

# PRELIMINARY REPORT: 2019 TAX PREFERENCE PERFORMANCE REVIEWS

## Commercial Airplane Parts: Place of Sale

### LEGISLATIVE AUDITOR'S CONCLUSION:

While the preference clarifies place of sale of certain airplane parts, it appears to conflict with policy objectives by providing more advantageous tax treatment to out-of-state manufacturers of airplane parts than to in-state manufacturers.

July 2019

### With preference, sales of certain airplane parts whose final inspection takes place outside of Washington are exempt from B&O tax

The preference applies to certain airplane parts that are made by out-of-state manufacturers and sold to a Washington manufacturer of commercial airplanes. Sale of these parts is exempt from B&O tax if the place of sale — defined for the preference as the location of final testing or inspection — is outside Washington. A 2014 JLARC staff review of the preference includes additional detail.

The preference does not have an expiration date.

Estimated Biennial  
Beneficiary Savings  
\$620,000




Tax Type  
Business & Occupation  
Tax  
RCW 82.04.627  
Applicable Statutes

### 2014 review concluded that the preference appeared to conflict with a public policy objective to reduce the cost of doing business in state

When the Legislature expanded aerospace preferences to in-state suppliers in 2008, it stated three broad public policy objectives:

1. More comprehensively address the cost of doing business in Washington compared to other states.
2. Encourage the continued presence of the aerospace industry for a broader group of suppliers.
3. Provide well-paying jobs.

When reviewing this preference in 2014, JLARC staff also inferred a fourth objective – to clarify place of sale of certain airplane parts. The preference met this objective by defining place of sale. However, JLARC staff found that it appeared to conflict with the Legislature’s stated objective of reducing the cost of doing business in Washington as compared to other states. Specifically, the preference provided greater tax advantages to out-of-state airplane part manufacturers than to in-state manufacturers. A Washington commercial airplane manufacturer could still benefit indirectly to the extent that the out-of-state parts manufacturer chose to pass on its taxpayer savings to the buyer.

|  PARTS MANUFACTURER |  PLACE OF SALE |  TAX RATE |
|--|---|--|
| In-state manufacturer  | Outside WA  | 0.29%  |
|  | In WA   | 0.29%  |
| Out-of-state manufacturer  | Outside WA  | 0%   |
|  | In WA   | 0.29%  |

Preference applies only to out-of-state manufacturers, when place of sale (final testing or inspection) is outside WA.

Source: JLARC Analysis of RCW 82.04.627 and WAC 458-20-193.

## In 2014 review, Legislative Auditor recommended reviewing and clarifying the preference

The Legislative Auditor recommended that the Legislature review and clarify the preferential tax treatment provided to out-of-state manufacturers and consider adding reporting or other accountability requirements to provide better information on use of this preference.

## Limited data is available to analyze use of the tax preference for 2019 review

There is no specific reporting line for the preference, and out-of-state beneficiaries may not need to register with the Department of Revenue. For these reasons, it is difficult to determine the exact number of beneficiaries that claim the preference or the actual amount of tax savings.

However, based on the available data, JLARC staff identified three businesses that claimed the preference in fiscal years 2016 and 2017. Based on this data, estimated beneficiary savings are \$620,000 per biennium. JLARC staff found fewer than three beneficiaries that claimed the preference in fiscal year 2018. Actual figures may be higher.

## Legislative Auditor's conclusions and recommendations from 2014 remain applicable

The Legislature has made no substantive changes to the preference since the 2014 review.

- One bill, enacted in 2015, updated Federal Aviation Regulation (FAR) citations and references in the statute governing the preference. The bill did not substantively change any of the provisions governing the preference.
- Three other bills were proposed, but did not pass. Each would have made broad changes to all tax preferences, but included no substantive provisions specific to this preference.

As a result, the preference continues to provide greater tax advantages to out-of-state airplane part manufacturers than to in-state manufacturers.

## Recommendations

### Legislative Auditor's Recommendation: Review and Clarify

The Legislature should review and clarify the preferential tax treatment provided to out-of-state manufacturers because it seems to run counter to the Legislature's stated policy objective of reducing the cost of doing business for Washington compared to locations in other states.

In addition, the Legislature may want to consider adding reporting or other accountability requirements that would provide better information on out-of-state manufacturers' use of this preference.

More information is available on the Recommendations Tab.

### Commissioners' Recommendation

[Available October 2019.](#)

## REVIEW DETAILS

### Applicable statutes

#### RCW 82.04.627

#### Exemptions - Commercial airplane parts.

(1) Except as provided in subsection (2) of this section, for purposes of the taxes imposed under this chapter on the sale of parts to the manufacturer of a commercial airplane, the sale is deemed to take place at the site of the final testing or inspection under federal aviation regulation part 21, subpart F or G.

(2) This section does not apply to:

(a) Sales of a standard part, such as a nut or bolt, manufactured in compliance with a government or established industry specification;

(b) Sales of a product produced under a technical standard order authorization or letter of technical standard order design approval pursuant to federal aviation regulation part 21, subpart O; or

(c) Sales of parts in respect to which final testing or inspection under federal aviation regulation part 21, subpart F or G takes place in this state.

(3) "Commercial airplane" has the same meaning given in RCW [82.32.550](#).

[ 2015 c 86 § 301; 2008 c 81 § 15.]

#### NOTES:

**Findings—Savings—Effective date—2008 c 81:** See notes following RCW 82.08.975.

# RECOMMENDATIONS & RESPONSES

## Legislative Auditor's Recommendation

### Legislative Auditor's Recommendation: Review and Clarify

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In addition, the Legislature may want to consider adding reporting or other accountability requirements that would provide better information on out-of-state manufacturers' use of this preference.

**Legislation Required:** Yes

**Fiscal Impact:** None

## Letter from Commission Chair

[Available October 2019.](#)

## Commissioners' Recommendation

[Available October 2019.](#)

## Agency Response

If applicable, available December 2019.

# MORE ABOUT THIS REVIEW

## Study questions



### Proposed Study Questions: Commercial Airplane Part Place of Sale

State of Washington Joint Legislative Audit and Review Committee • September 2018

#### **Citizen Commission scheduled a JLARC study of exemption for the sale of certain commercial airplane parts**

The 2006 Legislature directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct performance audits of tax preferences. This preference is included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.

#### **With preference, sales of certain airplane parts are exempt from B&O tax if “place of sale” is outside WA**

The preference:

- Applies to parts that are made by out-of-state manufacturers and sold to a Washington manufacturer of commercial airplanes.
- Provides an exemption if the place of sale — defined for the preference as the location of final testing or inspection — is outside Washington.



#### **Exemption intended to support the aerospace industry and clarify the meaning of “place of sale”**

This preference was one of many aerospace tax preferences included in legislation that passed in 2008. The Legislature stated three public policy objectives for the preferences:

- Encourage the continued presence of the aerospace industry for a broader group of suppliers.
- More comprehensively address the cost of doing business in Washington compared to other states.
- Provide well-paying jobs.

JLARC staff also infer from public testimony that the Legislature wanted to clarify the Department of Revenue's existing interpretation of “place of sale” for sales of commercial airplane parts made by out-of-state manufacturers.

#### **In 2014, Legislative Auditor recommended reviewing and clarifying preference**

When this preference was reviewed in 2014, JLARC staff found that the preference appeared to conflict with the Legislature's stated policy objective of reducing the cost of doing business in Washington compared to other states. The Legislative Auditor also recommended that the Legislature consider adding reporting or other accountability requirements that would provide better information about out-of-state manufacturers' use of this preference.

#### **Study will answer two questions**

- 1) Has there been legislative action, change, or discussion of the preference since 2014?
- 2) Are the Legislative Auditor's 2014 conclusions and recommendations still applicable to current circumstances?

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Joint Legislative Audit & Review Committee, 106 11<sup>th</sup> Ave SW, Olympia, WA 98501  
(360) 786-5171 • (360) 786-5180 (fax) • JLARC@leg.wa.gov • www.jlarc.leg.wa.gov  
Keenan Konopaski, Washington State Legislative Auditor

## Proposed Study Questions: Commercial Airplane Part Place of Sale

### Study Timeframe

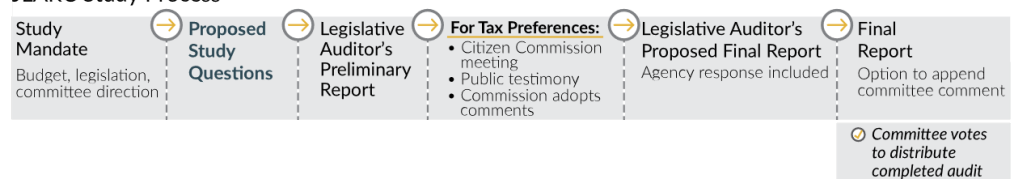
Preliminary Report: July 2019

Proposed Final Report: December 2019

### Study Team

|                      |                  |              |  |
|----------------------|------------------|--------------|--|
| Team Lead:           | Pete van Moorsel | 360.786.5185 | <a href="mailto:pete.vanmoorsel@leg.wa.gov">pete.vanmoorsel@leg.wa.gov</a> |
| Research Analyst:    | Zack Freeman     | 360.786.5179 | <a href="mailto:zack.freeman@leg.wa.gov">zack.freeman@leg.wa.gov</a>       |
| Project Coordinator: | Eric Thomas      | 360.786.5182 | <a href="mailto:eric.thomas@leg.wa.gov">eric.thomas@leg.wa.gov</a>         |

### JLARC Study Process



## Washington Joint Legislative Audit and Review Committee

106 11th Avenue SW, Suite 2500  
PO Box 40910  
Olympia, WA 98504-0910

Phone: 360-786-5171  
Fax: 360-786-5180  
Email: [JLARC@leg.wa.gov](mailto:JLARC@leg.wa.gov)

