed add-on automotive adaptive equipment, including charges incurred for labor and services rendered in respect to the installation and repairing of such equipment. The exemption provided in this section only applies if the eligible purchaser is reimbursed in whole or part for the purchase by the United States department of veterans affairs or other federal agency, and the reimbursement is paid directly by that federal agency to the seller.

(2) Sellers making tax-exempt sales under this section must:

(a) Obtain an exemption certificate from the eligible purchaser in a form and manner prescribed by the department. The seller must retain a copy of the exemption certificate for the seller's files. In lieu of an exemption certificate, a seller may capture the relevant data elements as allowed under the streamlined sales and use tax agreement;

(b) File their tax return with the department electronically; and

(c) Report their total gross sales on their return and deduct the exempt sales under subsection (1) of this section from their reported gross sales.

(3) For purposes of this section, the following definitions apply unless the context clearly requires otherwise:

(a) "Add-on automotive adaptive equipment" means equipment installed in, and modifications made to, a motor vehicle that are necessary to assist physically challenged persons to enter, exit, or safely operate a motor vehicle. The term includes but is not limited to wheelchair lifts, wheelchair restraints, ramps, under vehicle lifts, power door openers, power seats, lowered floors, raised roofs, raised doors, hand controls, left foot gas pedals, chest and shoulder harnesses, parking brake extensions, dual battery systems, steering devices, reduced and zero effort steering and braking, voice-activated controls, and digital driving systems. The term does not include motor vehicles and equipment installed in a motor vehicle by the manufacturer of the motor vehicle.

(b) "Eligible purchaser" means a veteran, or member of the armed forces serving on active duty, who is disabled, regardless of whether the disability is service connected as that term is defined by federal statute 38 U.S.C. Sec. 101, as amended, as of August 1, 2013.

(c) "Prescribed add-on automotive adaptive equipment" means add-on automotive adaptive equipment prescribed by a physician.

(4) This section expires July 1, 2018.

[2013 c 211 § 2.]

NOTES:

Findings—Intent—2013 c 211: "(1) The legislature finds that it is important to recognize the service of active duty military and veterans and to acknowledge the continued sacrifice of those veterans who have been catastrophically injured. The legislature further finds that many disabled veterans often need customized, accessible transportation to be self-sufficient and to maintain a high quality of life. The legislature further finds that individuals with a severe disability are three times more likely to be at or below the national poverty level. The legislature further finds that the federal government pays for the cost of mobility adaptive equipment for severely injured veterans; however, it does not cover the cost of sales or use tax owed on this equipment. The legislature further finds that this cost is then

shifted onto the veterans, who often times cannot afford the tax due to the substantial amount of adaptive equipment required in such customized vehicles. The legislature further finds that this added financial burden has the unintended effect of causing some veterans to acquire their mobility adaptive equipment in neighboring states that do not impose a sales tax, thereby negatively impacting Washington businesses providing mobility enhancing equipment and services to Washington veterans.

(2) It is the legislature's intent to provide specific financial relief for severely injured veterans and to ameliorate a negative consequence of Washington's tax structure by providing a sales and use tax exemption for mobility adaptive equipment required to customize vehicles for disabled veterans. It is the further intent of the legislature to reexamine this exemption in five years to determine whether it has mitigated the competitive disadvantage stemming from Washington's tax structure on mobility businesses and to assess whether the cost of the exemption in terms of forgone state revenue is beyond what was reasonably assumed in the fiscal estimate for the legislation." [2013 c 211 § 1.]

Effective date—2013 c 211: "This act takes effect August 1, 2013." [2013 c 211 § 4201

RCW 82.12.875

Automotive adaptive equipment. (Expires July 1, 2018.)

(1) The tax imposed by RCW 82.12.020 does not apply to the use of prescribed add-on automotive adaptive equipment or to labor and services rendered in respect to the installation and repairing of such equipment. The exemption under this section only applies if the sale of the prescribed add-on automotive adaptive equipment or labor and services was exempt from sales tax under RCW 82.08.875 or would have been exempt from sales tax under RCW 82.08.875 if the equipment or labor and services had been purchased in this state.

(2) For purposes of this section, "prescribed add-on automotive adaptive equipment" has the same meaning as provided in RCW 82.08.875.

(3) This section expires July 1, 2018.

[2013 c 211 § 3.]

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends clarifying the tax preference

The Legislature should clarify the sales and use tax exemption for veterans and service members with disabilities who purchase adaptive automotive equipment becausethe estimated beneficiary savings have exceeded the 2013 fiscal note estimate for the past three fiscal years.

The preference provides financial relief and removes a perceived competitive disadvantage. However, the Legislature intended to reexamine this preference after five years to assess if estimated beneficiary savings were beyond what was "reasonably assumed" in the fiscal note. The estimated beneficiary savings have exceeded the 2013 fiscal note estimate by at least 267 percent in each fiscal year since the preference was enacted.

Legislation required: Yes (preference expires on July 1, 2018).

Fiscal impact: Depends on legislative action.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, will be available December 2017.

Coal-Fired Electric Power Plants

JLARC Staff 2017 Tax Preference Performance Evaluation

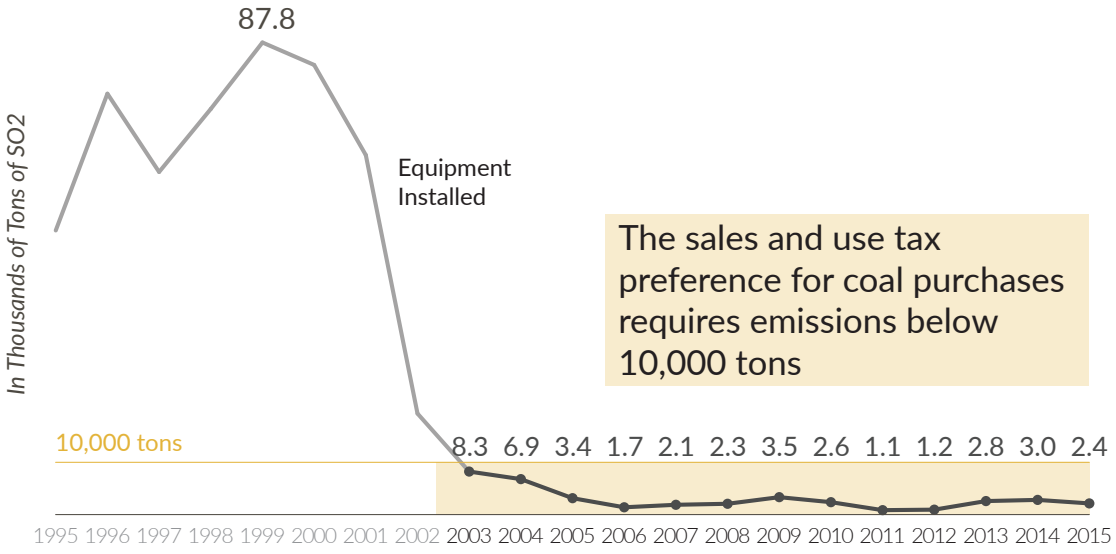
Three Tax Preferences
Air pollution control equipment/facilities property tax
Air pollution control equipment/facilities sales and use tax
Coal purchase sales and use tax

Objectives (stated)	Results
Help thermal electric power plants to:	
Update air pollution control equipment/facilities.	**Met.** The beneficiary installed equipment/facilities in 2001-02 and 2011-12.
Abate pollution.	**Met.** Sulfur dioxide emissions fell from 87.8 to 2.4 thousand tons.
Play a long-term economic role in their communities.	**Met.** Beneficiary provides 200 jobs and $4.58 million in annual community financial assistance.

Single beneficiary for the preferences

Only one eligible plant operating in Washington: TransAlta's coal-fired electric power plant in Centralia. Estimated FY16 beneficiary savings are $4.2 - $9.5 million.

Beneficiary reduced sulfur dioxide emissions



Source: JLARC staff analysis of EPA air markets program data.

Beneficiary provides required $4.58M in annual financial assistance payments for community

Assistance intended to support weatherization, economic and community development, and energy technology projects. The payments end if the sales and use tax preferences are eliminated.

Legislative Auditor recommendation: **Continue**

The Legislature should continue the tax preferences until the coal-fired boilers at the plant are decommissioned because they are meeting the stated public policy objectives.

Coal-Fired Power Plant Preferences | Multiple Taxes

Click here for One Page Overview

Summary of this Review

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A sales and use tax exemption for purchases of coal used in electric generation.	**Sales and Use Tax** RCWs 82.08.811, 82.12.811	$6.1-16.6 million in the 2017-19 biennium
A sales and use tax exemption for purchases of air pollution control equipment.	**Sales and Use Tax** RCWs 82.08.810, 82.12.810	$0 in the 2017-19 biennium
A property tax exemption for the assessed value of air pollution control equipment.	**Property Tax** RCW 84.36.487	$2.2 million in the 2017-19 biennium

Public Policy Objective
The Legislature's stated public policy objectives: 1. Update coal plant air pollution control equipment. 2. Abate pollution. 3. Play a long-term economic role in the communities where the plant is located.

Recommendations
Legislative Auditor's Recommendation **Continue:** The Legislature should continue the three tax preferences until the coal-fired boilers at the plant are decommissioned. The three tax preferences are meeting the stated public policy objectives of helping Washington's only coal-fired power plant to update air pollution control equipment, abate pollution, and play an economic role in its community through 2025. **Commissioner Recommendation:** Available in October 2017.

Details on this Preference

1. What are the Preferences?

Three tax preferences for coal-fired electric power plants

Purpose

-

The Legislature passed three preferences with the stated purpose to help certain thermal electric generation facilities (power plants) to:

- Update air pollution control equipment/facilities.
- Abate pollution.
- Play a long-term economic role in their communities.

Statute defines eligibility

A thermal electric generation facility is a power plant that converts heat energy (e.g., from burning coal) into electricity.

Plants that started operating between December 1969 and July 1975 are eligible for the tax preferences. JLARC staff identified only one eligible plant currently operating in Washington: a coal-fired electric power plant in Centralia.

Three preferences: two for sales and use tax, one for property tax

The Legislature passed a bill in 1997 that enacted these three preferences. They do not have expiration dates.

Exhibit 1.1: Three tax preferences for thermal electric power plants

Preference	Description	Effective Date	Expiration Date
Coal Purchases (Sales & Use Tax)	Exempts sales and use of coal at eligible power plants.	January 1, 1999	None
Air pollution control equipment (Sales & Use Tax)	Exempts sales and use of personal property, labor, and services related to the installation of air pollution control equipment/facilities.	May 15, 1997	None
Air pollution control equipment (Property Tax)	Exempts air pollution control equipment/facilities constructed or installed after May 15, 1997.	May 15, 1997	None

Source: RCWs 82.08.810-811, 84.36.487.

More detail on each preference can be found in the **Other Relevant Background** section.

2. Legal History

The preferences arose from efforts to reduce air pollution

1995-1997: Coal-fired power plant ordered to limit sulfur dioxide emissions

The federal government amended the Federal Clean Air Act in 1990 and required power plants to control emissions such as sulfur dioxide.

In 1995, the Southwest Washington Air Pollution Control Authority ordered the coal-fired Centralia power plant to cut its sulfur dioxide emissions in half by 2001. Two years later, a second order required a 90 percent cut by 2003, limiting emissions to 10,000 tons per year. The cost of installing the necessary equipment/facilities was estimated to be $200 million.

1997: Legislature enacted three preferences for coal power plants

The Legislature created three tax preferences for coal power plants:

1. A sales and use tax exemption for coal purchases.
2. A sales and use tax exemption for sales of personal property, labor, or services for air pollution control equipment/facilities installation.
3. A property tax exemption for air pollution control equipment/facilities installation.

The exemption for coal purchases required that at least 70 percent of the coal be local. That is, the coal had to be produced in either the county where the plant was located or a neighboring county. The Legislature repealed this requirement in 2000.

The three preferences have no expiration dates.

2007 – 2017: Legislature made additional changes to reduce greenhouse gas emissions from coal-fired power plants

In 2007, the Legislature created greenhouse gas emission performance standards. In 2009, Governor Gregoire issued an executive order requiring the Department of Ecology and the Centralia plant to develop a plan to comply with the standards by December 31, 2025.

In 2011, the Legislature amended the law to give the Centralia plant until 2025 to comply with the emission performance standards. The bill also required the plant to:

- Install additional pollution control technology.
- Make a total of $55 million in financial assistance payments to the community. The payments would end if the sales tax exemptions were repealed.

TransAlta, which owns the plant, announced it would transition away from coal and indicated it may convert to natural gas. The 2017 Legislature passed a sales and use tax exemption for converting a coal-fired power plant into a natural gas-fired plant or a biomass energy facility. This exemption was vetoed by the governor.

3. Other Relevant Background

Definitions and more preference detail found in statute

Air pollution control equipment and facilities are defined in statute

Statute uses the terms “air pollution control equipment” and “air pollution control facilities.” Both are defined as:

> “any treatment works, control devices and disposal systems, machinery, equipment, structures, property, property improvements, and accessories, that are installed or acquired for the primary purpose of reducing, controlling, or disposing of industrial waste that, if released to the outdoor atmosphere, could cause air

pollution, or that are required to meet regulatory requirements applicable to their construction, installation, or operation."

Sulfur dioxide scrubbers are one type of air pollution control equipment/facility at the Centralia plant. These scrubbers spray a wet limestone slurry onto the exhaust from burning coal to capture sulfur dioxide.

Centralia also uses **selective non-catalytic reduction**, which reduces emissions of nitrogen oxides. This technology uses a chemical reaction to convert nitrogen oxides into less harmful gases and water vapor.

More about eligibility

Plants that started operating between December 1969 and July 1975 are eligible for the tax preferences.

Sales and use tax exemption on coal purchases

This preference exempts purchases of coal from retail sales and use taxes. To be eligible for the exemption, the owners of the power plant must:

- Apply to the Department of Revenue (DOR) for the exemption;
- Demonstrate to the Department of Ecology that they have made initial and continued progress to install air pollution control equipment/facilities to meet applicable regulatory requirements established under state or federal law, including the Washington Clean Air Act; and
- Emit no more than 10 thousand tons of sulfur dioxide during the previous 12 months.

If a regional air pollution control authority or the Department of Ecology finds the plant's sulfur dioxide emissions exceed the limit, the plant will lose the tax exemption. It may reapply for the exemption when it meets the emission requirements.

Sales and use tax exemption for air pollution control equipment/facilities

This preference exempts the following from sales and use tax:

- Sales of tangible personal property to a light and power business for construction or installation of air pollution control equipment/facilities at a coal power plant; or
- Labor and services performed for construction or installation of air pollution control equipment/facilities.

To qualify for the preference, the equipment/facilities must be constructed or installed after May 15, 1997 and meet state or federal regulatory requirements. The preference excludes maintenance or repairs of pollution control equipment/facilities.

The preference includes a claw-back provision. If electricity production at the plant falls below 20 percent annual capacity between 2003 and 2023, the plant must pay back a portion of previously exempted tax.

Property tax exemption for air pollution control equipment/facilities

This preference exempts air pollution control equipment/facilities constructed or installed after May 15, 1997, from property taxation. Owners must maintain records to identify annual beginning and ending asset balance of the pollution control equipment/facilities and explain the depreciation method used.

4. Public Policy Objectives

The Legislature stated three public policy objectives in its intent statement

The Legislature stated its intent to help coal power plants to:

1. Update their air pollution control equipment/facilities.
2. Abate pollution.
3. Play a long-term economic role in the communities where they are located.

5. Are Objectives Being Met?

The public policy objectives are being met

The Centralia plant has updated its air pollution control equipment/facilities

Since the preferences were enacted, the Centralia plant, which is the only existing coal-fired power plant in Washington, has completed two installations of air pollution control equipment/facilities.

Exhibit 5.1: Two installations of air pollution control equipment/facilities at Centralia plant

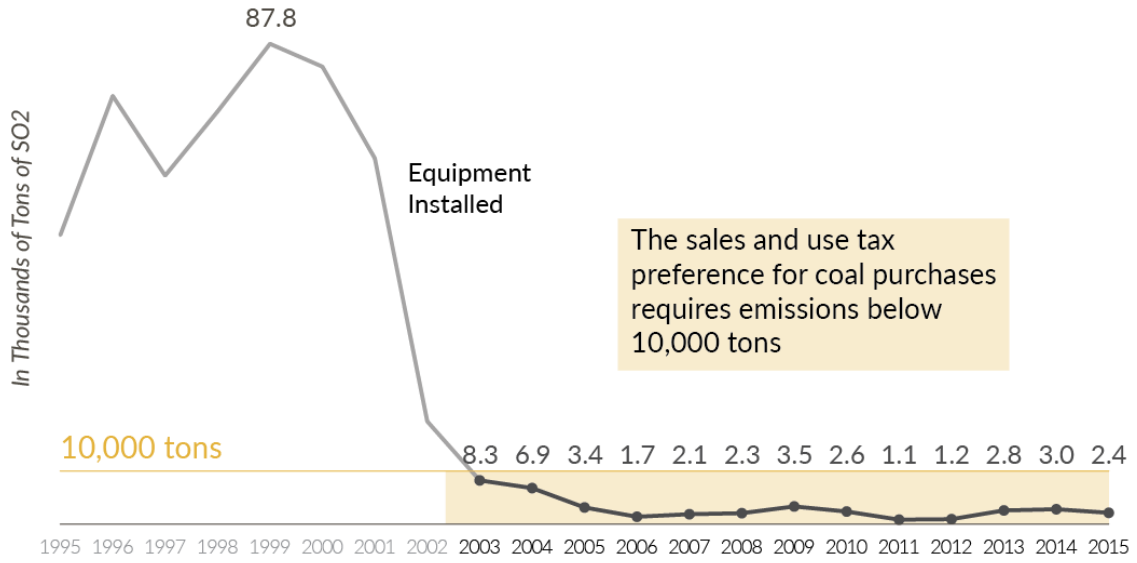
Equipment/Facilities	Pollution Removed	Year Installed
Sulfur dioxide scrubbers	Sulfur dioxide	2001- 02
Selective non-catalytic reduction	Nitrogen oxide	2011-12

Source: JLARC staff interviews of Centralia Plant staff, Department of Ecology staff.

The Centralia plant has reduced sulfur dioxide emissions

The sales and use tax preference for coal is contingent on the plant emitting less than 10 thousand tons of sulfur dioxide in any 12-month period. Sulfur dioxide emissions from the Centralia plant fell from a peak of 87.8 thousand tons in 1999 and have been below 10 thousand tons since 2003.

Exhibit 5.2: Sulfur dioxide emissions have been below 10 thousand tons since 2003



Source: JLARC staff analysis of EPA Air Markets program data.

The Centralia plant continues to play an economic role in its community

The Centralia plant's economic contribution includes employment and direct financial assistance:

- The plant has consistently employed more than 200 employees since 2001.
- TransAlta, which owns the Centralia plant, has made annual financial assistance payments of $4.58 million to support the community and energy development, as required by the 2011 agreement. From 2012 through 2016, these payments have totaled $22.9 million. According to the agreement, the payments will total $55 million by 2023: $10 million for weatherization, $20 million for economic and community development, and $25 million for developing energy technology.

6. Beneficiaries

The TransAlta coal-fired power plant in Centralia is the sole beneficiary of the preferences

Tax preferences have direct beneficiaries (entities whose state tax liabilities are directly affected) and indirect beneficiaries (entities that may receive benefits from the preference, but are not the primary recipient of the benefit).

Direct beneficiaries

The sponsor of the bill creating the preferences identified the Centralia plant as the beneficiary in committee testimony. Today, this plant is owned by TransAlta.

The plant notes its net generating capacity is 1,340 megawatts, and that its fuel (coal) is delivered by train from the Powder River Basin in Montana and Wyoming. Ranking behind two hydroelectric generating facilities, the Centralia plant has the third-largest generating capacity in Washington.

Indirect beneficiaries

Indirect beneficiaries may include:

- Sellers of coal and the air pollution control equipment/facilities.
- Residents and businesses in Centralia, Lewis County, and South Thurston County, to the extent that they benefit from the financial assistance payments.

7. Revenue and Economic Impacts

Beneficiary savings vary by preference. Beneficiary savings will decline as the Centralia plant transitions away from coal.

Each of the three preferences has different revenue and economic impacts.

Beneficiary savings from the coal exemption depend on the price and amount of coal

JLARC staff based its beneficiary savings estimate on Energy Information Administration (EIA) data showing the price and the amount of coal used for electric generation in Washington. EIA lists only one coal-fired electric power plant: TransAlta's Centralia plant. The estimate for local sales taxes is based on the rate in unincorporated Lewis County.

The estimated range is based on two estimates of the taxable value of coal sales. The lower estimate uses only the commodity cost of the coal, while the higher estimate includes the cost of transporting the coal from the Powder River Basin in Wyoming and Montana to Centralia.

Exhibit 7.1: Estimated direct beneficiary savings from the coal exemption

Biennium	Fiscal Year	Estimated State Sales/Use Tax	Estimated Local Sales Sales/Use Tax	Estimated Total Beneficiary Savings
2013-15 *7/1/13-6/30/15*	2014	$3.9-$10.6 million	$80-$210 thousand	$3.9-$10.8 million
	2015	$2.9-$8.1 million	$60-$160 thousand	$3.0-$8.3 million
2015-17 *7/1/15-6/30/17*	2016	$3.0-$8.1 million	$60-$160 thousand	$3.0-$8.3 million
	2017	$3.0-$8.1 million	$60-$160 thousand	$3.0-$8.3 million
2017-19 *7/1/17-6/30/19*	2018	$3.0-$8.1 million	$60-$160 thousand	$3.0-$8.3 million
	2109	$3.0-$8.1 million	$60-$160 thousand	$3.0-$8.3 million
	2017-19 Biennium	**$5.9-$16.3 million**	**$120-$320 thousand**	**$6.1-$16.6 million**

Source: JLARC staff analysis of EIA data.

Sales and use tax exemption for air pollution control equipment/facilities was last used for equipment/facilities installed in in 2011-12

TransAlta noted that, based on the statute requiring compliance with the emission performance standard by 2025, it does not currently plan to have qualifying expenditures in the forecast period, so JLARC staff estimates no beneficiary savings for this preference.

According to TransAlta, the last two installations of air pollution control equipment/facilities that qualified for the tax preference were:

- Installation of sulfur dioxide scrubbers in 2001-2002, at a cost of $200 million.
- Installation of technology to reduce nitrogen oxide in 2011-2012, at a cost of $17 million.

Based on sales and use tax rates in effect at the time, JLARC staff estimate these expenditures would have resulted in beneficiary savings of $13.2 million and $1.1 million, respectively.

Property tax exemption beneficiary savings average $1.1 million per year

The Department of Revenue reviewed this preference in its 2016 tax exemption study and calculated the following savings.

Exhibit 7.2: Estimated beneficiary savings from air pollution control equipment/facilities property tax exemption

Biennium	Fiscal Year	Estimated State Property Tax Savings	Estimated Local Property Tax Savings	Estimated Total Property Tax Savings
2015-17 *7/1/15-6/30/17*	2016	$214,000	$961,000	$1,175,000
	2017	$189,000	$875,000	$1,064,000
2017-19 *7/1/17-6/30/19*	2018	$194,000	$910,000	$1,104,000
	2109	$199,000	$946,000	$1,145,000
	2017-19 Biennium	**$393,000**	**$1,856,000**	**$2,249,000**

Source: JLARC staff analysis of DOR - 2016 Tax Exemption Study data.

Total beneficiary savings from all three preferences are expected to decline as the plant ends coal-fired generation

- As the Centralia plant transitions from burning coal by 2025, coal purchases and beneficiary savings attributable to those purchases will reduce to zero.
- TransAlta noted that it does not currently plan to have qualifying expenditures for air pollution control equipment/facilities in the forecast period, so JLARC staff estimates no future beneficiary savings for this preference.
- As the assessed value of existing air pollution control equipment/facilities depreciates, property tax savings are expected to decline.

Absent the tax preferences, the beneficiary would pay the taxes, but not the financial assistance payments

Terminating the tax preferences would:

- Impose sales and use taxes on coal purchases.
- Impose sales and use taxes on the installation of additional air pollution control equipment/facilities.
- Impose property taxes on the assessed value of air pollution control equipment/facilities.

Any increased sales tax revenue from a repeal would be partially offset by the loss of the remaining annual $4.58 million financial assistance payments. The statute governing the Centralia plant's transition away from coal-fired generation specifies that if the sales tax exemptions for coal or pollution control equipment/facilities are repealed, the balance of the $55 million in financial assistance payments are no longer required.

8. Other States with Similar Preference?

JLARC staff identified other states that provide tax relief for coal sales

Other states generate at least some of their power from coal-fired power plants, and some exempt coal from sales tax.

Because the sales and use tax preference for coal has the largest fiscal impact of the three preferences, the JLARC staff review of other states focused on the tax treatment of coal purchases. The review centered on the tax provisions governing coal in the ten states that use the most coal to generate electricity. All burn significantly more coal than Washington. Of these ten states:

- Illinois and Indiana impose sales tax for purchases of coal used to generate electricity.
- Pennsylvania exempts all retail sales and uses of coal.
- Texas, Ohio, Kentucky, and West Virginia have specific sales tax exemptions for the purchase of coal or fuel used to generate electricity.
- Missouri, Michigan, and Wyoming exempt coal consumed in manufacturing under more general manufacturing or industrial processing exemptions.

Exhibit 8.1: Washington ranks 34th in coal consumption for electric power generation

2015 Rank	State	Tons	Tax Treatment of Coal
1	Texas	86,779	Fuel for thermal electric generation exempt
2	Illinois	43,446	Taxable
3	Indiana	38,734	Taxable
4	Missouri	38,468	Coal consumed in manufacturing of any product exempt
5	Kentucky	34,380	Coal sales for electric generation exempt
6	Pennsylvania	31,391	All retail coal sales exempt
7	Ohio	30,518	Coal sales for electric generation exempt
8	Michigan	29,487	Fuel consumed for an industrial processing activity (including electric generation) exempt
9	West Virginia	28,223	Coal sales for electric generation exempt
10	Wyoming	26,313	Fuel used in manufacturing or processing exempt

2015 Rank	State	Tons	Tax Treatment of Coal
…	…	…	…
34	**Washington**	**3,405**	**Coal for thermal electric generation exempt**

Source: JLARC staff analysis of EIA data.

9. Applicable Statutes

Findings—Intent—1997 c 368 (reviser's note to RCW 82.08.810):

"(1) The legislature finds that:

(a) Thermal electric generation facilities play an important role in providing jobs for residents of the communities where such plants are located; and

(b) Taxes paid by thermal electric generation facilities help to support schools and local and state government operations.

(2) It is the intent of the legislature to assist thermal electric generation facilities placed in operation after December 31, 1969, and before July 1, 1975, to update their air pollution control equipment and abate pollution by extending certain tax exemptions and credits so that such plants may continue to play a long-term vital economic role in the communities where they are located." [1997 c 368 § 1.]

RCW 82.08.811

Exemptions—Coal used at coal-fired thermal electric generation facility—Application—Demonstration of progress in air pollution control—Notice of emissions violations—Reapplication—Payments on cessation of operation.

(1) For the purposes of this section:

(a) "Air pollution control facilities" means any treatment works, control devices and disposal systems, machinery, equipment, structure, property, property improvements, and accessories, that are installed or acquired for the primary purpose of reducing, controlling, or disposing of industrial waste that, if released to the outdoor atmosphere, could cause air pollution, or that are required to meet regulatory requirements applicable to their construction, installation, or operation; and

(b) "Generation facility" means a coal-fired thermal electric generation facility placed in operation after December 3, 1969, and before July 1, 1975.

(2) Beginning January 1, 1999, the tax levied by RCW 82.08.020 does not apply to sales of coal used to generate electric power at a generation facility operated by a business if the following conditions are met:

(a) The owners must make an application to the department of revenue for a tax exemption;

(b) The owners must make a demonstration to the department of ecology that the owners have made reasonable initial progress to install air pollution control facilities to meet applicable regulatory requirements established under state or federal law, including the Washington clean air act, chapter 70.94 RCW;

(c) Continued progress must be made on the development of air pollution control facilities to meet the requirements of the permit; and

(d) The generation facility must emit no more than ten thousand tons of sulfur dioxide during a previous consecutive twelve-month period.

(3) During a consecutive twelve-month period, if the generation facility is found to be in violation of excessive sulfur dioxide emissions from a regional air pollution control authority or the department of ecology, the department of ecology shall notify the department of revenue and the owners of the generation facility shall lose their tax exemption under this section. The owners of a generation facility may reapply for the tax exemption when they have once again met the conditions of subsection (2)(d) of this section.

(4) *RCW 82.32.393 applies to this section.

[1997 c 368 § 4.]

RCW 82.08.810

Exemptions—Air pollution control facilities at a thermal electric generation facility—Exceptions—Exemption certificate—Payments on cessation of operation.

(1) For the purposes of this section, "air pollution control facilities" mean any treatment works, control devices and disposal systems, machinery, equipment, structures, property, property improvements, and accessories, that are installed or acquired for the primary purpose of reducing, controlling, or disposing of industrial waste that, if released to the outdoor atmosphere, could cause air pollution, or that are required to meet regulatory requirements applicable to their construction, installation, or operation.

(2) The tax levied by RCW 82.08.020 does not apply to:

(a) Sales of tangible personal property to a light and power business, as defined in RCW 82.16.010, for construction or installation of air pollution control facilities at a thermal electric generation facility; or

(b) Sales of, cost of, or charges made for labor and services performed in respect to the construction or installation of air pollution control facilities.

(3) The exemption provided under this section applies only to sales, costs, or charges:

(a) Incurred for air pollution control facilities constructed or installed after May 15, 1997, and used in a thermal electric generation facility placed in operation after December 31, 1969, and before July 1, 1975;

(b) If the air pollution control facilities are constructed or installed to meet applicable regulatory requirements established under state or federal law, including the Washington clean air act, chapter 70.94 RCW; and

(c) For which the purchaser provides the seller with an exemption certificate, signed by the purchaser or purchaser's agent, that includes a description of items or services for which payment is made, the amount of the payment, and such additional information as the department reasonably may require.

(4) This section does not apply to sales of tangible personal property purchased or to sales of, costs of, or charges made for labor and services used for maintenance or repairs of pollution control equipment.

(5) If production of electricity at a thermal electric generation facility for any calendar year after 2002 and before 2023 falls below a twenty percent annual capacity factor for the generation facility, all or a portion of the tax previously exempted under this section in respect to construction or installation of air pollution control facilities at the generation facility shall be due as follows:

Year event occurs	Portion of previously exempted tax due
2003	100%

2004	95%
2005	90%
2006	85%
2007	80%
2008	75%
2009	70%
2010	65%
2011	60%
2012	55%
2013	50%
2014	45%
2015	40%
2016	35%
2017	30%
2018	25%
2019	20%
2020	15%
2021	10%
2022	5%
2023	0%

(6) *RCW 82.32.393 applies to this section.

[1997 c 368 § 2.]

RCW 82.12.811

Exemptions—Coal used at coal-fired thermal electric generation facility—Application—Demonstration of progress in air pollution control—Notice of emissions violations—Reapplication—Payments on cessation of operation.

(1) For the purposes of this section:

(a) "Air pollution control facilities" means any treatment works, control devices and disposal systems, machinery, equipment, structure, property, property improvements, and accessories, that are installed or acquired for the primary purpose of reducing, controlling, or disposing of industrial waste that, if released to the outdoor atmosphere, could cause air pollution, or that are required to meet regulatory requirements applicable to their construction, installation, or operation; and

(b) "Generation facility" means a coal-fired thermal electric generation facility placed in operation after December 3, 1969, and before July 1, 1975.

(2) Beginning January 1, 1999, the provisions of this chapter do not apply in respect to the use of coal to generate electric power at a generation facility operated by a business if the following conditions are met:

(a) The owners must make an application to the department of revenue for a tax exemption;

(b) The owners must make a demonstration to the department of ecology that the owners have made reasonable initial progress to install air pollution control facilities to meet applicable regulatory requirements established under state or federal law, including the Washington clean air act, chapter 70.94 RCW;

(c) Continued progress must be made on the development of air pollution control facilities to meet the requirements of the permit; and

(d) The generation facility must emit no more than ten thousand tons of sulfur dioxide during a previous consecutive twelve-month period.

(3) During a consecutive twelve-month period, if the generation facility is found to be in violation of excessive sulfur dioxide emissions from a regional air pollution control authority or the department of ecology, the department of ecology shall notify the department of revenue and the owners of the generation facility shall lose their tax exemption under this section. The owners of a generation facility may reapply for the tax exemption when they have once again met the conditions of subsection (2)(d) of this section.

(4) *RCW 82.32.393 applies to this section.

[1997 c 368 § 6.]

RCW 82.12.810

Exemptions—Air pollution control facilities at a thermal electric generation facility—Exceptions—Payments on cessation of operation.

(1) For the purposes of this section, "air pollution control facilities" mean any treatment works, control devices and disposal systems, machinery, equipment, structures, property, property improvements, and accessories, that are installed or acquired for the primary purpose of reducing, controlling, or disposing of industrial waste that, if released to the outdoor atmosphere, could cause air pollution, or that are required to meet regulatory requirements applicable to their construction, installation, or operation.

(2) The provisions of this chapter do not apply in respect to:

(a) The use of air pollution control facilities installed and used by a light and power business, as defined in RCW 82.16.010, in generating electric power; or

(b) The use of labor and services performed in respect to the installing of air pollution control facilities.

(3) The exemption provided under this section applies only to air pollution control facilities that are:

(a) Constructed or installed after May 15, 1997, and used in a thermal electric generation facility placed in operation after December 31, 1969, and before July 1, 1975; and

(b) Constructed or installed to meet applicable regulatory requirements established under state or federal law, including the Washington clean air act, chapter 70.94 RCW.

(4) This section does not apply to the use of tangible personal property for maintenance or repairs of the pollution control equipment or to labor and services performed in respect to such maintenance or repairs.

(5) If production of electricity at a thermal electric generation facility for any calendar year after 2002 and before 2023 falls below a twenty percent annual capacity factor for the generation facility, all or a portion of the tax previously exempted under this section in respect to construction or installation of air pollution control facilities at the generation facility shall be due according to the schedule provided in RCW 82.08.810(5).

(6) *RCW 82.32.393 applies to this section.

[2003 c 5 § 12;1997 c 368 § 3.]

RCW 84.36.487

Air pollution control equipment in thermal electric generation facilities—Records—Payments on cessation of operation.

(1) Air pollution control equipment constructed or installed after May 15, 1997, by businesses engaged in the generation of electric energy at thermal electric generation facilities first placed in operation after December 31, 1969, and before July 1, 1975, shall be exempt from property taxation. The owners shall maintain the records in such a manner that the annual beginning and ending asset balance of the pollution control facilities and depreciation method can be identified.

(2) For the purposes of this section, "air pollution control equipment" means any treatment works, control devices and disposal systems, machinery, equipment, structures, property, property improvements, and accessories, that are installed or acquired for the primary purpose of reducing, controlling, or disposing of industrial waste that, if released to the outdoor atmosphere, could cause air pollution, or that are required to meet regulatory requirements applicable to their construction, installation, or operation.

(3) *RCW 82.32.393 applies to this section.

[1997 c 368 § 11.]

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends continuing the three preferences

The Legislature should continue the three tax preferences until the coal-fired boilers at the plant are decommissioned. The tax preferences are meeting the stated public policy objectives of helping Washington's only coal-fired power plant to update air pollution control equipment/facilities, abate pollution, and play an economic role in its community through 2025.

As the Centralia plant transitions from burning coal by 2025, coal purchases and beneficiary savings attributable to those purchases will reduce to zero. Further, state statute and the memorandum of agreement between the owner, TransAlta, and the state provide that repeal of the tax preferences would mean any remaining financial assistance payments to the community are no longer required.

Legislation required: No (preferences have no expiration dates).

Fiscal impact: None.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, will be available December 2017.

Cogeneration Facilities and Renewable Resources

Objective (stated)	Results
Encourage efficient energy use and a reliable supply of energy from renewable energy resources.	**Not Currently Contributing.** Taxpayers have not claimed the preference since 2013.

Preference is time-limited but has no expiration date

Applies to new facilities or efficiency measures that started construction or installation between June 12, 1980 and January 1, 1990.

No utilities have claimed the preference since 2013

Department of Revenue tax records indicate:

Number of utilities claiming preference has declined since 1996 when 23 reported the deduction.

No taxpayers currently claim the preference.

Legislative Auditor recommendation: **Terminate**

The Legislature should add an expiration date to terminate this preference because it is not currently being used and there will be no remaining eligible taxpayers within a few years.

The complete report is on the JLARC web site.
For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
(360) 786-5187 ● keenan.konopaski@leg.wa.gov

Cogeneration Facilities and Renewable Resources | Public Utility Tax

Click here for One Page Overview

Summary of this Review

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A public utility tax deduction to utilities based on the cost to produce electricity from cogeneration or renewable energy resources.	**Public utility tax** RCW 82.16.550	$0

Public Policy Objective
The Legislature stated it wanted to encourage efficient energy use and a reliable supply of energy based on renewable energy resources.

Recommendations
Legislative Auditor's Recommendation **Terminate:** The Legislature should add an expiration date to terminate this preference because it is not currently being used and there will be no remaining eligible utilities within a few years. **Commissioner Recommendation:** Available in October 2017.

Details on this Preference

1. What is the Preference?

Public utility tax deduction for the cost of renewable electricity production

Purpose

The Legislature passed this preference with the stated purpose to:

- Encourage efficient energy use.
- Encourage a reliable supply of energy from renewable energy resources.

Public utility tax deduction for the cost of electricity production

The preference offers a deduction to utilities. The deduction is based on the cost to produce electricity from cogeneration or renewable energy resources.

- Cogeneration delivers two forms of energy (electricity and heat) from one fuel source.

- Renewable resources include solar, wind, hydroelectric, and geothermal energy, plus wood, wood wastes, municipal wastes, agricultural products and wastes, and end-use waste heat.

The preference also includes amounts utilities spent to improve the efficiency of consumers' energy use or reduce their electrical usage.

Preference is time limited, but has no expiration date

The preference was enacted in 1980 and does not have an expiration date. But, there is a time limit:

- Only new facilities and efficiency measures that started construction or installation between June 12, 1980 and January 1, 1990 are eligible.
- Utilities may claim the preference for up to 30 years after a project was placed in operation.

For example, if construction started on a facility in 1989 and it began operations in 1991, the utility could claim the deduction through 2020.

2. Other Relevant Background

Renewable energy generating equipment qualifies for a different preference

Washington law also provides a 75 percent remittance, or refund, for sales and use taxes paid on machinery and equipment for generating renewable energy. It is currently scheduled to expire in 2020.

3. History, Objectives, Beneficiaries, Impact

Stated public policy objective not currently met because utilities are not using the preference

Legislature stated its public policy objective

The Legislature passed the preference in 1980. In its findings, the Legislature stated that the public policy objective was to encourage "efficient energy use and a reliable supply of energy based upon renewable energy resources."

The bill enacting the preference also required the Utilities and Transportation Commission to adopt policies encouraging the use of cogeneration, energy efficiency, and renewable energy to meet new demand. The Commission was required to allow a higher rate of return on these projects when construction or installation took place before 1990. As a result, utilities had the opportunity to charge a higher rate to customers.

Preference may have met the objective at one time, but is not currently contributing to it

DOR tax records show that utilities claimed the preference until 2013.

The preference is not currently contributing to the achievement of the time-limited public policy objective because Department of Revenue tax records indicate that no utilities use it. The preference applies only to facilities where construction began before 1990.

Continuing the preference will not contribute to the public policy objective because no utilities are currently using it.

No beneficiaries are claiming the preference

Direct beneficiaries of this tax preference are utilities that started construction or installation on eligible facilities between June 12, 1980 and January 1, 1990, and are within the 30-year window for claiming the preference.

Northwest Power and Conservation Council data indicate there may be eligible utilities. However, DOR tax records show that:

- The number of utilities claiming the preference declined after 1996, when 23 reported the deduction.
- No utilities have claimed the preference since 2013.

Since the preference is unused, it is not currently meeting its objective.

No revenue or economic impacts of the tax preference

JLARC staff identified no current or future beneficiary savings associated with the preference because no utilities are claiming the preference.

No impact from terminating the preference

Eligibility is time limited, so there will soon be no utilities eligible to claim the preference. As a result, terminating the preference would have no negative effect. Further, continuing the preference will not contribute to the public policy objective because utilities are not claiming it.

No states appear to have similar incentives

JLARC staff did not identify any similar tax incentives for utilities based on production costs at cogeneration or renewable energy facilities.

4. Applicable Statutes

RCW 80.28.024

Legislative finding.

The legislature finds and declares that the potential for meeting future energy needs through conservation measures, including energy conservation loans, energy audits, the use of appropriate tree plantings for energy conservation, and the use of renewable resources, such as solar energy, wind energy, wood, wood waste, municipal waste, agricultural products and wastes, hydroelectric energy, geothermal energy, and end-use waste heat, may not be realized without incentives to public and private energy utilities. The legislature therefore finds and declares that actions and incentives by state government to promote conservation and the use of renewable resources would be of great benefit to the citizens of this state by encouraging efficient energy use and a reliable supply of energy based upon renewable energy resources.

RCW 82.16.055

Deductions relating to energy conservation or production from renewable resources.

(1) In computing tax under this chapter there shall be deducted from the gross income:

(a) An amount equal to the cost of production at the plant for consumption within the state of Washington of:

(i) Electrical energy produced or generated from cogeneration as defined in *RCW 82.35.020; and

(ii) Electrical energy or gas produced or generated from renewable energy resources such as solar energy, wind energy, hydroelectric energy, geothermal energy, wood, wood wastes, municipal wastes, agricultural products and wastes, and end-use waste heat; and

(b) Those amounts expended to improve consumers' efficiency of energy end use or to otherwise reduce the use of electrical energy or gas by the consumer.

(2) This section applies only to new facilities for the production or generation of energy from cogeneration or renewable energy resources or measures to improve the efficiency of energy end use on which construction or installation is begun after June 12, 1980, and before January 1, 1990.

(3) Deductions under subsection (1)(a) of this section shall be allowed for a period not to exceed thirty years after the project is placed in operation.

(4) Measures or projects encouraged under this section shall at the time they are placed in service be reasonably expected to save, produce, or generate energy at a total incremental system cost per unit of energy delivered to end use which is less than or equal to the incremental system cost per unit of energy delivered to end use from similarly available conventional energy resources which utilize nuclear energy or fossil fuels and which the gas or electric utility could acquire to meet energy demand in the same time period.

(5) The department of revenue, after consultation with the utilities and transportation commission in the case of investor-owned utilities and the governing bodies of locally regulated utilities, shall determine the eligibility of individual projects and measures for deductions under this section.

*Reviser's note: RCW 82.35.020 was repealed by 2005 c 443 § 7, effective July 1, 2006.

[1980 c 149 § 3.]

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends adding an expiration date to terminate the tax preference in the future

The Legislature should add an expiration date to terminate this preference because it is not currently being used and there will be no remaining eligible utilities within a few years.

Although tax records indicate no utilities are using the preference, data from the Northwest Power and Conservation Council indicate there may be eligible taxpayers not claiming the deduction. Taxpayers may only use the preference for up to thirty years after operations begin, and construction must have begun before 1990.

Legislation required: Yes (preference has no expiration date).

Fiscal impact: Depends on legislative action.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, will be available December 2017.

Electric Power in Rural Areas

Objective (inferred)	Results
Provide tax relief to utilities and their customers in rural areas.	**Met.** Preference provides tax relief to 17 rural utilities serving 156,000 customers.

Preference limited to electric utilities with few customers per mile and high power rates

> Must serve fewer than **17 customers** per mile of power line

> Must have retail power rates **above the statewide average**

Preference provides tax relief to 17 rural utilities & their customers

> Utilities can claim a deduction based on their density of customers and retail power rates

FY 16 average savings per utility: **$49,420**

FY 16 average customer savings: **$5.39**

Rural public utility customers tend to use more electricity than urban customers

Rural customers tend to use more electricity for heat and hot water and have higher monthly electric bills on average.

Urban customers tend to use more natural gas, which is less expensive.

Source: Northwest Power and Conservation Council

Legislative Auditor recommendation: **Continue**

The preference has no expiration date and is providing tax relief to rural utilities and their customers. The Legislature should consider stating the public policy objective in statute.

Electric Power Sold in Rural Areas | Public Utility Tax

Click here for One Page Overview

Summary of this Review

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A public utility tax deduction for utilities with fewer than 17 customers per mile of power line and retail power rates above the statewide average.	**Public utility tax** RCW 82.16.053	$1,680,000

Public Policy Objective
JLARC staff infer the public policy objective was to provide tax relief to utilities and their customers in rural areas where retail power rates exceed the statewide average.

Recommendations
Legislative Auditor's Recommendation **Continue:** The Legislature should continue the preference because it is meeting its inferred objective of providing tax relief to rural utilities with higher electricity costs and their customers. In continuing the preference, the Legislature should consider stating the public policy objective in statute. **Commissioner Recommendation:** Available in October 2017.

Details on this Preference

1. What is the Preference?

Public utility tax deduction for power purchased by utilities with rural service areas and high power rates

Purpose

The Legislature did not state a public policy objective for this preference.

Only electric utilities with few customers per mile and high power rates receive the preference

Electric utilities receive a deduction from the public utility tax if they have both:

- Fewer than 17 customers per mile of power line; and
- Retail power rates above the statewide average.

By definition, eligible utilities serve rural areas of the state.

Deduction tied to customer density, retail power rate, and monthly cap of $400,000 per utility

The deduction is a percentage of the utility's wholesale power costs. Utilities that claim the preference must use the lower of two percentages, based on either:

- **Number of customers per mile of power line.** The deduction ranges from 30 to 50 percent, depending on the number of customers per mile. Fewer customers means a higher deduction.
- **Average retail power rate.** The deduction is the percentage by which the utility's rate exceeds the statewide average, as determined by the Department of Revenue.

A utility's tax savings is the amount of the deduction multiplied by the tax rate (3.8734 percent). No utility may deduct more than $400,000 per month.

Exhibit 1.1: Example of how deduction is tied to customer density and retail power rates

Example	Utility A	Utility B	Utility C
Customers per mile of line	10 customers (40% deduction)	12 customers (30% deduction)	5 customers (50% deduction)
Average retail power rate	10% above state avg.	35% above state avg.	50% above state avg.
Wholesale power cost	$1,000,000	$1,000,000	$1,000,000
Percent deduction	x 10%	x 30%	Monthly cap applies
Deduction amount	$100,000	$300,000	$400,000
Deduction amount	$100,000	$300,000	$400,000
Tax rate	x 3.873%	x 3.873%	x 3.873%
Utility's tax savings	$3,873	$11,619	$15,492

Source: JLARC staff analysis of RCW 82.16.053.

Preference has no expiration date

The preference has been in effect since 1994 and is not currently scheduled to expire.

2. Legal History

Preference enacted in 1994 and increased in 1996

1994: Legislature enacted preference for rural electric utilities

The Legislature enacted this tax preference for electric utilities with few customers per mile of power line (customer density) and high power rates. At the time, electric utilities could deduct between 15 and 25 percent of the wholesale power cost based on customer density, or an amount based on its average retail rate. Utilities had to use the lowest percentage, and the monthly cap was $200,000.

The bill's prime sponsor stated small utilities have higher capital costs and higher purchasing costs than large utilities, and that this preference "tries to balance the playing field slightly."

Testimony from utilities indicated the cost of power from Bonneville Power Administration (BPA) was rapidly increasing. This increase was driving the utilities' rates up. Utility representatives noted that customers who paid higher rates for their power also paid more public utility tax as a result. They stated that if they were successful in keeping their rates competitive with others in the state, the deduction would no longer apply.

1996: Legislature increased the amount of the preference

The Legislature amended the law to double both the calculation based on customer density and the monthly cap.

The prime sponsor of the bill and industry representatives stated that power rates were increasing and the industry was consolidating.

3. Other Relevant Background

Other assistance is available to utilities. Rural customers tend to use more electricity.

BPA also provides assistance to utilities with fewer than 12 customers per mile of line

Utilities that purchase power from Bonneville Power Administration (BPA) may be eligible for a low-density discount. To qualify, utilities must:

- Pass the benefits on to their consumers;
- Have an average retail electricity rate over a set amount (5.125 cents per kilowatt-hour in fiscal year 2017); and
- Have fewer than 12 customers per mile of power line.

There are currently 19 utilities operating in Washington State that receive a low-density discount from BPA.

Rural residential customers use more electricity and have higher monthly bills than urban customers

The Northwest Power and Conservation Council published a report, *Northwest Residential Electric Bills,* in 2016. It compared use, rates, and overall monthly bills for customers of rural public, urban public, and private utilities. Some of the utilities that the Council considers to be rural may not qualify for the tax preference. This is because the Council used a definition for rural that was not based solely on density, and not all rural utilities have higher than average power rates.

The report noted that rural public utility customers tend to use more electricity for heat and hot water. Urban and private utility customers are more likely to use lower-priced natural gas. As a result, rural customers have higher average monthly electric bills, despite paying about the same rate per kilowatt-hour as urban customers and less than private utility customers.

Exhibit 3.1: Average annual residential use in rural areas is 25% higher than in urban areas

Source: JLARC staff analysis of EIA data on electricity sales to ultimate customers.

The public utility tax

The public utility tax is a tax on gross receipts of public service businesses, including those that engage in transportation, communications, and the supply of energy, natural gas, and water. Income subject to the public utility tax is exempt from the business and occupation (B&O) tax. Rates vary based on the type of business.

Electric utilities that generate, produce, or distribute electricity pay a rate of 3.8734 percent of their gross receipts. They may deduct any sales to others for resale, or sales for export outside Washington State.

4. Public Policy Objectives

Legislature did not state public policy objective

The Legislature did not state a public policy objective for this preference.

Inferred objective: Provide tax relief to utilities and their customers in rural areas

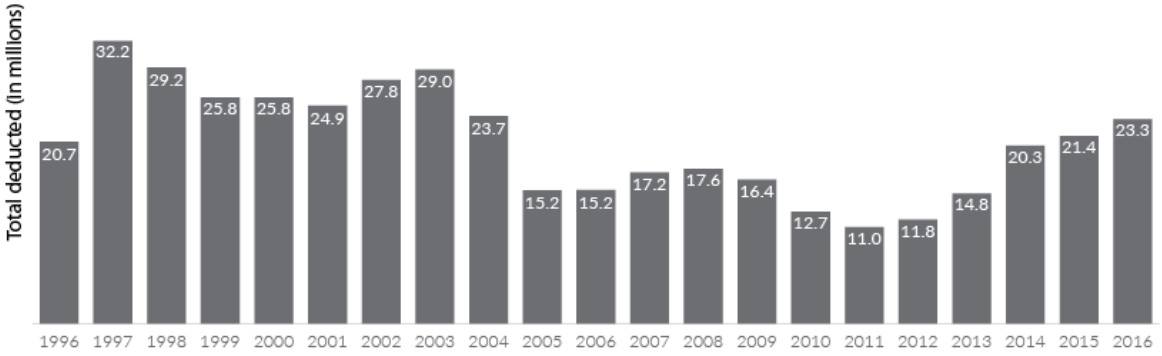
JLARC staff infer the public policy objective was to provide tax relief to utilities and their customers in rural areas where retail power rates exceed the statewide average.

5. Are Objectives Being Met?

The preference provides tax relief to 17 rural utilities and their customers

The structure of the preference ensures that it benefits only utilities with an average retail cost that is higher than the state average. Over time, the number of beneficiaries and the amount of the deduction has fluctuated, indicating utilities use the preference in years when their retail rates are higher. In 2016, the preference provided tax relief to 17 rural utilities with an estimated 156,000 total customers. Three utilities claimed the maximum $400,000 deduction in at least one month during fiscal year 2016.

Exhibit 5.1: The amount deducted by beneficiaries has fluctuated over the years but has been increasing since fiscal year 2011



Source: JLARC staff analysis of Department of Revenue taxpayer data.

If the preference continues, eligible rural utilities and their customers will continue to receive tax relief.

6. Beneficiaries

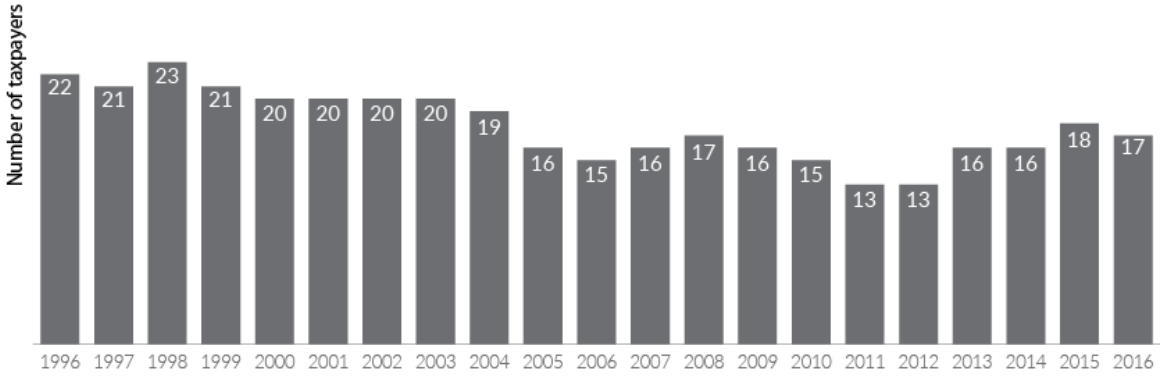
Electric utilities in rural areas benefit from the preference

Tax preferences have direct beneficiaries (entities whose state tax liabilities are directly affected) and may have indirect beneficiaries (entities that may receive benefits from the preference, but are not the primary recipient of the benefit).

Direct beneficiaries

The direct beneficiaries of the preference are utilities that provide electricity service to customers in rural areas and that have higher than average power rates. In fiscal year 2016, there were 17 utilities reporting use of the deduction. Eight of those utilities were public utility districts and nine were cooperatives.

Exhibit 6.1: The number of direct beneficiaries has fluctuated



Source: JLARC staff analysis of Department of Revenue taxpayer data.

Indirect beneficiaries

Customers of eligible rural utilities are indirect beneficiaries because the utility's tax savings reduce the customer's cost of power. In fiscal year 2016, JLARC staff estimate the utilities using the deduction served approximately 156,000 customers.

7. Revenue and Economic Impacts

Estimated direct beneficiary savings in 2017-19 Biennium are $1.66 million

Utilities report the amount of the deduction on a separate line on their tax returns. The tax preference resulted in estimated beneficiary savings of $904,000 in Fiscal Year 2016. JLARC staff estimate the savings will be $1.68 million in the 2017-19 Biennium.

Exhibit 7.1: Estimated direct beneficiary savings

Biennium	Fiscal Year	Estimated Amount Deducted	Estimated Beneficiary Savings
2013-15 *7/1/13-6/30/15*	2014	$20,283,000	$786,000
	2015	$21,446,000	$831,000
2015-17 *7/1/15-6/30/17*	2016	$23,348,000	$904,000
	2017	$21,692,000	$840,000
2017-19 Biennium *7/1/17-6/30/19*	2018	$21,692,000	$840,000
	2019	$21,692,000	$840,000
	2017-19 Estimated Biennial Savings		**$1,680,000**

Source: JLARC staff analysis of Department of Revenue taxpayer data.

Indirect beneficiary savings calculated

Based on 156,000 customers of beneficiary utilities, if fully passed on the preference is expected to save each customer an estimated $5.39 per year in the next biennium.

Absent the preference, utilities would pay more public utility tax

If the preference were terminated, the rural utilities that benefit from the preference would pay more public utility tax. The increased cost would likely be passed on to their customers.

8. Other States with Similar Preference?

States in BPA service territory have preferences for electric utilities, but none specific to rural utilities

JLARC staff reviewed taxes on electric utilities at the retail level for states in Bonneville Power Administration's service territory, which consists of Washington, California, Montana, Oregon, Idaho, Utah, Nevada, and Wyoming.

- California and Montana each impose a tax based on the number of kilowatt-hours of electricity purchased rather than the amount paid by the customer. As a result, the tax passed on to customers does not vary based on the rates they pay for electricity, as it does in Washington. Neither state has a preference specific to all rural utilities, but Montana exempts electricity delivered to municipal utilities and rural electric cooperatives from tax.
- Oregon and Idaho both allow electric cooperatives to pay a gross receipts tax instead of some property taxes. There are no preferences specific to rural utilities, but cooperatives in both states may fully deduct their cost of power.
- Utah imposes a gross receipts tax on some nonprofit utilities instead of its franchise or income taxes. There are no preferences specific to rural utilities.
- Nevada imposes a tax on gross receipts called the Commerce Tax. There are no preferences specific to rural utilities, but governmental entities and tax-exempt organizations like cooperatives are exempt from paying the tax.
- Wyoming does not appear to impose taxes on utilities at the retail level.

9. Applicable Statutes

RCW 82.16.053

Deductions in computing tax—Light and power businesses.

(1) In computing tax under this chapter, a light and power business may deduct from gross income the lesser of the amounts determined under subsections (2) through (4) of this section.

(2)(a) Fifty percent of wholesale power cost paid during the reporting period, if the light and power business has fewer than five and one-half customers per mile of line.

(b) Forty percent of wholesale power cost paid during the reporting period, if the light and power business has more than five and one-half but less than eleven customers per mile.

(c) Thirty percent of the wholesale power cost paid during the reporting period, if the light and power business has more than eleven but less than seventeen customers per mile of line.

(d) Zero if the light and power business has more than seventeen customers per mile of line.

(3) Wholesale power cost multiplied by the percentage by which the average retail electric power rates for the light and power business exceed the state average electric power rate. If more than fifty percent of the kilowatt-hours sold by a light and power business are sold to irrigators, then only sales to nonirrigators shall be used to calculate the average electric power rate for that light and power business. For purposes of this subsection, the department shall determine state average electric power rate each year based on the most recent available data and shall inform taxpayers of its determination.

(4) Four hundred thousand dollars per month.

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends continuing the preference

The Legislature should continue the preference because it is meeting its inferred objective of providing tax relief to rural utilities with higher electricity costs and their customers. In continuing the preference, the Legislature should consider stating the public policy objective in statute.

The structure of the preference ensures it applies only when a utility is rural and has higher than average retail power rates.

Legislation required: Yes, if the Legislature chooses to state a public policy objective (preference has no expiration date).

Fiscal impact: Depends on legislative action.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, will be available December 2017.

Electric Vehicle Batteries and Charging Stations

JLARC Staff 2017 Tax Preference Performance Evaluation — Sales and Use, Leasehold Excise Tax Preferences

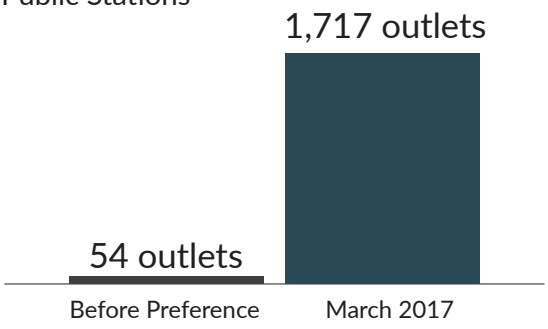
Objectives (stated)	Results
Develop convenient, cost-effective electric vehicle infrastructure in Washington.	**Unclear.** Number of charging stations has increased, but it may not be due to the preferences. Also, the Legislature did not set targets for the number of charging stations needed.
Encourage transition to greater use of electric vehicles.	**Unclear.** Enabling people to conveniently recharge an electric vehicle battery may encourage vehicle use, but it is unknown the extent to which the preferences may have contributed.

Three preferences with mixed impact

Type	Focus	Use and Impact
Sales & Use	Battery sales, installation, or repair Battery "lease and swap" option	Limited use and impact
Sales & Use	Charging station parts, construction, installation, or repair	Used, impact on charging station growth unclear
Leasehold Excise Tax	Businesses that use public property to build or operate electric vehicle charging stations	May be used, but no data exists, so impact unclear

Increase in stations since preference enacted

Public Stations



Source: U.S. Department of Energy EVSE data through 3/22/17

Private Stations

Source: JLARC staff estimate based on registered EVs and PHEVs as of 6/30/16

Legislative Auditor recommendations: **Clarify**

Prior to the January 2020 expiration date:

1. **Sales and use tax exemption for electric vehicle battery sales and installation: Clarify** if limited use is consistent with legislative expectations.
2. **Sales and use tax for electric vehicle charging stations: Clarify** to set a target for the number of new electric vehicle charging stations needed to meet legislative objectives.
3. **Leasehold excise tax preference: Clarify** to include reporting that will help determine the direct beneficiaries and the extent to which they benefit.

The complete report is on the JLARC web site.

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
(360) 786-5187 • keenan.konopaski@leg.wa.gov

Electric Vehicle Batteries and Charging Stations | Multiple Taxes

Click here for One Page Overview

Summary of this Review

The Preferences Provide	Tax Type	Estimated Biennial Beneficiary Savings
A **sales and use tax exemption** for: • Electric vehicle (EV) battery purchases, installations, and repairs. • EV charging stations and component parts, and labor and services to install, repair, and improve them. A **leasehold excise tax (LET) exemption** for private use of publicly owned property for installing, maintaining, or operating EV charging stations. The preferences are scheduled to expire on January 1, 2020.	**Sales and Use** RCWs 82.08.816; 82.12.816 **Leasehold Excise** RCW 82.29A.125	Sales and Use Tax for EV Batteries: Limited use and impact Sales and Use Tax for EV Charging Stations: range between $1.8 - $3.4 million LET for EV Charging Stations: Unknown

Public Policy Objective

The Legislature stated the public policy objectives:

- Encourage transition to greater use of EVs; and
- Develop convenient, cost-effective EV infrastructure in Washington.

Recommendations

Legislative Auditor's Recommendation

Before the January 1, 2020, expiration date, the Legislature should:

- **Review and clarify the electric vehicle battery tax preference** to determine if the use matches legislative expectations for the preference.
- **Review and clarify the electric vehicle charging station** components, construction, installation, and repair tax preference to set a target for the number of new EV charging stations.
- **Clarify the leasehold excise tax preference** for private use of publicly owned property for electric vehicle infrastructure to require direct beneficiaries to report their use of the preference.

Commissioner Recommendation: Available in October 2017.

Details on this Preference

1. What are the Preferences?

Tax preferences intended to encourage electric vehicle use and establish more electric vehicle charging stations

Purpose

The Legislature passed these preferences with the stated intent to:

- Encourage electric vehicle (EV) use; and
- Establish convenient, cost-effective EV charging infrastructure.

Preference 1: EV battery sales and use tax exemption

An exemption for EV battery purchases, installation, and repair services.

Preference 2: Charging station sales and use tax exemption

An exemption for EV charging stations and component parts, or labor and services to install, repair, or improve them.

Preference 3: Charging station infrastructure leasehold excise tax exemption

An exemption for entities that lease publicly owned land for installing, maintaining, or operating EV charging stations.

- **What is leasehold excise tax?** Parties pay leasehold excise tax when they use public property. The tax is based on the amount of the lease or rent. If there is no contract for renting or leasing, the Department of Revenue determines the "taxable rent" upon which the tax will be determined.

Preferences scheduled to expire in 2020

The preferences took effect July 26, 2009, and are set to expire January 1, 2020.

2. Legal History

Legislature passed preferences to encourage use of electric vehicles and development of charging stations

2009: Legislature passed preferences

The Legislature passed these preferences to help the state transition to electric vehicles (EV). The bill included a sales and use tax exemption for EV batteries, a sales and use tax exemption for EV charging stations, and a leasehold excise tax (LET) exemption for operating EV charging stations on public land.

The preferences have not changed since they were passed in 2009. They are scheduled to expire in 2020.

3. Other Relevant Background

There are a number of other legislative efforts, both at the state and federal level, to expand use of electric vehicles in Washington

The Legislature has taken many actions to encourage the use of clean alternative fuels and vehicles, including electric vehicles (EV).

A report to the Legislature

In 2015, the Joint Transportation Committee (JTC) of the Legislature released a report stating that widespread EV adoption depends in part on "a robust publicly available charging network." The report also noted that many parts of the state remain inaccessible to EV drivers who depend on public charging stations.

Subsequent to the JTC report, the Legislature passed two bills in 2015 to increase and expand EV charging stations in Washington.

1. The Utilities and Transportation Commission (UTC) was directed to adopt policies and consider developing incentives to encourage utilities to build EV infrastructure such as charging stations.

   As of March 2017, the UTC had adopted draft policies. Currently, utilities may petition the UTC for up to a 2 percent additional return on capital investments if they install charging stations for ratepayers' benefit. A report to the Legislature on this incentive program is due December 2017.

   Three Washington utilities – Avista Corporation, Seattle City Light, and Puget Sound Energy – have developed projects to encourage residential and business customers to install Level 2 or 3 charging stations. While only the Avista project is related to the UTC incentive program, they share similar research goals, including how charging affects load and the power grid, and how it can be supported in the future.

2. The Department of Transportation was directed to develop a pilot program to support EV charging stations with public and private financing.

   The Legislature provided $1 million for grants to cities, counties, transit agencies, or tribes to work with private charging networks to install charging stations along key highways. As of March 2017, WSDOT plans to have contracts beginning after July 1, 2017.

Other incentives

Two other tax preferences are designed to encourage use of clean alternative fuel vehicles, including electric vehicles.

Exhibit 3.1: Other tax preferences to encourage clean alternative fuel vehicle use

Preference	Type	Description	Began	Expiration Date	JLARC Review

Alternative Fuel Vehicles (AFV)	Sales and use	Exempts up to $32,000 of sale or lease price for eligible new passenger vehicles exclusively powered by clean alternative fuel and plug-in hybrids	2009, amended in 2015 and 2016	Earliest of when total number of AFVs titled in Washington after July 15, 2015, reaches 7,500 or July 1, 2019	**Full review in 2017**
Clean Alternative Fuel Commercial Vehicle Credit	B&O; Public utility	B&O tax or PUT credits for businesses that purchase a clean alternative fuel commercial vehicle or modify a vehicle to use such fuel	2015, amended in 2016 and 2017	Credits may be earned through January 1, 2021, and must be used by January 1, 2022	Scheduled for 2020

Source: JLARC staff analysis of tax statutes, DOR tax incentives web site, and U.S. Department of Energy Alternative Fuels Data Center web site.

Alternative fuel and hybrid electric vehicles with an EPA fuel economy rating of at least 50 MPG also are exempt from state emissions control inspections.

At the federal level, an income tax credit for alternative fuel infrastructure recently expired

Consumers who purchased qualified residential fueling equipment before the December 31, 2016, expiration date were eligible for a tax credit of up to $1,000.

A credit was available for commercial installations made between January 1, 2015, and December 31, 2016, and covered 30 percent of the infrastructure costs, up to $30,000.

Different charging levels

There are three ways electric vehicles can be charged. Level 2 and Level 3 chargers are eligible for the sales and use tax and/or leasehold excise tax preferences.

Exhibit 3.2: Availability, cost, and recharging speed

	Level 1	Level 2	Level 3 (fast charging)
			
Availability	Standard wall outlet	• 240-volt outlet and connector • Dedicated public charging station	Commercial or high-traffic location (e.g., near highways)

	Level 1	Level 2	Level 3 (fast charging)
Cost to install	None – cable provided with vehicles	$1,000 - $3,000 for home outlets $4,500 - $6,500 for public stations	$90,000 or more
Recharging speed	Overnight	4 to 7 hours	Under 30 minutes

Source: JLARC staff analysis of charging equipment detail and images. WSDOT Washington State Electric Vehicle Action Plan 2015-2020, pg. 5, Supercharger information from EV Obsession and Tesla supercharger websites.

4. Public Policy Objectives

Legislature stated public policy objectives for preferences in 2009

The Legislature stated its objectives for the electric vehicle (EV) sales and use tax exemptions and the leasehold excise tax exemption:

- Encourage transition to greater use of electric vehicles; and
- Develop convenient, cost-effective electric vehicle infrastructure in Washington.

The Legislature also stated:

- Developing EV charging stations was a critical step in creating jobs, fostering economic growth, reducing greenhouse gas emissions, reducing reliance on foreign fuels, and reducing pollution in Puget Sound linked to gas-powered vehicles.
- Limited driving distance between battery chargers was a key obstacle to broad EV adoption.

5. EV battery sales and use tax exemption

Exemption for battery sales, installation, and repair has limited use

Less than three firms report qualified sales under this preference for sales, installation, and repair of electric vehicle batteries. This means the preference has limited impact on the objective of encouraging more electric vehicle (EV) use.

"Lease and swap" approach not used

When the Legislature considered this preference in 2009, one of the approaches discussed by the industry to increase the distance EVs might travel was a "lease and swap" of batteries.

In a "lease and swap," drivers would lease batteries from private companies, swapping out depleted batteries for charged batteries at automated stations. This approach is not used in Washington or elsewhere.

Limited use for the sale of batteries

Less than three taxpayers report making qualified sales of batteries.

Beneficiary savings cannot be disclosed

The preference's limited use indicates that current or future beneficiary savings associated with the preference are small compared to the other two preferences. Department of Revenue tax return data reflects less than three taxpayers reported qualifying sales for Fiscal Year 2016. No qualifying sales were reported in Fiscal Years 2014 or 2015.

JLARC staff found no other state with a sales and use tax exemption specifically for EV batteries or services to install, repair, or replace them.

6. Charging station sales and use tax exemption

Exemption for charging stations is used, but it's unclear if growth meets the Legislature's goal for expanded charging infrastructure

When the Legislature considered this preference in 2009, one of the approaches discussed by the industry to increase the distance EVs might travel was providing a network of rapid charging EV battery stations. This would allow EV drivers to quickly recharge their batteries.

This preference was structured to encourage increasing the number of these charging stations and is being used.

More EV charging equipment and stations added since preferences enacted

Since 2009, the number of EV charging stations has increased in Washington. Most of the growth has been in Level 2 chargers rather than Level 3. However, JLARC staff do not assert that there is a causal relationship between the increase in charging stations and the tax preference.

Publicly available charging stations

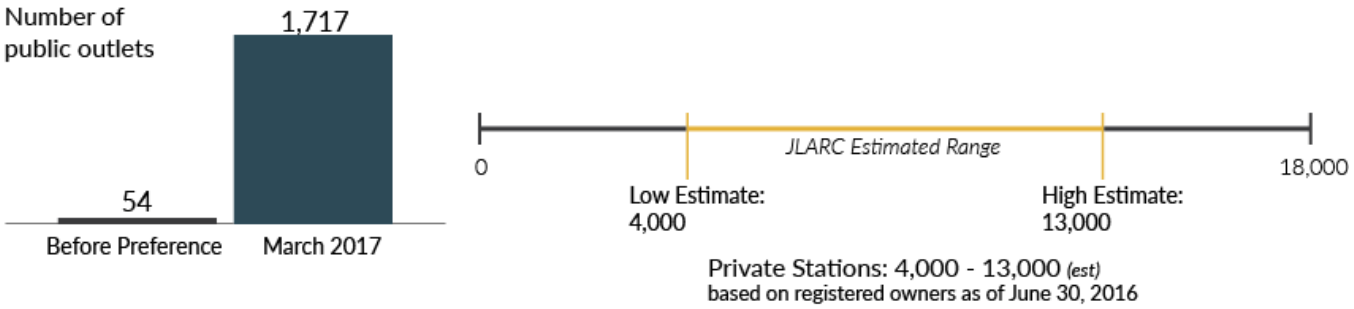
As of March 2017, the U.S. Department of Energy reported there were 669 open publicly available charging stations with 1,717 outlets in Washington. Of these, 1,663 opened after the preference took effect in July 2009.

Private charging stations

Individuals and businesses also may purchase and install private charging equipment at their homes and workplaces. Data is not available on the number of these installations.

The graphic below estimates the number of private charging units if between 25 and 75 percent of Washington EV owners installed such equipment at their homes.

Exhibit 6.1: Washington had 1,717 public charging units and an estimated 4,000–13,000 private units



Source: JLARC staff analysis of U.S. Department of Energy EVSE data on Washington EV charging stations through March 22, 2017 showing publicly available charging outlets. Private stations estimated by JLARC staff using a range of 25% to 75% of all Washington registered EVs and PHEVs as of June 30, 2016.

Continuing this preference will continue to lower costs

The tax preference provides cost savings to individuals, businesses, government entities, and others on purchases of EV charging station components, as well as any charging station construction, installation, or repair services.

Several recent studies note that EV charging station businesses that rely solely on direct revenue from charging vehicles are not currently financially feasible.

Preferences benefit individuals, businesses, government entities that build or install EV charging stations at public and private locations

Tax preferences have direct beneficiaries (entities whose state tax liabilities are directly affected) and may have indirect beneficiaries (entities that may receive benefits from the preference, but are not the primary recipient of the benefit.)

Direct Beneficiaries

The direct beneficiaries are those who purchase EV charging components or build, install, or repair EV charging stations for public or private use.

Indirect Beneficiaries

Indirect beneficiaries are EV drivers who benefit because they may have greater access to charging stations throughout the state.

Estimated beneficiary savings in 2017-19 Biennium range between $1.8 and $3.4 million

JLARC staff estimated the direct beneficiary savings by calculating the number of and costs associated with three different EV charger type and site location combinations:

- **Level 2 and 3 publicly available charging stations** installed in Washington per U.S. Department of Energy (USDOE) data, with a range of possible costs per installation.
- **Level 2 EV charging stations installed at private residences or businesses** in Washington. JLARC staff used data from the Department of Licensing on all newly titled or title transfers for EVS for Fiscal Years 2014 through nearly half of Fiscal Year 2017. Staff then estimated a range of the number of Level 2 charging equipment installed at private residences or businesses from 25 percent to 75 percent.

Exhibit 6.2: Estimated direct beneficiary savings range

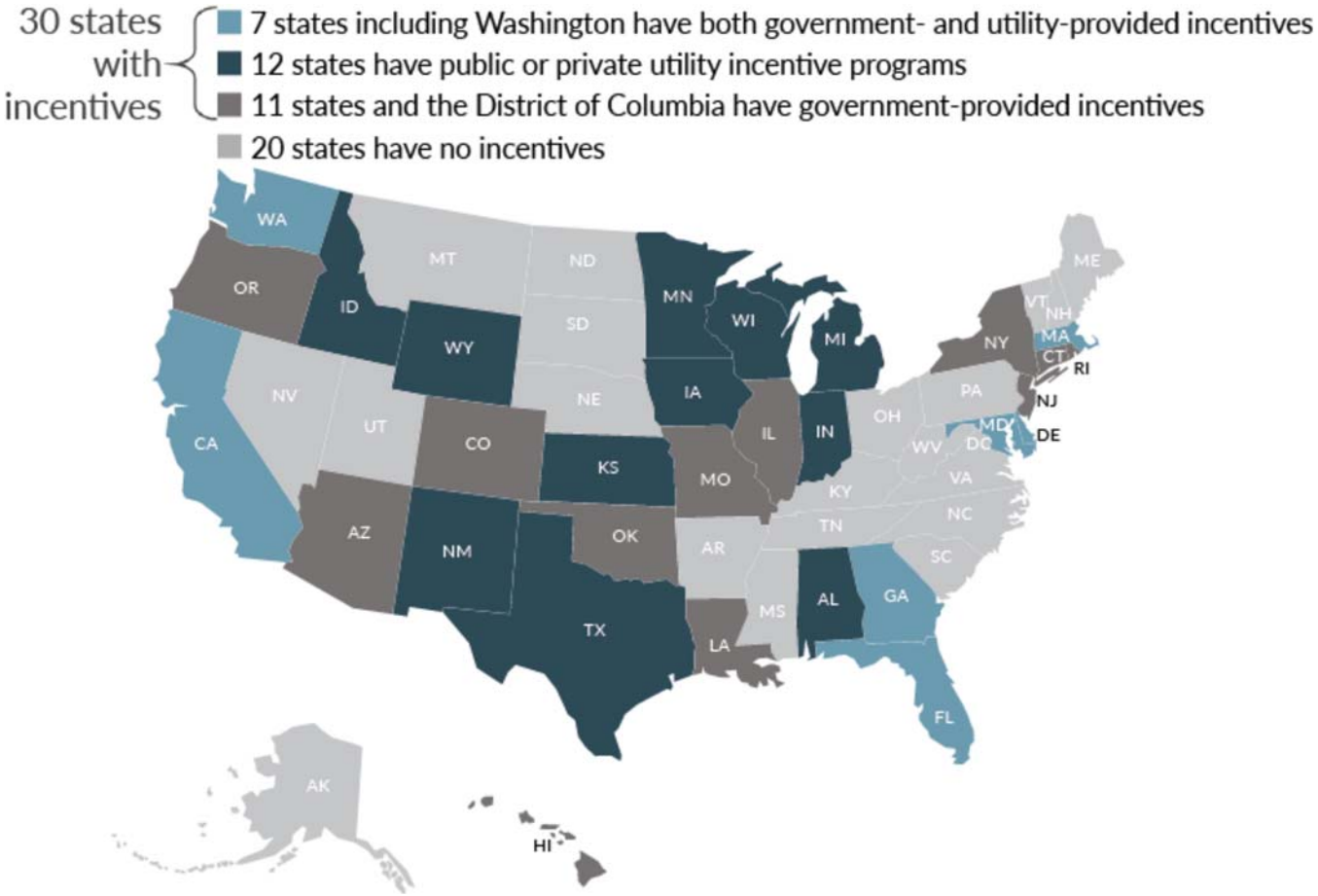
Biennium	FY	Range of Public Stations		Range of Private Stations		Total savings range (public + private)
		Low Estimate	High Estimate	25% Owners	75% Owners	
2013-15 *7/1/13-6/30/15*	2014	$327,000	$333,000	$247,000	$740,000	$574,000 - $1,073,000
	2015	$185,000	$188,000	$268,000	$803,000	$453,000 - $991,000
2015-17 *7/1/15-6/30/17*	2016	$554,000	$650,000	$219,000	$658,000	$773,000 - 1,308,000
	2017	$505,000	$584,000	$368,000	$1,105,000	$873,000 – 1,609,000
2017-19 *7/1/17-6/30/19*	2018	$512,000	$590,000	$368,000	$1,105,000	$880,000 - $1,695,000
	2019	$520,000	$595,000	$368,000	$1,105,000	$888,000 - $1,700,000
	2017-19 Biennium	**$1,032,000**	**$1,185,000**	**$736,000**	**$2,210,000**	**$1,768,000 - $3,395,000**

Source: JLARC staff analysis of: U.S. Department of Energy data on public EVSE level 2 and level 3 charging units installed July 2013 – March 2017. Estimates on level 2 and public level 3 EVSE units, installation, and other costs from 2015 Joint Transportation Committee Report for 2014 and 2015 – on. Estimates on level 3 and public Level 2 EVSE unit, installation and other costs from Avista Corp. Estimates for private level 2 EVSE installations from Avista Corp and Seattle City Light estimated costs. Department of Licensing new qualifying and nonqualifying EV Titles for July 2014 – December 2016.

Other states and utilities offer a variety of incentives to encourage EV use and charging equipment installations

Washington is the only state with a sales and use tax exemption to promote and encourage electric vehicle charging stations. However, other states offer a number of related incentives.

Exhibit 6.3: Thirty states offer government and/or utility-based incentives for charging stations



Source: JLARC staff analysis of state and local government, utility, and other incentives offered throughout U.S. Note: Georgia's income tax credit was repealed in 2015, but still may be claimed within 5 years of purchase.

State or local government programs to incentivize installation of charging equipment generally:

- Benefit both residential and commercial locations.
- Include a variety of incentives, such as rebates, income tax credits, and grants.
- Have time limits or are provided on a first-come-first-served basis and capped.

Utility-sponsored programs to incentivize EVSE installation generally:

- Benefit residential and sometimes commercial customers.
- Provide funding or rebates for a percentage of costs or an amount below a cap.
- Sometimes only available to participants who agree to time-of-use rates.
- Limited to a certain number of participants or for a limited time.

7. Charging station infrastructure leasehold excise tax exemption

Extent of use and contribution to objectives is unknown

It is unknown to what extent the leasehold excise tax (LET) exemptions for private use of publicly owned property to operate EV charging stations is being used or whether it has had any impact toward achieving the public policy objectives.

No data available to assess leasehold excise tax exemption for private use of public property

Qualifying EV charging stations can be located at sites owned by state, local, or the federal government.

However, there is no requirement for these government entities or beneficiaries to report their use of the preference. The result is that no records are available to help inform how much the preference is used or the circumstances for its use.

Therefore, it is unknown how much the leasehold excise tax exemption is being used or whether it has had any impact toward achieving the objectives.

Preference benefits businesses that build, install, or operate EV charging stations on public property

Tax preferences have direct beneficiaries (entities whose state tax liabilities are directly affected) and may have indirect beneficiaries (entities that may receive benefits from the preference, but are not the primary recipient of the benefit.)

Direct beneficiaries are businesses that lease or use publicly owned property to operate EV charging stations. While there may be direct beneficiaries, no data is available to identify them.

Indirect beneficiaries are EV drivers, who benefit because they may have greater access to charging stations throughout the state.

JLARC staff did not identify a method to determine the beneficiary savings for the preference.

There are no records documenting use of this preference. The Department of Revenue's 2016 Tax Exemption study identified the taxpayer savings for this preference as "indeterminate." The preference is currently set to expire January 1, 2020.

Absent this tax preference, impact on use of publicly owned property uncertain

Any businesses that lease or use publicly owned property to locate or operate EV charging equipment or stations would owe leasehold excise tax on the lease amount or value of the arrangement. It is unknown how this would impact such arrangements.

No other states offer a similar tax preference

JLARC staff identified two states, Arizona and Florida, with a tax similar to Washington's leasehold excise tax. Neither state has an exemption for electric vehicle charging infrastructure.

8. Applicable Statutes

RCW 82.08.8182

Exemptions—Electric vehicle batteries and infrastructure. (Expires January 1, 2020.)

(1) The tax imposed by RCW 82.08.020 does not apply to:

(a) The sale of batteries for electric vehicles;

(b) The sale of or charge made for labor and services rendered in respect to installing, repairing, altering, or improving electric vehicle batteries;

(c) The sale of or charge made for labor and services rendered in respect to installing, constructing, repairing, or improving electric vehicle infrastructure; and

(d) The sale of tangible personal property that will become a component of electric vehicle infrastructure during the course of installing, constructing, repairing, or improving electric vehicle infrastructure.

(2) Sellers may make tax exempt sales under this section only if the buyer provides the seller with an exemption certification in a form and manner prescribed by the department. The seller must retain a copy of the certificate for the seller's files.

(3) The definitions in this subsection apply throughout this section unless the context clearly requires otherwise.

(a) "Battery charging station" means an electrical component assembly or cluster of component assemblies designed specifically to charge batteries within electric vehicles, which meet or exceed any standards, codes, and regulations set forth by chapter 19.28 RCW and consistent with rules adopted under RCW 19.27.540.

(b) "Battery exchange station" means a fully automated facility that will enable an electric vehicle with a swappable battery to enter a drive lane and exchange the depleted battery with a fully charged battery through a fully automated process, which meets or exceeds any standards, codes, and regulations set forth by chapter 19.28 RCW and consistent with rules adopted under RCW 19.27.540.

(c) "Electric vehicle infrastructure" means structures, machinery, and equipment necessary and integral to support an electric vehicle, including battery charging stations, rapid charging stations, and battery exchange stations.

(d) "Rapid charging station" means an industrial grade electrical outlet that allows for faster recharging of electric vehicle batteries through higher power levels, which meets or exceeds any standards, codes, and regulations set forth by chapter 19.28 RCW and consistent with rules adopted under RCW 19.27.540.

(4) This section expires January 1, 2020.

[2009 c 459 § 4.]

RCW 82.12.816

Exemptions—Electric vehicle batteries and infrastructure. (Expires January 1, 2020.)

(1) The tax imposed by RCW 82.12.020 does not apply to the use of:

(a) Electric vehicle batteries;

(b) Labor and services rendered in respect to installing, repairing, altering, or improving electric vehicle batteries; and

(c) Tangible personal property that will become a component of electric vehicle infrastructure during the course of installing, constructing, repairing, or improving electric vehicle infrastructure.

(2) The definitions in this subsection apply throughout this section unless the context clearly requires otherwise.

(a) "Battery charging station" means an electrical component assembly or cluster of component assemblies designed specifically to charge batteries within electric vehicles, which meet or exceed any standards, codes, and regulations set forth by chapter 19.28 RCW and consistent with rules adopted under RCW 19.27.540.

(b) "Battery exchange station" means a fully automated facility that will enable an electric vehicle with a swappable battery to enter a drive lane and exchange the depleted battery with a fully charged battery through a fully automated process, which meets or exceeds any standards, codes, and regulations set forth by chapter 19.28 RCW and consistent with rules adopted under RCW 19.27.540.

(c) "Electric vehicle infrastructure" means structures, machinery, and equipment necessary and integral to support an electric vehicle, including battery charging stations, rapid charging stations, and battery exchange stations.

(d) "Rapid charging station" means an industrial grade electrical outlet that allows for faster recharging of electric vehicle batteries through higher power levels, which meets or exceeds any standards, codes, and regulations set forth by chapter 19.28 RCW and consistent with rules adopted under RCW 19.27.540.

(3) This section expires January 1, 2020.

[2009 c 459 § 5.]

RCW 82.29A.1282

Exemptions—Electric vehicle infrastructure. (Expires January 1, 2020.)

(1) Leasehold excise tax may not be imposed on leases to tenants of public lands for purposes of installing, maintaining, and operating electric vehicle infrastructure.

(2) The definitions in this subsection apply throughout this section unless the context clearly requires otherwise.

(a) "Battery charging station" means an electrical component assembly or cluster of component assemblies designed specifically to charge batteries within electric vehicles, which meet or exceed any standards, codes, and regulations set forth by chapter 19.28 RCW and consistent with rules adopted under RCW 19.27.540.

(b) "Battery exchange station" means a fully automated facility that will enable an electric vehicle with a swappable battery to enter a drive lane and exchange the depleted battery with a fully charged battery through a fully automated process, which meets or exceeds any standards, codes, and regulations set forth by chapter 19.28 RCW and consistent with rules adopted under RCW 19.27.540.

(c) "Electric vehicle infrastructure" means structures, machinery, and equipment necessary and integral to support an electric vehicle, including battery charging stations, rapid charging stations, and battery exchange stations.

(d) "Rapid charging station" means an industrial grade electrical outlet that allows for faster recharging of electric vehicle batteries through higher power levels, which meets or exceeds any standards, codes, and regulations set forth by chapter 19.28 RCW and consistent with rules adopted under RCW 19.27.540.

(3) This section expires January 1, 2020.

[2009 c 459 § 3.]

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends clarifying the three preferences

Before the January 1, 2020, expiration date, the Legislature should:

- **Review and clarify the electric vehicle battery tax preference to determine if the use matches legislative expectations for the preference.**

It appears that the original intent of the preference was to incentivize a "lease and swap" approach for electric vehicle batteries. While this approach is not being used, the preference is being used on a limited basis (less than three firms making qualified sales) for battery sales. The Legislature should clarify if that use matches legislative expectations for the preference.

- **Review and clarify the electric vehicle charging station components, construction, installation, and repair tax preference to set a target for the number of new EV charging stations.**

  The Legislature could consider a metric for the number of stations that would be sufficient to achieve the public policy objectives. Metrics might be a number of charging stations per registered electric vehicles, or ensuring the geographic availability of charging infrastructure throughout the state.

- **Clarify the leasehold excise tax preference for private use of publicly owned property for electric vehicle infrastructure to require direct beneficiaries to report their use of the preference.**

  If the Legislature wants information on use of this preference and some estimation of the beneficiary savings, an application or other reporting requirements to identify use of the preference is needed. This would likely require information and compliance from both government entities that own the property and the businesses that lease or use the property.

Legislation required: Yes (preferences expire on January 1, 2020).

Fiscal impact: Depends on legislative action.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, will be available December 2017.

Electrolytic Processors

Objectives (inferred)	Results
Retain family-wage jobs.	**Met.** Processors provided 106 jobs in 2015, compared to 33 in 2005. Processors pay above state and county average wages.
Continue electrolytic processing in Washington.	**Met.** There are now two processors in Washington, compared to one in 2005.

This preference has no stated objectives. These objectives come from 2004 when the preference was originally enacted. In 2010, the Legislature consolidated statutory reporting requirements and repealed the stated objectives.

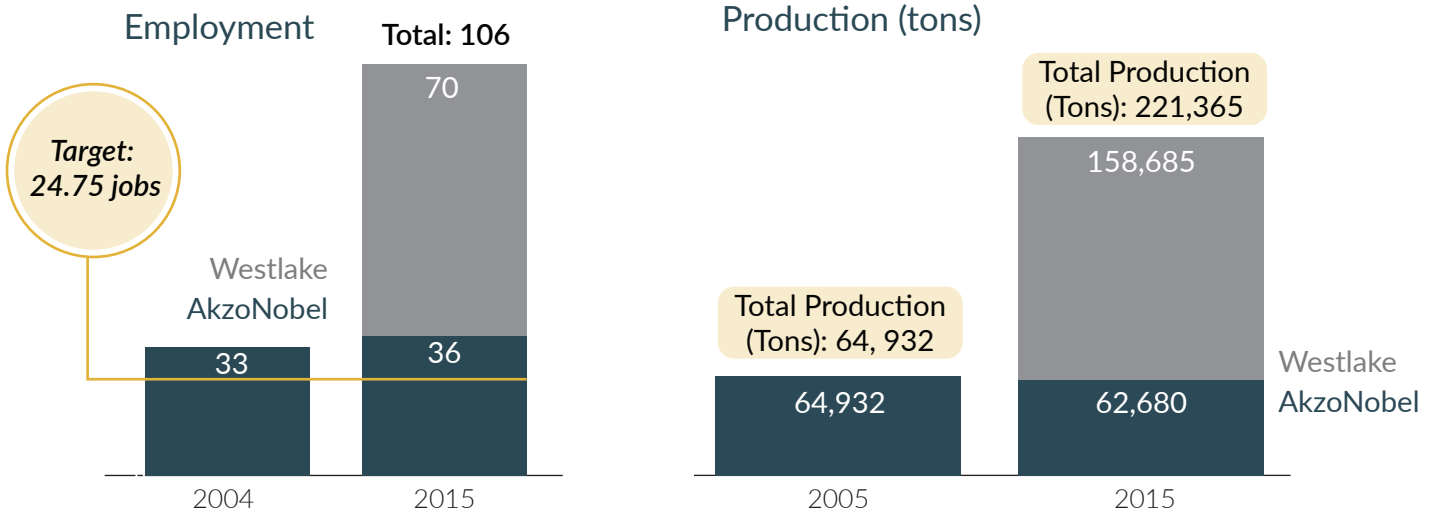
Sales of electricity to electrolytic processors exempt from public utility tax

Electrolytic processors use electricity to convert dissolved salt into chemicals (such as chlorine), which are used by other industries.

Utilities do not pay public utility tax on their sales of electricity for electrolysis. They must pass the savings on to the electrolytic processors.

Processors have increased jobs and production

Washington's processors have increased jobs. They report that 105 of the 106 jobs had wages more than $20 per hour in 2015. Production has also increased since the preference began.



Source: JLARC staff analysis of DOR annual reports.

Legislative Auditor recommendation: **Clarify**

The Legislature should clarify by stating public policy objectives and metrics. Metrics could include job targets, definition of "family-wage," employment concentration, or the level of production compared with the industry as a whole.

Electricity for Electrolytic Processors | Public Utility Tax

Click here for One Page Overview

Summary of this Review

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A public utility tax exemption for sales of electricity to businesses that use electrolysis to make chemicals. The preference is scheduled to expire June 30, 2019.	**Public Utility Tax** RCW 82.16.0421	$1 million in the 2017-19 biennium.

Public Policy Objective
JLARC staff infer the public policy objectives are to: • Retain family-wage jobs. • Allow the electrolytic processors to continue production in Washington so that the industries will remain competitive and be positioned to preserve and create new jobs.

Recommendations
Legislative Auditor's Recommendation **Clarify:** The Legislature should review and clarify the tax preference because the law no longer includes public policy objectives and the metric for jobs may not reflect current employment levels in the industry. **Commissioner Recommendation:** Available in October 2017.

Details on this Preference

1. What is the Preference?

Public utility tax exemption for businesses that use electrolysis to make chemicals

Purpose

The Legislature originally passed this preference to:

- Retain family-wage jobs in the electrolytic processing industry.
- Continue electrolytic production in Washington.

While these goals are no longer stated in law, JLARC staff infer that they are the public policy objectives for the preference.

Preference provides public utility tax exemption on sales of electricity to electrolytic processors

Public utilities do not pay public utility tax on their sales of electricity to chlor-alkali and sodium chlorate electrolytic processors. These processors use electricity to convert dissolved salt into chemicals like chlorine, sodium hydroxide, sodium chlorate, and hydrogen in a process called **electrolysis.**

Utilities that take the exemption must pass the savings on to the processors.

Statute sets eligibility criteria and reporting requirements

To qualify, utilities must sell electricity to processors that:

- Use an average of more than 10 megawatts of electricity per month.
- Meter the electricity used in electrolysis separately from the electricity used for general operations of the business.
- Are not a direct service industrial customer of the Bonneville Power Administration as of June 10, 2004.

A processor that benefits from the tax preference must file an annual report with the Department of Revenue (DOR). The report must include information on employment and production levels. The processor, not the utility, must pay back any amount that DOR determines to be ineligible for the exemption.

Exemption scheduled to expire in June 2019

The exemption took effect on July 1, 2004. Utilities may claim the exemption for sales of electricity through December 31, 2018. The preference expires June 30, 2019.

2. Legal History

Since 2004, the Legislature has changed the goals and expiration date, but not the preference itself

2004: Preference enacted through June 30, 2011

The Legislature passed this preference and scheduled it to expire June 30, 2011. The law included two goals:

1. Keep at least 75 percent of the family-wage jobs that existed on January 1, 2004.
2. Allow electrolytic processors to continue production through 2011 so that they could preserve and create new jobs when energy costs fell.

A potential beneficiary testified that the bill could save manufacturing jobs, and that competitors in North America had similar tax incentives.

2009: Legislature extended preference and amended goals, Legislative Auditor recommended continuation

The Legislature:

- Extended the expiration date of the preference to June 30, 2019. The extension allowed utilities to claim the exemption for sales of electricity through December 31, 2018.

- Amended the second goal by removing a reference to falling energy prices and clarifying that the goal was to maintain industry competitiveness.

JLARC staff completed a review of this preference in 2009 and cited evidence that the public policy objectives were being met. The Legislative Auditor recommended that the Legislature continue the preference.

2010: Statutory reorganization repealed stated goals

The Legislature consolidated statutory reporting requirements for several tax preferences. In doing so, the legislation also repealed the stated goals of this tax preference.

3. Other Relevant Background

Electrolysis is an energy-intensive process to produce chemicals used by other industries

Electrolytic processors convert dissolved salt into chemicals. The tax preference eliminates the public utility tax on electricity used in the process.

Electrolysis produces chlorine, hydrogen, and sodium hydroxide

This preference relates to two electrolysis processes: chlor-alkali and sodium chlorate. In each, an electric current passes through saltwater to create chemicals such as chlorine, sodium chlorate, sodium hydroxide, and hydrogen. Other industries use these chemicals.

- Uses of chlorine and sodium chlorate include bleaching pulp and paper, treating wastewater, sanitizing municipal water supplies and swimming pools, and producing other chemicals.
- Sodium hydroxide has many uses in the pulp and paper industry, water treatment, and soap production.
- Hydrogen can be used as a combustible fuel or to produce hydrochloric acid and ammonia. Hydrogen also helps to convert liquids into solids for use in food (e.g., hydrogenated vegetable oil).

Electrolysis is an energy-intensive process, and processors report that it represents most of their total electricity use. Processors measure the amount of electricity used for electrolysis separately from other electricity they use.

The value of the tax preference depends on electricity price

The preference's value is the tax rate (3.8734 percent) times the price of the electricity used in electrolysis. The utility deducts the amount of the exemption from its tax due to the state, and reduces the total paid by the processor by the same amount.

Exhibit 3.1: Exemption reduces processor's total power bill

EXAMPLE:	Without Exemption	With Exemption
Price of electricity used in electrolysis	$1,000,000	$1,000,000
Utility tax rate	3.8734%	Exempt
Tax due	$38,734	$0
Total paid by processor	$1,038,734	$1,000,000
		Savings = 3.8734% of price

Source: JLARC staff analysis of RCW.

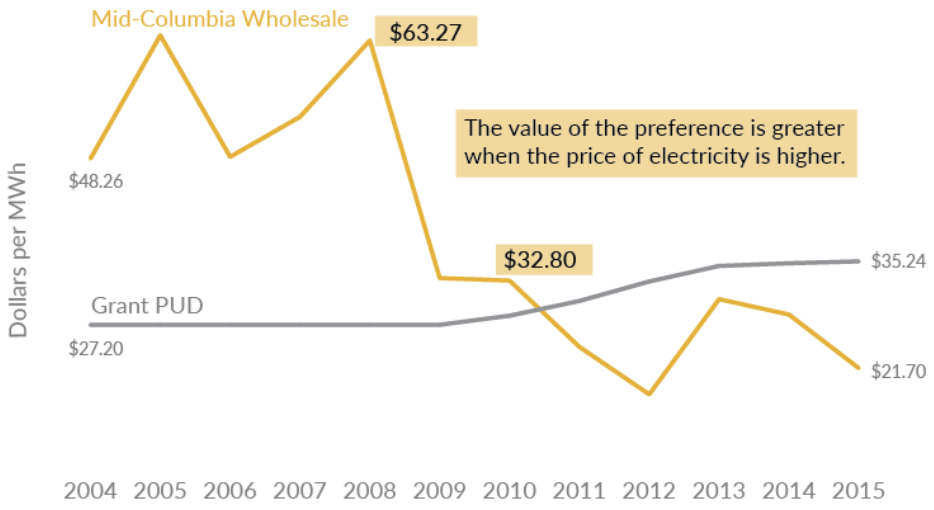
The price of electricity can have a significant effect on the value of the tax preference. Industry representatives state that the cost of electricity represents about 50 percent of production costs, depending on the price of power.

The preference's value varies based on the price of electricity

The electricity price paid by processors varies. For example:

- AkzoNobel is a processor that purchases electricity from Grant PUD. The PUD produces hydropower from its own dams and sets its own price. The price has remained relatively stable over the past 12 years.
- Another processor, Westlake Chemical, purchases its electricity from Cowlitz PUD. This PUD sells electricity at the mid-Columbia wholesale market price. This price has fluctuated in the past 12 years.

Exhibit 3.2: The electricity price paid by processors varies



Source: JLARC staff analysis of Grant PUD Cost of Service Model; NWPCC Seventh Power Plan.

Electricity costs in the Pacific Northwest are relatively low

The Energy Information Administration (EIA) reports ranges of wholesale electricity prices in eight regional markets across the country.

Exhibit 3.3: Northwest region averaged lowest wholesale electricity market prices in 2016

Region	Intercontinental Exchange Electricity Product Name	Weighted Avg. Price $/MWh
Northwest	Mid Columbia Peak	$23.04

Region	Intercontinental Exchange Electricity Product Name	Weighted Avg. Price $/MWh
Southwest	Palo Verde Peak	$25.55
Texas	ERCOT North 345KV Peak	$27.16
Southern California	SP15 EZ Gen DA LMP Peak	$30.85
Northern California	NP15 EZ Gen DA LMP Peak	$33.53
Mid-Atlantic	PJM WH Real Time Peak	$34.54
Midwest	Indiana Hub RT Peak	$34.96
New England	Nepool MH DA LMP Peak	$35.57

Source: JLARC staff analysis of EIA - 2016 Wholesale Electricity Market data.
MWh = Megawatt Hours

The public utility tax

The public utility tax is a tax on gross receipts of public service businesses, including those that engage in transportation, communications, and the supply of energy, natural gas, and water. Income subject to the public utility tax is exempt from the business and occupation (B&O) tax. Rates vary based on the type of business.

Electric utilities that generate, produce, or distribute electricity pay a rate of 3.8734 percent of their gross receipts. They may deduct any sales to others for resale, or sales for export outside Washington State.

4. Public Policy Objectives

JLARC staff infer that the originally stated goals are still the public policy objectives

The preference included two stated goals until the Legislature reorganized the reporting requirements in 2010. At that time, the stated goals were removed from statute. However, JLARC staff infer that these goals remain the public policy objectives.

Inferred objectives: Retain family-wage jobs and continue electrolytic processing

The preference's originally stated goals are to:

1. **Retain family-wage jobs** (at least 75 percent of the jobs that were on the payroll for electrolytic processors in January 1, 2004).
2. Allow the electrolytic processors **to continue production in Washington** so that the industries will remain competitive and be positioned to preserve and create new jobs.

5. Are Objectives Being Met?

Evidence indicates that processors have met both public policy objectives

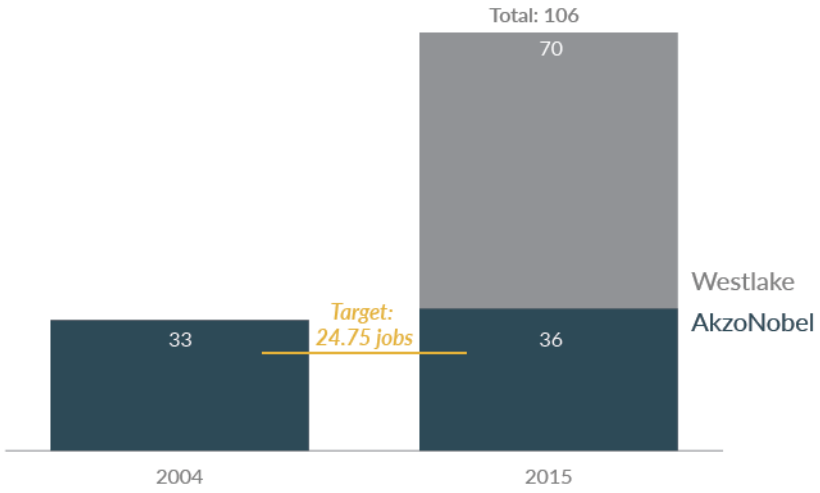
Jobs and production have both increased since the preference was passed in 2004. JLARC staff do not assert whether there is a causal relationship between these outcomes and the tax preference.

Inferred objective: Retain family-wage jobs

The processors have met the public policy objective of retaining family-wage jobs at a level that preserves at least 75 percent of the jobs that were on the payroll effective January 1, 2004.

- In 2004, only EKA Chemical (now AkzoNobel) qualified for the exemption. On January 1, it employed 33 workers in its manufacturing operation, making the target employment level 24.75 jobs.
- The Washington processors now include AkzoNobel in Moses Lake, and Westlake Chemical in Longview. Together, they employed 106 workers in 2015.

Exhibit 5.1: Employment exceeded target



Source: JLARC staff analysis of DOR Annual Report data.

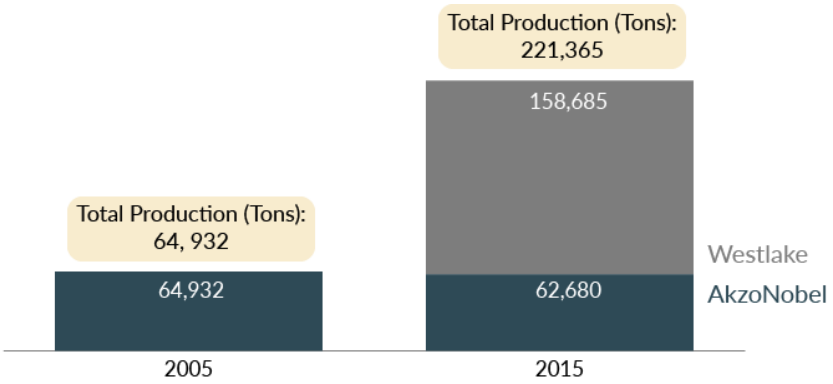
"Family-wage" jobs are required, but not defined, in statute. For this review, JLARC staff assume "family-wage" jobs pay wages and benefits comparable to other Washington jobs. Data from the Bureau of Labor Statistics and the processors' reports to the Department of Revenue indicate that in 2015:

- The median hourly wage for all Washington occupations was $20.28.
- The median hourly wage in Cowlitz and Grant counties was $18.20 and $16.23, respectively. The processors are located in these counties.
- The hourly wage for 105 of the 106 jobs reported by the processors was over $20 per hour. Of those, 77 paid more than $30 per hour.

Inferred objective: Allow processors to continue production

There is evidence that the processors are meeting the second public policy objective as well. In 2004, one electrolytic processor operated in Washington. Today, there are two. Total production also increased.

Exhibit 5.2: Production increased between 2005 and 2015



Source: JLARC staff analysis of DOR Annual Reports.

Continuing the preference reduces electricity costs for electrolysis

Continuing the preference would allow electrolytic processors to continue to buy electricity at reduced cost. To the extent that this benefit allows them to maintain employment and remain competitive, the public policy objectives would continue to be met.

6. Beneficiaries

Public utilities must pass the preference savings to electrolytic processors

Tax preferences have direct beneficiaries (entities whose state tax liabilities are directly affected) and indirect beneficiaries (entities that may receive benefits from the preference, but are not the primary recipient of the benefit).

Direct beneficiaries

Direct beneficiaries are the utilities that claim the tax preference by deducting the exempted amount from their gross electricity sales. They may claim the preference only if they pass the tax savings on to electrolytic processors. The two direct beneficiaries, Grant PUD and Cowlitz PUD, authorized JLARC staff to identify them.

Indirect beneficiaries

Electrolytic processors are indirect beneficiaries of the preference because the utilities must pass on the savings. Because they receive the benefit of the tax preference, the processors must submit annual reports to the Department of Revenue. As of 2015, two processors reported that they benefited from the tax preference:

- A sodium chlorate plant in Moses Lake owned by AkzoNobel Pulp and Performance Chemicals, Inc, a subsidiary of Amsterdam-based AkzoNobel.
- A chlor-alkali plant in Longview owned by Westlake Chemical, based in Houston, Texas.

7. Revenue and Economic Impacts

Estimated beneficiary savings in 2017-19 Biennium are $1 million

The tax preference resulted in estimated beneficiary savings of $667,000 in Fiscal Year 2015. JLARC staff estimate the electrolytic processors' savings will be $1 million in the 2017-19 Biennium. The electrolytic processors shared historic savings amounts with JLARC staff and authorized their disclosure.

Exhibit 7.1: Estimated savings for electrolytic processors

Biennium	Fiscal Year	Total Exempt Sales	Total Estimated Beneficiary Savings
2013-15 *7/1/13-6/30/15*	2014	$19,400,000	$750,000
	2015	$17,200,000	$667,000
2015-17 *7/1/15-6/30/17*	2016	$18,100,000	$701,000
	2017	$16,500,000	$641,000
2017-19 *7/1/17-6/30/19*	2018	$17,100,000	$662,000
	2019 (half year)	$8,800,000	$341,000
	2017-19 Biennium	**$25,900,000**	**$1,003,000**

Source: JLARC staff analysis of tax preference beneficiary data, estimates grown using price forecasts.

According to their 2015 annual reports, employment at the beneficiaries totals 106. This equates to 2015 beneficiary savings of $6,300 per job.

Absent the tax preference, processors would experience a 3.8734 percent cost increase in electricity costs

Repealing the tax preference would lead to a 3.8734 percent increase in the cost of the electricity used by the processors for electrolysis. It is unclear how this cost increase would impact employment and production.

8. Other States with Similar Preference?

JLARC staff identified other states that provide tax relief for electricity sales

JLARC staff reviewed how other states with electrolytic processors treat the taxes on electricity. Each provides some type of tax relief for electricity used in electrolysis.

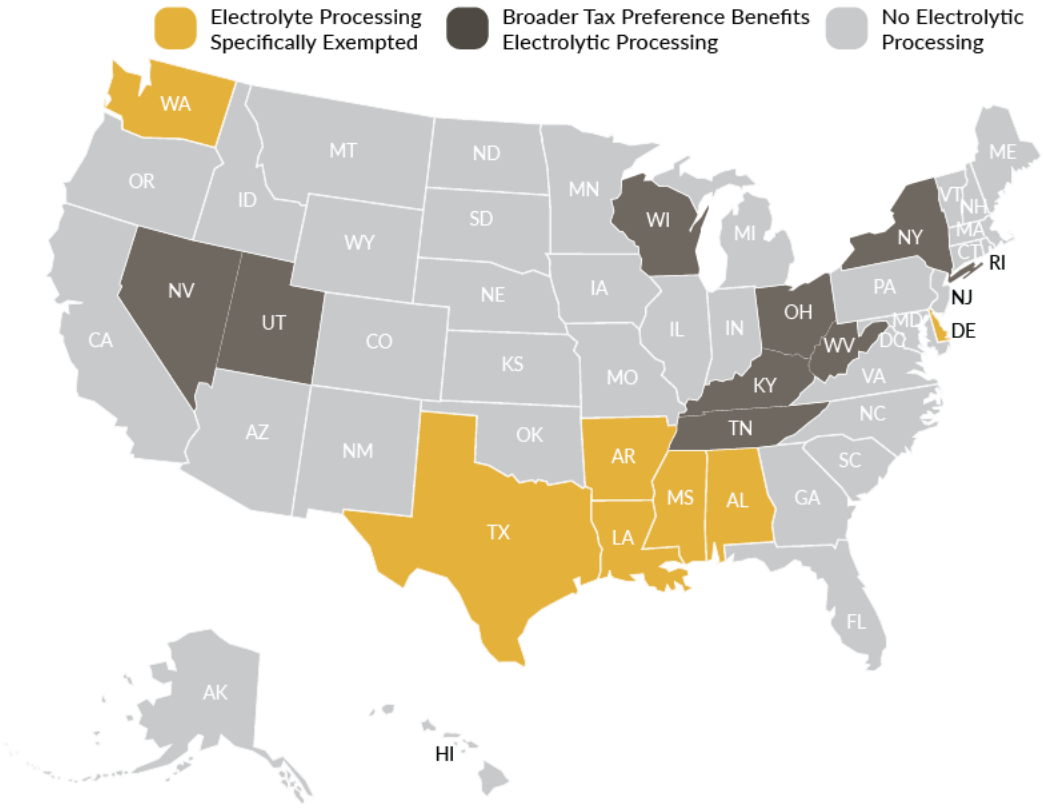
Seven states have **a specific exemption** for electricity used in electrolysis

- States that specifically exempt electricity used for electrolysis are Washington, Alabama, Arkansas, Delaware, Louisiana, Mississippi, and Texas.

Eight other states have **broader exemptions or lower tax rates** for electricity

- Six states do not tax sales of electricity consumed in the manufacturing process: Kentucky, Nevada, New York, Utah, West Virginia, and Wisconsin.
- Ohio does not define electricity as tangible personal property and does not tax its sale.
- Tennessee imposes a lower sales tax rate on electricity sold to manufacturers. The tax commissioner can approve an exemption for electricity used directly in the manufacturing process.

Exhibit 8.1: Other states with electrolytic processors provide tax relief for electricity used in electrolysis



Source: JLARC staff analysis of all-states research.

9. Applicable Statutes

RCW 82.16.0421

Exemptions—Sales to electrolytic processing businesses. (Expires June 30, 2019.)

(1) For the purposes of this section:

(a) "Chlor-alkali electrolytic processing business" means a person who is engaged in a business that uses more than ten average megawatts of electricity per month in a chlor-alkali electrolytic process to split the electrochemical bonds of sodium chloride and water to make chlorine and sodium hydroxide. A "chlor-alkali electrolytic processing business" does not include direct service industrial customers or their subsidiaries that contract for the purchase of power from the Bonneville power administration as of June 10, 2004.

(b) "Sodium chlorate electrolytic processing business" means a person who is engaged in a business that uses more than ten average megawatts of electricity per month in a sodium chlorate electrolytic process to split the electrochemical bonds of sodium chloride and water to make sodium chlorate and hydrogen. A "sodium chlorate electrolytic processing business"

does not include direct service industrial customers or their subsidiaries that contract for the purchase of power from the Bonneville power administration as of June 10, 2004.

(2) Effective July 1, 2004, the tax levied under this chapter does not apply to sales of electricity made by a light and power business to a chlor-alkali electrolytic processing business or a sodium chlorate electrolytic processing business for the electrolytic process if the contract for sale of electricity to the business contains the following terms:

(a) The electricity to be used in the electrolytic process is separately metered from the electricity used for general operations of the business;

(b) The price charged for the electricity used in the electrolytic process will be reduced by an amount equal to the tax exemption available to the light and power business under this section; and

(c) Disallowance of all or part of the exemption under this section is a breach of contract and the damages to be paid by the chlor-alkali electrolytic processing business or the sodium chlorate electrolytic processing business are the amount of the tax exemption disallowed.

(3) The exemption provided for in this section does not apply to amounts received from the remarketing or resale of electricity originally obtained by contract for the electrolytic process.

(4) In order to claim an exemption under this section, the chlor-alkali electrolytic processing business or the sodium chlorate electrolytic processing business must provide the light and power business with an exemption certificate in a form and manner prescribed by the department.

(5) A person receiving the benefit of the exemption provided in this section must file a complete annual report with the department under RCW 82.32.534.

(6)(a) This section does not apply to sales of electricity made after December 31, 2018.

(b) This section expires June 30, 2019.

[2010 c 114 § 133; 2009 c 434 § 1; 2004 c 240 § 1.]

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends clarifying the tax preference

The tax preference is making electricity less expensive for electrolytic processors. While the preference is lowering the price of electricity to processors, the Legislature repealed the public policy objectives in 2010 when it made other statutory changes.

The Legislature should clarify the tax preference because the law no longer includes public policy objectives and the metric for jobs may not reflect current employment levels in the industry.

1. If the Legislature is interested in family wage jobs, then **a jobs target and definition of "family wage jobs"** would help future reviews of the preference and inform legislative decision-making.

2. If the Legislature is interested in allowing the industry to continue production, **clarifying the criteria to use to assess competitiveness and production** would help future reviews and inform legislative decision-making. Possible options for such criteria include the relative industry employment concentration in Washington, or the level of production compared with the industry as a whole.

The Legislative Auditor's guidance document for drafting performance statements provides a framework for identifying policy objectives and linking these to performance metrics.

Legislation required: Yes (preference expires on June 30, 2019).

Fiscal impact: Depends on legislative action.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, will be available December 2017.

International Banking Facilities

JLARC Staff 2017 Tax Preference Performance Evaluation | Business & Occupation Tax Preference

Objectives (inferred)	Results
Encourage the establishment of International Banking Facilities (IBFs) in Washington, keeping them from moving "offshore."	**Mixed.** Currently one IBF in Washington. Recent changes in tax laws may make the preference unnecessary.

IBFs: Separate set of accounts established by certain banks to serve foreign customers

Customers include:

- Foreign residents, such as governments, corporations, and other banks.
- U.S. offices of the IBF's parent institution.
- Other IBFs.

IBFs allow certain U.S. banks to compete with foreign banks without moving offshore. **Earnings from these accounts are not taxed due to the preference.**

JLARC staff identified one IBF in Washington

Taiwan Cooperative Bank, Ltd., a U.S. branch of a foreign bank.

Benefits of preference may have diminished after changes in other tax laws

Most IBF customers are likely located outside of Washington. With more recent changes in tax laws (apportionment), earnings from these customers would not be taxed. Estimated FY16 beneficiary savings are $30,000.

Preference continues to benefit IBFs when they generate income from any WA-based customers.

Legislative Auditor recommendation: **Review & Clarify**

Legislature should provide an explicit public policy objective and metrics to determine if the objective has been achieved. In addition, the Legislature should determine the relevance of the preference given changes to Washington's apportionment laws.

The complete report is on the JLARC web site.

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
(360) 786-5187 • keenan.konopaski@leg.wa.gov

International Banking Facilities | B&O Tax

Click here for One Page Overview

Summary of this Review

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A business and occupation tax exemption for the gross receipts of international banking facilities.	**Business and Occupation Tax** RCW 82.04.315	$208 thousand in the 2017-19 biennium

Public Policy Objective
JLARC staff infer the public policy objective is to encourage the establishment of international banking facilities in Washington.

Recommendations
Legislative Auditor's Recommendation **Review and Clarify:** The Legislature should review and clarify the B&O tax exemption for international banking facilities to provide an explicit public policy objective and metrics to determine if the objective has been achieved. The Legislature may also want to review the relevance of the preference given changes to Washington's apportionment laws. **Commissioner Recommendation:** Available in October 2017.

Details on this Preference

1. What is the Preference?

B&O tax exemption for gross receipts of international banking facilities

Purpose

The Legislature did not state a public policy objective when passing this preference.

Certain banking institutions do not pay B&O tax on their earnings

The preference exempts international banking facilities (IBFs) from paying business & occupation (B&O) taxes on their gross receipts.

An IBF is a separate set of deposit and loan accounts established by certain banking institutions in the U.S. to accept deposits from and extend credit to primarily foreign institutional customers. These customers include:

- Foreign entities such as governments, corporations, and other banks.

- U.S. offices of the IBF's parent institution.
- Other IBFs.

International banking facilities are maintained separately from a bank's other accounts and records. Although the term "facility" implies an independent location, many IBFs are located within an existing bank branch.

The following types of banking institutions may establish IBFs in Washington and benefit from the preference:

- A **commercial bank** with its **principal office in Washington—**these are banks incorporated and doing business under the laws of the United States or the state of Washington.
- A U.S. **branch or agency of a foreign bank**.
- An **Edge Act corporation—**banks with a special charter from the U.S. Federal Reserve to conduct international banking operations.
- An **Agreement corporation—**banks chartered by a state to engage in international banking. The bank limits its activities to those allowed by an Edge Act corporation.

There is no expiration date for the preference.

2. Legal History

Soon after Federal Reserve authorized IBFs, Legislature passed B&O tax preference

1981: Federal government authorizes IBFs

On June 18, 1981, the Federal Reserve Board of Governors approved the establishment of international banking facilities (IBFs) beginning December 3, 1981.

After the Federal Reserve authorized IBFs, state legislatures began to consider whether to revise state laws to determine how to tax these newly created entities.

1982: Legislature exempts IBFs from B&O tax

The Legislature passed this preference, exempting IBFs from paying B&O taxes on their gross receipts. The bill's sponsor testified that the preference would help bring several Washington banks operating offshore financial centers back to the United States. The sponsor indicated that other states had enacted similar preferences in order to attract IBFs to their states.

2010: Changes to state apportionment laws reduce amount of income IBFs would apportion to Washington

The 2010 Legislature revised Washington's laws governing how service businesses apportion their income.

The apportionment changes did not affect the tax liability of Washington's IBFs because their gross receipts were already exempt due to the preference. However, the changes would reduce the amount of an IBF's gross receipts that would become subject to B&O tax if the preference were to end.

3. Other Relevant Background

IBFs allow banks to operate under less regulation and compete with offshore financial centers without leaving U.S.

Offshore financial centers provide similar services to IBFs

In the 1960s and 1970s, governments attempted to control capital flows and monetary policy through restrictive domestic regulations. International banks shifted deposits and borrowing to less-regulated offshore financial centers. The offshore centers could operate more freely in markets where banks borrow and lend currency outside of the country where it is legal tender.

IBFs allow banks to compete with offshore financial centers without leaving U.S.

U.S. banks can operate international banking facilities (IBFs) in a regulatory environment similar to their offshore competitors without having to leave the country. IBFs allow financial institutions in the U.S. to take deposits and extend credit to foreign customers without being subject to all of the U.S. banking regulations that apply to domestic banks, such as reserve requirements, interest rate ceilings and deposit insurance assessments.

Federal Reserve places some limits on IBF business transactions

The Federal Reserve established rules specific to IBFs. For example:

- Extensions of credit can only be made to foreign customers, other IBFs, or the U.S. offices of the IBF parent bank.
- Nonbank customer deposits or withdrawals must be at least $100,000.
- Deposits received may only be used to support the IBF's non-U.S. operations.
- Extensions of credit may only be used to finance a customer's non-U.S. operations.

4. Public Policy Objectives

JLARC staff infer public policy objective is to encourage IBFs in Washington

The Legislature did not state a public policy objective when passing this preference.

JLARC staff infer the objective is to encourage the establishment of international banking facilities in Washington.

5. Are Objectives Being Met?

JLARC staff identified one IBF currently in Washington; influence of tax preference is unknown

JLARC staff identified one IBF currently in Washington based on data from the Washington Department of Financial Institutions and the Federal Reserve Board.

There were no IBFs in Washington prior to 1982. IBFs were not authorized to exist anywhere in the U.S. until December 1981.

The majority of IBF assets are located in New York and California. These states are home to 98 percent of the $126 billion in IBF assets of U.S. branches and agencies of foreign banks at the end of 2016.

It is unclear if the IBF in Washington would have located in the state without the preference. Given the changes to apportionment rules, the benefit IBFs realize from the preference may be minimal.

6. Beneficiaries

International banking facilities benefit from the preference

Beneficiaries are international banking facilities in Washington and the financial institutions that establish them.

Based on data from the Washington Department of Financial Institutions and publicly available data from the Federal Reserve Board, JLARC staff estimate that there is one international banking facility (IBF) in Washington as of March 31, 2017. The IBF is established by Taiwan Cooperative Bank, Ltd., a U.S. branch of a foreign bank.

7. Revenue and Economic Impacts

Beneficiary savings based on estimates of IBF assets; actual savings may be lower due to changes in apportionment rules

JLARC staff **estimated beneficiary savings** using publicly available information on the total amount of assets for Washington financial institutions that have established inernational banking facilities (IBFs). The estimates assume that the **share of total assets attributable to the IBFs is the same share as California's IBFs (37 percent).** JLARC staff also estimated the future growth of those assets, and the interest rate they earn.

Tax return data cannot be used to estimate the beneficiary savings because there is no specific tax reporting line for this exemption.

Exhibit 7.1: Beneficiary savings estimated at $208 thousand for the 2018-19 Biennium

Biennium	Fiscal Year	B&O Tax--exempt Earnings	Estimated Beneficiary Savings
2013-15 *7/1/13-6/30/15*	2014	$606,000	$9,000
	2015	$737,000	$11,000
2015-17 *7/1/15-6/30/17*	2016	$1,986,000	$30,000
	2017	$3,246,000	$49,000
2018-19 *7/1/18-6/30/19*	2018	$5,291,000	$79,000
	2019	$8,572,000	$129,000
	2017-19 Biennium	**$13,863,000**	**$208,000**

Source: JLARC staff analysis of Economic and Revenue Forecast Council, Federal Reserve Board of Governors data.

Beneficiary savings may be lower than estimate if IBF income is from customers outside of Washington

The estimated beneficiary savings are not adjusted to reflect Washington's apportionment rules. For financial institutions, 2010 changes to apportionment rules shifted from a three-factor apportionment formula to a single-factor formula:

- **Three-factor:** Prior to the 2010 changes a financial institution's income was generally apportioned to Washington based on the average share of the institution's total **property** and **payroll** in Washington, and **earnings** from Washington sources.
- **Single-factor:** After the 2010 changes a financial institution's income is generally apportioned to Washington based only on the share of the institution's **earnings** that is from Washington sources.

Bank earnings from extending credit to customers located outside of Washington are not apportioned to Washington for tax purposes. Because IBFs serve primarily foreign customers, a large portion of an IBF's earnings would not be apportioned to Washington, and would therefore not be subject to B&O tax absent the preference. If the preference were terminated, IBFs would be subject to the B&O tax on gross receipts attributable to Washington.

8. Other States with Similar Preference?

Two states have the majority of IBFs and provide some tax relief

Ninety-eight percent of international banking facility (IBF) assets of U.S. offices of foreign banks are located in New York and California. JLARC staff reviewed the statutes of these states, and found that both provide beneficial tax treatment to IBFs.

- **New York –** New York tax law allows IBFs to exclude income attributable to foreign persons from income taxation.
- **California** – No IBF assets or revenues are taxed in California. The portion of a bank's worldwide income subject to California taxation is determined by an apportionment formula that takes into account the ratio of California-based business to worldwide assets, revenues, and payroll. California treats IBF intangible personal property and sales as if they were located outside California for purposes of this formula.

9. Applicable Statutes

RCW 82.04.315

Exemptions—International banking facilities.

This chapter shall not apply to the gross receipts of an international banking facility.

As used in this section, an "international banking facility" means a facility represented by a set of asset and liability accounts segregated on the books and records of a commercial bank, the principal office of which is located in this state, and which is incorporated and doing business under the laws of the United States or of this state, a United States branch or agency of a foreign bank, an Edge corporation organized under Section 25(a) of the Federal Reserve Act, 12 United States Code 611-631, or an Agreement corporation having an agreement or undertaking with the Board of Governors of the Federal Reserve

System under Section 25 of the Federal Reserve Act, 12 United States Code 601-604(a), that includes only international banking facility time deposits (as defined in subsection (a)(2) of Section 204.8 of Regulation D (12 C.F.R. Part 204), as promulgated by the Board of Governors of the Federal Reserve System), and international banking facility extensions of credit (as defined in subsection (a)(3) of Section 204.8 of Regulation D).

[1982 c 95 § 7.]

NOTES:

Effective date—1982 c 95: See note following RCW 30A.42.0730A

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends reviewing and clarifying the preference

The Legislature should review and clarify the B&O tax exemption for international banking facilities (IBFs) to provide an explicit public policy objective and metrics to determine if the objective has been achieved. The Legislature may also want to review the relevance of the preference given changes to Washington's apportionment laws.

- **Public policy objective**: The Legislature did not state a public policy objective for this preference. JLARC staff infer that the objective is to encourage the establishment of IBFs in Washington. It is unclear if the one IBF in Washington would have located in the state without the preference.
- **Changes to apportionment laws**: The 2010 legislative changes to the apportionment formula may have diminished the value of this preference. The apportionment formula is based only on the institutions' **earnings** from Washington sources. The majority of IBFs customers are likely located outside of Washington and earnings from those customers would not be taxed, even without the preference.

  The preference continues to benefit IBFs when they generate earnings from Washington sources.

Legislation required: Yes (preference has no expiration date).

Fiscal impact: Depends on legislative action.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, available December 2017.

Sales of Manufactured and Mobile Home Communities

JLARC Staff 2017 Tax Preference Performance Evaluation — Real Estate Excise Tax Preference

Objectives (stated)	Results
Encourage and facilitate preservation of existing manufactured and mobile home communities.	**Met.** Preference increases the purchasing power of tenant organizations relative to other potential buyers.
Involve tenants and organizations representing tenants in preserving the communities where they live.	

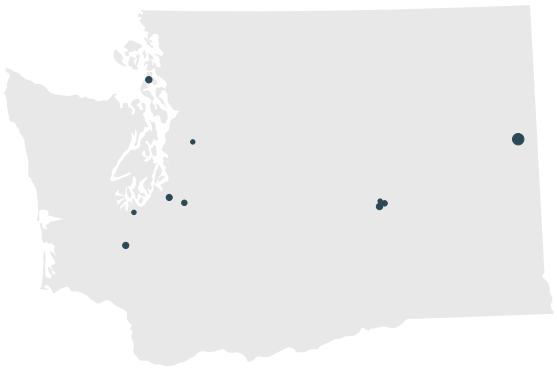
Seller does not pay real estate excise tax (REET) when selling to tenants

Example:
Property selling for
$1,000,000

Offer 1
Potential buyer offers
$1,000,000
- $18,000 REET paid by owner
$982,000

Offer 2
Tenant organization could offer
$982,000
with preference

Property owner net price received
$982,000
under both offers



Tenant organizations purchased 10 communities since the preference enacted

Manufactured or mobile home spaces preserved:	Average actual savings for sellers:
480	$32,000

Source: JLARC staff analysis of grant and loan data from the Housing Finance Commission, ROC USA list of communities.

Closures continue across the state

Department of Commerce received notice of 51 closures affecting up to 1,607 homes from 2007 through 2016. Eight communities are scheduled to close in 2017.

Legislative Auditor recommendation: **Continue**

Preference meets public policy objectives. The Legislature should consider adding a performance statement with metrics for future reviews.

The complete report is on the JLARC web site.

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
(360) 786-5187 • keenan.konopaski@leg.wa.gov

Sales of Manufactured and Mobile Home Communities | Real Estate Excise Tax

Click here for One Page Overview

Summary of this Review

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
An exemption for sellers from real estate excise tax when they sell a mobile or manufactured home community to an organization for the purpose of preserving the community.	**Real Estate Excise Tax** RCWs 82.45.010(r), 59.20.030	$96,000

Public Policy Objective
The Legislature stated the public policy objectives were to encourage and facilitate preservation of existing manufactured and mobile home communities, and involve community tenants or eligible organizations representing their interests in preservation.

Recommendations
Legislative Auditor's Recommendation **Continue:** The Legislature should continue the preference because it is meeting its stated public policy objective of facilitating the preservation of existing manufactured and mobile home communities. **Commissioner Recommendation:** Available in October 2017.

Details on this Preference

1. What is the Preference?

Real estate excise tax exemption for qualifying sales of manufactured and mobile home communities

Purpose

The Legislature passed the preference to:

- Encourage and facilitate preservation of existing manufactured and mobile home communities.
- Involve tenants and organizations that represent tenants' interests in preserving the communities where they live.

Preference exempts sellers from real estate excise tax when property is sold to an eligible organization

The preference exempts sellers from real estate excise tax when they sell a manufactured/mobile home community to an eligible organization "for the purpose of preserving the property as a manufactured/mobile home community."

- Real estate excise tax is a tax on the sale of real estate. It is based on the full selling price, and is typically paid by the seller of the property. The state tax rate is 1.28 percent. City and county rates vary for a combined state and local rate of up to 2.78 percent.

Statute specifies that qualifying sales must remain as a manufactured home community

To qualify for the exemption, the **seller** must transfer the community in a single purchase. The **purchaser** must preserve the property as a manufactured or mobile home community and be one of the following eligible organizations:

- Qualified formal organization of tenants in the community.
- Local government.
- Local housing authority.
- Nonprofit community or neighborhood-based organization.
- Federally recognized Indian tribe in the state of Washington.
- Regional or statewide nonprofit housing assistance organization.

Exemption scheduled to expire in December 2018

The preference was enacted in 2008 and is currently scheduled to expire on December 31, 2018.

2. Legal History

Preference to facilitate sales that preserve manufactured or mobile home communities

1993: Legislature required owners to give tenants a chance to purchase their community

The Legislature enacted a set of requirements for sales of mobile home communities. One provision stated that before an owner could sell a community, it must give the tenant organization an opportunity to buy it. The requirements were part of a larger bill that amended the rights and duties of landlords and tenants in mobile home communities.

2000: State Supreme Court invalidated 1993 act

The state Supreme Court held that the provision giving tenants the right to purchase parks before other buyers violated the Washington state constitution by taking private property for private use.

2008: Legislature created this preference to preserve existing mobile home communities

The Legislature passed legislation which:

- Required a 14-day notice of sale.
- Encouraged owners to negotiate in good faith with tenants.
- Created an exemption from the real estate excise tax for qualifying sales to tenant organizations or other organizations representing tenants' interests.

The prime sponsor of the companion bill cited concerns about the number of communities that had closed since 2006, the difficulty of moving homes when communities close, and the number of tenants who were low-income or senior citizens on a fixed income.

The preference is scheduled to expire on December 31, 2018.

3. Other Relevant Background

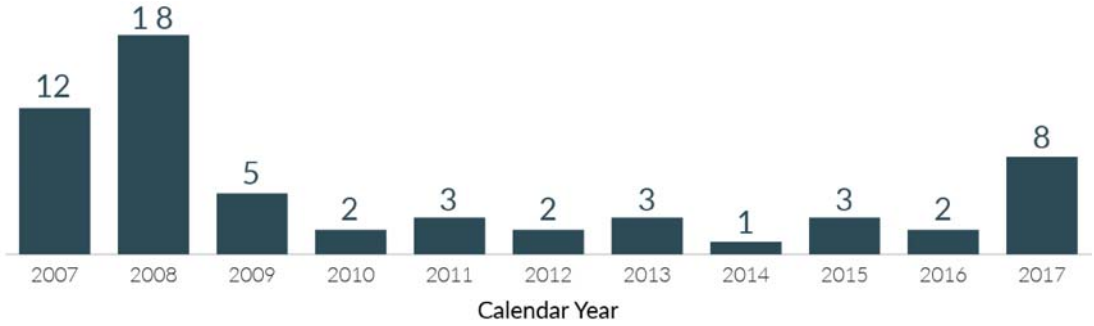
Commerce is involved when communities close and offers relocation assistance to some tenants.

Manufactured or mobile home communities are properties that have common areas and at least two spaces rented out for manufactured or mobile homes. Tenants rent spaces from the community owner.

Since 2007 Commerce has received notices of 59 community closures

Since 1989, separate legislation requires owners to notify tenants and the Department of Commerce at least 12 months before closing a community. Closures are planned across the state, and agencies and housing advocates state that closures rise and fall with the local economy.

Exhibit 3.1: Community closures continue to occur

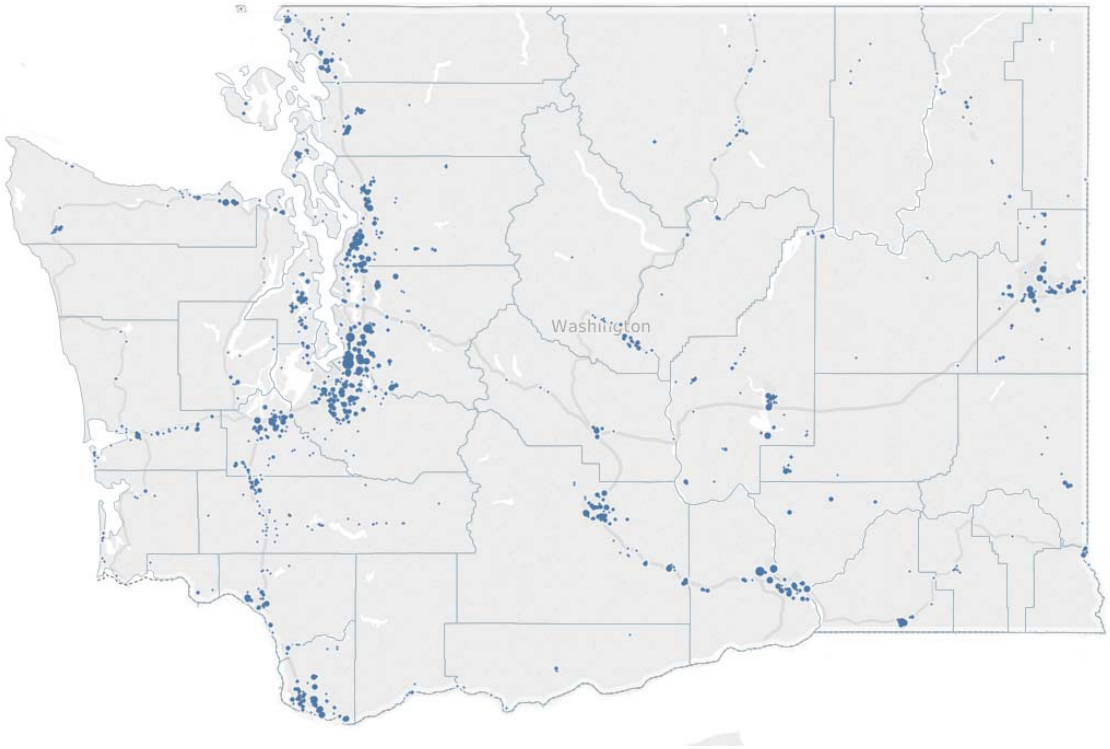


Source: JLARC staff presentation of Department of Commerce park closure data.

Some of the communities that will close in 2017 are planned for market rate apartments or hotels. Others will be used to expand schools and hospitals. According to Manufactured Home Communities of Washington, no new communities are being developed.

In May 2016, there were 1,377 registered mobile and manufactured home communities in Washington, with a total of 69,279 spaces for homes.

Exhibit 3.2: May 2016: 1,377 registered communities, 69,279 spaces for homes



Source: JLARC staff presentation of Department of Revenue registered park data as of May 2016.

Commerce program may reimburse low-income tenants for relocation expenses

When communities close, the tenants must either move, or demolish and dispose of a manufactured or mobile home that they own.

The Department of Commerce may **reimburse** low-income tenants for eligible expenses through the Mobile and Manufactured Home Relocation Assistance Program. A tenant may receive up to $7500 for a single-section home or up to $12,000 for a multi-section home. Eligible expenses include the costs of relocation, demolition, disposal, and purchase of a newer manufactured or mobile home.

To qualify, a tenant must:

- Own the home and live in it at the time a closure notice is issued.
- Meet low-income requirements.
- Initially pay for any costs related to relocation, demolition, disposal, or purchasing a newer manufactured or mobile home before requesting reimbursement.

In January 2017, Commerce reported that since 2006:

- Communities with 2,322 spaces have closed.
- Commerce has provided assistance to 475 tenants – an average of $8,153 each.

Commerce does not have information about the remaining tenants because they may not have applied to the program or qualified for assistance.

4. Public Policy Objectives

Legislature stated public policy objectives in its intent statement

The Legislature stated that the public policy objectives for this preference were to:

- Encourage and facilitate preservation of existing manufactured and mobile home communities.
- Involve community tenants or eligible organizations representing their interests in preservation.

5. Are Objectives Being Met?

Preference facilitates sales that preserve communities by increasing tenants' purchasing power

The preference facilitates sales by increasing the potential purchasing power of tenant organizations relative to other potential buyers.

For example, if an owner considered selling a property for $1 million, the real estate excise tax would be approximately $18,000. The net price received by the owner would be $982,000.

With the preference, tenants could provide a competing offer of $982,000 without impacting the net price the seller would receive, or consider offering more.

Exhibit 5.1: The preference helps increase the potential purchasing power of tenants

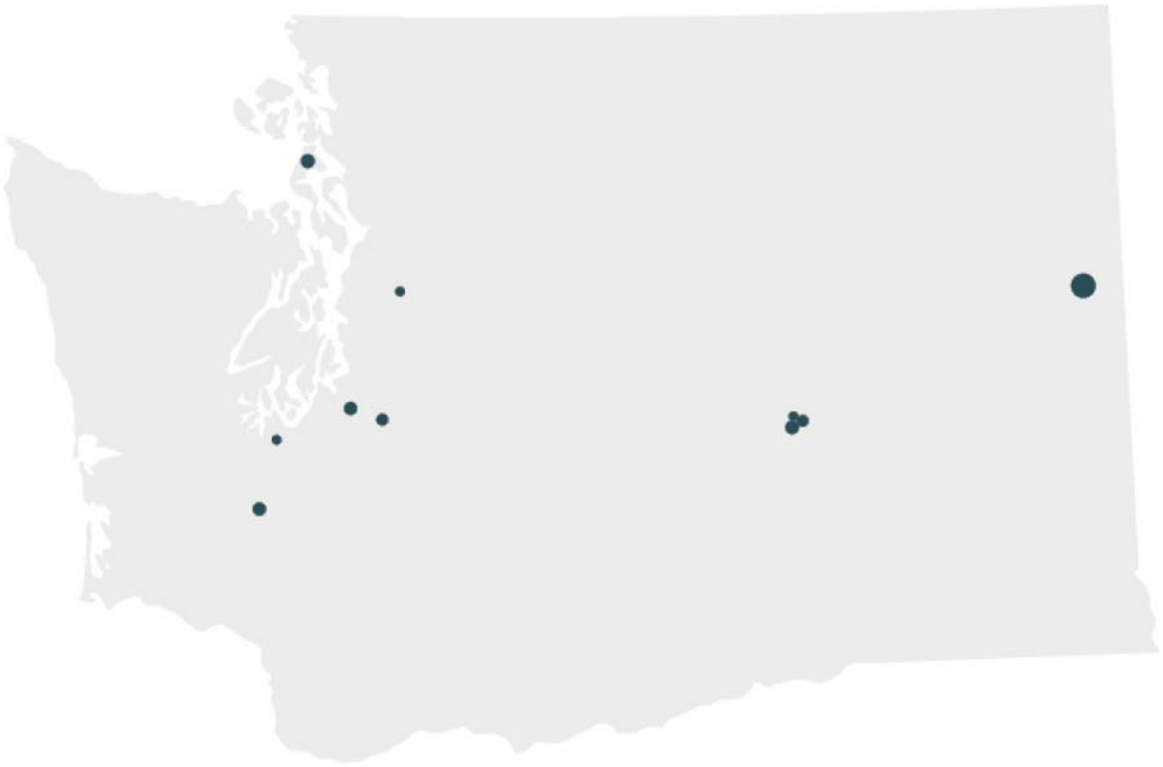
Source: JLARC staff analysis of RCW 82.45.010(3)(r).

Department of Commerce staff, Housing Finance Commission staff, and housing advocates all noted that the preference is an important negotiation tool. They stated they believe owners express more interest in selling to tenants once they explain the preference.

Tenant organizations purchased 10 communities since the preference was enacted

As of March 2017, JLARC staff identified 10 communities purchased by tenant organizations since the preference was enacted, with a total of 480 spaces for homes. It is unclear whether the sales would have occurred without the preference.

Exhibit 5.2: Ten communities purchased by tenant organizations since 2008



Source: JLARC staff analysis of grant and loan data from the Housing Finance Commission, ROC USA list of communities.

Continuing the preference would facilitate sales of communities to tenants and other eligible organizations

The preference is scheduled to expire on December 31, 2018. If the preference were continued, tenants and eligible organizations could continue to offer community owners a tax benefit for selling the property to them.

6. Beneficiaries

Owners receive the preference when they sell to eligible organizations to preserve the community

Tax preferences have direct beneficiaries (entities whose state tax liabilities are directly affected) and indirect beneficiaries (entities that may receive benefits from the preference, but are not the primary recipient of the benefit).

Direct beneficiaries

The direct beneficiaries of the preference are owners who sell their manufactured or mobile home communities to eligible organizations. JLARC staff estimate there have been ten qualifying sales since the preference was enacted.

Indirect beneficiaries

Indirect beneficiaries of the preference include organizations that help community tenants stay in their housing. The preference may help them be competitive with other potential buyers while staying at a lower price point. The Legislature noted its intent to involve these organizations in the preservation of manufactured and mobile home communities.

7. Revenue and Economic Impacts

Estimated beneficiary savings in 2017-19 Biennium are $96,000

JLARC staff estimate the average beneficiary savings for each sale is $32,000. The number of sales has fluctuated between one and four sales per year, so staff assume two qualifying sales per year in the future.

Exhibit 7.1: Estimated direct beneficiary savings

Biennium	Fiscal Year	Number of qualifying sales	Estimated Beneficiary Savings
2013-15 *7/1/13-6/30/15*	2014	1	$32,000
	2015	4	$85,000
2015-17 *7/1/15-6/30/17*	2016	2	$118,000
	2017 (projected)	2	$64,000
2017-19 *7/1/17-6/30/19*	2018 (projected)	2	$64,000
	2019 (projected) (preference scheduled to expire 12/31/2018)	1 (half year)	$32,000
	2017-19 Estimated Biennial Savings		**$96,000**

Source: JLARC staff analysis of sales data from county websites, loan data from the Housing Finance Commission.

Absent the preference, sellers would pay real estate excise tax regardless of the buyer.

If the preference were terminated, owners of manufactured and mobile home communities would pay real estate excise tax when selling their properties regardless of the buyer. As a result, organizations working to preserve these communities would lose a competitive advantage the preference may provide to them over other buyers.

8. Other States with Similar Preference?

JLARC staff identified three states with capital gains exclusions

JLARC staff identified three states Oregon, Vermont, and Montana that offer a capital gains exclusion for similar qualifying sales. None offer an exemption from real estate excise tax.

- Since 2005, **Oregon** law has provided an income tax deduction from capital gains on sales of a manufactured dwelling park to a corporate entity formed by tenants, a nonprofit, or a housing authority.
- Since 1997, **Vermont** law has provided an income tax credit of 7 percent of the taxpayer's taxable gains from a qualified sale of a mobile home park to leaseholders in the park or a nonprofit representing them.

- Since 2009, **Montana** law has provided an exclusion from income tax on the gains from a qualified sale of a mobile home park to a residents' association, nonprofit or housing authority. The exclusion is 100% of gains for parks with 50 or fewer lots and 50% of gains for parks with more than 50 lots.

9. Applicable Statutes

Findings—Intent—2008 c 116 (reviser's note to RCW 59.20.300):

"(1) The legislature finds that:

(a) Manufactured/mobile home communities provide a significant source of homeownership opportunities for Washington residents. However, the increasing closure and conversion of manufactured/mobile home communities to other uses, combined with increasing mobile home lot rents, low vacancy rates in existing manufactured/mobile home communities, and the extremely high cost of moving homes when manufactured/mobile home communities close, increasingly make manufactured/mobile home community living insecure for manufactured/mobile home tenants.

(b) Many tenants who reside in manufactured/mobile home communities are low-income households and senior citizens and are, therefore, those residents most in need of reasonable security in the siting of their manufactured/mobile homes because of the adverse impacts on the health, safety, and welfare of tenants forced to move due to closure, change of use, or discontinuance of manufactured/mobile home communities.

(c) The preservation of manufactured/mobile home communities:

(i) Is a more economical alternative than providing new replacement housing units for tenants who are displaced from closing manufactured/mobile home communities;

(ii) Is a strategy by which all local governments can meet the affordable housing needs of their residents;

(iii) Is a strategy by which local governments planning under RCW 36.70A.040 may meet the housing element of their comprehensive plans as it relates to the provision of housing affordable to all economic sectors; and

(iv) Should be a goal of all housing authorities and local governments.

(d) The loss of manufactured/mobile home communities should not result in a net loss of affordable housing, thus compromising the ability of local governments to meet the affordable housing needs of its residents and the ability of these local governments planning under RCW 36.70A.040 to meet affordable housing goals under chapter 36.70A RCW.

(e) The closure of manufactured/mobile home communities has serious environmental, safety, and financial impacts, including:

(i) Homes that cannot be moved to other locations add to Washington's landfills;

(ii) Homes that are abandoned might attract crime; and

(iii) Vacant homes that will not be reoccupied need to be tested for asbestos and lead, and these toxic materials need to be removed prior to demolition.

(f) The self-governance aspect of tenants owning manufactured/mobile home communities results in a lesser usage of police resources as tenants experience fewer societal conflicts when they own the real estate as well as their homes.

(g) Housing authorities, by their creation and purpose, are the public body corporate and politic of the city or county responsible for addressing the availability of safe and sanitary dwelling accommodations available to persons of low income, senior citizens, and others.

(2) It is the intent of the legislature to encourage and facilitate the preservation of existing manufactured/mobile home communities in the event of voluntary sales of manufactured/mobile home communities and, to the extent necessary and possible, to involve manufactured/mobile home community tenants or an eligible organization representing the interests of tenants, such as a nonprofit organization, housing authority, or local government, in the preservation of manufactured/mobile home communities." [2008 c 116 § 1.]

RCW 82.45.010

"Sale" defined.

(1) As used in this chapter, the term "sale" has its ordinary meaning and includes any conveyance, grant, assignment, quitclaim, or transfer of the ownership of or title to real property, including standing timber, or any estate or interest therein for a valuable consideration, and any contract for such conveyance, grant, assignment, quitclaim, or transfer, and any lease with an option to purchase real property, including standing timber, or any estate or interest therein or other contract under which possession of the property is given to the purchaser, or any other person at the purchaser's direction, and title to the property is retained by the vendor as security for the payment of the purchase price. The term also includes the grant, assignment, quitclaim, sale, or transfer of improvements constructed upon leased land.

(2)(a) The term "sale" also includes the transfer or acquisition within any twelve-month period of a controlling interest in any entity with an interest in real property located in this state for a valuable consideration.

(b) For the sole purpose of determining whether, pursuant to the exercise of an option, a controlling interest was transferred or acquired within a twelve-month period, the date that the option agreement was executed is the date on which the transfer or acquisition of the controlling interest is deemed to occur. For all other purposes under this chapter, the date upon which the option is exercised is the date of the transfer or acquisition of the controlling interest.

(c) For purposes of this subsection, all acquisitions of persons acting in concert must be aggregated for purposes of determining whether a transfer or acquisition of a controlling interest has taken place. The department must adopt standards by rule to determine when persons are acting in concert. In adopting a rule for this purpose, the department must consider the following:

(i) Persons must be treated as acting in concert when they have a relationship with each other such that one person influences or controls the actions of another through common ownership; and

(ii) When persons are not commonly owned or controlled, they must be treated as acting in concert only when the unity with which the purchasers have negotiated and will consummate the transfer of ownership interests supports a finding that they are acting as a single entity. If the acquisitions are completely independent, with each purchaser buying without regard to the identity of the other purchasers, then the acquisitions are considered separate acquisitions.

(3) The term "sale" does not include:

(a) A transfer by gift, devise, or inheritance.

(b) A transfer by transfer on death deed, to the extent that it is not in satisfaction of a contractual obligation of the decedent owed to the recipient of the property.

(c) A transfer of any leasehold interest other than of the type mentioned above.

(d) A cancellation or forfeiture of a vendee's interest in a contract for the sale of real property, whether or not such contract contains a forfeiture clause, or deed in lieu of foreclosure of a mortgage.

(e) The partition of property by tenants in common by agreement or as the result of a court decree.

(f) The assignment of property or interest in property from one spouse or one domestic partner to the other spouse or other domestic partner in accordance with the terms of a decree of dissolution of marriage or state registered domestic partnership or in fulfillment of a property settlement agreement.

(g) The assignment or other transfer of a vendor's interest in a contract for the sale of real property, even though accompanied by a conveyance of the vendor's interest in the real property involved.

(h) Transfers by appropriation or decree in condemnation proceedings brought by the United States, the state or any political subdivision thereof, or a municipal corporation.

(i) A mortgage or other transfer of an interest in real property merely to secure a debt, or the assignment thereof.

(j) Any transfer or conveyance made pursuant to a deed of trust or an order of sale by the court in any mortgage, deed of trust, or lien foreclosure proceeding or upon execution of a judgment, or deed in lieu of foreclosure to satisfy a mortgage or deed of trust.

(k) A conveyance to the federal housing administration or veterans administration by an authorized mortgagee made pursuant to a contract of insurance or guaranty with the federal housing administration or veterans administration.

(l) A transfer in compliance with the terms of any lease or contract upon which the tax as imposed by this chapter has been paid or where the lease or contract was entered into prior to the date this tax was first imposed.

(m) The sale of any grave or lot in an established cemetery.

(n) A sale by the United States, this state or any political subdivision thereof, or a municipal corporation of this state.

(o) A sale to a regional transit authority or public corporation under RCW 81.112.320 under a sale/leaseback agreement under RCW 81.112.300.

(p) A transfer of real property, however effected, if it consists of a mere change in identity or form of ownership of an entity where there is no change in the beneficial ownership. These include transfers to a corporation or partnership which is wholly owned by the transferor and/or the transferor's spouse or domestic partner or children of the transferor or the transferor's spouse or domestic partner. However, if thereafter such transferee corporation or partnership voluntarily transfers such real property, or such transferor, spouse or domestic partner, or children of the transferor or the transferor's spouse or domestic partner voluntarily transfer stock in the transferee corporation or interest in the transferee partnership capital, as the case may be, to other than (i) the transferor and/or the transferor's spouse or domestic partner or children of the transferor or the transferor's spouse or domestic partner, (ii) a trust having the transferor and/or the transferor's spouse or domestic partner or children of the transferor or the transferor's spouse or domestic partner as the only beneficiaries at the time of the transfer to the trust, or (iii) a corporation or partnership wholly owned by the original transferor and/or the transferor's spouse or domestic partner or children of the transferor or the transferor's spouse or domestic partner, within three years of the original transfer to which this exemption applies, and the tax on the subsequent transfer has not been paid within sixty days of becoming due, excise taxes become due and payable on the original transfer as otherwise provided by law.

(q)(i) A transfer that for federal income tax purposes does not involve the recognition of gain or loss for entity formation, liquidation or dissolution, and reorganization, including but not limited to nonrecognition of gain or loss because of application of 26 U.S.C. Sec. 332, 337, 351, 368(a)(1), 721, or 731 of the internal revenue code of 1986, as amended.

(ii) However, the transfer described in (q)(i) of this subsection cannot be preceded or followed within a twelve-month period by another transfer or series of transfers, that, when combined with the otherwise exempt transfer or transfers described in (q)(i) of this subsection, results in the transfer of a controlling interest in the entity for valuable consideration, and in which one

or more persons previously holding a controlling interest in the entity receive cash or property in exchange for any interest the person or persons acting in concert hold in the entity. This subsection (3) (q)(ii) does not apply to that part of the transfer involving property received that is the real property interest that the person or persons originally contributed to the entity or when one or more persons who did not contribute real property or belong to the entity at a time when real property was purchased receive cash or personal property in exchange for that person or persons' interest in the entity. The real estate excise tax under this subsection (3)(q)(ii) is imposed upon the person or persons who previously held a controlling interest in the entity.

(r) A qualified sale of a manufactured/mobile home community, as defined in RCW 59.20.030, that takes place on or after June 12, 2008, but before December 31, 2018.

[2014 c 58 § 24; 2010 1st sp.s. c 23 § 207. Prior: 2008 c 116 § 3; 2008 c 6 § 701; 2000 2nd sp.s. c 4 § 26; 1999 c 209 § 2; 1993 sp.s. c 25 § 502; 1981 c 93 § 1; 1970 ex.s. c 65 § 1; 1969 ex.s. c 223 § 28A.45.010; prior: 1955 c 132 § 1; 1953 c 94 § 1; 1951 2nd ex.s. c 19 § 1; 1951 1st ex.s. c 11 § 7. Formerly RCW 28A.45.010, 28.45.010.]

RCW 59.20.030

Definitions.

For purposes of this chapter:

(1) "Abandoned" as it relates to a mobile home, manufactured home, or park model owned by a tenant in a mobile home park, mobile home park cooperative, or mobile home park subdivision or tenancy in a mobile home lot means the tenant has defaulted in rent and by absence and by words or actions reasonably indicates the intention not to continue tenancy;

(2) "Eligible organization" includes local governments, local housing authorities, nonprofit community or neighborhood-based organizations, federally recognized Indian tribes in the state of Washington, and regional or statewide nonprofit housing assistance organizations;

(3) "Housing authority" or "authority" means any of the public body corporate and politic created in RCW 35.82.030;

(4) "Landlord" means the owner of a mobile home park and includes the agents of a landlord;

(5) "Local government" means a town government, city government, code city government, or county government in the state of Washington;

(6) "Manufactured home" means a single-family dwelling built according to the United States department of housing and urban development manufactured home construction and safety standards act, which is a national preemptive building code. A manufactured home also: (a) Includes plumbing, heating, air conditioning, and electrical systems; (b) is built on a permanent chassis; and (c) can be transported in one or more sections with each section at least eight feet wide and forty feet long when transported, or when installed on the site is three hundred twenty square feet or greater;

(7) "Manufactured/mobile home" means either a manufactured home or a mobile home;

(8) "Mobile home" means a factory-built dwelling built prior to June 15, 1976, to standards other than the United States department of housing and urban development code, and acceptable under applicable state codes in effect at the time of construction or introduction of the home into the state. Mobile homes have not been built since the introduction of the United States department of housing and urban development manufactured home construction and safety act;

(9) "Mobile home lot" means a portion of a mobile home park or manufactured housing community designated as the location of one mobile home, manufactured home, or park model and its accessory buildings, and intended for the exclusive use as a primary residence by the occupants of that mobile home, manufactured home, or park model;

(10) "Mobile home park," "manufactured housing community," or "manufactured/mobile home community" means any real property which is rented or held out for rent to others for the placement of two or more mobile homes, manufactured homes, or park models for the primary purpose of production of income, except where such real property is rented or held out for rent for seasonal recreational purpose only and is not intended for year-round occupancy;

(11) "Mobile home park cooperative" or "manufactured housing cooperative" means real property consisting of common areas and two or more lots held out for placement of mobile homes, manufactured homes, or park models in which both the individual lots and the common areas are owned by an association of shareholders which leases or otherwise extends the right to occupy individual lots to its own members;

(12) "Mobile home park subdivision" or "manufactured housing subdivision" means real property, whether it is called a subdivision, condominium, or planned unit development, consisting of common areas and two or more lots held for placement of mobile homes, manufactured homes, or park models in which there is private ownership of the individual lots and common, undivided ownership of the common areas by owners of the individual lots;

(13) "Notice of sale" means a notice required under RCW 59.20.300 to be delivered to all tenants of a manufactured/mobile home community and other specified parties within fourteen days after the date on which any advertisement, multiple listing, or public notice advertises that a manufactured/mobile home community is for sale;

(14) "Park model" means a recreational vehicle intended for permanent or semi-permanent installation and is used as a primary residence;

(15) "Qualified sale of manufactured/mobile home community" means the sale, as defined in RCW 82.45.010, of land and improvements comprising a manufactured/mobile home community that is transferred in a single purchase to a qualified tenant organization or to an eligible organization for the purpose of preserving the property as a manufactured/mobile home community;

(16) "Qualified tenant organization" means a formal organization of tenants within a manufactured/mobile home community, with the only requirement for membership consisting of being a tenant;

(17) "Recreational vehicle" means a travel trailer, motor home, truck camper, or camping trailer that is primarily designed and used as temporary living quarters, is either self-propelled or mounted on or drawn by another vehicle, is transient, is not occupied as a primary residence, and is not immobilized or permanently affixed to a mobile home lot;

(18) "Tenant" means any person, except a transient, who rents a mobile home lot;

(19) "Transient" means a person who rents a mobile home lot for a period of less than one month for purposes other than as a primary residence;

(20) "Occupant" means any person, including a live-in care provider, other than a tenant, who occupies a mobile home, manufactured home, or park model and mobile home lot.

[2008 c 116 § 2; 2003 c 127 § 1; 1999 c 359 § 2; 1998 c 118 § 1; 1993 c 66 § 15; 1981 c 304 § 4; 1980 c 152 § 3; 1979 ex.s. c 186 § 1; 1977 ex.s. c 279 § 3.]

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends continuing the tax preference

The Legislature should continue the real estate excise tax exemption on qualifying sales of manufactured and mobile home communities because it is meeting its stated public policy objective of facilitating their preservation. However, such communities continue to be sold and closed across the state. In extending the preference, the Legislature should consider adding a performance statement creating metrics for future reviews.

Legislation required: Yes (preference expires on December 31, 2018).

Fiscal impact: Depends on legislative action.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, will be available December 2017.

Standard Financial Information

JLARC Staff 2017 Tax Preference Performance Evaluation — Sales and Use Tax Preference

Objectives (stated)	Results
Exempt standard financial information purchased by international investment management companies from sales and use tax.	**Met.** Exempts the first $15 million in qualifying purchases of standard financial information per company, per year.
Revenue impact to "reasonably conform" to the original fiscal estimates.	**Unknown.** Standard financial information is taxed based on its format. Some may be exempt without the preference. How much is not reported.

Standard financial information has many formats, including searchable online databases

- Information such as financial market data, bond ratings, and credit ratings
- Created for use by multiple customers

Searchable online databases would be taxed without preference, others not taxed regardless

- Businesses not required to report what portion of information is a searchable database

Revenue impact, conformity to original fiscal estimate unknown

	Estimated fiscal impact	Original fiscal estimate	Increase over original estimate
If 100% are searchable online databases	$1.1 million	$0.5 million	+ 120%
If 42% are searchable online databases	$0.5 million	$0.5 million	0%

Legislative Auditor recommendation: **Clarify**

The Legislature should clarify what is meant by "reasonably conforms" and require reporting by taxpayers to determine the preference's fiscal impact.

The complete report is on the JLARC web site.

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
(360) 786-5187 ● keenan.konopaski@leg.wa.gov

Standard Financial Information | Sales & Use Tax

Click here for One Page Overview

Summary of this Review

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A sales and use tax exemption for buyers of standard financial information. The preference is scheduled to expire July 1, 2021.	**Sales and Use Tax** RCWs 82.08.207; 82.12.207	$3.1 million in the 2017-19 biennium

Public Policy Objective
The Legislature stated the public policy objectives were to: • Exempt standard financial information purchased by international investment management companies from sales and use tax. • Provide the exemption with a minimal fiscal impact.

Recommendations
Legislative Auditor's Recommendation **Clarify:** The Legislature should clarify the sales and use tax exemption for standard financial information because, while the preference is meeting the stated objective of exempting sales of standard financial information, it is unclear if the actual fiscal impact reasonably conforms to the 2013 fiscal estimate. **Commissioner Recommendation:** Available in October 2017.

Details on this Preference

1. What is the Preference?

Sales and use tax exemption for companies that purchase standard financial information

Purpose

The Legislature established this preference with the stated purpose to:

- Exempt certain standard financial information purchased by international investment management companies from sales and use tax.
- Provide the exemption with minimal fiscal impact.

Back to Top

Preference provides a sales & use tax exemption to eligible international investment management firms

With the preference, international investment management companies do not pay retail sales or use tax on purchases of standard financial information.

Standard financial information is:

- Financial data, facts or information services (e.g., financial market data, bond ratings, credit ratings, and deposit, loan, or mortgage reports).
- Created for use by multiple customers.
- Provided to the buyer in a tangible format such as paper or a digital format that is transferred electronically.

Use of the preference is limited to $15 million in purchases per business

Each buyer of standard financial information may make up to $15 million in tax-exempt purchases in a calendar year. Buyers must report the purchases to the Department of Revenue (DOR) using the Buyer Addendum.

Sellers are not responsible for ensuring that buyers comply with the $15 million limit.

Preference scheduled to expire in 2021

The tax preference took effect October 1, 2013. Its scheduled expiration date is July 1, 2021.

2. Legal History

Three legislative efforts to exempt standard financial information from sales and use tax

2007: Legislature passed tax preference for sales of standard financial information

The Legislature created a sales and use tax exemption for electronically delivered standard financial information that is sold to an investment management company or a financial institution.

In comments to the House Finance Committee supporting the tax preference, staff of the Russell Investment Group stated that the company did not currently pay sales and use tax on its purchases of electronic financial information. The company indicated to JLARC staff that it supported the preference out of concern that the Department of Revenue (DOR) could interpret purchases of electronically transmitted standard financial information as taxable.

Also in 2007, the Legislature directed DOR to study the taxation of electronically delivered products. DOR worked with legislators, academics, government agencies, and the financial industry. Its final report, issued in December 2008, identified issues for the Legislature to consider, but made no recommendations.

2009: New legislation repealed the 2007 tax preference but offered broader exemption for digital goods purchased solely for a business purpose

The Legislature passed a bill to address some of the issues identified in DOR's study. Among its provisions, this legislation:

- Repealed the 2007 exemption for sales of standard financial information delivered electronically.
- Defined "digital products" (goods and services) and made them subject to sales and use tax.

Back to Top

- Specified that “standard digital information,” is a digital good that is exempt from sales and use tax when purchased solely for a business purpose.
- Defined “digital automated services” as services that are transferred electronically and use one or more software applications. These services are subject to sales and use tax.

2010: DOR interpretation of law meant online searchable databases were taxable

DOR issued a special notice stating that online searchable databases are digital automated services, not digital goods. As a result, any standard financial information provided as a searchable database would meet the definition of a digital automated service. Under the law passed in 2009, it would be subject to sales tax.

2013: Legislature enacted the current preference for sales to international investment management companies

The Legislature created the current preference to exempt sales of standard financial information, including online searchable databases. Unlike the 2007 preference, it applies only to sales to international investment management companies and not to financial institutions.

The statement of legislative intent noted that the Legislature repealed the initial exemption in 2009 because it believed the broad-based exemptions for digital goods encompassed an exemption for standard financial information.

The Legislature added that electronic transmission of data to investment management companies had evolved over time, and that data providers had begun adding search tools to their web-based data. As a result, the broad-based exemptions enacted in 2009 might not exempt all sales of standard financial information.

The preference is scheduled to expire on July 1, 2021.

3. Other Relevant Background

The American investment industry is a major buyer of financial information

The global market data industry is substantial, with global spending on financial news and market analysis totaling $26.6 billion in 2015. Bloomberg and Thomson-Reuters are the major suppliers, who together represent 58 percent of the market. Spending in North and South America represents 47 percent the global total, and approximately 30 percent of that market data spending is done by the investment management industry.

4. Public Policy Objectives

The Legislature stated two public policy objectives in its intent statement

The Legislature stated its intent to:

1. Exempt standard financial information purchased by international investment management companies from sales and use tax.

Back to Top

2. Provide the exemption with a minimal fiscal impact.

The Legislature stated that it intended to measure whether the objectives were met by reevaluating the exemption in three years. It wanted to ensure that the actual fiscal impact on state revenues "reasonably conforms" to the estimate in the fiscal note.

5. Are Objectives Being Met?

The preference exempts some sales of standard financial information, but it is unclear whether fiscal impact is minimal

This tax preference is achieving one stated objective, but it is unclear if it is meeting the second.

The preference exempts sales of standard financial information

By exempting sales of standard financial information to international investment management companies, the preference is meeting the first stated objective.

Unclear if state revenue impact is minimal

JLARC staff are unable to determine whether the second public policy objective is met for two reasons:

1. There is no metric in statute to evaluate whether the difference between the initial fiscal note and the state revenue impact is minimal.
2. The state revenue impact depends on the share of standard financial information purchases that are online searchable databases, and that share is not known.

State revenue impact depends on the percentage of purchases that would be taxable without the preference

Although JLARC staff estimated the beneficiary savings of the tax preference, that estimate may not reflect the impact on state revenues. Revenue impact is the amount of forgone revenue that the state does not collect because of the tax preference:

- Standard financial information sold as an online searchable database is a "digital automated service." It would be taxable if the preference did not exist.
- Conversely, standard financial information that is not a digital automated service would still be exempt under the broader "standard digital information for a business purpose" exemption.
- As the percentage of purchases that are online searchable databases increases, the estimated revenue impact grows. Three scenarios illustrating how the fiscal impact depends on this percentage are shown below.

Exhibit 5.1: State revenue impact depends on percentage of purchases that are online searchable databases

	Percentage of SFI that is Online Searchable Database	Fiscal Note Estimate, State Revenue (FY16)	Estimated Revenue Impact (FY16)	Difference ($)	Difference (%)

Back to Top

Scenario 1	42%	($469,000)	($469,000)	$0	0%
Scenario 2	50%	($469,000)	($563,000)	$94,000	+20%
Scenario 3	100%	($469,000)	($1,125,000)	$656,000	+140%

Source: JLARC staff analysis of DOR Buyer Addendum, Fiscal Note data. Estimated revenue impact equals beneficiary savings from state sales tax multiplied by the percentage of sales that is otherwise taxable.

The share of standard financial information purchases that are online searchable databases is unknown. Staff of the Russell Investment Group commented in 2013 committee hearings that most purchased standard financial information was not searchable at the time, but that the percentage would increase as vendors added search capabilities to the standard financial data. Russell subsequently reported to JLARC staff that it does not estimate the share of its purchases that are online searchable databases.

6. Beneficiaries

International investment management companies benefit from the preference

Direct beneficiaries of the tax preference are international investment management companies that purchase standard financial information. In 2016, three businesses reported tax-exempt purchases to the Department of Revenue (DOR). Beneficiaries use the data to evaluate performance of investments and managers, to inform investment selection and investment strategy, and to prepare reports.

Since the preference was enacted, no more than four businesses have reported exempt purchases in any year. The 2014 purchases reported by two beneficiaries can be disclosed pursuant to RCW 82.32.808:

- Frank Russell Company: $15,000,000 in purchases.
- Rainier Investment Management, LLC: $154,671 in purchases.

7. Revenue and Economic Impacts

JLARC staff estimate beneficiary savings of $3.1 million in the 2017-19 biennium

JLARC staff estimated beneficiary savings by using the amount of tax-exempt purchases of standard financial information reported to the Department of Revenue (DOR) on Buyer Addenda for calendar years 2014-2016. JLARC staff cannot confirm whether the data reflects all purchases of standard financial information, as it is possible that some purchasers may not have submitted Buyer Addenda.

Exhibit 7.1: Estimated beneficiary savings

Biennium	Fiscal Year	Tax-exempt Purchases	State Sales Tax	Local Sales Tax	Estimated Beneficiary Savings

2013-15 *7/1/13-6/30/15*	2014	$15,163,000	$987,000	$385,000	$1,371,000
	2015	$17,825,000	$1,159,000	$453,000	$1,611,000
2015-17 *7/1/15-6/30/17*	2016	$17,303,000	$1,125,000	$439,000	$1,564,000
	2017	$16,940,000	$1,101,000	$430,000	$1,531,000
2018-19 *7/1/18-6/30/19*	2018	$17,134,000	$1,114,000	$435,000	$1,549,000
	2019	$17,347,000	$1,128,000	$441,000	$1,568,000
	2017-19 Biennium	**$34,482,000**	**$2,241,000**	**$876,000**	**$3,117,000**

Source: JLARC staff analysis of DOR Buyer Addendum data, DOR Tax Exemption Study Work Papers.

Terminating the preference would mean some standard financial information would become taxable

Absent the tax preference, some standard financial information purchases by international investment management companies would become taxable. Specifically, information provided as an online searchable database would be subject to sales tax as they are considered digital automated services. Other purchases could remain tax-exempt if they qualify as digital goods purchased for a business purpose.

8. Other States with Similar Preference?

States with large financial services industries do not tax sale of digital products

In a review of other states' tax policies, JLARC identified various approaches to taxing digital products, but did not identify specific sales and use tax exemptions for standard financial information.

Rather, assuming financial information is largely purchased in digital format, the tax treatment of financial information in other states appears to depend on whether these states consider digital products to be tangible personal property. JLARC staff reviewed three states with large financial services industries: New York, California, and Illinois. None consider digital products to be tangible personal property, so their sale is not subject to sales or use tax.

9. Applicable Statutes

Findings—Intent—2013 2nd sp.s. c 13 (reviser's note to RCW 82.08.207):

"(1) The legislature finds that in 2007, Engrossed Substitute House Bill No. 1981 was enacted into law, which provided a sales tax exemption for electronically delivered standard financial information if the sales were to an investment management company or financial institution. The legislature further finds that in 2009 and 2010, Engrossed Substitute House Bill No. 2075 and Substitute House Bill No. 2620 were passed, to address the taxation of electronically delivered products. The legislature further finds that this legislation imposed sales and use tax on most digital services, goods, and prewritten software, but provided a broad business exemption for digital goods. The legislature further finds that the sales tax exemption for standard financial information from the 2007 legislation was eliminated because it was believed that the

broader business exemption in Engrossed Substitute House Bill No. 2075 covered these transactions. The legislature further finds that the method of transmission of data by data providers to investment management companies has evolved over time where data providers add search tools to their web-based data, which makes it subject to sales tax.

(2) The legislature's intent under part VII of this act is to conform with a previously determined policy objective of exempting certain standard financial information purchased by international investment management companies from sales and use tax on the understanding that the fiscal impact is minimal. Therefore, it is the legislature's further intent to reevaluate the exemption in three years to ensure that actual fiscal impact on state revenues reasonably conforms with the fiscal estimate in the fiscal note for this legislation." [2013 2nd sp.s. c 13 § 701.]

RCW 82.08.207

Investment data for investment firms. (Expires July 1, 2021.)

(1) The tax imposed by RCW 82.08.020 does not apply to sales of standard financial information to qualifying international investment management companies. The exemption provided in this section applies regardless of whether the standard financial information is provided to the buyer in a tangible format or on a tangible storage medium or as a digital product transferred electronically.

(2) Sellers making tax-exempt sales under this section must obtain an exemption certificate from the buyer in a form and manner prescribed by the department. The seller must retain a copy of the exemption certificate for the seller's files. In lieu of an exemption certificate, a seller may capture the relevant data elements as allowed under the streamlined sales and use tax agreement. For sellers who electronically file their taxes, the department must provide a separate tax reporting line for exemption amounts claimed under this section.

(3) A buyer may not continue to claim the exemption under this section once the buyer has purchased standard financial information during the current calendar year with an aggregate total selling price in excess of fifteen million dollars and an exemption has been claimed under this section or RCW 82.12.207 for such standard financial information. The fifteen million dollar limitation under this subsection does not apply to any other exemption under this chapter that applies to standard financial information. Sellers are not responsible for ensuring a buyer's compliance with the fifteen million dollar limitation under this subsection. Sellers may not be assessed for uncollected sales tax on a sale to a buyer claiming an exemption under this section after having exceeded the fifteen million dollar limitation under this subsection, except as provided in RCW 82.08.050 (4) and (5).

(4) The definitions in this subsection apply throughout this section unless the context clearly requires otherwise.

(a)(i) "Qualifying international investment management company" means a person:

(A) Who is primarily engaged in the business of providing investment management services; and

(B) Who has gross income that is at least ten percent derived from providing investment management services to:

(I) Persons or collective investment funds residing outside the United States; or

(II) Collective investment funds with at least ten percent of their investments located outside the United States.

(ii) The definitions in RCW 82.04.293 apply to this subsection (4)(a).

(b)(i) "Standard financial information" means financial data, facts, or information, or financial information services, not generated, compiled, or developed only for a single customer. Standard financial information includes, but is not limited to, financial market data, bond ratings, credit ratings, and deposit, loan, or mortgage reports.

(ii) For purposes of this subsection (4)(b), "financial market data" means market pricing information, such as for securities, commodities, and derivatives; corporate actions for publicly and privately traded companies, such as dividend schedules and reorganizations; corporate attributes, such as domicile, currencies used, and exchanges where shares are traded; and currency information.

(5) This section expires July 1, 2021.

[2013 2nd sp.s. c 13 § 702.]

RCW 82.12.207

Investment date for investment firms. (Expires July 1, 2021.)

(1) The tax imposed by RCW 82.12.020 does not apply to the use of standard financial information by qualifying international investment management companies. The exemption provided in this section applies regardless of whether the standard financial information is in a tangible format or resides on a tangible storage medium or is a digital product transferred electronically to the qualifying international investment management company.

(2) The definitions, conditions, and requirements in RCW 82.08.207 apply to this section.

(3) This section expires July 1, 2021.

[2013 2nd sp.s. c 13 § 703.]

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends clarifying the preference

The Legislature should clarify the sales and use tax exemption for standard financial information because, while the preference is meeting the stated objective of exempting sales of standard financial information, it is unclear if the actual fiscal impact reasonably conforms to the 2013 fiscal estimate.

Legislation required: Yes (preference expires on July 1, 2021).

Fiscal impact: Depends on legislative action.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, will be available December 2017.

State-Chartered Credit Unions

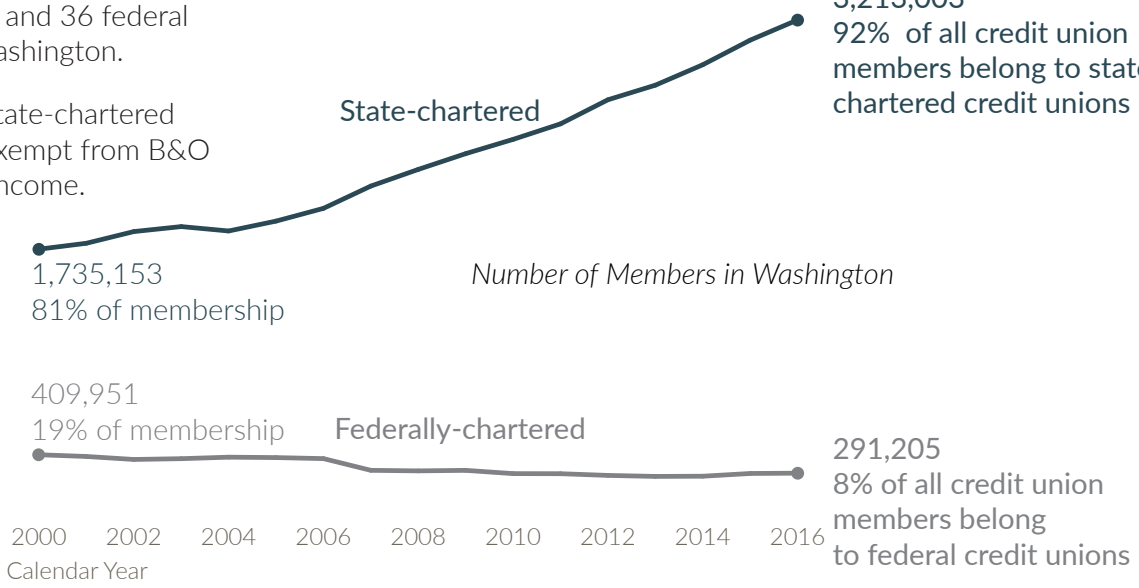
JLARC Staff 2017 Tax Preference Performance Evaluation | Business and Occupation Tax Preference

Objectives (inferred)	Results
Keep state chartered credit unions under state regulation.	**Met.** State-chartered and federally chartered credit unions have same B&O tax exemption.
Serve low-income, underserved populations.	**Unclear.** Serving these populations is not required as a primary focus. Number of low-income members unknown.

State credit union membership has increased while federal membership has decreased

As of September 2016, there were 55 state credit unions and 36 federal credit unions in Washington.

With preference, state-chartered credit unions are exempt from B&O tax on their gross income.



Source: JLARC staff analysis of National Credit Union Administration data, January 2000 - September 30, 2016.

Expectations for serving low-income are unclear

Washington's state-chartered credit unions serve a broad field of members.

No requirements in law or regulation to primarily serve low-income persons.

16 of the 55 state-chartered credit unions reported that over half of their membership is considered low-income.

Legislative Auditor recommendation: **Clarify**

There are no public policy objectives stated in statute. The Legislature should:

- Provide a **performance statement that provides targets and metrics** to measure whether objectives have been achieved.
- Consider whether an objective to serve low-income populations is consistent with other state-chartered credit union policy objectives, such as providing a broad field of membership.

The complete report is on the JLARC web site.

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
(360) 786-5187 • keenan.konopaski@leg.wa.gov

State-Chartered Credit Unions | B&O Tax

Click here for One Page Overview

Summary of this Review

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A B&O tax exemption for gross income earned by state-chartered credit unions.	**B&O** RCW 82.04.405	$47.9 million

Public Policy Objective
The Legislature did not state a public policy objective. JLARC staff infer two: • To keep state-chartered credit unions under state regulation by removing an incentive for them to switch to a federal charter. • To continue support for credit unions, which were originally formed to provide financial services for low-income groups underserved by commercial banks.

Recommendations
Legislative Auditor's Recommendation **Clarify:** The Legislature should clarify the preference to identify public policy objectives because none are stated in statute. As part of the clarification, the Legislature should provide a performance statement that provides targets and metrics to measure whether the objectives have been achieved. **Commissioner Recommendation:** Available in October 2017.

Details on this Preference

1. What is the Preference?

B&O tax exemption for state-chartered credit unions

Purpose

The Legislature did not state a public policy objective when passing this preference.

State-chartered credit unions do not pay B&O tax on their gross income

This preference provides a business and occupation (B&O) tax exemption for the gross income earned by state-chartered credit unions.

Credit unions are nonprofit, cooperative organizations that provide services similar to banks. Credit unions may be chartered under state or federal law. Although similar in powers, the two charter types differ in several ways.

Credit unions are owned and controlled by their members. In Washington, credit union membership is statutorily limited to "groups" that share at least one of the following characteristics:

- A common bond of occupation or association.
- Located within a well-defined neighborhood, community, or rural district.

The preference was enacted in 1970 and does not have an expiration date.

2. Legal History

Tax exemptions in place for federal and state credit unions, other banking institutions now taxed

The first credit unions established in the United States in the early 1900s were state-chartered. State-chartered credit unions were not explicitly exempted from federal income tax.

In 1917, a U.S. Attorney General administrative ruling exempted state credit unions from federal income tax. The ruling held that the credit unions closely resembled cooperative banks and similar institutions that Congress had expressly exempted from taxation in 1913 and 1916.

For additional detail on the legal history of this preference, click **here** to see the 2011 JLARC tax preference performance review.

2011: JLARC reviewed this preference

JLARC staff reviewed the state-chartered B&O tax preference as part of its 2011 tax preference performance reviews. Since the public policy objective was not stated, JLARC staff inferred two objectives: 1) to remove an incentive for state-chartered credit unions to switch to federal charters so they would remain under state regulation, and 2) to support credit unions because they were originally formed to serve low-income groups.

The Legislative Auditor recommended the Legislature continue the preference because it removes an incentive for state-chartered credit unions to switch to a federal charter and leave the state's regulatory system. The Citizen Commission endorsed the recommendation.

The preference has no expiration date.

3. Other Relevant Background

Credit unions, banks, and savings and loan institutions have similarities and differences

How are credit unions, banks, and savings and loan institutions alike?

Credit unions, banks, and savings and loan institutions all:

- Operate under federal or state charters.

- Are insured for up to $250,000 of their deposits by one of two federal agencies: the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration (NCUA).
- Are subject to periodic regulatory and federal insurance examination.

How do credit unions, banks, and savings and loan institutions differ?

There are **distinct differences** in the scope, ownership, and governance of these financial institutions.

Exhibit 3.1: Credit union membership and organization differ from banks and savings and loans

	Credit Unions	Banks	Savings and Loans
Scope	Membership limited to groups with "common bonds," such as occupations, associations, or to groups within a well-defined geographic area.	Community, regional, or national. Available to anyone.	Focus on residential mortgages to promote affordable home ownership. Available to anyone.
Ownership	Members of the credit union own these nonprofit cooperatives.Each member gets one vote.	Private investors own these for-profit corporations.	Two options: 1. Mutuals: Mutually owned by members. Generally, voting rights allocated per size of member's deposits rather than each member getting a vote. 2. Corporations: Owned by a consortium of shareholders controlling stock issued by the S&L's charter.
Governance	Board of directors elected by and from its members.	Board of directors chosen by stockholders.	Elected board of directors.

Source: JLARC staff analysis of banking literature.

Taxes owed by state credit unions differ from federal credit unions, banks, and savings and loans

Washington's tax laws are different for state-chartered credit unions, federally chartered credit unions, and banks and savings and loans.

Exhibit 3.2: Taxation of state credit unions differs from federal credit unions and other financial institutions

Tax Type	Type of Financial Institution

Tax Type	Type of Financial Institution		
	WA State-Chartered Credit Unions	Federally Chartered Credit Unions	Banks and Savings and Loan Institutions
WA B&O Tax	Exempt (Due to preference).	Exempt.	Owe, except first $[illegible] of gross income is exempt.
WA Sales and Use Tax	Owe, except items acquired from a federal or out-of-state credit union during a merger or conversion are exempt from use tax.	Exempt.	Owe.
WA Property Tax (real and personal)	Owe.	Owe.	Owe.
Federal Income Tax	Exempt.	Exempt.	Owe, except when a bank has Subchapter S status. This means the shareholders report their share of the corporation's income or losses on their individual income tax returns.

Source: JLARC staff analysis of Washington Department of Financial Institutions.

4. Public Policy Objectives

Legislature did not state public policy objectives

The Legislature did not state public policy objectives when it provided this B&O tax exemption for state-chartered credit unions.

Two inferred objectives: Keep under state regulation and support low-income groups

This preference was passed before the Legislature required a performance statement for new preferences.

In its 2011 review of this tax preference, JLARC staff inferred two objectives based on historical documents. Because the preference has not changed since, JLARC staff infer the same two public policy objectives:

- To **keep state chartered credit unions under state regulation** by removing a potential incentive for them to switch to a federal charter in order to avoid paying B&O tax.
- To **continue support** for credit unions, which were **originally formed** to **provide financial services for low-income groups underserved** by commercial banks.

Inferred objective: Keep state-chartered credit unions under state regulation

JLARC staff infer the original public policy objective was to give state-chartered credit unions the same B&O tax exemption as federally chartered credit unions. This would keep the state-chartered credit unions under state regulation by removing a potential incentive for state credit unions to switch to federal charters to avoid paying B&O tax.

Inferred objective: Support serving low-income populations

Laws and past statements suggest credit unions have an underlying purpose to serve low-income populations.

- Washington's 1933 statute defined state-chartered credit unions as nonprofit cooperatives formed for the purpose of "promoting thrift among its members and creating a source of credit for them at legitimate rates of interest for provident, productive and educational purposes."
- The 1934 Federal Credit Union Act states "Congress finds the . . . American credit union movement began as a cooperative effort to service the productive and provident credit needs of **individuals of small means**."
- In 1970, Governor Dan Evans stated he supported a B&O tax exemption for state-chartered credit unions because credit unions "primarily provide financial assistance to low-income people."

5. Are Objectives Being Met?

Tax preference incentivizes credit unions to remain under state regulation, but objective of serving low-income is unclear

This tax preference is achieving one inferred objective, but the second inferred objective is unclear.

Preference provides an incentive to remain under state regulation

The preference provides state-chartered credit unions with the same exemption from paying B&O tax as federally chartered credit unions. Before this preference, state-chartered credit unions may have switched to federal charters to avoid paying B&O tax on their gross income. Switching would have removed them from state regulation.

In Washington, state credit union membership has increased while federal credit union membership has decreased

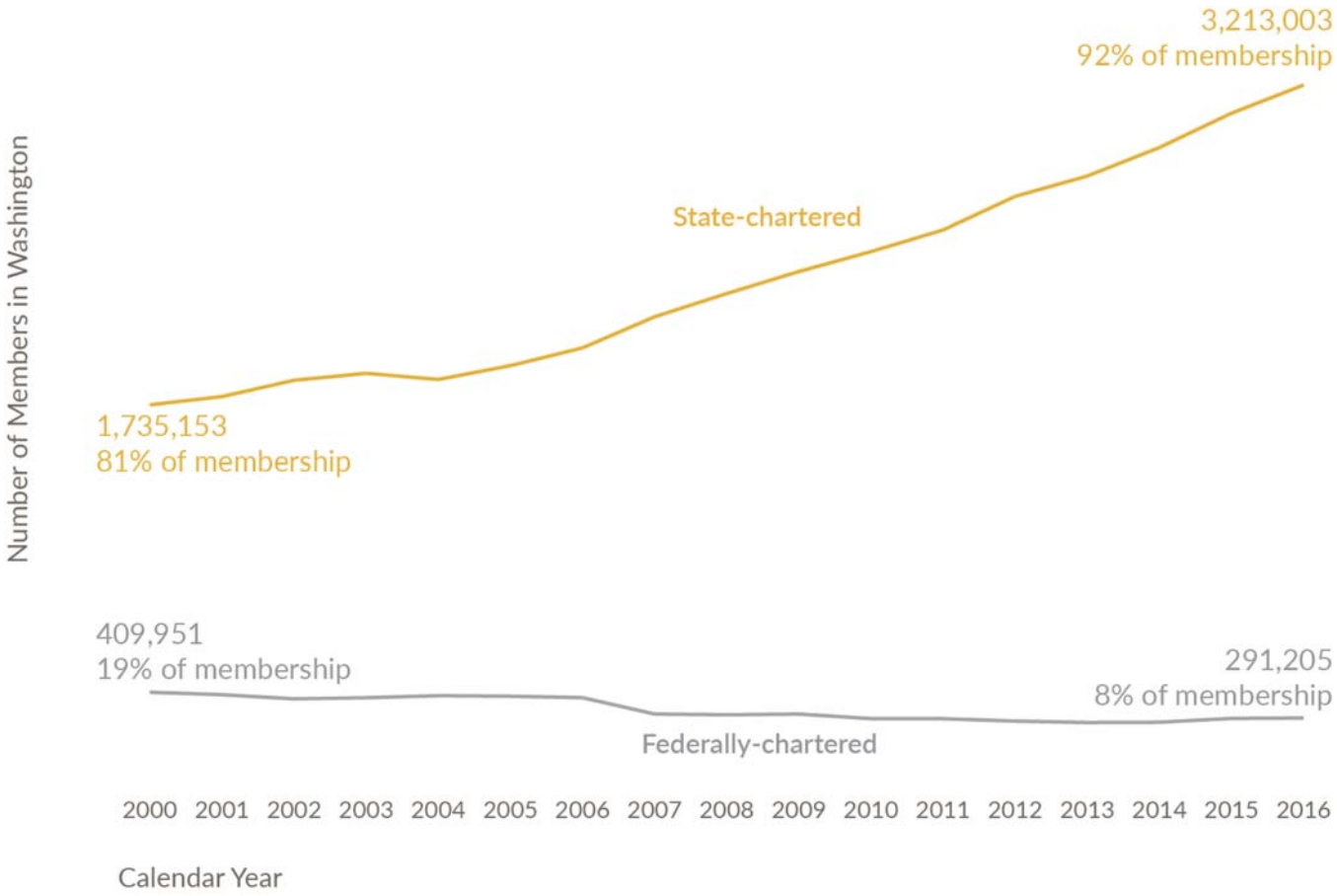
In Washington, 92 percent of credit union members belong to state-chartered credit unions. Since 2000:

- State-chartered credit union membership increased to over 3.2 million.
- Federally chartered credit union membership dropped to 291,000 members.

While the total number of state-chartered credit unions declined recently (65 state credit unions in 2011 compared to 55 as of September 30, 2016), the Department of Financial Institutions (DFI) indicates this is due to mergers and acquisitions, not closures or switches to federal charters. As of September 2016, there were a total of **55 state credit unions** in Washington and **36 federal credit unions**.

Credit union membership trends in Washington contrast with national trends. As of September 30, 2016, there were 56.2 million federal credit union members nationally, compared to 49.9 million state-chartered credit union members.

Exhibit 5.1: Most credit union accounts remain under state regulation and have increased since 2000



Note: Federally chartered credit union figure includes membership in federally chartered credit unions headquartered in Washington.
Source: JLARC staff analysis of National Credit Union Administration data, January 2000 - September 30, 2016.

State charters differ in several ways from federal charters

Credit unions headquartered in Washington may choose to charter with the federal or state regulator. The Department of Financial Institutions (DFI) and other industry sources identified several advantages to state charters, including:

- A more local or "state" perspective on financial issues not necessarily shared at the federal level.
- An interest in ensuring local credit unions are successful and strengthen local economies.
- A broader field of membership than traditionally allowed under federal charters. A "field of membership" is the legal definition of who is eligible to join the credit union. Washington credit union membership is open to those who share "a common bond of occupation or association, or groups within a well-defined neighborhood, community, or district." For some state-chartered credit unions, the field of membership extends to any person that lives in or works in Washington or certain areas in surrounding states.
- Local regulators that respond to local citizens' values and concerns and state legislative mandates.

Recent changes may diminish advantages to state-chartered credit unions

According to the DFI and other industry sources, some of the advantages Washington state-chartered credit unions have over federal charters may be diminishing.

- **Field of membership:** In October 2016, the National Credit Union Administration (NCUA) Board approved new, more flexible field-of-membership rules for federally chartered credit unions. As a result, the field of membership for

federally chartered credit unions may begin to expand like state-chartered credit unions.

- **More flexible rules for business loans:** Effective January 1, 2017, the NCUA amended member business and commercial loan rules to ease regulatory burdens and allow federally chartered credit unions to better serve small business members. Previously, Washington state-chartered credit unions had more flexible rules for business loans than federally chartered credit unions.
- **Additionally, federal charters have the following differences over state charters:**
    - **Locating in multiple states:** Federally chartered credit unions have a national charter and are authorized to cross state lines. Washington state-chartered credit unions are more limited in their ability to provide interstate branching. As of December 2015, Washington credit unions had interstate branching agreements with 17 states, including Oregon and Idaho.
    - **No state fees or sales and use taxes:** The state collects regulatory fees as well as sales and use tax from state-chartered credit unions on purchases of goods (like office equipment) and certain services. Federally chartered credit unions do not pay the state fees or sales and use taxes, but do pay federal fees.

Unclear how low-income should be served

It is unclear whether the Legislature had specific goals for low-income services by state credit unions. While legal and historical documents suggest that credit unions serve low-income populations, this is not explicitly stated as a primary focus in state law or regulation.

The broad field of membership available to state-chartered credit unions does not restrict them to primarily serving low-income populations. Credit unions may continue to serve low-income populations, but it is not required to be their sole focus.

JLARC staff could not identify information that measured how low-income populations were served across all state-chartered credit unions, nor whether that service differed for federal credit unions or banks.

Low income is defined in statute as the greater of: 80 percent or less of the median income in the metropolitan area where they live or 80 percent or less of the national median average.

Of the 55 state-chartered credit unions in Washington as of September 30, 2016:

- 16 are designated as low-income credit unions, which means over 50 percent of their members are low income.
    - These 16 credit unions make up 27 percent of all state-chartered credit union members in Washington.

6. Beneficiaries

State-chartered credit unions and their members benefit from the preference

Tax preferences have direct beneficiaries (entities whose state tax liabilities are directly affected) and may have indirect beneficiaries (entities that may receive benefits from the preference, but are not the primary recipient of the benefit).

Direct beneficiaries

Direct beneficiaries are the 55 Washington state-chartered credit unions with a membership of over 3.2 million. The top five credit unions based on membership numbers make up 52 percent of all state credit union members in Washington.

Boeing Employees Credit Union (BECU) is the largest credit union in Washington, with 31 percent of all state credit union members. BECU is the second largest state-chartered credit union in the country.

Exhibit 6.1: Washington's five largest credit unions hold 52% of state credit union membership

State Credit Union	Membership (as of September 30, 2016)	Percent of Total State Credit Union Members in Washington
Boeing Employees	988,691	31%
Washington State Employees	247,720	8%
Spokane Teachers	160,723	5%
GESA	143,324	4%
HAPO Community	140,665	4%
Total Top Five	1,681,123	52%
All Other State-Chartered Credit Unions	1,530,616	48%
Total Membership	3,211,739	

Source: JLARC staff analysis of National Credit Union Administration data, September 30, 2016.

Indirect beneficiaries

JLARC staff did not identify any indirect beneficiaries.

7. Revenue and Economic Impacts

Estimated beneficiary savings in 2017-19 Biennium are $47.9 million

JLARC staff estimate the direct beneficiary savings for Fiscal Year 2016 was $23.9 million. The estimated beneficiary savings for the 2017-19 Biennium is $47.9 million.

Exhibit 7.1: Estimated direct beneficiary savings

Biennium	Fiscal Year	State Chartered Credit Union Gross Income	Estimated Direct Beneficiary Savings
2013-15 *7/1/13-6/30/15*	2014	$1,870,543,000	$28,058,000
	2015	$1,561,336,000	$23,420,000

Biennium	Fiscal Year	State Chartered Credit Union Gross Income	Estimated Direct Beneficiary Savings
2015-17 *7/1/15-6/30/17*	2016	$1,596,611,000	$23,949,000
	2017	$1,596,611,000	$23,949,000
2017-19 *7/1/17-6/30/19*	2018	$1,596,611,000	$23,949,000
	2019	$1,596,611,000	$23,949,000
	Total 2017-19 Estimated Savings	**$3,193,222,000**	**$47,898,000**

Source: National Credit Union Association data on state chartered credit union income for FYs 2014, 2015, and January through September 2016. No growth in state-chartered credit union income due to limited growth from 2014–2016.

Utah's experience offers insights into whether Washington state-chartered credit unions might switch to federal if taxed

If the exemption were terminated, state-chartered credit unions would pay B&O tax on parts of their gross income. It is unclear if this might encourage some state-chartered credit unions to consider switching to a federal charter or the extent to which this might happen.

Since 2010, three credit unions changed charters in Washington. Two switched from federal to state charters, and one switched from a state to a federal charter.

- In 2010, Puget Sound switched from a state to a federal charter and OUR Community switched from a federal to a state charter.
- In 2012, SnoCope converted from a federal to a state charter.

The Department of Financial Institutions notes that the advantages of a Washington state charter may have narrowed recently as federal rules for federal credit unions were updated.

In 2003, Utah lawmakers passed a bill to tax and limit expansion of Utah's largest state-chartered credit unions.

The uncodified provisions of the bill created a task force to determine if the Legislature should impose state corporate income taxes on Utah state-chartered credit unions when their membership exceeded a certain amount. The tax force also was to decide if all state-chartered credit unions should pay a "competitive equity assessment" if they wanted a waiver from limits on business loans they grant.

According to the Utah Department of Financial Institutions (DFI), the law never took effect because the credit unions targeted by the law converted to federal charters. The Utah DFI noted that within six months of the law's passage, 14 state-chartered credit unions converted their charters to federal.

8. Other States with Similar Preference?

JLARC staff identified only a few states that tax state-chartered credit union income

Forty-seven states, including Washington, authorize state-chartered credit unions. Delaware, South Dakota, Wyoming, and the District of Columbia do not.

Two of the 47 states (Arkansas and Hawaii) have a state-chartered credit union act, but do not have any state-chartered credit unions.

In the other 45 states, most have a corporate net income tax as their primary business tax. Credit unions are typically exempt from state net income taxes due to their nonprofit status.

JLARC staff obtained information from three states that tax the income of state-chartered credit unions in some way:

- **Indiana** and **Nebraska** impose a financial institutions tax on financial institutions, including state-chartered credit unions.
- **Oklahoma** imposes a bank privilege tax on financial institutions, including state-chartered credit unions.

9. Applicable Statutes

RCW 82.04.405

Exemptions—Credit unions.

This chapter shall not apply to the gross income of credit unions organized under the laws of this state, any other state, or the United States.

[1998 c 311 § 4; 1970 ex.s. c 101 § 3.]

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends clarifying the tax preference

The Legislature should clarify the B&O tax exemption for state-chartered credit unions to identify public policy objectives because none are stated in statute. As part of the clarification, the Legislature should provide a performance statement that provides targets and metrics to measure whether the public policy objectives have been achieved.

The preference has incentivized credit unions to remain under state regulations, but the inferred objective of serving low-income populations is unclear.

The Legislature may want to consider if a public policy objective to serve low-income populations is consistent with other state-chartered credit union policy objectives, such as providing a broad field of membership.

Legislation required: Yes (preference has no expiration date).

Fiscal impact: Depends on legislative action.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, will be available December 2017.

Vessel Deconstruction

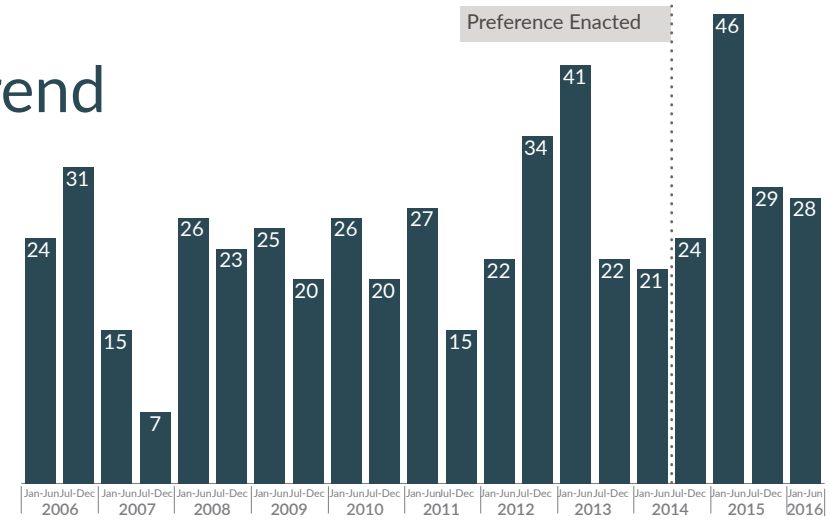
JLARC Staff 2017 Tax Preference Performance Evaluation | Sales and Use Tax Preference

Objectives (stated)	Results
Decrease the number of abandoned and derelict vessels by lowering deconstruction costs and encouraging investment in deconstruction facilities.	**Mixed.** Deconstruction costs have decreased but no evidence of increased investment in deconstruction facilities or capacity. Not all vessel removals involve deconstruction.

Vessel removals have varied with no clear trend

Average removals have increased slightly, but no clear trend identified – removals vary by year and season.

Deconstruction costs decreased by amount of sales/use tax.



Source: JLARC staff analysis of Department of Natural Resources Derelict Vessel Removal Program data, July 2005 through July 2016.

Other factors may impact removals as much or more so than reduced deconstruction costs:

- Available funds for deconstruction and removal
- Cost of removal
- Vessel size and condition

No growth in vessel deconstruction work or capacity

Not all vessel removals require deconstruction.

DNR staff and industry representatives have not seen an increase in deconstruction activities or available capacity to perform the work.

Legislative Auditor recommendation: **Review & Clarify**

Consider adopting a metric other than number of vessels removed. If the intent is to lower costs, the Legislature should consider re-categorizing the preference as one intended to provide tax relief rather than one intended to induce a certain behavior.

The complete report is on the JLARC web site.

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
(360) 786-5187 ● keenan.konopaski@leg.wa.gov

Vessel Deconstruction | Sales and Use Tax

Click here for One Page Overview

Summary of this Review

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A sales and use tax exemption for vessel deconstruction services when done at either a qualified vessel deconstruction facility or over the water in an area permitted under federal law. The preference is scheduled to expire on January 1, 2025.	**Sales and Use** RCWs 82.08.9996; 82.12.9996	$246,000

Public Policy Objective
The Legislature stated the public policy objective was to decrease the number of abandoned and derelict vessels by providing incentives to increase vessel deconstruction.

Recommendations
Legislative Auditor's Recommendation The Legislature should review and clarify the preference because: • The average cost is lower, but it is unclear if it leads to an increase in vessel removals. • Other factors, such as available DVRP funds, removal costs, and size and condition of the vessel, may impact vessel removals as much or more than reduced deconstruction costs. When reviewing the preference, the Legislature may want to consider: 1. **Adopting a metric** other than the number of vessels removed to measure if the public policy objective has been achieved. 2. **Re-categorizing the purpose** of the preference as intended to provide tax relief rather than intended to induce a certain behavior. **Commissioner Recommendation:** Available in October 2017.

Details on this Preference

1. What is the Preference?

Sales and use tax exemption aims to reduce the number of abandoned or derelict vessels

Purpose

The Legislature passed this preference to reduce the number of abandoned or derelict vessels in Washington by:

- Lowering the cost of vessel deconstruction services.
- Encouraging businesses to invest in vessel deconstruction facilities.

Preference provides sales and use tax exemption for vessel deconstruction

Public and private entities may act to remove abandoned or derelict vessels. Sometimes they must contract with a business to permanently dismantle the vessel (vessel deconstruction).

The entities do not pay sales and use tax on vessel deconstruction services if the work is done at either:

- A qualified vessel deconstruction facility.
- Over the water in an area permitted under federal law.

The Department of Natural Resources (DNR) is one of the largest buyers of these services in Washington. A DNR program can also reimburse other authorized public entities when they remove vessels.

Not all vessel removals require deconstruction

"Vessel deconstruction" means permanently dismantling a vessel. Some abandoned or derelict vessels can be removed without deconstruction. The removal may still involve storing, towing, and transporting intact vessels.

Statute defines vessel deconstruction activities

Entities can claim the preference for vessel deconstruction when they:

- Abate and remove hazardous materials, such as fuel, lead, and oils.
- Remove mechanical, hydraulic, or electronic components.
- Remove vessel machinery and equipment.
- Cut apart and/or dispose of vessel infrastructure.

Entities cannot claim the preference for other removal activities:

- Modifying or repairing a vessel.
- Hauling vessels out of water or off land.
- Towing, storage, fees to dispose at a landfill, and legal notices.

The tax preference became effective October 1, 2014, and is set to expire January 1, 2025.

2. Legal History

Between 2002 and 2014, Legislature took steps to address abandoned or derelict vessels

Until 2002, Washington had no state-coordinated, comprehensive approach to the problem of abandoned or derelict vessels in Washington waters and shorelines.

- The Department of Natural Resources (DNR) addressed the problem on its 2.6 million acres of aquatic lands. DNR relied on vessel owners' cooperation, legal action such as trespass and nuisance abatement, and federal action, which was limited in both scope and the ability to remove vessels.
- Cities, ports, and other authorized entities addressed the vessels in their jurisdictions.

2002: Legislature enacted the Derelict Vessel Removal Program (DVRP)

The Legislature enacted the Derelict Vessel Removal Program (DVRP) in response to the growing number of vessels grounded or submerged on publicly or privately owned lands.

The law:

- Stated such derelict vessels created public nuisances and safety hazards, were unsightly, and threatened the environment.
- Put DNR in charge of the DVRP.
- Defined abandoned or derelict vessel.
- Listed specific procedures for taking custody of vessels.
- Created an account funded by annual recreational vessel registration fees to help offset vessel removal and disposal costs for "authorized public entities."
- Took effect January 1, 2003.

The DVRP gives funding and expertise to authorized public entities that remove and dispose of abandoned or derelict vessels. The entities are DNR, the Department of Fish and Wildlife, the Parks and Recreation Commission, metropolitan park districts, port districts, cities, and counties. DNR removes vessels from its lands and helps other authorized public entities upon request.

Annual recreational vessel registration fees funded DVRP. Until 2006, authorized public entities could receive up to 75 percent reimbursement for costs, depending on the account's balance. In 2006, the reimbursement rate increased to 90 percent.

2013: Legislature enacted changes to DVRP

Based on proposed legislation from DNR, the Legislature addressed several issues regarding derelict vessel removal and funding. Among other things, the legislation:

- Increased vessel owner accountability.
- Developed a voluntary vessel turn-in program (VTIP). Under VTIP, owners can turn in boats under 45 feet long that could become derelict. Biennial funding for this program is statutorily limited to not exceed $200,000.
- Directed DNR to work with stakeholders to evaluate the DVRP and suggest legislative changes if needed.

DNR's 2013-15 budget for the DVRP was $7 million. This total included a one-time $4.5 million appropriation to remove several large abandoned vessels that were threatening navigation and the environment.

2014: Legislature enacted this preference and set additional requirements for vessel owners

The Legislature responded to suggestions from DNR and a stakeholder workgroup by enacting this sales and use tax exemption for vessel deconstruction services. The same bill set requirements for vessel owners:

- Required **owners and purchasers of vessels** over 65 feet and more than 40 years old to ensure the vessel is seaworthy and to obtain marine liability insurance.
- Required **marinas, ports, and their tenants** to be insured. Allowed private marinas to contract with DNR to remove nuisance vessels.
- Required **certain commercial vessel**s to pay a new annual derelict vessel removal fee of $1 per foot to help fund the vessel removal account. The Legislature stated:
    - Fees paid by recreational vessel owners were insufficient to fund the account.
    - Using General Fund revenue was an unfair burden on the non-boating public.
- Enacted new penalties for failing to register a vessel that is subject to a watercraft excise tax.

The preference will expire January 1, 2025. The performance statement, which includes public policy objectives, expires six years earlier, on January 1, 2019.

3. Other Relevant Background

Derelict Vessel Removal Program prioritizes vessels for removal and partially reimburses authorized public entities

The Department of Natural Resources (DNR) manages the Derelict Vessel Removal Program (DVRP). DVRP reimburses authorized entities for removing abandoned or derelict vessels. Costs can include vessel deconstruction. Statute provides key definitions, some of which are noted below.

Derelict Vessel Removal Program (DVRP) prioritizes vessels for removal

DNR maintains an inventory of abandoned or derelict vessels that need removal. As of October 2016, the list included 172 vessels. DNR adds vessels to the list when they are reported as abandoned or derelict.

Statute directs DNR to prioritize vessels for removal. DNR assigns a priority level based on criteria including:

- Vessel condition and size.
- Proximity to navigation channels, or sensitive areas or populations.
- Potential for harmful encounters.
- Toxicity or hazard potential.

A vessel's priority can change with the condition of the vessel or its environment.

Exhibit 3.1: DNR DVRP reimbursement priority scale

Priority 1	Emergencies
Priority 2	Non-emergency existing threats to human health, safety, and environment
Priority 3	Vessels impacting habitat and not already covered in a prior category
Priority 4	Minor navigation or economic impact
Priority 5	Other abandoned or derelict vessels
Priority 6	Vessels abandoned in boatyards

Source: JLARC staff analysis of Department of Natural Resources Derelict Vessel Replacement Program Priorities List, June 2016.

Voluntary turn-in program for vessels that are at risk of becoming derelict

The voluntary Vessel Turn-In Program (VTIP) allows DNR to dismantle and dispose of vessels that are at high risk for becoming abandoned or derelict, but do not yet meet the definition.

State law limits program funding to $200,000 per biennium. DNR prioritizes vessels for removal under this program separately from the DVRP list.

DVRP funded through fees and leases

The DVRP budget of $2.46 million (2015-17 Biennium) comes from two accounts and is used to:

- Remove derelict vessels.
- Reimburse authorized public entities for up to 90 percent of their vessel cleanup expenses, including vessel deconstruction work.
- Fund the voluntary vessel turn-in program (VTIP).

Exhibit 3.2: DVRP 2015-17 budget details

Account	2015-17 Amount	Fund Source
Derelict Vessel Removal Account	$1.93 million	• Recreational vessel registration fees • Vessel visitor permit fees • Fees on certain commercial vessels (beginning January 1, 2015)
Aquatic Lands Enhancement Account	$528,900	Revenue from state-owned aquatic leases.

Source: JLARC staff analysis of Department of Natural Resources Derelict Vessel Recovery Program web page, January 2017.

DNR did not have funds to reimburse all authorized entities for vessel cleanup costs through the end of the 2015-17 Biennium.

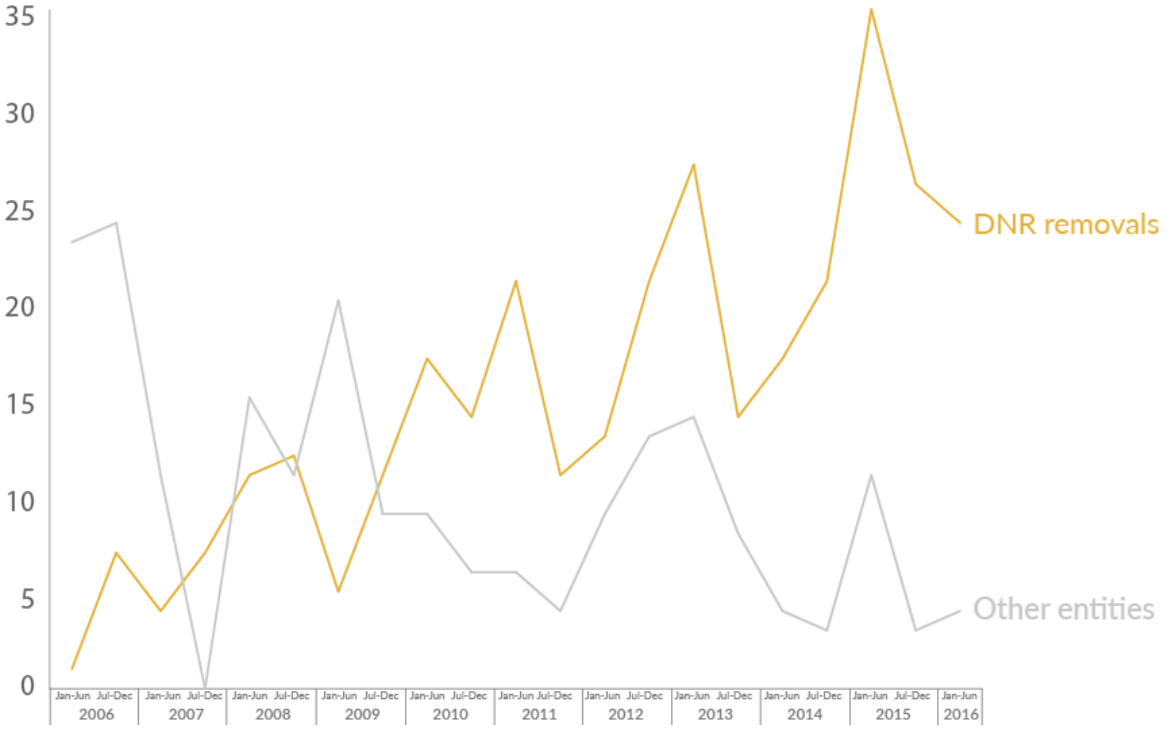
- As of January 1, 2017, DNR was unable to pay 21 reimbursement requests from authorized public entities totaling over $300,000.
- As of August 2016, DNR had spent $150,000 of the $200,000 allotment for VTIP to remove 34 vessels. DNR withheld the remaining $50,000 to help cover DRVP program costs due.

DNR staff note that for vessels that require deconstruction work, approximately 50 percent of vessel removal costs are related to the vessel deconstruction.

DNR conducts most removals in DVRP

The number of abandoned or derelict vessels removed by DNR has increased over time. But, the number of removals by other authorized public entities, as tracked by DNR, has decreased.

Exhibit 3.3: DNR increases number of vessels it removes since 2006



Source: JLARC staff analysis of Department of Natural Resources Derelict Vessel Removal Program data, July 2005 through July 2016.

DNR notes there are many possible reasons that DVRP removals are increasing overall, but removals by other entities are decreasing. DNR identified several issues that could affect the removal numbers, including:

- **DVRP Resources:** One-time funding in the 2013-15 budget for large vessel removals allowed DNR to use all of their normal allocation for other vessels. Further, the DVRP has had a slight increase in funding and staffing since 2006, allowing for more projects to be worked on simultaneously.
- **Tracking:** All of the vessels removed under the VTIP program are now reflected in DNR's removal numbers. VTIP started in 2014. These vessels are not yet considered abandoned or derelict.
- **Authorized Entity Funding and Policy:** Many other authorized public entities ran out of funding in 2008, which affected their ability to fund removals up-front (DVRP is a reimbursement program). Also, entities may have tightened their moorage agreements to discourage dilapidated vessels from mooring in their jurisdictions.

Key definitions

Vessel: Any type of watercraft or other mobile artificial contrivance, powered or not, intended to transport people or goods on water or for floating marine construction or repair. A vessel cannot be more than 200 feet long.

Abandoned vessel: A vessel that has been left, moored, or anchored in the same area without the express consent, or in violation of rules of, the owner or operator of the aquatic lands. The vessel must be left for 30 or more consecutive days or for more than 90 out of any 360 days to be considered abandoned. The vessel's owner must be either not known, not locatable, or known and unwilling to take control of the vessel.

Aquatic lands: Tidelands, shorelands, harbor areas, and the beds of navigable waters, regardless of ownership.

Derelict vessel: A vessel that:

- Has been moored, anchored, or left in state waters or on public property illegally; or
- Has been left on private property without the owner's authorization: and
    - Is sunk or in danger of sinking;
    - Is obstructing a waterway; or
    - Is endangering life or property.

The vessel's owner must be known and locatable, and exert control of the vessel.

Qualified vessel deconstruction facility: Structures, including those that float, permitted under section 402 of the federal Clean Water Act for vessel deconstruction.

4. Public Policy Objectives

Legislature stated public policy objective in the performance statement

The Legislature stated that it aimed to decrease abandoned or derelict vessels, and provided metrics for this review.

Stated objective: Decrease abandoned or derelict vessels by removing them from Washington waters

The Legislature categorized this preference as "intended to induce certain designated behaviors by taxpayers." In its tax preference performance statement, the Legislature stated that the public policy objective was to:

> . . . . decrease the number of abandoned and derelict vessels by providing incentives to increase vessel deconstruction in Washington. . . .This incentive will lower the costs associated with vessel deconstruction and encourage businesses to make investment in vessel deconstruction facilities.

Legislature provided metrics for JLARC review

The Legislature directed JLARC to review the preference by December 1, 2018, and provided the following metrics for evaluation. In short, if either an increase in capacity or a reduction in the average cost led to more derelict vessels being removed from Washington waters, then the Legislative Auditor should recommend extending the preference.

While the tax preference does not expire until January 1, 2025, the performance statement identifying the objectives and metrics expires six years earlier, on January 1, 2019.

If Either...	Resulted in...	Then:
An **increase in available capacity** to deconstruct derelict vessels OR A **reduction in the average cost** to deconstruct vessels	An increase in the number of derelict vessels removed from Washington waters *(compared to before June 12, 2014)*	The Legislative Auditor should recommend extending the January 1, 2025, expiration date

5. Are Objectives Being Met?

Vessel removals have varied without a clear trend, and it is unclear if changes are related to the tax preference or other factors

The Legislature stated that the public policy objective was to decrease the number of abandoned and derelict vessels by removing them from Washington's waters. It intended to do so by lowering the cost of deconstruction activities and encouraging businesses to invest in deconstruction facilities.

Stated objective: Decrease abandoned or derelict vessels by removing them from Washington waters

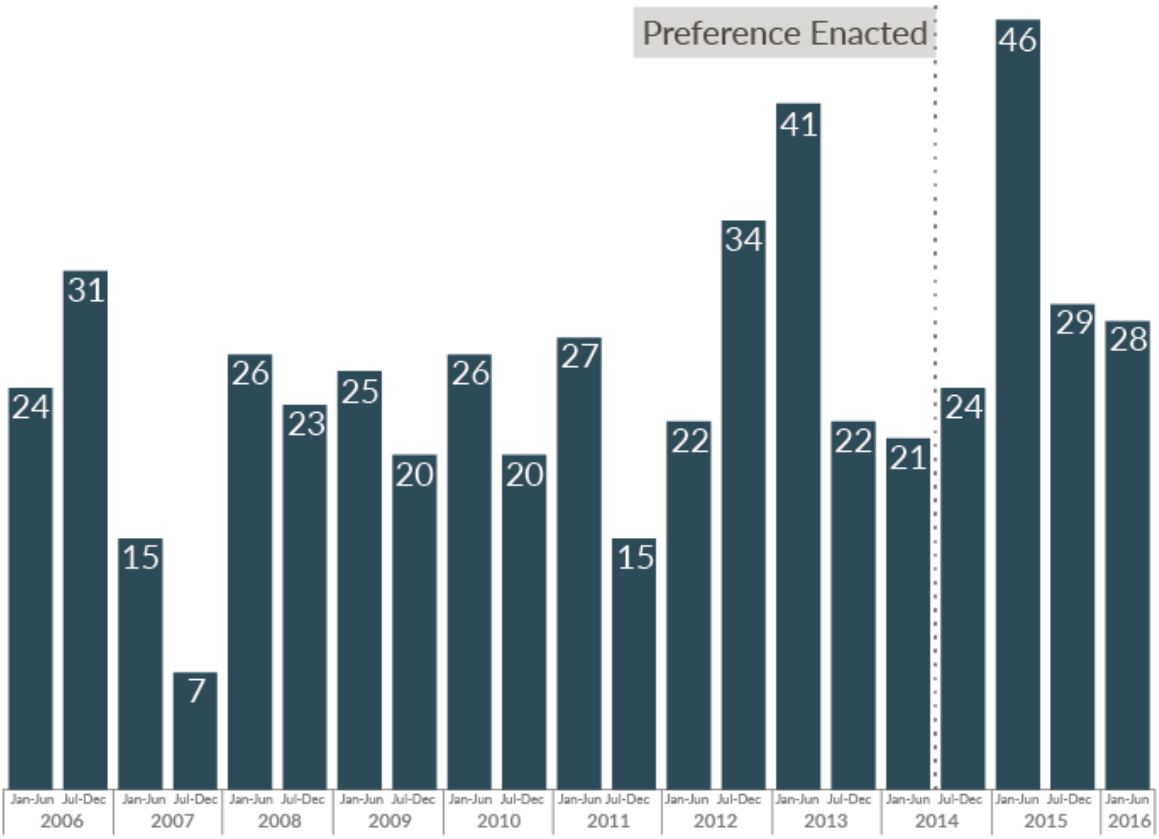
Department of Natural Resources (DNR) data shows that:

- The number of vessels removed has varied without a clear trend since 2006.
- The average number of removals per half-year has increased slightly – from 29.5 every six months in the two fiscal years before the preference to 31.8 after the preference took effect.

However, it is unclear whether the preference caused the increase:

- The preference lowers deconstruction costs, but **not all vessel removals require deconstruction**. Between October 2014 and September 2016, deconstruction work at approved sites was involved in 78 of the 205 vessels removed through the DVRP.

Exhibit 5.1: Number of abandoned and derelict vessels removed through the DVRP has fluctuated since 2006 (reflected in fiscal years)



Source: JLARC staff analysis of Department of Natural Resources Derelict Vessel Removal Program data, July 2005 through July 2016.

JLARC staff were unable to obtain records on how many vessels were removed or deconstructed outside of the DVRP.

No evidence of increase in vessel deconstruction facilities or capacity in Washington

Removals have increased slightly, but there is no evidence that the preference has increased capacity for vessel deconstruction work in Washington. **Not all removals involve deconstruction**. JLARC staff interviewed DNR staff, and representatives of two large businesses that deconstruct vessels and a small boatyard. They all noted:

- They have seen **no increase** in **vessel deconstruction work** at their facilities or elsewhere since the preference was enacted.
- They have seen **no increase** in the **available capacity to deconstruct** abandoned or derelict vessels or an increase in the number of businesses doing this work.
- Abandoned and derelict vessel deconstruction is a very minor part of their business activity, and the work is too sporadic to build a successful business model.

Deconstruction costs decreased by the amount of sales tax

The preference decreases costs to deconstruct vessels by the applicable sales tax rate for where the work is performed (9.0 percent on average). It is unclear if the cost reduction caused or contributed to the slight increase in vessel removals.

DNR representatives stated that the sales tax savings was intended to increase the amount of removal and deconstruction work the agency could complete within DVRP budget limits.

Other factors may have contributed to the number of vessels removed

JLARC staff identified factors that, along with the lowered costs for deconstruction, may have contributed to the increase in vessel removals.

Public funds available for removal: In the 2013-15 Biennium, the DVRP received a one-time $4.5 million appropriation to remove several large vessels.

Cost of removal: If costs are lower, more vessels can be removed within DVRP funding limits.

Size and condition of the vessel: DVRP records from the 2015-17 Biennium indicate that the removal cost varies by vessel size.

Exhibit 5.2: Average vessel removal cost varies by vessel size

2015-17 Biennium (through July 2016)	Vessels Under 35 ft	Vessels 35 – 65 ft	Vessels Over 65 ft
Average Removal Cost	$6,200	$14,500	$290,000

Source: JLARC staff analysis of Department of Natural Resources Derelict Vessel Removal Program project detail July 1, 2015 - July 30, 2016.

DNR and industry sources note that commercial and submerged vessels are complicated and expensive to remove. For example, businesses must use a lift to remove vessels over 35 feet long from the water. Currently, there are no lifts on Washington's outer Pacific Coast. Removing large derelict vessels located far from lifts increases removal costs.

Unclear whether continuing tax preference beyond expiration date will achieve public policy objectives.

The preference is scheduled to expire on July 1, 2025.

Continuing the preference:

- Would provide tax relief to DNR, other authorized public entities, and any other businesses or individuals that contract for vessel deconstruction work. The preference decreased vessel deconstruction costs by 9.0 percent on average.
- May or may not impact the number of abandoned or derelict vessels removed.
- Industry representatives note the preference has not changed the number of deconstruction businesses or the state's capacity to deconstruct vessels.

6. Beneficiaries

Public and private entities that use vessel deconstruction services benefit from the preference

Tax preferences have direct beneficiaries (entities whose state tax liabilities are directly affected) and may have indirect beneficiaries (entities that may receive benefits from the preference, but are not the primary recipient of the benefit).

Direct beneficiaries

Direct beneficiaries of the tax preference are authorized public entities, private organizations (e.g., businesses, marinas), or individuals that use a qualified vessel deconstruction service to dismantle and remove a vessel. Direct beneficiaries do not pay sales or use tax on deconstruction services. Absent the preference, they would pay sales tax of 9.0 percent on average. Authorized public entities include:

- Department of Natural Resources.
- Department of Fish and Wildlife.
- Parks and Recreation Commission and city parks departments.
- Port districts.
- Cities, counties, or towns that own, manage, or have jurisdiction over aquatic lands where abandoned or derelict vessels are located.

Industry representatives stated that most deconstruction work is contracted by DNR or other authorized public entities (estimated at 95 percent). DNR appears to be the largest beneficiary.

Indirect beneficiaries

Indirect beneficiaries of the preference are businesses that deconstruct vessels. They may see an increase in vessel deconstruction work directed to them because of the preference.

7. Revenue and Economic Impacts

Estimated beneficiary savings in 2017-19 Biennium are $246,000

JLARC staff estimate a minimum direct beneficiary savings of $42,000 in Fiscal Year 2016 and $246,000 for the 2017-19 Biennium. This estimate is likely low, as other vessel deconstruction work that is not paid for through the DVRP program is not included in this estimate. The preference is currently scheduled to expire January 1, 2025.

Exhibit 7.1: Estimated direct beneficiary savings

Biennium	Fiscal Year	Qualifying Deconstruction Work (per DNR)	Estimated Beneficiary Savings
2013-15 7/1/13-6/30/15	2015 (beginning Oct. 1, 2014)	$2,267,000	$205,000
2015-17 7/1/15-6/30/17	2016	$445,000	$42,000
	2017	$1,356,000	$123,000
2017-19 7/1/17-6/30/19	2018	$1,356,000	$123,000
	2019	$1,356,000	$123,000

Biennium	Fiscal Year	Qualifying Deconstruction Work (per DNR)	Estimated Beneficiary Savings
	2017-19 Estimated Biennial Savings	$2,712,000	$246,000

Source: JLARC staff analysis of Department of Natural Resources budget expenditure detail for October 2014 through June 30, 2016. JLARC staff estimated qualifying work for future fiscal years using the average qualifying work of the two prior fiscal years. No growth forecast for Fiscal Years 2018 and 2019 due to uncertainty with future budget amounts.

Absent the tax preference, beneficiaries would pay sales or use tax, but economic impact is unlikely

If the tax preference were terminated or allowed to expire as scheduled, the authorized public entities and others that purchase vessel deconstruction work would pay sales or use tax on the deconstruction work as they did before October 1, 2014.

It is unlikely that termination or expiration of the preference would impact employment or the economy because there is no evidence that this preference has resulted in an increase in vessel deconstruction capacity.

8. Other States with Similar Preference?

JLARC staff did not identify any other states that provide a sales and use tax exemption for vessel deconstruction services

JLARC staff reviewed statutes for 29 states that border a coast, the Great Lakes, or other waterway.

Most of these 29 states have a formal process to deal with abandoned or derelict vessels. Many require that owners (if known) be responsible for removal and disposal costs. None appears to have a sales and use tax exemption for vessel deconstruction. JLARC staff identified six states with a dedicated funding source for removal efforts.

- **California** has a grant program for local public agencies statewide. It covers both surrendered or abandoned vessels and a voluntary vessel turn-in program.
- **Hawaii** allows funds from a special boating fund to be used to remove abandoned or derelict vessels.
- **Michigan** has a fund for abandoned vessels, off-road vehicles, and snowmobiles.
- **Mississippi** has a special derelict vessel fund.
- **Oregon** provides an account ($150,000 per biennium) funded in part by registration fees to pay up to 90 percent of the costs associated with derelict vessel removal.
- **Rhode Island** has an account funded by a special abandoned or derelict vessel fee to cover removal work.

9. Applicable Statutes

RCW 82.08.9996

Exemptions—Vessel deconstruction.

(1) The tax levied by RCW 82.08.020 does not apply to sales of vessel deconstruction performed at:

(a) A qualified vessel deconstruction facility; or

(b) An area over water that has been permitted under section 402 of the clean water act of 1972 (33 U.S.C. Sec. 1342) for vessel deconstruction.

(2) The definitions in this subsection apply throughout this section unless the context clearly requires otherwise.

(a)(i) "Vessel deconstruction" means permanently dismantling a vessel, including: Abatement and removal of hazardous materials; the removal of mechanical, hydraulic, or electronic components or other vessel machinery and equipment; and either the cutting apart or disposal, or both, of vessel infrastructure. For the purposes of this subsection, "hazardous materials" includes fuel, lead, asbestos, polychlorinated biphenyls, and oils.

(ii) "Vessel deconstruction" does not include vessel modification or repair.

(b) "Qualified vessel deconstruction facility" means structures, including floating structures, that are permitted under section 402 of the clean water act of 1972 (33 U.S.C. Sec. 1342) for vessel deconstruction.

(3) Sellers making tax-exempt sales under this section must obtain from the purchaser an exemption certificate in a form and manner prescribed by the department. The seller must retain a copy of the certificate for the seller's files. In lieu of an exemption certificate, a seller may capture the relevant data elements as allowed under the streamlined sales and use tax agreement.

[2014 c 195 § 301.]

NOTES:

Reviser's note: Section 301, chapter 195, Laws of 2014 expires January 1, 2025, pursuant to the automatic expiration date established in RCW 82.32.805(1)(a).

Effective date—2014 c 195 §§ 301 and 302: "Sections 301 and 302 of this act take effect October 1, 2014." [2014 c 195 § 304.]

Intent—2014 c 195 §§ 301 and 302: "(1) This section is the tax preference performance statement for the tax preference contained in sections 301 and 302 of this act. This performance statement is only intended to be used for subsequent evaluation of this tax preference. It is not intended to create a private right of action by any party or be used to determine eligibility for preferential tax treatment.

(2) The legislature categorizes this tax preference as intended to induce certain designated behavior by taxpayers as indicated in RCW 82.32.808(2)(a).

(3) It is the legislature's specific public policy objective to decrease the number of abandoned and derelict vessels by providing incentives to increase vessel deconstruction in Washington by lowering the cost of deconstruction. It is the legislature's intent to provide businesses engaged in vessel deconstruction a sales and use tax exemption for sales of vessel deconstruction. This incentive will lower the costs associated with vessel deconstruction and encourage businesses to make investments in vessel deconstruction facilities. Pursuant to chapter 43.136 RCW, the joint legislative audit and review committee must review the sales tax exemptions provided under sections 301 and 302 of this act by December 1, 2018.

(4) If a review finds that the increase in available capacity to deconstruct derelict vessels or a reduction in the average cost to deconstruct vessels has resulted in an increase of the number of derelict vessels removed from Washington's waters as compared to before June 12, 2014, then the legislature intends for the legislative auditor to recommend extending the expiration date of the tax preference.

(5) In order to obtain the data necessary to perform the review in subsection (3) of this section, the joint legislative audit and review committee should refer to data kept and maintained by the department of natural resources.

(6) This section expires January 1, 2019." [2014 c 195 § 303.]

Findings—Intent—2014 c 195: See notes following RCW 79.100.170 and 79.100.180.

RCW 82.12.9996

Exemptions—Vessel deconstruction.

(1) This chapter does not apply to the use of vessel deconstruction services performed at:

(a) A qualified vessel deconstruction facility; or

(b) An area over water that has been permitted under section 402 of the federal clean water act of 1972 (33 U.S.C. Sec. 1342) for vessel deconstruction.

(2) The definitions in RCW 82.08.9996(2) apply to this section.

[2014 c 195 § 302.]

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends reviewing and clarifying the tax preference

When it enacted this preference, the Legislature directed the Legislative Auditor to recommend extending the expiration date if either:

- an **increase** in the **capacity** to deconstruct derelict vessels, or
- a **reduction** in the **average cost** to deconstruct vessels

resulted in an **increase** in the number of **derelict vessels removed** compared to before June 12, 2014.

Based on this directive, the Legislature should review and clarify this tax preference because:

- The average cost for deconstruction is lower, but it is unclear if it led to changes in vessel removals. Not all vessel removals require deconstruction.
- Other factors may impact vessel removals as much or more so than the reduced deconstruction costs. Factors may include available DVRP funds, removal costs, and size and condition of the vessel.
- The performance statement that details the public policy objective and metrics is set to expire six years before the preference expires.

When reviewing the preference, the Legislature may want to consider one of the following two options:

1. **Adopt a metric** other than the number of vessels removed to measure if the public policy objective has been achieved. While removals continue to occur, there is no evidence that the capacity to deconstruct vessels has increased. It is also unclear whether the removals were impacted by the reduction in deconstruction costs or by other contributing factors, such as vessel size and condition or available budget funds. Also, removing one large, potentially damaging vessel may be more beneficial to the state than removing ten smaller ones that pose no immediate threat.
2. **Re-categorize the purpose of this preference** as one intended to provide tax relief, rather than one intended to induce a certain behavior (**RCW 82.32.808(2)(e)**). The tax relief category reflects the Legislature's stated goal of reducing the average cost to deconstruct vessels and would eliminate the need to identify a new metric.

Legislation required: Yes (preference expires January 1, 2025. The performance statement expires six years earlier, on January 1, 2019).

Fiscal impact: Depends on legislative action.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, will be available December 2017.

Wood Biomass Fuel Manufacturing

JLARC Staff 2017 Tax Preference Performance Evaluation | Business & Occupation Tax Preference

Objectives (stated)	Results
Encourage the production of wood biomass fuel in Washington.	**Not met.** The preference has not been used.
Reduce air pollution and greenhouse gas emissions by promoting the production of wood biomass fuel.	
Increase demand for wood biomass.	

Preferential B&O tax rate for businesses that make liquid fuel from wood biomass

Wood biomass is wood, forest, or field residue (e.g., wood chips, bark) or crops grown specifically for fuel production.

Businesses must use specific manufacturing processes to qualify.

Preference has not been used

No beneficiaries claiming the tax preference, past or present.

Preference is one of six passed in 2003 and the only one still in effect

Preference	*Tax Type*	*Expired*
Wood biomass fuel manufacturing	Business and occupation	No
Wood biomass fuel sales	Business and occupation	Yes
Wood biomass fuel machinery & equipment	Sales and use	Yes
Wood biomass fuel production facilities	Real and personal property	Yes
Wood biomass fuel production facilities	Leasehold Excise	Yes
Retail sales and use tax deferral	Sales and use	Never took effect*

** The Legislature extended a separate sales and use tax deferral, nullifying this preference.*

Legislative Auditor recommendation: **Terminate**

The preference is not used and other tax preferences directed at wood biomass fuel manufacturing are no longer in effect. Having only one preference may not provide sufficient incentive to meet the objectives.

Wood Biomass Fuel Manufacturing | B&O Tax

Click here for One Page Overview

Summary of this Review

The Preference Provides	Tax Type	Estimated Biennial Beneficiary Savings
A preferential business and occupation tax rate (0.138 percent) for manufacturers that create liquid fuel from wood biomass.	**Business and Occupation Tax** RCW 82.04.260(1)(f)	$0 in 2017-19 biennium.

Public Policy Objective
JLARC staff infer the public policy objectives are to: • Encourage the production of wood biomass fuel in Washington. • Reduce air pollution and greenhouse gas emissions by promoting the production of wood biomass fuel. • Increase demand for wood biomass.

Recommendations
Legislative Auditor's Recommendation **Terminate**: The Legislature should terminate the tax preference because the preference is not being used and other tax preferences directed at wood biomass fuel manufacturing are no longer in effect. **Commissioner Recommendation:** Available in October 2017.

Details on this Preference

1. What is the Preference?

Preferential B&O tax rate for manufacturers that create liquid fuel from wood biomass

Purpose

The Legislature did not state a public policy objective when passing this preference.

Preference provides a preferential B&O tax rate for businesses that make wood biomass fuel

Manufacturers can make liquid fuel from organic matter called wood biomass.

- With the preference, manufacturers of wood biomass fuel pay a business and occupation (B&O) tax rate of 0.138 percent.

- Without the preference, they would pay the general manufacturing B&O tax rate of 0.484 percent.

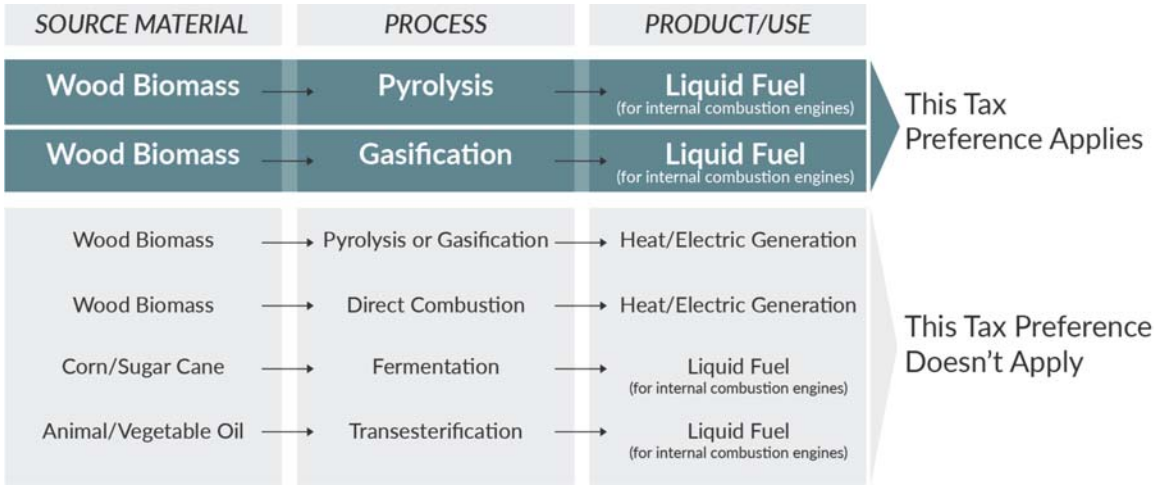
Statute limits eligibility

Manufacturers have many ways to change organic matter into energy. The tax preference applies only if the manufacturer creates liquid fuel that meets the following three criteria:

- **Made from wood biomass** that has not been treated with chemical preservatives such as creosote. Biomass is wood, forest, or field residue (e.g., wood chips, bark) or crops grown specifically for fuel production.
- **Manufactured through pyrolysis or gasification,** which decompose biomass in high-heat, low-oxygen environments. Both processes create oils and gases that can be refined into fuel.
- Created for use in **internal combustion engines**, such as those in motor vehicles and airplanes.

Manufacturing processes that use different sources, different processes, or yield other products are not eligible for the preference.

Exhibit 1.1 Tax preference applies to two manufacturing processes that create liquid fuel from wood biomass



Source: JLARC Staff Analysis of RCW.

Exemption has no expiration date

The preference took effect July 1, 2003. It has no expiration date.

2. Legal History

Preference is one of six passed in 2003 and the only one still in effect

2003: Legislature passed six preferences to benefit wood biomass fuel production

The Legislature initially created five preferences for biodiesel and alcohol fuels. Testimony for the biodiesel legislation suggested that the Legislature enact similar preferences for wood biomass fuel. The Legislature responded with a bill that created six preferences to benefit wood biomass fuel production:

1. B&O tax rate for manufacturing (this preference).
2. B&O deduction for retail sale or distribution (expired 2009).
3. Sales and use tax exemption (expired 2009).
4. Property tax exemption (expired 2015).
5. Leasehold excise tax exemption (expired 2015).

The bill included a sixth preference, a retail sales and use tax deferral. However, because the Legislature extended a different sales and use tax deferral program, this preference did not become law.

This preference is the only one with no expiration date. More detail on the preferences is in **Relevant Background**.

2008: JLARC review found four preferences were not used

In 2008, JLARC staff performed a full review of the four wood biomass tax preferences with expiration dates (B&O deduction for retail sales, sales and use tax, property tax, and leasehold excise tax). The review found no manufacturers used the preferences.

- The Legislative Auditor recommended that the Legislature continue the tax preferences and review them for effectiveness in the future if they were used.
- The Citizen Commission for the Performance Measurement of Tax Preferences did not endorse the Legislative Auditor's recommendation. Instead, the Commission recommended allowing the preferences to expire in 2009 unless there was evidence that taxpayers planned to use them.

2009 – 2010: Two preferences expired, two were extended

Both the B&O deduction for retail sales and the sales and use tax exemption expired in 2009. In 2010, the property and leasehold excise tax exemptions were extended through 2015.

2013: Expedited review indicated this preference and others remained unused

The JLARC expedited review report included this preference. The review cited information from the 2012 Department of Revenue (DOR) tax exemption study that found no wood biomass fuel manufacturers operating in Washington. The expedited review also included the property and leasehold tax exemptions, citing JLARC's 2008 review in reporting that they were not being used.

3. Other Relevant Background

Related preferences have expired

The Legislature has enacted other preferences to encourage businesses to manufacture biomass or biofuel.

Related biomass and biofuel preferences: 11 of 12 are no longer in effect

In addition to the wood biomass fuel manufacturing tax preference, the Legislature enacted 12 other biofuel-related preferences:

- Four additional wood-biomass-fuel tax preferences, passed in 2003, which either have expired or can no longer be claimed.
- Five biodiesel and alcohol fuel tax preferences, passed in 2003, which either have expired or can no longer be claimed.
- Three tax preferences related to biomass and hog fuel, passed in 2009. Two of these preferences have expired, while one remains in effect.

Exhibit 3.1 Additional wood biomass fuel tax preferences

Preference	RCW	Description	Enacted	Extended	Expired
Wood Biomass Fuel Sales (B&O)	82.04.4335	Amounts received from the retail sale, or for the distribution, of wood biomass fuel may be deducted from the B&O Tax.	2003	NA	July 1, 2009
Wood Biomass Fuel Machinery & Equipment (Sales & Use)	82.08.960	Sales of machinery and equipment for the retail sale of wood biomass fuel are exempt from sales and use tax.	2003	NA	July 1, 2009
Wood Biomass Fuel Production Facilities (Property)	84.36.640	Real and personal property used for manufacturing wood biomass fuel are exempt from property taxation for 6 years after the facility becomes operational.	2003	2010	No Claims after Dec. 31, 2015
Wood Biomass Fuel Production Facilities (Leasehold Excise)	82.29A.135	Leasehold interests in property used for manufacturing wood biomass fuel are exempt from LET for 6 years after the facility becomes operational.	2003	2010	No Claims after Dec. 31, 2015

Source: JLARC Staff Analysis of RCW.

Exhibit 3.2 Biodiesel and alcohol fuel tax preferences

Preference	RCW	Description	Enacted	Extended	Expired
Alcohol, Biodiesel Fuel Manufacturing (B&O)	82.04.260(1)(e)	Manufacturers pay a B&O tax rate of 0.138% for manufacturing alcohol fuel, biodiesel fuel, or biodiesel feedstock.	2003	NA	July 1, 2009
Biodiesel Sales (B&O)	82.04.4334	Amounts received from retail sale or for distribution of biodiesel fuel or E85 alcohol fuel may be deducted from B&O Tax.	2003	2007	July 1, 2015

Preference	RCW	Description	Enacted	Extended	Expired
Biodiesel Fuel Production Facilities (Property)	84.36.635	Real and personal property used to manufacture alcohol fuel, biodiesel fuel, or biodiesel feedstock are exempt from property taxation for 6 years after the facility becomes operational.	2003	2010	No Claims after Dec. 31, 2015
Biodiesel Fuel Production Facilities (Leasehold Excise)	82.29A.135	Leasehold interests in property used to manufacture biodiesel fuel are exempt from LET for 6 years after the facility becomes operational.	2003	2010	No Claims after Dec. 31, 2015
Biodiesel M&E (Sales and Use)	82.08.955	Sales of machinery and equipment for retail sale of a biodiesel or alcohol fuel blend are exempt from sales and use tax.	2003	2007	July 1, 2015

Source: JLARC Staff Analysis of RCW.

Exhibit 3.3 Other bioenergy-related tax preferences

Preference	RCW	Description	Enacted	Extended	Expired
Forest Derived Biomass (Sales and Use)	82.08.957	Sales of forest derived biomass used for production of electricity, steam, heat, or biofuel are exempt from sales and use tax.	2009	NA	June 30, 2013
Hog Fuel (Sales and Use)	82.08.956	Sales of hog fuel used to produce electricity, steam, heat, or biofuel are exempt from sales and use tax.	2009	2013 Scheduled expiration: June 30, 2024	NA
Forest Derived Biomass (B&O)	82.04.4494	Harvesters of forest derived biomass are allowed a credit against B&O tax per harvested green ton sold, transferred, or used for production of electricity, steam, heat, or biofuel	2009	NA	June 30, 2015

Source: JLARC Staff Analysis of RCW.

Challenges and opportunities exist for commercial wood biomass fuel manufacturing

The Congressional Research Service noted that transportation logistics are a challenge to using pyrolysis or gasification to create biomass fuel. This challenge includes:

- Transporting the source material (e.g., wood chips, sawdust, bark) to the processing facility, or
- Transporting a mobile processing facility to where the source material is located.

However, wood biomass is abundant in Washington:

- A 2005 Department of Ecology and Washington State University report showed that Washington produces over 16.4 million tons of underutilized biomass each year. The majority is timber and field residue.
- Forest thinning also could provide residue: the U.S. Forest Service stated that 8.4 billion dry tons of material need to be removed from America's national forests to reduce the risk of fire hazard, insect infestation, and disease.
- The Forest Service also reports that biomass is a renewable resource, can contribute to a reduction in greenhouse gas emissions, and can grow in marginal soils that will not support agriculture.

4. Public Policy Objectives

JLARC staff infer three objectives for the preference

The Legislature did not state a public policy objective for this preference. The preference was passed before the Legislature's requirement to provide a performance statement for each preference.

For this review, JLARC staff infer three public policy objectives from testimony to legislative committees about the package of biomass fuel preferences:

- Encourage the production of wood biomass fuel in Washington. The bill's sponsor stated that the preference would support the creation of alternative fuels that lessen the dependence on foreign oil.
- Reduce air pollution and greenhouse gas emissions by promoting the production of wood biomass fuel. Supporters of the bill testified that the preference would help to support a carbon-neutral source of fuel.
- Increase demand for wood biomass. Supporters of the bill testified that increased demand for forest residue could help to partially offset the costs of forest thinning and wildfire prevention.

5. Are Objectives Being Met?

Preferences are not being used

JLARC staff reviewed tax return data and interviewed staff from three state agencies, but identified no beneficiaries that currently claim the tax preference. DOR tax exemption studies also have not identified beneficiaries for the related leasehold excise tax or property tax exemptions. More detail is on the **Beneficiaries Tab**.

Other preferences have expired, so changing this tax preference may not meet the inferred public policy objectives

The Legislature passed this tax preference as part of a package of preferences for wood biomass fuel manufacturers. The other tax preferences have since expired.

Changing the sole remaining tax preference may not by itself result in achievement of the inferred public policy objectives.

6. Beneficiaries

No beneficiaries identified through analysis of tax data and interviews with agencies

Beneficiaries of the preference would be firms that manufacture wood biomass fuel as defined in statute.

JLARC staff conclude no businesses are using the preference:

- JLARC staff reviewed tax return data from 2008 through 2015 and found no businesses claiming the preference.
- Staff from the Departments of Revenue, Natural Resources, and Commerce stated that they were unaware of any beneficiaries.
- DOR's 2016 Tax Exemption study found no beneficiaries of the related leasehold excise tax or property tax exemptions for wood biomass fuel manufacturing facilities.
- JLARC staff found no beneficiaries for the other wood biomass fuel tax preferences when they were in effect.

JLARC staff are unable to determine why no beneficiaries claim the tax preference. Staff from the Departments of Commerce and Natural Resources note that several factors may contribute:

- Low oil prices and the excess global oil supply place a downward pressure on prices of alternative fuels if they are to compete with fossil fuels.
- The technology to produce commercial quantities of liquid wood biomass fuel through pyrolysis or gasification is improving, but may not yet be economically viable.

7. Revenue and Economic Impacts

Because it is not being used, there are no economic impacts

Based on tax return data that show **no beneficiaries**, JLARC staff estimate that there are no beneficiary savings and no tax revenue or economic impacts of the tax preference.

8. Other States with Similar Preference?

While states offer incentives for alternative fuels or renewable energy, none has an identical preference

The tax treatment of the production, delivery, sale, and use of alternative fuels varies widely across states. For example:

- Oregon provides a property tax exemption for property used to produce biofuels, and a personal income tax credit of $10 per ton of biomass collected or produced, up to $200 per person per year.

- Maine offered an income tax credit of $0.05 per gallon of biofuel production, including some wood biomass fuel produced through pyrolysis. The tax preference was repealed in 2015 because it was not being used.

JLARC staff identified three states that offer tax preferences that specifically mention pyrolysis or gasification:

- **Michigan** provides a property tax exemption for property used for gasification to generate electricity or heat.
- **Missouri** provides a property tax exemption and an income tax credit to employers that generate renewable energy, including pyrolysis for converting waste material to energy.
- **Texas** provides a property tax exemption for renewable energy systems that convert solar energy into thermal, mechanical, or electrical energy. This includes systems that use gasification and pyrolysis.

9. Applicable Statutes

RCW 82.04.260

Tax on manufacturers and processors of various foods and by-products—Research and development organizations—Travel agents—Certain international activities—Stevedoring and associated activities—Low-level waste disposers—Insurance producers, surplus line brokers, and title insurance agents—Hospitals—Commercial airplane activities—Timber product activities—Canned salmon processors.

(1) Upon every person engaging within this state in the business of manufacturing:

(a) Wheat into flour, barley into pearl barley, soybeans into soybean oil, canola into canola oil, canola meal, or canola by-products, or sunflower seeds into sunflower oil; as to such persons the amount of tax with respect to such business is equal to the value of the flour, pearl barley, oil, canola meal, or canola by-product manufactured, multiplied by the rate of 0.138 percent;

(b) Beginning July 1, 2025, seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing by that person; or selling manufactured seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing, to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales, multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(c)(i) Beginning July 1, 2025, dairy products; or selling dairy products that the person has manufactured to purchasers who either transport in the ordinary course of business the goods out of state or purchasers who use such dairy products as an ingredient or component in the manufacturing of a dairy product; as to such persons the tax imposed is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state or sold to a manufacturer for use as an ingredient or component in the manufacturing of a dairy product.

(ii) For the purposes of this subsection (1)(c), "dairy products" means:

(A) Products, not including any marijuana-infused product, that as of September 20, 2001, are identified in 21 C.F.R., chapter 1, parts 131, 133, and 135, including by-products from the manufacturing of the dairy products, such as whey and casein; and

(B) Products comprised of not less than seventy percent dairy products that qualify under (c)(ii)(A) of this subsection, measured by weight or volume.

(iii) The preferential tax rate provided to taxpayers under this subsection (1)(c) does not apply to sales of dairy products on or after July 1, 2023, where a dairy product is used by the purchaser as an ingredient or component in the manufacturing in Washington of a dairy product;

(d)(i) Beginning July 1, 2025, fruits or vegetables by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables, or selling at wholesale fruits or vegetables manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state.

(ii) For purposes of this subsection (1)(d), "fruits" and "vegetables" do not include marijuana, useable marijuana, or marijuana-infused products;

(e) Until July 1, 2009, alcohol fuel, biodiesel fuel, or biodiesel feedstock, as those terms are defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of alcohol fuel, biodiesel fuel, or biodiesel feedstock manufactured, multiplied by the rate of 0.138 percent; and

(f) Wood biomass fuel as defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of wood biomass fuel manufactured, multiplied by the rate of 0.138 percent.

(2) Upon every person engaging within this state in the business of splitting or processing dried peas; as to such persons the amount of tax with respect to such business is equal to the value of the peas split or processed, multiplied by the rate of 0.138 percent.

(3) Upon every nonprofit corporation and nonprofit association engaging within this state in research and development, as to such corporations and associations, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(4) Upon every person engaging within this state in the business of slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale only and not at retail; as to such persons the tax imposed is equal to the gross proceeds derived from such sales multiplied by the rate of 0.138 percent.

(5) Upon every person engaging within this state in the business of acting as a travel agent or tour operator; as to such persons the amount of the tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(6) Upon every person engaging within this state in business as an international steamship agent, international customs house broker, international freight forwarder, vessel and/or cargo charter broker in foreign commerce, and/or international air cargo agent; as to such persons the amount of the tax with respect to only international activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(7) Upon every person engaging within this state in the business of stevedoring and associated activities pertinent to the movement of goods and commodities in waterborne interstate or foreign commerce; as to such persons the amount of tax with respect to such business is equal to the gross proceeds derived from such activities multiplied by the rate of 0.275 percent. Persons subject to taxation under this subsection are exempt from payment of taxes imposed by chapter 82.16 RCW

for that portion of their business subject to taxation under this subsection. Stevedoring and associated activities pertinent to the conduct of goods and commodities in waterborne interstate or foreign commerce are defined as all activities of a labor, service or transportation nature whereby cargo may be loaded or unloaded to or from vessels or barges, passing over, onto or under a wharf, pier, or similar structure; cargo may be moved to a warehouse or similar holding or storage yard or area to await further movement in import or export or may move to a consolidation freight station and be stuffed, unstuffed, containerized, separated or otherwise segregated or aggregated for delivery or loaded on any mode of transportation for delivery to its consignee. Specific activities included in this definition are: Wharfage, handling, loading, unloading, moving of cargo to a convenient place of delivery to the consignee or a convenient place for further movement to export mode; documentation services in connection with the receipt, delivery, checking, care, custody and control of cargo required in the transfer of cargo; imported automobile handling prior to delivery to consignee; terminal stevedoring and incidental vessel services, including but not limited to plugging and unplugging refrigerator service to containers, trailers, and other refrigerated cargo receptacles, and securing ship hatch covers.

(8) Upon every person engaging within this state in the business of disposing of low-level waste, as defined in RCW 43.145.010; as to such persons the amount of the tax with respect to such business is equal to the gross income of the business, excluding any fees imposed under chapter 43.200 RCW, multiplied by the rate of 3.3 percent.

If the gross income of the taxpayer is attributable to activities both within and without this state, the gross income attributable to this state must be determined in accordance with the methods of apportionment required under RCW 82.04.460.

(9) Upon every person engaging within this state as an insurance producer or title insurance agent licensed under chapter 48.17 RCW or a surplus line broker licensed under chapter 48.15 RCW; as to such persons, the amount of the tax with respect to such licensed activities is equal to the gross income of such business multiplied by the rate of 0.484 percent.

(10) Upon every person engaging within this state in business as a hospital, as defined in chapter 70.41 RCW, that is operated as a nonprofit corporation or by the state or any of its political subdivisions, as to such persons, the amount of tax with respect to such activities is equal to the gross income of the business multiplied by the rate of 0.75 percent through June 30, 1995, and 1.5 percent thereafter.

(11)(a) Beginning October 1, 2005, upon every person engaging within this state in the business of manufacturing commercial airplanes, or components of such airplanes, or making sales, at retail or wholesale, of commercial airplanes or components of such airplanes, manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of:

(i) 0.4235 percent from October 1, 2005, through June 30, 2007; and

(ii) 0.2904 percent beginning July 1, 2007.

(b) Beginning July 1, 2008, upon every person who is not eligible to report under the provisions of (a) of this subsection (11) and is engaging within this state in the business of manufacturing tooling specifically designed for use in manufacturing commercial airplanes or components of such airplanes, or making sales, at retail or wholesale, of such tooling manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, be equal to the gross income of the business, multiplied by the rate of 0.2904 percent.

(c) For the purposes of this subsection (11), "commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(d) In addition to all other requirements under this title, a person reporting under the tax rate provided in this subsection (11) must file a complete annual report with the department under RCW 82.32.534.

(e)(i) Except as provided in (e)(ii) of this subsection (11), this subsection (11) does not apply on and after July 1, 2040.

(ii) With respect to the manufacturing of commercial airplanes or making sales, at retail or wholesale, of commercial airplanes, this subsection (11) does not apply on and after July 1st of the year in which the department makes a determination that any final assembly or wing assembly of any version or variant of a commercial airplane that is the basis of a siting of a significant commercial airplane manufacturing program in the state under RCW 82.32.850 has been sited outside the state of Washington. This subsection (11)(e)(ii) only applies to the manufacturing or sale of commercial airplanes that are the basis of a siting of a significant commercial airplane manufacturing program in the state under RCW 82.32.850.

(12)(a) Until July 1, 2024, upon every person engaging within this state in the business of extracting timber or extracting for hire timber; as to such persons the amount of tax with respect to the business is, in the case of extractors, equal to the value of products, including by-products, extracted, or in the case of extractors for hire, equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(b) Until July 1, 2024, upon every person engaging within this state in the business of manufacturing or processing for hire: (i) Timber into timber products or wood products; or (ii) timber products into other timber products or wood products; as to such persons the amount of the tax with respect to the business is, in the case of manufacturers, equal to the value of products, including by-products, manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(c) Until July 1, 2024, upon every person engaging within this state in the business of selling at wholesale: (i) Timber extracted by that person; (ii) timber products manufactured by that person from timber or other timber products; or (iii) wood products manufactured by that person from timber or timber products; as to such persons the amount of the tax with respect to the business is equal to the gross proceeds of sales of the timber, timber products, or wood products multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(d) Until July 1, 2024, upon every person engaging within this state in the business of selling standing timber; as to such persons the amount of the tax with respect to the business is equal to the gross income of the business multiplied by the rate of 0.2904 percent. For purposes of this subsection (12)(d), "selling standing timber" means the sale of timber apart from the land, where the buyer is required to sever the timber within thirty months from the date of the original contract, regardless of the method of payment for the timber and whether title to the timber transfers before, upon, or after severance.

(e) For purposes of this subsection, the following definitions apply:

(i) "Biocomposite surface products" means surface material products containing, by weight or volume, more than fifty percent recycled paper and that also use nonpetroleum-based phenolic resin as a bonding agent.

(ii) "Paper and paper products" means products made of interwoven cellulosic fibers held together largely by hydrogen bonding. "Paper and paper products" includes newsprint; office, printing, fine, and pressure-sensitive papers; paper napkins, towels, and toilet tissue; kraft bag, construction, and other kraft industrial papers; paperboard, liquid packaging containers, containerboard, corrugated, and solid-fiber containers including linerboard and corrugated medium; and related types of cellulosic products containing primarily, by weight or volume, cellulosic materials. "Paper and paper products" does not include books, newspapers, magazines, periodicals, and other printed publications, advertising materials, calendars, and similar types of printed materials.

(iii) "Recycled paper" means paper and paper products having fifty percent or more of their fiber content that comes from postconsumer waste. For purposes of this subsection (12)(e)(iii), "postconsumer waste" means a finished material that would normally be disposed of as solid waste, having completed its life cycle as a consumer item.

(iv) "Timber" means forest trees, standing or down, on privately or publicly owned land. "Timber" does not include Christmas trees that are cultivated by agricultural methods or short-rotation hardwoods as defined in RCW 84.33.035.

(v) "Timber products" means:

(A) Logs, wood chips, sawdust, wood waste, and similar products obtained wholly from the processing of timber, short-rotation hardwoods as defined in RCW 84.33.035, or both;

(B) Pulp, including market pulp and pulp derived from recovered paper or paper products; and

(C) Recycled paper, but only when used in the manufacture of biocomposite surface products.

(vi) "Wood products" means paper and paper products; dimensional lumber; engineered wood products such as particleboard, oriented strand board, medium density fiberboard, and plywood; wood doors; wood windows; and biocomposite surface products.

(f) Except for small harvesters as defined in RCW 84.33.035, a person reporting under the tax rate provided in this subsection (12) must file a complete annual survey with the department under RCW 82.32.585.

(13) Upon every person engaging within this state in inspecting, testing, labeling, and storing canned salmon owned by another person, as to such persons, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(14)(a) Upon every person engaging within this state in the business of printing a newspaper, publishing a newspaper, or both, the amount of tax on such business is equal to the gross income of the business multiplied by the rate of 0.35 percent until July 1, 2024, and 0.484 percent thereafter.

(b) A person reporting under the tax rate provided in this subsection (14) must file a complete annual report with the department under RCW 82.32.534.

Recommendations

Legislative Auditor Recommendation

Legislative Auditor recommends terminating the tax preference

The Legislature should terminate the tax preference because the preference is not being used and other tax preferences directed at wood biomass fuel manufacturing are no longer in effect.

The preference was initially enacted in 2003 with other wood biomass fuel tax preferences. While this package of preferences was in effect, none appears to have been claimed. Because only one tax preference directed toward manufacturers of wood biomass fuel remains, it may not provide sufficient incentive to meet the inferred public policy objectives.

Legislation required: Yes (preference has no expiration date).

Fiscal impact: Depends on legislative action.

Letter from Commission Chair

Available December 2017.

Commissioners' Recommendation

Available December 2017.

Agency Response

If applicable, will be available December 2017.