

PRELIMINARY REPORT: 2023 TAX PREFERENCE PERFORMANCE REVIEWS

International Services

LEGISLATIVE AUDITOR'S CONCLUSION:

Preference use is 99% lower than originally expected. It has not met the goal of attracting and retaining jobs.

July 2023

Executive Summary

B&O tax credit for businesses that create new professional service jobs in certain urban areas. Jobs must serve international customers.

The 1998 Legislature created a \$3,000 business and occupation (B&O) tax credit to businesses for each job created in Washington that:

- Is located in a community empowerment zone (CEZ)¹ or an international service district (ISD)².
- Provides certain professional services to international clients or provides services outside the United States. Eligible professional services include, but are not limited to, financial or management services, accounting or legal services, or engineering services.

**Estimated Biennial
Beneficiary Savings**
\$80,000
(2025-27 biennium)

Tax Type
Business and occupation
tax
RCW 82.04.44525

Businesses may receive credits for the year the job was created and for four more years if the job is retained. The maximum amount of the tax credit is \$15,000 per job.

The preference took effect July 1, 1998. It does not have an expiration date.

¹ Urban areas designated by the Department of Commerce in the early 1990s, characterized by limited employment opportunities, low incomes, a lack of affordable housing, deteriorating infrastructure, and limited community service, job training, or education facilities.

² A contiguous group of census tracts with unemployment and poverty characteristics similar to CEZs, in a county meeting certain population definitions, and designated by December 31, 1998.

Stated public policy objective of creating and retaining jobs not achieved

The 1998 Legislature stated that the preference was intended to attract and retain businesses that provide professional services to international customers. To concentrate the preference's impact, the Legislature limited it to businesses that create new jobs in CEZs or ISDs. The Legislature stated that both of these urban areas are "characterized by unemployment and poverty."

A 1998 fiscal note estimated that in 2003, 148 businesses would claim the preference and the total beneficiary savings would be \$9.9 million. To date, no more than five businesses have claimed the preference in a single year, and beneficiary savings have not exceeded \$71,500 per year.

Objectives (stated)	Results
Attract and retain businesses to CEZs or ISDs that provide professional services to international customers.	Not achieved. Employment at beneficiary businesses declined 74% between 2013 and 2021, and wage growth lagged behind statewide averages.

Recommendations

Legislative Auditor's Recommendation: Terminate

The Legislature should terminate this preference because it has not achieved the stated intent to attract and retain businesses in community empowerment zones or international service districts that provide professional services to international customers.

The Legislature may want to consult with the Department of Commerce and local economic development entities to consider other approaches to encourage business development in CEZs.

You can find more information in Recommendations.

Commissioners' Recommendation

Available on [Citizen Commission website](#) October 2023.

REVIEW DETAILS

1. B&O tax credit for professional service jobs

B&O tax credit is intended to create and retain jobs serving international customers in qualifying urban areas

Preference provides a B&O tax credit for each professional service job a business creates and retains

Businesses receive a \$3,000 business and occupation (B&O) tax credit for each permanent, full-time professional service job they create in qualifying urban areas. The credit is received the year the job is created and for four more years if the job is retained. A business can receive up to \$15,000 for each job.

Jobs created must involve services that are:

- Provided to a customer located outside the United States.
- Used primarily outside the United States.

The law lists the following eligible professional services:

- **Computer services**, such as computer programming or modifying custom software.
- **Data processing services**, such as word processing, data entry, and payroll processing.
- **Information services**, such as electronic data retrieval or research that entails furnishing financial or legal information.
- **Legal services**, such as representation by an attorney or legal drafting.
- **Accounting and tax preparation services**, such as bookkeeping, auditing, or tax preparation.
- **Engineering or architectural services**, such as structural or architectural design.
- **Business consulting or management services**, such as general management consulting or human resource consulting or training.
- **Public relations or advertising services**, such as market research, art direction, or graphic design.
- **Surveying and geological consulting services**, such as land surveying or services for the oil, gas, and mining industry.
- **Real estate appraisal services**, such as market appraisal and other real estate valuation.
- **Financial services**, such as banking or investment management by a financial business.

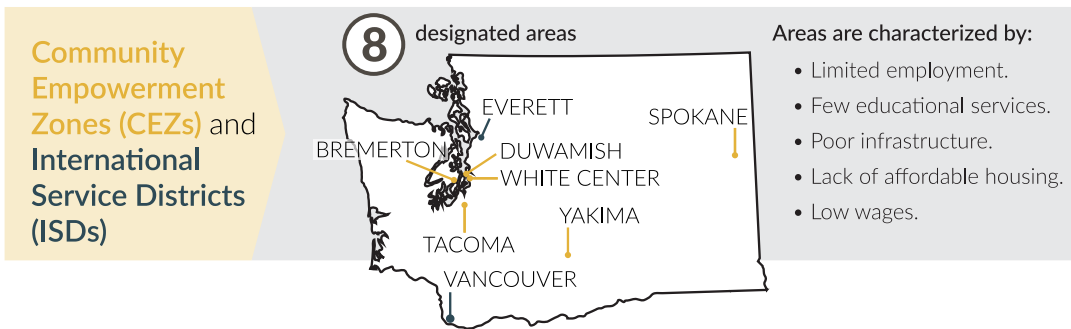
Jobs must be located in community empowerment zones (CEZs) or international service districts (ISDs)

The 1998 Legislature stated its intent to concentrate the impact of the preference by limiting it to businesses that create jobs located in the following designated urban areas:

- **Community empowerment zones (CEZ):** Urban areas designated by the Department of Commerce in the early 1990s, characterized by limited employment opportunities, low incomes, a lack of affordable housing, deteriorating infrastructure, and limited community service, job training, or education facilities. State law allows up to six CEZs statewide. Current CEZs are located in Bremerton, Duwamish, Spokane, Tacoma, White Center, and Yakima.
- **International service districts (ISD):** A contiguous group of census tracts with unemployment and poverty characteristics similar to CEZs, in a county meeting certain population definitions, and designated by December 31, 1998. Everett and Vancouver each designated an ISD.

No additional CEZs or ISDs may be designated under current state law.

Exhibit 1.1: Eligible jobs must be located in CEZs or ISDs

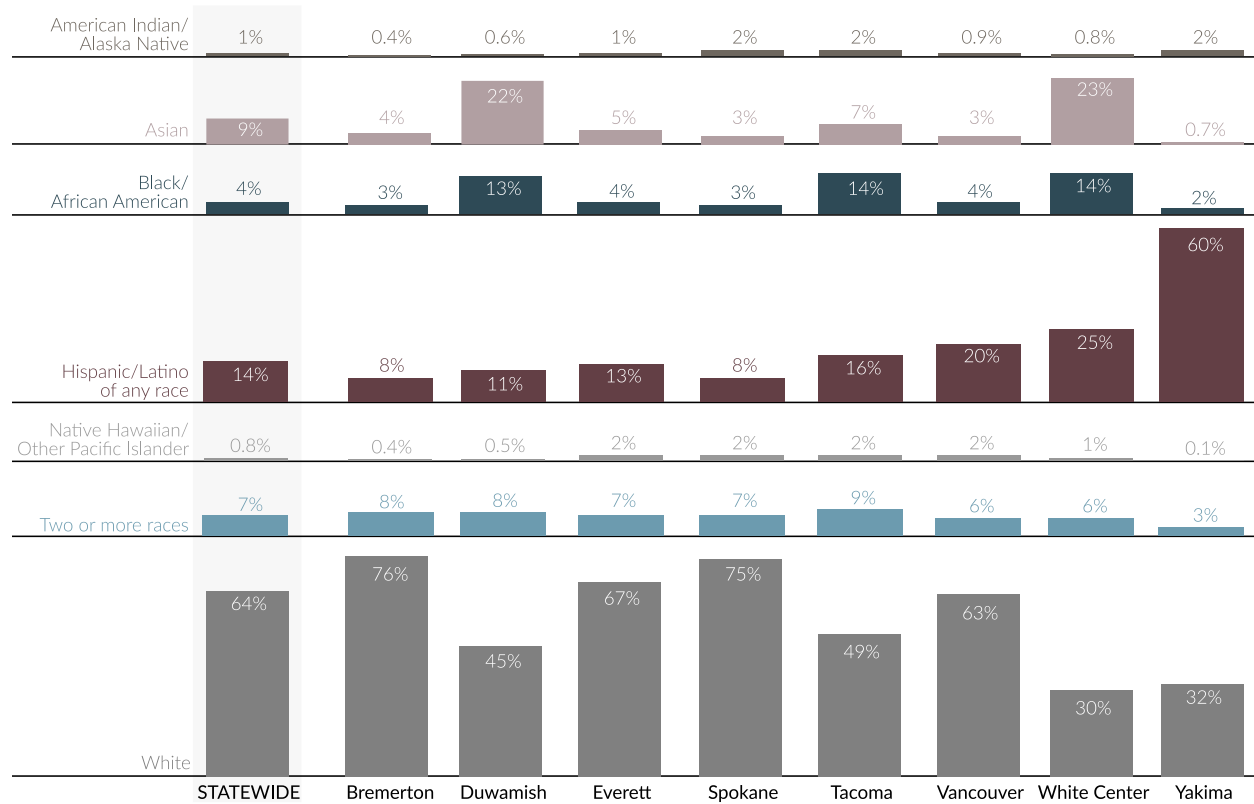


Source: JLARC staff analysis of Department of Commerce and Department of Revenue detail and maps of CEZs and ISDs.

Most CEZs and ISDs have more demographic diversity than the state overall

Information about the racial and ethnic characteristics of business owners that have used the preference or employees hired to fill qualifying new jobs was not available. JLARC staff used 2020 U.S. Census Bureau census tract detail for the six CEZs and two ISDs to analyze the racial and ethnic characteristics of these areas.

Exhibit 1.2: CEZs and ISDs are more racially and ethnically diverse than the state overall



Source: JLARC staff analysis of 2020 U.S. Census race and ethnicity data for specific census blocks within CEZ and ISD boundaries.

Preference has no expiration date

The preference took effect July 1, 1998. It does not have an expiration date.

2. Preference use and savings less than expected

Since 2013, the number of beneficiaries and annual beneficiary savings have been 99% lower than expected levels

The Department of Revenue's (DOR) 1998 fiscal note estimated that in the 2001-03 biennium, 148 businesses would use the preference and beneficiary savings would be \$17.6 million (\$9.9 million in fiscal year 2003).

Eight businesses claimed the preference between 2013 and 2022. Beneficiary savings ranged from \$12,300 to \$71,500.

JLARC staff reviewed DOR tax return data from fiscal years 2013 through 2022 to determine the number of beneficiary businesses and estimate their savings.

In total, eight businesses claimed the preference between 2013 and 2022. This is 5% of the 148 beneficiaries estimated in the 1998 fiscal note. Since 2020, fewer than three businesses used the preference each year. The most businesses to use the preference in a single year were five in 2015 and 2017.

Beneficiary savings ranged from \$12,300 in 2013 to \$71,500 in 2015. The 2015 beneficiary savings are less than 1% of the \$9.9 million savings estimated in the 1998 fiscal note. DOR tax exemption studies published from 2004 to 2012 noted limited use of the preference prior to 2013.

Exhibit 2.1: JLARC staff estimate future beneficiary savings of \$40,000 per fiscal year based on the trend reflected in prior years

Biennium	Fiscal year	Number of beneficiaries	Estimated beneficiary savings
2011-13	2013	3	\$12,300
2013-15 7/1/13 - 6/30/15	2014	4	\$68,700
	2015	5	\$71,500
2015-17 7/1/15 - 6/30/17	2016	4	\$54,700
	2017	5	\$51,400
2017-19 7/1/17 - 6/30/19	2018	4	\$53,500
	2019	3	\$46,000
2019-21 7/1/19 - 6/30/21	2020	Fewer than 3	Not disclosable
	2021	Fewer than 3	Not disclosable
2021-23 7/1/21 - 6/30/23	2022	Fewer than 3	Not disclosable
	2023		\$40,000
2023-25 7/1/23 - 6/30/25	2024		\$40,000
	2025		\$40,000
2025-27 7/1/25 - 6/30/27	2026		\$40,000
	2027		\$40,000
	2025-27 biennium		\$80,000

Source: JLARC staff analysis of DOR tax return data for fiscal years 2013 through 2022. Fiscal years 2023-2027 estimated based on taxpayer usage trends from fiscal years 2013-2019.

Note: DOR's taxpayer confidentiality policy prohibits disclosing tax return data for years with fewer than three taxpayers. JLARC staff reached out to businesses that used the preference in fiscal years 2020 through 2022 to obtain authorization to disclose the beneficiary savings. The businesses did not reply.

Statutory changes in 2010 may affect the amount that international service businesses owe in B&O taxes and the relative value of the preference

When the preference was enacted in 1998, Washington apportioned³ service income based on **where a business activity occurred**. Businesses that provided interstate or international services were taxed on the portion of their income earned from activities performed in Washington.

In 2010, the Legislature changed the apportionment of businesses' income so that it is based on **where a customer receives the benefit of the service**. DOR notes that the apportionment of service income has continued to evolve since 2010.

According to DOR, this change in the apportionment of income may impact the total amount a business owes in business and occupation (B&O) taxes and the relative value of this tax credit to qualifying businesses. JLARC staff did not have access to the detail needed to determine whether this change affected beneficiary businesses (e.g., type of services provided, who the services are performed for, where the customers receive the "product" of the service).

Beneficiaries did not respond to JLARC staff questions

JLARC staff sent a survey to the eight businesses that have used the preference since July 2012, asking for the business's experience using the preference. None responded.

3. Preference has not helped create or retain jobs

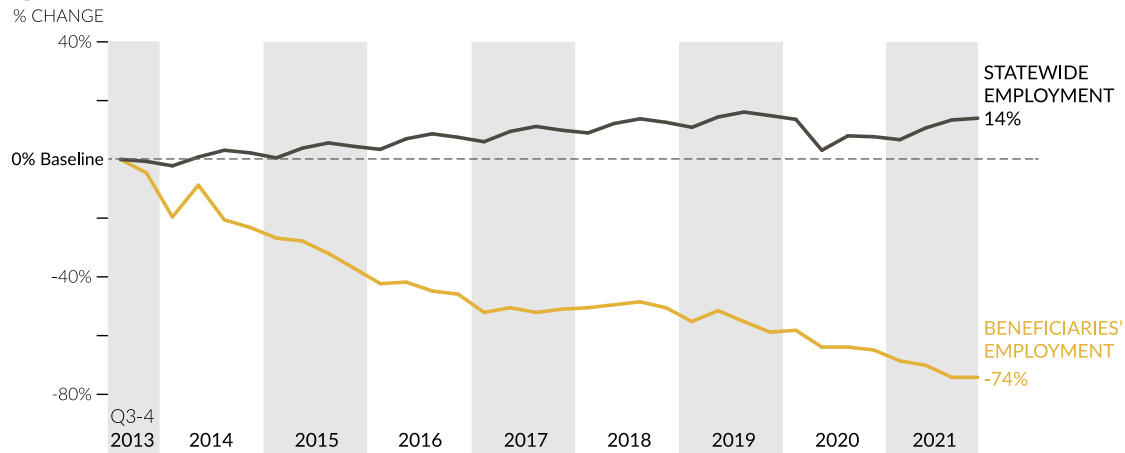
Preference has not achieved stated intent to attract and retain businesses. Employment at beneficiary businesses declined by 74%.

The 1998 Legislature stated its intent for the preference to attract and retain businesses that provide professional services to international customers. It specified that the preference's success should be measured by job growth at beneficiary businesses.

Beneficiaries' employment decreased by 74% from July 1, 2013, through December 31, 2021, while statewide employment grew by 14%.

³ Assigning a portion of a business's income to a particular state in order to determine how much state tax is owed.

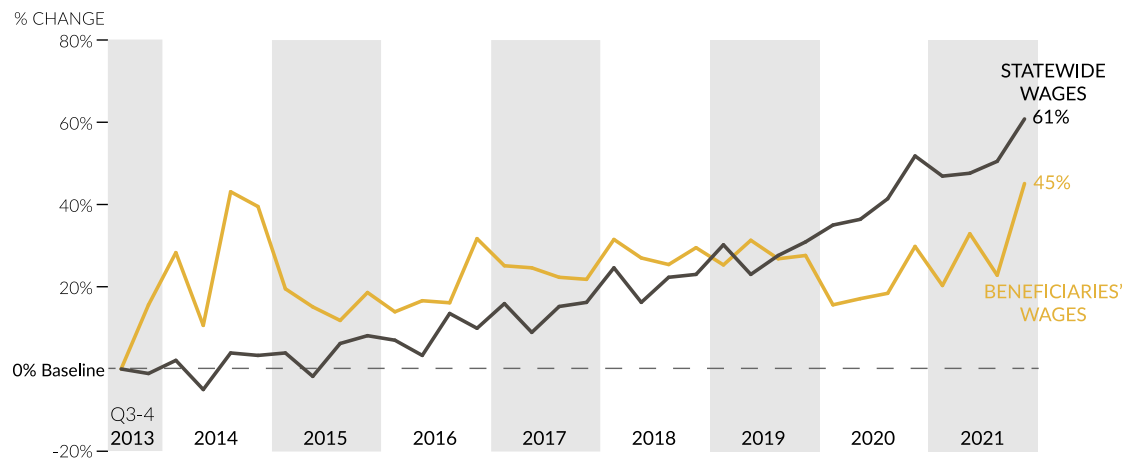
Exhibit 3.1: Beneficiary employment decreased by 74% and statewide employment increased by 14% between third quarter 2013 and fourth quarter 2021



Source: JLARC staff analysis of Employment Security Department Quarterly Census of Employment data for Washington total employment, all covered employment, and combined beneficiary employment for third quarter 2013 through fourth quarter 2021.

For the same period, wages for employees at beneficiary businesses increased but at a slower pace than the statewide average.

Exhibit 3.2: Average wages for beneficiary employees increased by 45%, while statewide average wages increased by 61%



Source: JLARC staff analysis of Employment Security Department Quarterly Census of Employment wage data for Washington total covered, total wages, all covered employees, and combined beneficiary wages for third quarter 2013 through fourth quarter 2021.

City economic development officials reported limited awareness of the preference

JLARC staff contacted city economic development officials and other staff in the six community empowerment zones (CEZs) and two international service districts (ISDs). Officials from five locations replied with one of the following responses:

- They were unaware of the preference.
- They didn't know if businesses in their cities had used the preference.
- The preference was not successful in recruiting businesses to their cities.

4. Applicable statutes

RCW 82.04.44525

Credit - New Employment for International service activities in eligible areas - Designation of census tracts for eligibility - Records - Tax due upon ineligibility - Interest assessment - Information from employment security department.

RCW 82.04.44525

1. Subject to the limits in this section, an eligible person is allowed a credit against the tax due under this chapter. The credit is based on qualified employment positions in eligible areas. The credit is available to persons who are engaged in international services as defined in this section. In order to receive the credit, the international service activities must take place at a business within the eligible area.
2.
 - a. The credit shall equal three thousand dollars for each qualified employment position created after July 1, 1998, in an eligible area. A credit is earned for the calendar year the person is hired to fill the position, plus the four subsequent consecutive years, if the position is maintained for those four years.
 - b. Credit may not be taken for hiring of persons into positions that exist on July 1, 1998. Credit is authorized for new employees hired for new positions created after July 1, 1998. New positions filled by existing employees are eligible for the credit under this section only if the position vacated by the existing employee is filled by a new hire.
 - c. When a position is newly created, if it is filled before July 1st, this position is eligible for the full yearly credit. If it is filled after June 30th, this position is eligible for half of the credit.
 - d. Credit may be accrued and carried over until it is used. No refunds may be granted for credits under this section.
3. For the purposes of this section:
 - a. "Eligible area" means: (i) A community empowerment zone under RCW 43.31C.020; or (ii) a contiguous group of census tracts that meets the unemployment and poverty criteria of RCW 43.31C.030 and is designated under subsection (4) of this section;
 - b. "Eligible person" means a person, as defined in RCW 82.04.030, who in an eligible area at a specific location is engaged in the business of providing international services;
 - c.

- i. "International services" means the provision of a service, as defined under (c)(iii) of this subsection, that is subject to tax under RCW 82.04.290 (2) or (3), and either:
 - A. Is for a person domiciled outside the United States; or
 - B. The service itself is for use primarily outside of the United States.
- ii. "International services" excludes any service taxable under RCW 82.04.290(1).
- iii. Eligible services are: Computer; data processing; information; legal; accounting and tax preparation; engineering; architectural; business consulting; business management; public relations and advertising; surveying; geological consulting; real estate appraisal; or financial services. For the purposes of this section these services mean the following:
 - A. "Computer services" are services such as computer programming, custom software modification, customization of canned software, custom software installation, custom software maintenance, custom software repair, training in the use of software, computer systems design, and custom software update services;
 - B. "Data processing services" are services such as word processing, data entry, data retrieval, data search, information compilation, payroll processing, business accounts processing, data production, and other computerized data and information storage or manipulation. "Data processing services" also includes the use of a computer or computer time for data processing whether the processing is performed by the provider of the computer or by the purchaser or other beneficiary of the service;
 - C. "Information services" are services such as electronic data retrieval or research that entails furnishing financial or legal information, data or research, internet access as defined in RCW 82.04.297, general or specialized news, or current information;
 - D. "Legal services" are services such as representation by an attorney, or other person when permitted, in an administrative or legal proceeding, legal drafting, paralegal services, legal research services, and court reporting services, arbitration, and mediation services;
 - E. "Accounting and tax preparation services" are services such as accounting, auditing, actuarial, bookkeeping, or tax preparation services;
 - F. "Engineering services" are services such as civil, electrical, mechanical, petroleum, marine, nuclear, and design engineering,

machine designing, machine tool designing, and sewage disposal system designing services;

- G. "Architectural services" are services such as structural or landscape design or architecture, interior design, building design, building program management, and space planning services;
- H. "Business consulting services" are services such as primarily providing operating counsel, advice, or assistance to the management or owner of any business, private, nonprofit, or public organization, including but not limited to those in the following areas: Administrative management consulting; general management consulting; human resource consulting or training; management engineering consulting; management information systems consulting; manufacturing management consulting; marketing consulting; operations research consulting; personnel management consulting; physical distribution consulting; site location consulting; economic consulting; motel, hotel, and resort consulting; restaurant consulting; government affairs consulting; and lobbying;
- I. "Business management services" are services such as administrative management, business management, and office management. "Business management services" does not include property management or property leasing, motel, hotel, and resort management, or automobile parking management;
- J. "Public relations and advertising services" are services such as layout, art direction, graphic design, copy writing, mechanical preparation, opinion research, marketing research, marketing, or production supervision;
- K. "Surveying services" are services such as land surveying;
- L. "Geological consulting services" are services rendered for the oil, gas, and mining industry and other earth resource industries, and other services such as soil testing;
- M. "Real estate appraisal services" are services such as market appraisal and other real estate valuation; and
- N. "Financial services" are services such as banking, loan, security, investment management, investment advisory, mortgage servicing, contract collection, and finance leasing services, engaged in by financial businesses, or businesses similar to or in competition with financial businesses; and

- d. "Qualified employment position" means a permanent full-time position to provide international services. If an employee is either voluntarily or involuntarily separated from employment, the employment position is considered filled on a full-time basis if the employer is either training or actively recruiting a replacement employee.
4. By ordinance, the legislative authority of a city, or legislative authorities of contiguous cities by ordinance of each city's legislative authority, with population greater than eighty thousand, located in a county containing no community empowerment zones as designated under RCW 43.31C.020, may designate a contiguous group of census tracts within the city or cities as an eligible area under this section. Each of the census tracts must meet the unemployment and poverty criteria of RCW 43.31C.030. Upon making the designation, the city or cities shall transmit to the department of revenue a certification letter and a map, each explicitly describing the boundaries of the census tract. This designation must be made by December 31, 1998.
5. No application is necessary for the tax credit. The person must keep records necessary for the department to verify eligibility under this section. This information includes:
 - a. Employment records for the previous six years;
 - b. Information relating to description of international service activity engaged in at the eligible location by the person; and
 - c. Information relating to customers of international service activity engaged in at that location by the person.
6. If at any time the department finds that a person is not eligible for tax credit under this section, the amount of taxes for which a credit has been used shall be immediately due. The department shall assess interest, but not penalties, on the credited taxes for which the person is not eligible. The interest shall be assessed at the rate provided for delinquent excise taxes under chapter 82.32 RCW, shall be assessed retroactively to the date the tax credit was taken, and shall accrue until the taxes for which a credit has been used are repaid.
7. The employment security department shall provide to the department of revenue such information needed by the department of revenue to verify eligibility under this section.

[2009 c 535 § 1104; 2008 c 81 § 9; 1998 c 313 § 2.]

Notes:

Intent—Construction—2009 c 535: See notes following RCW 82.04.192.

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

Intent—Findings—1998 c 313: "It is the intent of the legislature to attract and retain businesses that provide professional services and insurance services to international customers. To that end, the legislature finds that an incentive measured by a business's growth in jobs is a meaningful method of attracting and retaining such businesses. Therefore, the incentive in this act is

specifically targeted at "net new jobs." In addition, to further the impact and benefit of this program, this incentive is limited to those urban areas of the state, both in eastern Washington and western Washington, that are characterized by unemployment and poverty. The legislature finds that providing this targeted incentive will be of benefit to the state as a whole." [1998 c 313 § 1.]

Effective date—1998 c 313: "This act takes effect July 1, 1998." [1998 c 313 § 4.]

RECOMMENDATIONS & RESPONSES

Legislative Auditor's Recommendation

Legislative Auditor's Recommendation: Terminate

The Legislature should terminate this preference because it has not achieved the stated intent to attract and retain businesses to community empowerment zones or international services districts that provide professional services to international customers.

The Legislature may want to consult with the Department of Commerce and local economic development entities to consider other approaches to encourage business development in community empowerment zones.

Legislation Required: Yes

Fiscal Impact: Estimated \$80,000 increase to the general fund in future biennia.

Letter from Commission Chair

Letter from Commission Chair will be included in the proposed final report, planned for November 2023.

Commissioners' Recommendation

Commissioners' recommendation will be included in the proposed final report, planned for November 2023.

Agency Response

Agency response(s) will be included in the proposed final report, planned for November 2023.

MORE ABOUT THIS REVIEW

Study questions

Click image to view PDF of proposed study questions



B&O tax credit for creating new jobs in eligible areas that provide services to international customers

The 1998 Legislature created a \$3,000 B&O credit for each job created by businesses that:

- Are located in either a Community Empowerment Zone or other designated geographic area known as an International Services District.
- Provide certain professional services to international clients, or provide services outside the United States. Examples include computer, accounting, or engineering services.

Businesses may receive credits for the year the job is created and for four more years if the job is maintained.

This preference is included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.



Preference is intended to attract and retain businesses providing professional services to international clients and create new jobs in certain urban areas

The legislation creating the preference included an intent statement. The preference is intended to attract and retain businesses that provide professional services to international customers by incentivizing new jobs.

This study will address the following questions:

1. To what extent has the preference been used and what are the beneficiary savings?
 - a. What are the racial and ethnic characteristics of the beneficiaries using the tax preference and the new jobs created?
 - b. How do beneficiaries using the preference learn about it?
2. Have subsequent tax policy changes for services provided to out-of-state customers changed the taxation of international services?
3. How has employment changed for businesses that claim the preference?
4. To what extent has the preference attracted businesses providing professional services to international clients in qualifying areas?

In accordance with RCW 44.28.076, JLARC staff determined there are racial equity considerations for this study and they are included in the study questions above.

Study timeframe

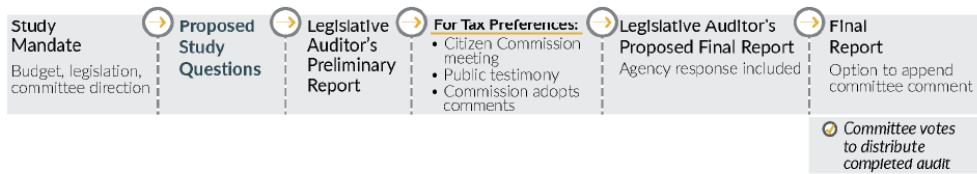
Preliminary Report: July 2023

Proposed Final Report: December 2023

Study team

Team Lead	Dana Lynn	(360) 786-5177	dana.lynn@leg.wa.gov
Research Analyst	Eric Whitaker	(360) 786-5618	eric.whitaker@leg.wa.gov
Project Coordinator	Eric Thomas	(360) 786-5182	eric.thomas@leg.wa.gov
Legislative Auditor	Keenan Konopaski	(360) 786-5187	keenan.konopaski@leg.wa.gov

JLARC Study Process



Washington Joint Legislative Audit and Review Committee
 106 11th Ave SW, Suite 2500
 PO Box 40910
 Olympia, WA 98504-0910

Phone: 360-786-5171
 Email: JLARC@leg.wa.gov

