

PROPOSED FINAL 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.

December 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 RCWs 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

The Commission endorses the Legislative Auditor's recommendation with comment. The tax preference addresses what had previously been an area of significant dispute between taxpayers and the Department of Revenue on sourcing of sales where final inspection of the products for Federal Aviation Administration (FAA) purposes occurs outside of Washington. The Legislature should clarify this by continuing the preference and re-stating that its purpose is to define the place of sale as opposed to reducing Washington's cost of business. Doing so will avoid further disputes and will not require further reporting for this structural clarification.

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

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.

Legislation Required: Yes

Fiscal Impact: None

Letter from Commission Chair

State of Washington
Citizen Commission for Performance Measurement of Tax Preferences

COMMISSION MEMBERS

Dr. Grant Forsyth Chair
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October 30, 2019

The Honorable Representative Timm Ormsby
The Honorable Representative Drew Stokesbary
The Honorable Representative Cindy Ryu
The Honorable Representative Bill Jenkin
The Honorable Representative Zack Hudgins
The Honorable Representative Norma Smith
The Honorable Representative Gael Tarleton

The Honorable Representative Ed Orcutt
The Honorable Senator Patty Kuderer
The Honorable Senator Hans Zeiger
The Honorable Senator Mark Mullet
The Honorable Senator Lynda Wilson
The Honorable Senator Christine Rolfes
The Honorable Senator John Braun

Re: 2019 Tax Preference Reviews

Dear Senators and Representatives,

I am pleased to forward to you the comments that the Citizen Commission for Performance Measurement of Tax Preferences unanimously adopted for this year's review of tax preferences. The Citizen Commission consists of five voting members, with a member appointed by each of the four caucuses and the Governor's office. Notably, reviews this year included the \$569M aerospace preferences that were expanded and extended in 2013, as well as a \$262M preference to encourage development of multifamily and affordable housing.

We adopted positions similar to the Legislative Auditor for eight of the nine recommendations issued this year. I would like to call your attention to a recommendation from the Citizen Commission to the Legislature to form a taskforce to improve the information available to the Legislature on the use and consistency of the multifamily tax preference.

The full text of our Commissioner recommendations, summaries of the JLARC staff's analysis and recommendations, and brief video summaries of each preference are available on the 2019 Tax Preference Reviews overview page linked [here](#).

Tax preference reviews provide valuable information as the Legislature considers whether specific preferences are meeting the Legislature's policy objectives. With this year's report, there are now 13 years of tax preference evaluations available to the Legislature, comprising over 296 individual reviews.

I urge you to consider this year's and previous years' recommendations and comments on tax preference statutes in the upcoming legislative session. An interactive summary of legislative action on prior reviews is available [here](#).

As Chair of the Citizen Commission, I would be pleased to discuss the Commission's position and comments with you and any interested legislators. Please feel free to contact me (grant.forsyth@leg.wa.gov) or the Legislative Auditor, Keenan Konopaski (keenan.konopaski@leg.wa.gov or 360-786-5187).

Sincerely,



Grant D. Forsyth, Chair
Citizen Commission for Performance Measurement of Tax Preferences

Commissioners' Recommendation

The Commission endorses the Legislative Auditor's recommendation with comment. The tax preference addresses what had previously been an area of significant dispute between taxpayers and the Department of Revenue on sourcing of sales where final inspection of the products for Federal Aviation Administration (FAA) purposes occurs outside of Washington. The Legislature should clarify this by continuing the preference and re-stating that its purpose is to define the place of sale as opposed to reducing Washington's cost of business. Doing so will avoid further disputes and will not require further reporting for this structural clarification.

Agency Response




STATE OF WASHINGTON

October 1, 2019

TO: Keenan Konopaski, Legislative Auditor
Joint Legislative Audit and Review Committee

FROM: David Schumacher, Director 
Office of Financial Management

Vikki Smith, Director 
Department of Revenue

**SUBJECT: JLARC PRELIMINARY REPORT ON 2019 TAX PREFERENCE
PERFORMANCE REVIEWS**

The Office of Financial Management and Department of Revenue have reviewed the Joint Legislative Audit and Review Committee's (JLARC) preliminary report on the 2019 tax preference performance reviews.

We appreciate JLARC's thorough analysis and the detailed assessment provided by the Citizen Commission for Performance Measurement of Tax Preferences. A system that provides for a continuous review of state tax preferences is critical to ensure that the state of Washington maintains a fair and equitable tax system.

The Department of Revenue has provided a formal response on the property tax exemption for multifamily housing in urban areas. While we have no specific comments on the other eight preferences in the 2019 preliminary report, we continue to support JLARC's recommendations for the inclusion of performance statements and specific public policy objectives for all tax preferences where they do not exist in statute today.

Thank you for the opportunity to provide comments on this material and the recommendations made by JLARC.

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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Keenan Konopaski, Washington State Legislative Auditor

Proposed Study Questions: Commercial Airplane Part Place of Sale

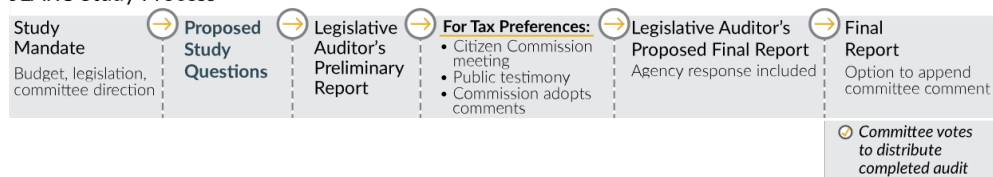
Study Timeframe

Preliminary Report: July 2019 Proposed Final Report: December 2019

Study Team

Team Lead:	Pete van Moorsel	360.786.5185	pete.vanmoorsel@leg.wa.gov
Research Analyst:	Zack Freeman	360.786.5179	zack.freeman@leg.wa.gov
Project Coordinator:	Eric Thomas	360.786.5182	eric.thomas@leg.wa.gov

JLARC Study Process



More about 2019 reviews

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 findings and conclusions, and any exceptions to the application of audit standards have been explicitly disclosed in the body of this report.

Timeframe for the study

A preliminary audit report will be presented at the July 2019 JLARC meeting and at the August 2019 meeting of the Commission. A final report will be presented to JLARC in December 2019.

More about 2019 reviews

Study process

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 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 2019, JLARC staff reviewed 17 preferences compiled into nine reports (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 main topics 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))

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 of the preference

The Legislature now requires that any legislation creating a new preference, or expanding or extending an existing preference, must include a tax preference performance statement. The performance statement must contain a statement of legislative purpose as well as metrics to evaluate the effectiveness of the preference (RCW [82.32.808](#)).

Some of the preferences included in this report were passed before the 2013 legislation that requires performance statements. When a preference's purpose or objective is identified in statute, staff are able to affirmatively state the public policy objective. Sometimes the objective may be found in intent statements or in other parts of statute if there is no tax preference performance statement.

When the Legislature did not state the public policy objective of a preference, JLARC 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 when there is explicit statutory language.

More about 2019 reviews

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Shelly Short

Dean Takko

Lynda Wilson, *Secretary*

Keith Wagoner

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