

PROPOSED FINAL REPORT:  
2019 TAX PREFERENCE PERFORMANCE  
REVIEWS

# Aircraft Part Prototypes

## LEGISLATIVE AUDITOR'S CONCLUSION:

The preference has not been claimed and does not contribute to the public policy objectives, so the Legislative Auditor continues to recommend termination.

December 2019

## Preference applies to the sale of materials used to make prototypes of aircraft parts and equipment

The exemption applies to sales or use of:

- Materials incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications.
- Materials that are incorporated into a prototype but later destroyed in the testing or development of the prototype.

The preference is limited to businesses whose gross income and value of products manufactured had a combined total value of \$20 million or less in the previous year, minus any [multiple activities tax credit claims](#)<sup>1</sup>. A business may not claim more than \$100,000 in tax savings from this preference in a calendar year. To claim the preference, a business must first pay the tax on a sale subject to the preference, and then apply to the Department of Revenue (DOR) for a refund. A 2014 JLARC [review of the preference](#) includes additional detail.

The preference does not have an expiration date.

## In 2014, the Legislative Auditor found no businesses were claiming the tax preference and recommended termination

The Legislature stated two public policy objectives when it enacted the tax preference in 1996. The preference was part of a larger bill that addressed machinery and equipment used in research, development, and testing. The objectives applied to all exemptions in the bill.

<b>Estimated Biennial Beneficiary Savings</b> None
<b>Tax Type</b> Sales and Use Tax RCWs 82.08.02566, 82.12.02566 Applicable Statutes

<sup>1</sup>The multiple activities tax credit is specified in RCW 82.04.440

JLARC staff [reviewed the preference in 2014](#). Because the review found no businesses were claiming the tax preference, the Legislative Auditor recommended that the Legislature terminate the preference as it had not contributed to the stated public policy objectives.

Objectives (Stated)	2014 JLARC Review Results
Encourage, develop, and expand opportunities for family wage employment in manufacturing industries.	No businesses claim the tax preference.
Solidify and enhance the state's competitive position.	

## With no legislative changes to the preference and no beneficiaries, the Legislative Auditor's 2014 conclusions and recommendations remain applicable

**No substantive legislative changes.** Since 2014, three bills have proposed broad changes to all tax preferences. While each bill would have affected this preference, none included provisions specific to it. None of the bills passed.

**No businesses claim the preference.** Beneficiaries must pay the sales or use tax and then apply for a refund from DOR. This process allows DOR to track the number of firms that claim the exemption. DOR reports that there have been no requests for refunds, and thus, no beneficiaries. Efforts to reach two Washington companies that supported the legislation to create the preference in 1996 were unsuccessful. In 2014 these same companies indicated they were not claiming the preference.

## Recommendations

### Legislative Auditor's Recommendation: Terminate

The Legislature should terminate the sales and use tax exemption for prototypes for aircraft parts, auxiliary equipment, and modifications because the tax preference is not being used and has not contributed to the stated public policy objectives.

The Legislature may wish to consider other strategies beyond this tax incentive to accomplish the public policy objectives.

More information is available on the Recommendations Tab.

### Commissioners' Recommendation

The Commission endorses the Legislative Auditor's recommendation without comment.

# ADDITIONAL DETAILS

## Applicable statutes

### RCWs 82.08.02566, 82.12.02566

#### Sales Tax

##### RCW 82.08.02566

Exemptions - Sales of tangible personal property incorporated in prototype for parts, auxiliary equipment, and aircraft modification - limitation on yearly exemption.

(1) The tax levied by RCW [82.08.020](#) shall not apply to sales of tangible personal property incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications; or to sales of tangible personal property that at one time is incorporated into the prototype but is later destroyed in the testing or development of the prototype.

(2) This exemption does not apply to sales to any person whose total taxable amount during the immediately preceding calendar year exceeds twenty million dollars. For purposes of this section, "total taxable amount" means gross income of the business and value of products manufactured, less any amounts for which a credit is allowed under RCW [82.04.440](#).

(3) State and local taxes for which an exemption is received under this section and RCW [82.12.02566](#) shall not exceed one hundred thousand dollars for any person during any calendar year.

(4) Sellers shall collect tax on sales subject to this exemption. The buyer shall apply for a refund directly from the department.

[ 2003 c 168 § 208; 1997 c 302 § 1; 1996 c 247 § 4.]

#### SELECTED NOTES:

**Findings—Intent—1996 c 247:** "The legislature finds that the health, safety, and welfare of the people of the state of Washington are heavily dependent upon the continued encouragement, development, and expansion of opportunities for family wage employment in the state's manufacturing industries.

The legislature also finds that sales and use tax exemptions for manufacturing machinery and equipment enacted by the 1995 legislature have improved Washington's ability to compete with other states for manufacturing investment, but that additional incentives for manufacturers need to be adopted to solidify and enhance the state's competitive position.

The legislature intends to accomplish this by extending the current manufacturing machinery and equipment exemptions to include machinery and equipment used for research and development with potential manufacturing applications." [ 1996 c 247 § 1.]

## Use Tax

### RCW 82.12.02566

Exemptions—Use of tangible personal property incorporated in prototype for aircraft parts, auxiliary equipment, and aircraft modification—Limitations on yearly exemption.

(1) The provisions of this chapter shall not apply with respect to the use of tangible personal property incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications; or in respect to the use of tangible personal property that at one time is incorporated into the prototype but is later destroyed in the testing or development of the prototype.

(2) This exemption does not apply in respect to the use of tangible personal property by any person whose total taxable amount during the immediately preceding calendar year exceeds twenty million dollars. For purposes of this section, "total taxable amount" means gross income of the business and value of products manufactured, less any amounts for which a credit is allowed under RCW [82.04.440](#).

(3) State and local taxes for which an exemption is received under this section and RCW [82.08.02566](#) shall not exceed one hundred thousand dollars for any person during any calendar year.

(4) Sellers obligated to collect use tax shall collect tax on sales subject to this exemption. The buyer shall apply for a refund directly from the department.

[ 2003 c 168 § 209; 1997 c 302 § 2; 1996 c 247 § 5.]

#### SELECTED NOTES:

**Findings—Intent—1996 c 247:** See note following RCW 82.08.02566.

## RECOMMENDATIONS & RESPONSES

### Legislative Auditor's Recommendation

#### Legislative Auditor's Recommendation: Terminate

The Legislature should terminate the sales and use tax exemption for prototypes for aircraft parts, auxiliary equipment, and modifications because the tax preference is not being used and has not contributed to the stated public policy objectives.

**Legislation Required:** Yes

**Fiscal Impact:** None

# Letter from Commission Chair

State of Washington  
**Citizen Commission for Performance Measurement of Tax Preferences**

COMMISSION MEMBERS

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**Ronald Bueing Vice 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](mailto:grant.forsyth@leg.wa.gov)) or the Legislative Auditor, Keenan Konopaski ([keenan.konopaski@leg.wa.gov](mailto: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 without comment.

## Agency Response

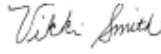


### STATE OF WASHINGTON

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: Aircraft Part Prototypes

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

#### Citizen Commission scheduled a JLARC study of the sales and use tax exemption for aircraft part prototypes

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.

The preference is a sales and use tax exemption for sales of materials used to make prototypes for aircraft parts and auxiliary equipment. A prototype is an original model of a product that may be developed in the future.

The exemption is available to businesses whose taxable income and value of manufactured products was \$20 million or less in the previous year. Businesses may claim up to \$100,000 annually in tax savings from this preference. Eligible businesses must first pay the tax, and then apply to the Department of Revenue (DOR) for a refund.



#### Sales and use tax exemption to encourage family-wage employment and improve the state's competitive position

The preference has two stated public policy objectives:

- To encourage, develop, and expand opportunities for family-wage employment in manufacturing industries.
- To solidify and enhance the state's competitive position for aerospace manufacturing.

#### Legislative Auditor recommended terminating this preference in 2014

JLARC staff previously reviewed the preference in 2014 and determined that no businesses used it. In that review, the Legislative Auditor recommended terminating the preference.

DOR reports no other businesses have applied for a refund for this sales & use tax exemption since 2014.

#### 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?

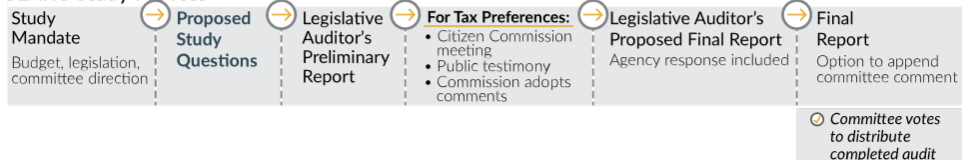
#### Study Timeframe

Preliminary Report: July 2019      Proposed Final Report: December 2019

#### Study Team

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Project Coordinator:	Eric Thomas	360.786.5182	<a href="mailto:eric.thomas@leg.wa.gov">eric.thomas@leg.wa.gov</a>

#### JLARC Study Process



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 Keenan Konopaski, Washington State Legislative Auditor

## 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

### Contact information

#### JLARC staff members

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**Eric Thomas, Audit Coordinator**

**Keenan Konopaski, Legislative Auditor**

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Bob Hasegawa  
Mark Mullet, *Chair*  
Rebecca Saldaña  
Shelly Short  
Dean Takko  
Lynda Wilson, *Secretary*  
Keith Wagoner

### Representatives

Jake Fey  
Noel Frame  
Larry Hoff  
Christine Kilduff  
Vicki Kraft  
Ed Orcutt, *Vice Chair*  
Gerry Pollet, *Assistant Secretary*  
Drew Stokesbary

## 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

Mark Mullet, JLARC Chair  
Pat McCarthy, State Auditor

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