State of Washington
Joint Legislative Audit and Review Committee (JLARC)

2007 Full Tax Preference Performance Reviews

Report 07-14

November 28, 2007

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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.

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Report Summary

What Is a Tax Preference?

Tax preferences are 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 more than 500 tax preferences.

Why a JLARC Review of Tax Preferences?

Legislature Creates a Process to Review Tax Preferences

In 2006, the Legislature expressly 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. The legislation assigns specific roles in the process to two different entities. The Legislature assigns the job of scheduling tax preferences, holding public hearings, and commenting on the reviews to a new Citizen Commission for Performance Measurement of Tax Preferences. The Legislature assigns responsibility for conducting the reviews to the staff of the Joint Legislative Audit and Review Committee (JLARC).

Citizen Commission Sets the Schedule

EHB 1069 directs the Citizen Commission for Performance Measurement of Tax Preferences to develop a schedule to accomplish a review of tax preferences at least once every ten years. The legislation directs the Commission to omit certain tax preferences from the schedule such as those required by constitutional law.

The Legislature also directs the Commission to consider two additional factors in developing its schedule. First, the Commission is to schedule tax preferences for review in the order in which the preferences were enacted into law, except that the Commission must schedule tax preferences that have a statutory expiration date before the preference expires. This means that Washington's longest-standing tax preferences are evaluated first.

Second, the legislation gives the Commission the option to schedule an expedited review for any tax preference that has an estimated biennial fiscal impact of $10 million or less. Expedited reviews incorporate a less detailed analysis than the full reviews of tax preferences.

In January 2007, the Commission adopted its first ten-year schedule for the tax preference reviews. The schedule for 2007 included a total of 22 tax preferences with 14 property tax, four business and occupation tax, three fuel tax, and one sales tax deferral. Of these 22, six tax preferences were slated to undergo the full review process.

JLARC Staff Conduct the Tax Preference Reviews

JLARC's assignment from EHB 1069 is to conduct the reviews of tax preferences according to the schedule developed by the Commission and consistent with the guidelines set forth in statute. This report presents JLARC's reviews for the six tax preferences scheduled by the Commission for full review.

JLARC's Approach to the Tax Preference Reviews

Consistent with the Scope and Objectives for conducting the full tax preference reviews, JLARC has evaluated the answers to a set of ten questions for each tax preference:

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?
2. What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives?
3. To what extent will continuation of the tax preference contribute to these public policy objectives?
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?

Beneficiaries:

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

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?
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?
9. If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes?

Other States:

10. Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

Methodology

JLARC staff analyzed the following evidence in conducting these full reviews: 1) legal and public policy history of the tax preferences; 2) public policy objectives of the tax preferences; 3) beneficiaries of the tax preferences; 4) government data pertaining to the utilization of these tax preferences and other relevant data; 5) economic and revenue impacts of the tax preferences; and 6) other states' laws to identify any similar tax preferences.

Staff placed particular emphasis on the legislative history of the tax preferences, researching the original enactments as well as any subsequent amendments. Staff reviewed State Supreme Court, lower court, or Board of Tax Appeals decisions relevant to each tax preference. JLARC staff conducted extensive research on other state practices using the Commerce Clearing House database of state laws and regulations.

Staff interviewed the agencies that administer the tax preferences (primarily the Department of Revenue and the Department of Licensing), as well as several county assessors. These parties provided data on the value and usage of the tax preference and the beneficiaries. Data was also obtained from other state and federal agencies to which the beneficiaries are required to report. In several cases, additional information was provided to JLARC staff from the beneficiaries of the tax preference or other agencies that had special knowledge of either the tax preference or the beneficiaries.

It is not within the purview of these reviews to resolve or draw definitive conclusions regarding any legal issues that are discussed within the reviews.

Summary of the Results from JLARC's Reviews

The table on page 5 provides a summary of the results from JLARC's analysis of the tax preferences scheduled for full review in 2007. Of the six tax preferences included in this volume, this report recommends that the Legislature continue four of the current tax preferences. The report raises issues for the Legislature's consideration for two of the current tax preferences.

Organization of This Report

This report includes a separate section for each of the six tax preferences. Each section begins with a summary of the findings and recommendations from JLARC's analysis of that individual tax preference. Then, each chapter provides additional detail on that tax preference, including additional information supporting the answers to the questions outlined in the approach. Appendices provide the text of current law for each preference as well as an explanation of JLARC's property tax estimation procedure.

Additional Background Information on Charitable and Nonprofit Organizations

At the Legislature's direction, many of Washington's oldest tax preferences are being reviewed first in this overall tax preference review process. Several of these date back to legislative actions in early statehood or even Territorial days. The majority of these earliest exemptions reviewed in 2007 involve charitable and nonprofit organizations. To provide context for the individual sections that follow, this report summary concludes with some general information about tax preferences for charitable and nonprofit organizations.

Some of the oldest tax preferences in Washington are property tax exemptions for charitable organizations such as churches, cemeteries, orphanages, hospitals, homes for the aged, and libraries. This is consistent with the general history of the United States and with the treatment of such institutions in the colonies under British law, with some exemptions dating as far back as 1601.

By 1904, the State of Washington had recorded 250 charitable organizations. Charitable organizations have grown and diversified over the ensuing years. In 2006, the Secretary of State registered 21,850 exempt public charities, as well as more than 50,000 nonprofit corporations. Nonprofit organizations cover a wide variety of institutions including entities that provide services in education, health care, credit unions, labor unions, chambers of commerce, and many others.

It is common to describe charitable organizations as nonprofit organizations. However, the term "nonprofit" comes with several specific qualifications. In state law, all regular nonprofit corporations have guidelines outlined in Chapter 24.03 RCW. There are various types of nonprofit organizations distinguished in federal law. Nonprofit organizations apply to the federal Internal Revenue Service (IRS) to establish their tax exempt status. A public benefit nonprofit organization is organized and eligible for tax exempt status under 26 U.S.C. 501(c)(3). These nonprofit organizations are common and are referred to as "public charities." Nonprofit organizations have a wide range of public charitable activities and purposes. According to federal law, the promotion of health for the benefit of the community is considered a charitable purpose.

Some of the primary requirements that all nonprofits must meet are organizational restrictions on what can be done with the organizations' profits. Essentially, a nonprofit may not lawfully pay its profits to owners or to anyone associated with the organization. In addition, upon dissolution of the nonprofit, its assets must be distributed exclusively for charitable purposes. Another requirement is that the organization must have only a small part of its activities which is not furthering its charitable purpose. In addition to a restriction on the distribution of profits, a "nonprofit" designation also requires limitations on lobbying efforts and in political activities or efforts to influence legislation.

For charitable health care providers, there is an additional requirement of demonstrating community benefits. The standard adopted in 1969, and still in place today, does not require health care organizations to provide a specific level of care to the poor in order to qualify for the tax exemption. Instead, the IRS has established a "community benefit" standard, allowing the IRS to weigh several factors regarding provision of services to the community as a whole.

In exchange for the constraints on distribution of profits and business activities, nonprofits receive a variety of tax and subsidy benefits. At the federal level, nonprofits do not pay corporate taxes. At the state and local level, many nonprofits are eligible for one of several property tax exemptions. Nonprofits also receive an exemption for the state business and occupation tax for their income from contributions and donations, membership dues and fees, and grants.

Summary of Recommendations – 2007 Tax Preference Reviews

Tax Preference	Year Enacted	RCW Citation	# of Claimants in 2006 ($ amount)	Summary of Recommendation
Churches, parsonages and convents (p. 31)	1854	RCW 84.36.020	5,137 ($66 million)	Legislature should continue the tax preference
Cemeteries (p. 59)	1854	RCW 84.36.020	196 ($7.4 million)	
Household goods (p. 71)	1935	RCW 84.36.110(1)	2.4 million ($341 million)	
Refund of fuel tax for exported fuel (p. 83)	1923	RCW 82.36.300 RCW 82.38.180(2)	89 ($1.3 million)	
Nonprofit hospitals (p. 7)	1886	RCW 84.36.040(1)(e)	45 ($47 million)	Legislature should re-examine or clarify the intent of the tax preference*
Nonsectarian organizations (p. 43)	1915	RCW 84.36.030(1)	651 ($17 million)	

* See specific sections for detail on the issues recommended for the Legislature's consideration.

NONPROFIT HOSPITALS – SUMMARY

Current Law

Under current law, all real and personal property of nonprofit hospitals are exempt from property taxes. The main requirements for this tax exemption in state law are that the property be used exclusively for the purposes of the hospitals and that the benefits of the exemption inure to the user, the nonprofit entity. Appendix 3 includes the current law statute, RCW 84.36.040(1)(e), which provides for the property tax exemption.

Findings and Recommendations

This review of Washington's nonprofit hospitals' property tax exemption has evaluated the legal history, public policy objectives, economic and revenue impacts, and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- The property tax exemption for hospitals dates back to an 1854 section exempting "benevolent, charitable, literary, or scientific" institutions, various government properties, schools, cemeteries, and public libraries from the tax base. A public policy objective of this tax preference, as it was initially written, was to define the property tax base.
- An 1895 law established that hospitals had to be supported in whole by public appropriation or by private charity, or had to ensure that all income and profits were devoted to charitable purposes. This indicates an historic public policy objective that hospitals had to be performing charitable services to communities.
- The original property tax exemption applied to all hospitals that met the charity conditions. In 1973, the Legislature narrowed the exemption to nonprofit hospitals only. The 1973 legislation did not include a clear statement of the Legislature's intent in making this change.
- The 1973 legislation created a direct connection between qualifying for this tax preference and meeting the federal requirements for nonprofit organizations in order to receive the "nonprofit" designation. There are various federal requirements for nonprofit organizations, which restricts their distribution of income and includes a requirement to provide community benefits.
- In 1984, the Legislature specified that this property tax exemption is only allowed for the property of a hospital that is used exclusively for the purposes for which the exemption is granted, e.g. hospital purposes. Due to a lack of clarity in state law, court cases and board rulings are defining which hospital properties and services are eligible for the property tax exemption. It is unclear which hospital services the Legislature intended to be exempt when this language was enacted.

- This tax preference has achieved the public policy objective of defining the property tax base to provide property tax relief to nonprofit hospitals in order to support hospital services for the sick.
- It is not clear how well nonprofit hospitals have met expectations for charitable services and community benefits as compared to the performance of private for-profit hospitals.

Beneficiaries

- The beneficiaries from this property tax exemption are 45 nonprofit hospitals that received an exemption in property tax year 2006-07.
- There is no indication of this tax preference providing unintended benefits to other hospitals.

Economic and Revenue Impacts

- In property tax year 2006-07, the nonprofit hospitals had an annual property tax savings of approximately $47 million.
- The future property tax savings for nonprofit hospitals over the next three years is between $50 and $58 million per year.
- According to Washington Employment Security Department data for 2005, Washington general medical and surgical hospitals had nearly 62,000 employees and paid more than $2 billion in wages. Based on Department of Health report for 2005, nonprofit hospitals employed 72 percent of all full-time equivalent hospital employees.

Other States

- Forty states and the District of Columbia, have specific provisions to exempt certain hospitals from property taxes as charitable institutions. There are 11 states that do not specify hospitals as an exempt class of property, but some hospitals may qualify for the property tax exemption in these states as a charitable institution. The majority of states have no restrictions on the hospital property other than it must be owned by a nonprofit organization. Some states, however, have imposed restrictions and specific threshold tests for nonprofit organizations to meet in order to qualify for a property tax exemption.

Due to the fact that this tax preference was originally enacted to exclude all hospitals from the property tax base and that the beneficiaries of the tax preference are hospitals, this tax preference has achieved its first public policy objective of defining the tax base. There is little guidance in state law regarding which services are exclusively hospital service so it is unclear which hospital services the Legislature intended to be tax exempt for nonprofit hospitals.

With regard to the second public policy objective, it is clear from the legislative history that there was an early connection between this tax exemption and hospitals' provision of charitable services to local communities. It is less clear what the Legislature's additional intentions were in restricting the tax preference to nonprofit hospitals beginning in 1973. In the administration of this tax preference, the Department of Revenue has connected to the federal requirements of nonprofits in order to qualify for this tax preference but it is unclear what the expectations were for nonprofit organizations. The federal law has a "community benefit standard" to determine if hospitals qualify and can retain their tax-exempt status as nonprofits. The "community benefits standard" does not specify a certain amount of charity care or even any charity care be provided by hospitals to qualify for tax-exempt status, even though it is a component of community benefit. In addition, there are limitations in federal law on the distribution of profits and assets of nonprofit organizations but it is unclear what characteristics the Legislature intended nonprofit hospitals to possess.

In terms of meeting this second policy objective, JLARC's analysis shows that private for-profit hospitals (that do not receive the property tax exemption) have traditionally had a higher percentage of total revenue from low-income Medicaid patients. In recent years, there are mixed results about whether nonprofit hospitals are providing more charity care as a percent of adjusted revenue than for-profit hospitals not receiving the tax exemption. Overall, the data do not support the premise that the nonprofit hospitals are serving more low-income patients than other hospitals, in terms of percentage of hospital revenue. Information is not available that would allow for a comparison among all hospitals of other community benefits that hospitals may provide, such as educational seminars or medical screening programs. So it is not clear that the current tax preference is accomplishing a public policy objective related to provision of additional charitable services or community benefits, as compared to other types of hospital ownerships.

Currently, there is different tax treatment among hospitals because for-profit hospitals are typically serving more low-income Medicaid residents and providing nearly comparable charity care without a property tax exemption. In addition, other nonprofit nonsectarian organizations, also seeking a property tax exemption, have to meet a gift giving test that demonstrates that the nonprofit organization is providing services at or below costs or is providing other charitable services to local communities. This test is not required of nonprofit hospitals.

Recommendation 1

If the Legislature intended to provide a nonprofit hospital property tax exemption under the assumption that these organizations were providing more charity or low-income care than other hospitals, then the Legislature should modify the property tax exemption to be dependent on meeting a threshold of charity or low-income care.

Legislation Required:	Yes
Fiscal Impact:	A change in revenue could be possible depending on how this is implemented.

Recommendation 2

If the Legislature wants additional information on community service activities performed by hospitals, then it should require hospitals to report an annual community services inventory.

Legislation Required: Yes
Fiscal Impact: N/A

Recommendation 3

The Legislature should clarify which specific services provided by nonprofit hospitals qualify for a property tax exemption.

Legislation Required: Yes
Fiscal Impact: A change in revenue could be possible depending how it is implemented.

NONPROFIT HOSPITALS – REPORT DETAIL

Statutory History

The property tax exemption for hospitals predates the establishment of the state and is consistent with the general history of the U.S. and the colonies under British law, which exempted charitable institutions from various taxes as far back as 1601. The general exemption for hospitals dates back to an 1854 section exempting "benevolent, charitable, literary, or scientific" institutions, various government properties, schools, cemeteries, and public libraries from the tax base. This tax preference is a definition of the tax base.

The specific tax exemption for hospitals was initially an 1891 section stating that hospitals were not to be part of the tax base:

> All property in this section shall be exempt from taxation:
> all free…, <u>hospitals…, homes for the aged and infirm, …;</u>

In 1893, the law restricted the size of the exempt parcel of land to 120 feet by 200 feet. In addition, the law required the grounds to be used exclusively for purposes of the exempt organization. In 1895, the law placed a requirement on hospitals that they must be supported in whole by public appropriation or by private charity or must be supported in part by charity and all of the income and profits had to be devoted to charitable purposes.

In addition to this specific requirement related to charitable purposes, the Legislature also added record-keeping requirements, which it then adjusted in the ensuing years. In order to qualify for the property tax exemption in 1895, the state Board of Health, county, and city officials had to have access to the financial records of the institutions, and the manager of the hospital had to swear before the county assessor that all income had been applied to actual expenses of maintaining the hospital and to charitable purposes. The hospital had to annually file a report to the state Board of Health describing the source of its receipts and the expenses that were paid. The law required that the hospitals allow the mayor of the city and the chairman of the board of the county commissioners, where the institution was located, to be on its board of trustees.

In 1925, the Legislature adjusted the law to allow hospitals to rent or lease property for use in their institutions, and all the property used would qualify for the property tax exemption. In 1933, the Legislature removed the requirement that the mayor and chairman of the county commissioners needed to serve on the hospital board. In addition, the law required that just the state Board of Health, not the city and county officers, had access to the hospitals' financial records.

In 1969, the reporting and auditing requirement for hospitals changed from the state Department of Health to the Department of Revenue. The law deleted the requirement that the manager of the hospital take an oath before the assessor and instead required the hospital's manager to sign a statement that the income and receipts had been applied to the actual expenses of maintaining the institution.

The Legislature made major changes in 1973 to the statutes regarding the property tax exemption for many nonprofits including hospitals. The Legislature narrowed the exemption from all hospitals to only nonprofit hospitals. The Legislature also defined "nonprofit" in statute to mean that no part of income could be paid directly or indirectly to members, directors, stockholders, officers, or trustees except for services rendered and the salary paid to officers had to be comparable to public officials' salaries.[1] The revised property tax exemption was dependent on the property being used exclusively for the purposes of the nonprofit organizations, and the benefits of the exemption had to accrue to the nonprofit organization. All of the annual report filing requirements for hospitals were moved to another section of law that required most organizations to report to the Department of Revenue annually in order to receive a property tax exemption.[2]

In 1984, the Legislature specified that all property must be used exclusively for the purposes for which the exemption is granted, which are exclusively hospital purposes.

Federal Requirements for Nonprofits

The state Legislature's change in 1973, to narrow the tax exemption to nonprofit hospitals, created a direct connection between qualifying for this tax preference and meeting the federal requirements for organizations to receive the "nonprofit" designation. According to federal law, the promotion of health for the benefit of the community is a charitable purpose. A hospital may qualify for tax-exempt status under IRC 501(c)(3) provided it is organized and operated exclusively for charitable purposes. There are various federal requirements for nonprofit organizations including organizational tests and meeting a "community benefits" standard.

Organizational Test

The organizational test is the same for health care organizations as it is for any other IRC 501(c)(3) organizations.[3] The health care organization must be operated exclusively for charitable purposes and that upon dissolution of the nonprofit, its assets must be distributed exclusively for charitable purposes. Another requirement for nonprofit organizations is that the organization must have only a small part of its activities which is not furthering its charitable health purpose. The federal law also stipulates that no part of an organization's net earnings can be distributed in whole or part to benefit private shareholders or individuals. Essentially, a nonprofit may not lawfully pay its profits to owners or to anyone associated with the organization. These requirements are also in Washington State law.[4] Along with these tests, there are also restrictions placed on lobbying efforts and political activities to influence legislation.

[1] RCW 84.36.800(4).

[2] RCW 84.36.840.

[3] "Health Care Provider Reference Guide," IRS by Janet Gitterman and Marvin Friedlander.

[4] RCW 24.03.

Community Benefits

Federal policy requires hospitals to provide community benefits in order to qualify as tax exempt nonprofit entities. Prior to 1969, when the Internal Revenue Service adopted the community benefit standard, indigent care was the primary measure for the federal tax exemption. The standard adopted in 1969 and still in place today does not require hospitals to provide a specific level of care to the poor in order to qualify for tax exemption. Instead, health care organizations must demonstrate that they provide sufficient benefits to the community.[5] Other factors that demonstrate that the hospital is operating for the benefit of the public may also be considered. Some factors that may be considered are whether the hospital conducts medical training or research activities, engages in activities to educate the public on health matters or provides types of health care services not otherwise available in the community.

Washington State does not require health care organizations to identify and inventory their community benefits but the Washington State Hospital Association (WSHA) has conducted surveys of 32 of their nonprofit hospitals to completed Community Benefits Inventory Reports on Washington Hospitals. The most recent report on hospital activities in fiscal year 2005 determined that nonprofit hospitals spent $502.89 million in community benefits. Of that $500 million, 80 percent, or $400 million, of that was for low-income patient care shortfalls and the remaining 20 percent was spent on community services.[6] This WSHA report estimated the total value of all federal, state and local tax benefits for these surveyed nonprofit hospitals at $269.3 million. JLARC did not verify the accuracy of the findings in this report.

Board of Tax Appeals and Court Cases on Administration of the Tax Preference

The property tax exemption for nonprofit hospitals is quite technical to administer, given the language in the statute that the property be used exclusively for hospital purposes. Hospitals are often times performing different health care functions based on the availability of other health care services in local communities; this adds to the complexity in administering this hospital tax exemption.

There have been numerous cases before the Board of Tax Appeals over the years due to difficulty in administering this tax exemption. Since the property tax exemption does not apply to all facilities and services performed by a hospital but only to those that are exclusively for hospital purposes, there must be a division made between different types of health care services and facilities. The property tax exemption is determined on a parcel-by-parcel basis and is based on the particular service performed at that facility. Some parcels are only partially tax exempt if certain services are performed in those facilities which are not exclusively for the care of the sick.

Based in part on court decisions and board rulings, there are now criteria defining which property qualifies for this tax preference. There is a requirement that the exempt hospital

[5] "A Review of the Tax-Exempt Hospital Sector," written statement of Mark Everson Commissioner of Internal Revenue Before the Committee on Ways and Means United States House of Representatives May 26, 2005.

[6] Community Benefits Inventory Annual Report, Washington State Hospital Association, December 2006.

property generally be for a facility that provides 24-hour care and is an essential part of the central functions of the hospital.[7] In another case, Northwest Hospital v. DOR, the Board of Tax Appeals found that the Department of Revenue was correctly assessing property taxes on certain hospital buildings but one facility was a surgery ambulatory center.[8] The Board found that the hospital should have been allowed the property tax exemption for that building as well. Criteria used to determine if facilities are taxable include the following:

- Does the hospital own the facility which is providing the services? To what degree is the hospital serving outpatients at that facility?
- Are the facility's services typically provided in a hospital or medical clinic setting?
- Do the services provided at the facility meet the definition of hospital (defined in RCW 70.41.020(4))?
- Is the facility an integrated part of the main hospital campus?
- Is the use of the facility exclusively for the hospital purpose of providing care to the sick?
- Is the function provided by the facility necessary for operating the hospital?

Typically, property which has outpatient care services has not qualified for a property tax exemption.[9]

In the Yakima Valley Memorial Hospital v. DOR case, a hospital claimed that its home health facility owned by the hospital should be considered an integral part of the hospital even though it provided strictly outpatient home health care to former patients of the hospital.[10] The Board noted the following in that case:

> Much of the difficulty in establishing the line between taxable and nontaxable hospital services stems from the changing role of the hospital in the health care system. Medical practice changes, at least partly attributable to economics, have resulted in shorter hospital stays and the development of alternatives to hospitalization.

The Board noted further that, "We must examine with care exemption claims which are based on the status of the exempt organizations rather than on the type of service provided."

The Board found in this case that the home health care facility of the hospital should not be property tax exempt because many of the types of services performed by the facility are not

[7] In the case Group Health Cooperative of Puget Sound, Inc. v. Washington State Tax Commission (1967), the Court ruled that certain physicians' offices and examining rooms were exempt from property tax because the medical clinic functions were located within the main campus of the hospital and formed an integral, interrelated and essential part of the central facility. The clinic also provided the same 24-hour care and emergency services which are part of a normal hospital.

[8] Northwest Hospital v. Washington State Department of Revenue, (1989), Docket Nos. 88-6, 88-12 & 88-13.

[9] In the Board of Tax Appeals cases Kadlec Medical Ctr v. Department of Revenue (1987) and Virginia Mason. Hospital Ass'n and Virginia Mason Clinic v. Department of Revenue, both cases found that services provided on an outpatient basis do not qualify for a property tax exemption.

[10] Yakima Valley Memorial v. Washington State Department of Revenue, (1998), Docket No. 49902.

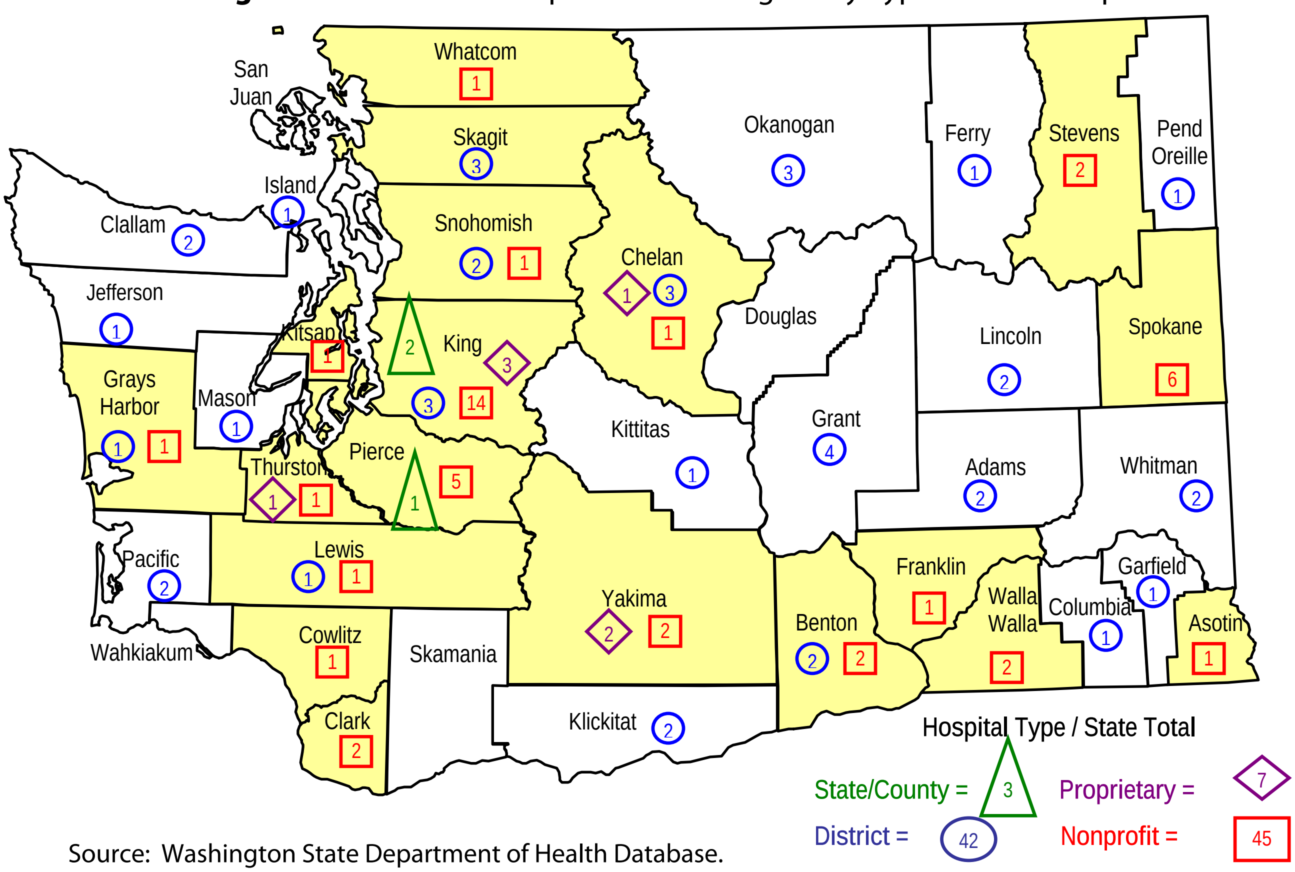
performed exclusively by hospitals. These services are also performed in private, for-profit nursing homes and other types of care centers. In addition, the home health care facility did not provide continuous services to "inpatients" of the hospital and therefore did not meet the criterion of "exclusive use."

Additional Background on Washington Hospitals

Washington has a long history of providing care to the sick. The first hospital, St. Joseph Hospital, opened in 1858 at Fort Vancouver and provided a variety of health care services to pioneers. By 1900, 12 Washington cities had hospitals: Vancouver, Aberdeen, Port Angeles, Olympia, Port Townsend, Everett, Seattle, Tacoma, Yakima, Walla Walla, Spokane, and Colfax. Many of the early hospitals were started by religious organizations. Most of the early hospitals, up until 1900, were started by religious or other charitable organizations with a few exceptions.

More than 100 years later, in 2005, there were 97 hospitals operating in the state with a range of ownership configurations: 45 nonprofit hospitals, 42 hospitals from special public hospital taxing districts, seven hospitals owned by private for-profit companies, one hospital owned by King county (Harborview Medical Center), one hospital owned by Pierce county (Puget Sound Behavioral Health), and one hospital owned by the state (University of Washington Medical Center).[11] Figure 1 identifies the location of these hospitals by county with the shaded counties

Figure 1: Number of Hospitals in Washington by Type of Ownership



Source: Washington State Department of Health Database.

[11] The Washington State Department of Health – CHS/Hospital and Patient Data, 2005.

having at least one nonprofit hospital. The majority of the nonprofit hospitals are in more urban counties like King, Snohomish, Spokane, Pierce and Thurston.

In 2005, operating revenue for all hospitals totaled $11 billion. Nonprofit hospitals accounted for 75 percent of this total ($8.29 billion), followed by government-owned hospitals at 22 percent ($2.39 billion) and private for-profit hospitals at three percent ($334 million).[12]

Public Policy Objectives

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?

The statutory history for this tax preference indicates several public policy objectives for this tax preference. Tax base defining theory states that at the time Legislatures are developing a tax, they will define the elements that will be subject to the tax and the elements excluded. The first objective of this tax preference is one of defining the property tax base since this exemption was enacted at the time of statehood and is consistent with the general history of the U.S. and with exemptions for charitable institutions dating back to colonial days under British law. There has been a traditional public policy objective of exempting hospitals from the tax base under one or more of the benevolent, charitable, or scientific institution categories. In an 1866 case, the U.S. Supreme Court recognized this long-standing exemption of hospitals from taxes:

> It is known as sound policy that, in every well regulated and enlightened state or government, certain descriptions of property, and also certain institutions—such as churches, hospitals, academies, cemeteries, and the like—are exempt from taxation; but these exemptions have never been regarded as disturbing the rates of taxation, even where the fundamental law had ordained that it should be uniform. [13]

A second public policy objective for hospitals relates to hospitals' work for charitable purposes and community benefits. In 1895, the Legislature placed a requirement on all hospitals that they must be supported in whole by public appropriation or by private charity or must be supported in part by charity and all of the income and profits had to be devoted to charitable purposes. While this provision is no longer in place, in 1973, the Legislature narrowed the use of the tax exemption from all hospitals to nonprofit hospitals only. As discussed earlier, there are federal requirements related to charitable purposes and community benefits that the nonprofit hospitals must meet in order to receive their official designation as a nonprofit organization.

Since 1895, all hospitals, receiving this property tax exemption, had annual reporting requirements in which they had to provide information on their revenue sources and expenditures. A third public policy objective for this property tax exemption was that this property tax exemption be limited to nonprofit hospitals due to the profit and asset restrictions

[12] The Washington State Department of Health – CHS/Hospital and Patient Data.

[13] People v. Commissioners, 71 U.S. 244, 256 (1866).

placed on these organizations so the net earnings will be used for charitable purposes. From the beginning of this tax preference, there was a public policy objective that these quasi public institutions should be accountable for the sources of their revenue as well as their expenditures. It appears that the Legislature assumed in 1973 that in restricting the property tax exemption to nonprofits, it would be meeting those requirements by connecting to the federal definition and requirements of charitable hospitals. There was not a clear statement of any further change in public policy objective in the Legislature's narrowing of the exemption to nonprofit hospitals only.

A fourth public policy objective of this property tax exemption for hospitals was that the exempt property had to be used exclusively for hospital purposes. The property tax exemption is only allowed on property of a hospital that is used exclusively for the purposes for which the exemption is granted. The purpose of the property tax exemption is for hospitals to care for the sick and infirm patients. Over the years, as the types of services provided by hospitals has grown, the definition of a hospital's purpose as treating sick inpatients has generally not included outpatient services for the property tax exemption. This public policy objective of which hospital property is taxable and which is exempt is being driven by court cases and board rulings.

Another objective of this property tax exemption for nonprofit hospitals is that it provides them with the same tax treatment as government owned public hospitals. There are other reasons noted by academics on why nonprofit organizations in the health arena have been tax exempt. One argument is that universities and hospitals were expensive to build and the owners needed access to capital. One of the best sources of capital was voluntary, community-based endowments which were more likely to be given to nonprofit organizations.

What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives?

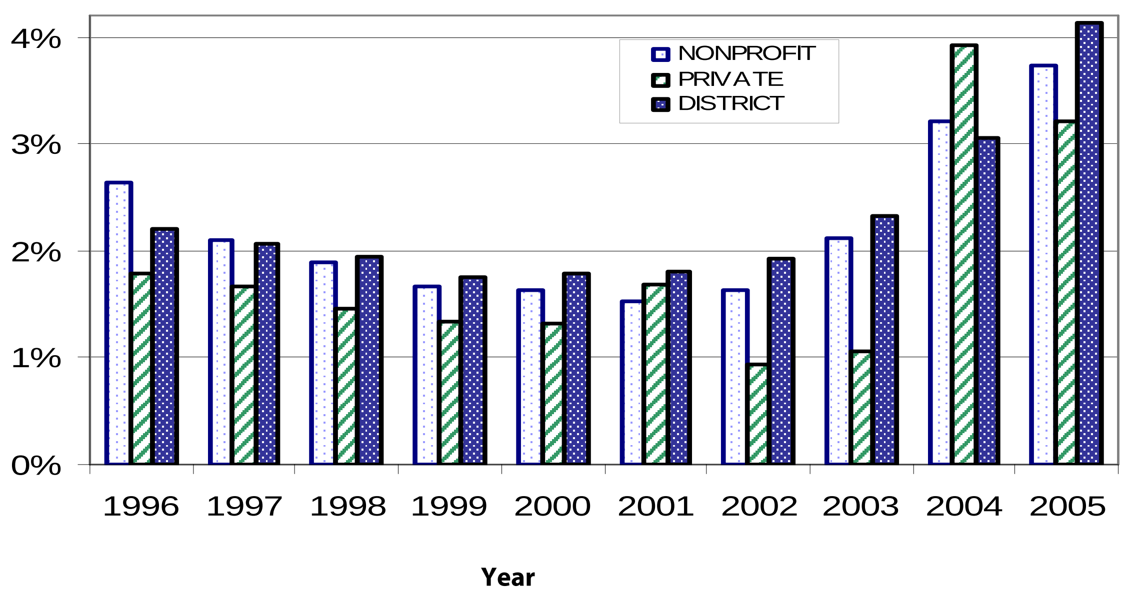
After examining the Department of Revenue's property tax exemption database, the entities claiming this property tax exemption are nonprofit hospitals so this tax preference has achieved its objective of providing a tax preference to certain hospitals which are nonprofit as part of defining the property tax base. This tax preference does meet the objective of providing equal tax treatment for most hospitals in Washington since both government run and nonprofit hospitals have a property tax exemption. It is unclear if the public policy objective of allowing the property tax exemption for property used exclusively for hospital purposes is being fulfilled. In the administration of this tax preference, it does not appear to be providing uniform tax treatment to all types of hospital services. For example, certain doctor's clinics, owned by nonprofit hospitals, which are located within the main part of the hospital campus and are providing services exclusively for the patients of the hospital which is a necessary function for the operation of the hospital, are likely exempt from property taxes. On the other hand, another doctor's clinic, which is owned by a nonprofit hospital, which is not part of the main hospital campus and is serving a large portion of outpatients and is not an integrated and necessary function for the operation of the hospital is likely not property tax exempt.

- To assess whether the tax preference has achieved the second public policy objective of providing charitable services to local communities, JLARC staff analyzed the available information on hospital data by different ownership types for charitable services and community benefits using three factors: 1) charity care; 2) Medicaid patients; and 3) other types of community benefits. The first two factors are based on the Department of Health – CHS/Hospital and Patient Data Systems that includes reports that hospitals must file annually. The hospitals are separated as either nonprofit, private and others.[14]

1) Charity Care

Charity care is hospital care rendered to people who are unable to pay for the care or to pay for the deductibles or co-insurance amounts required by a third-party payer. A person qualifies for charity care if the family income is below 200 percent of the federal poverty level. Typically, hospitals restrict their uncompensated health care programs to individuals unable to access entitlement programs such as Medicaid,[15] unable to pay for medical obligations or to those with limited financial resources.[16]

Figure 2: Charity Care as Percent of Adjusted Revenue by Ownership Type: 1996-2005



Source: Washington Department of Health Hospital and Patient database.

[14] This includes public hospital districts, county owned hospitals and a state owned hospital.

[15] Medicaid is health insurance for low-income individuals and families who fit into an eligibility group that is recognized by federal and state law.

[16] Examples of patients that could be classified as a charity care patient would be the following: recently unemployed, employer does not provide health insurance, those whose health insurance requires high deductibles or co-payments, homeless, retired persons not yet eligible for Medicare or the elderly who have limited or no Medicare supplemental insurance coverage.

Since 1991, the Washington Legislature has required all hospitals to provide some charity care, regardless of type of ownership.[17] Annually, each hospital reports to the Department of Health total charges for charity care and bad debt as part of the hospital's year end financial report.[18] Washington hospitals' charity care has been rising rapidly. Over the past ten years, the total amount of charity care provided by Washington hospitals has grown from $101.4 million in calendar year 1996 to $521 million in 2005. The amount of charity care ranged from $0 to $139 million in calendar year 2005 which reflects hospital differences in their size, types of services provided, provisions for charity care in their mission statements and characteristics of local communities. JLARC staff reviewed the Department of Health's data on charity care as a percentage of adjusted revenue to see if nonprofit hospitals provide more charity care than private and other government run hospitals, see Figure 2. There is an upward trend in charity care as a percent of adjusted revenue which is consistent among all hospitals. On average over this ten-year period, nonprofit and for-profit hospitals' charity care as a percent of adjusted revenue has been similar at 2.2 percent and 1.8 percent, respectively.

2) Medicaid Hospital Patients

In addition to charity care, another way in which hospitals provide services to low-income residents by providing care to Medicaid eligible patients. JLARC staff reviewed Medicaid revenues as a percentage of total revenues to see if nonprofit hospitals have a greater percentage of Medicaid revenues as compared to private and government run hospitals.

Medicaid is available for low-income individuals who cannot afford care. The payments from Medicaid and Medicare[19] do not cover charity care. For health care organizations, the Medicaid reimbursement rate in the state becomes a critical factor in hospitals' financial picture. In Washington, Medicaid rates for health care facilities are set individually for each facility. It is a cost based rate system based on a facility's costs, its occupancy level, and the individual health care needs of its patients. The Medicaid payment rate system does not guarantee that all allowable costs relating to the care of Medicaid residents will be fully reimbursed. Hospitals adjust their private pay rates to recoup the uncompensated care and any un-reimbursed costs from Medicaid patients.

Over the past ten years, hospital revenue from Medicaid patients has been growing from $964.6 million in 1996 to $3.36 billion in 2005. This corresponds to an annual increase of 25 percent in this type of hospital revenue. In 2005, nonprofit hospitals collected $2.49 billion or 74 percent of all Medicaid revenue. Private for-profit hospitals collected $102 million, (3 percent of all Medicaid revenue), public district hospitals collected $287.6 million (8.6 percent of all Medicaid revenue), the county hospital collected $275 million (8.2 percent of all Medicaid revenue) and the state owned hospital collected $206.9 million (6.2 percent). Medicaid as a percent of total revenue

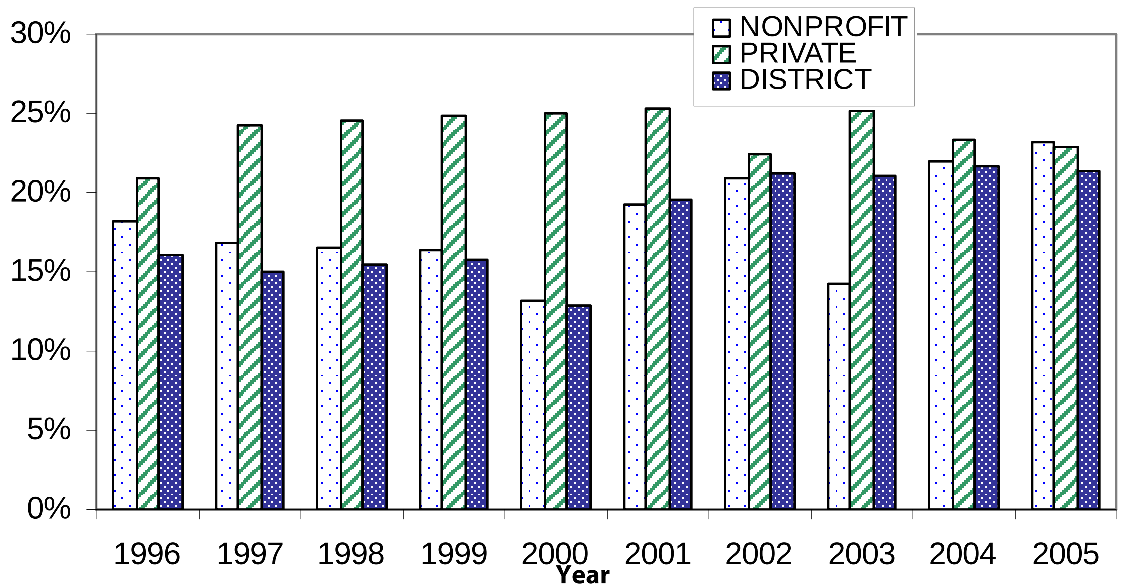
[17] RCW 70.170 and WAC 246-453.

[18] Bad debt is uncollectible accounts arising from a patient's unwillingness to pay and charity care is patients who can not afford to pay or have an inability to pay.

[19] Medicare is health insurance for people age 65 or older, under 65 with certain disabilities and any age with permanent kidney failure or kidney transplant.

has revealed differences between ownership types over the past ten years, see Figure 3. Harborview Hospital in Seattle has by far the highest portion of their total revenue as Medicaid revenue at 43 percent compared to all other hospitals statewide. Up until 2005, for-profit hospitals have had a higher percent of their total revenue as Medicaid revenue than nonprofit hospitals or public district hospitals. In 2005, all three types of hospitals' Medicaid revenue as a percent of total revenue are nearly the same between 21 and 23 percent.

Figure 3: Medicaid Revenue as Percent of Total Revenue by Ownership Type: 1996-2005



Source: Washington Department of Health Hospital and Patient database.

3) Other Types of Community Benefits

In addition to charity care and services to low-income people, hospitals may also be providing other benefits to their communities, for example, through lectures, seminars, and other educational purposes. Assessing these other community benefits uniformly to achieve the full-impact that hospitals have on communities is difficult because not all community-benefit activities are readily measurable. Some draw more attention than others and caring for indigent patients falls into both categories. Hospitals can easily track the number of uninsured patients and the dollars spent on uncompensated care. Washington does not require hospitals to identify and inventory these types of community benefits. The Washington State Hospital Association (WSHA) has conducted surveys of their nonprofit hospitals to completed Community Benefits Inventory Reports on Washington Hospitals. The report for hospital activities in fiscal year 2005 had information on 32 nonprofit hospitals and it determined that nonprofit hospitals spent $502.89 million in community benefits. Of that $500 million, 80 percent, or $400 million, of that was for low-income patient care shortfalls and the remaining 20 percent was spent on community services.[20] This WSHA report estimated the total value of all federal, state and local tax benefits for these surveyed nonprofit hospitals at $269.3 million. JLARC did not verify the accuracy of the findings in this report. However, there is no information on other community services for the remaining nonprofit hospitals, nor for private and government run hospitals that would allow a comparison by ownership type of whether nonprofit hospitals provide more community benefits than hospitals of other ownership types. Based on this assessment of charity care, services to low-income Medicaid patients, and provision of other community benefits, it is not clear that the nonprofit hospitals currently receiving this property tax exemption are providing relatively more charitable services and community benefits than hospitals under other ownership types.

To assess whether the tax preference has achieved the third public policy objective of restricting the tax preference to nonprofit hospitals due to the fact that this specific ownership type has restrictions pertaining to the retention of its net earnings for the hospital's charitable purposes. JLARC staff analyzed the available information on hospital data by different ownership types for various financial characteristics.

Tables 1 and 2 provide financial data about hospitals in Washington, differentiated by type of ownership. The tables also allow for a comparison for changes in financial data over time, with one table for 1996 and the second for 2005 (the most recent data available). These statistics are based on the Department of Health – CHS/Hospital and Patient Data Systems that includes reports that hospitals must file annually. Examination of these statistics reveals whether there are differences in hospital financial performance due to the ownership of hospitals. These two tables compare hospital statistics by ownership type to determine the differences in Washington hospitals by ownership type. Some other states are using thresholds related to some of these types of financial indicators as a basis for qualifying for nonprofit status and receiving a property tax exemption.

The tables use the following eight financial measures:

1) **Net patient revenue per adjusted patient day** – an indicator of how much it costs on average to get hospital services per patient per day, for inpatient and outpatient services combined;
2) **Outpatient revenue as percent of total patient revenue** – an indicator of the share of revenues that are coming from the delivery of outpatient services only;
3) **Net patient revenue (percent of total revenue)** – an indicator of the share of total revenue that is derived from providing care to patients;
4) **Operating margin (percent)** – a measure profits or revenues above expenses;
5) **Investment and other non-property assets (percent of total assets)** – an indicator of the share of total assets that are investments such as stocks;
6) **Salaries + Wages/FTE** – an indicator of employee average salaries;
7) **Benefits/FTE** – an indicator of employee average benefits; and

[20] Community Benefits Inventory Annual Report, Washington State Hospital Association, December 2006.

8) **Total paid hours per adjusted patient day** – an indicator of the amount of staff time employed in the hospital per patient per day. This includes all staff; those providing patient care as well as administrative positions.

The first indicator (1) is net patient revenue per adjusted patient day and this represents the hospital's per day revenue per patient. Net patient revenue is gross revenue from all types of patients reduced by the amount of bad debts, charity care, contractual adjustments (including negotiated rates) and policy discounts. Examining this indicator by ownership type in 1996 reveals that nonprofits had higher net patient revenue per day at $1,516 than private for-profit hospitals which have net revenue at $1,381. There was a $156 difference between the nonprofit net patient revenue and the for-profit net patient revenue per patient day. Ten years later, the difference between the nonprofit hospitals' net patient revenue per day and the for-profit hospital net patient revenue had grown to $716 per patient day.

Table 1: Hospitals' Financial Data by Type of Ownership – Calendar Year 1996

		Hospital Type	
Item#	**Description**	**Nonprofits**	**For-Profit**
Measures of Sources of Revenue and Economic Performance			
(1)	Net patient revenue per adjusted patient day	$1,516	$1,361
(2)	Outpatient revenue as percent of total patient revenue	37.8%	43.9%
(3)	Net patient revenue (% of total revenue)	95.6%	98.1%
(4)	Operating margin (%)	4.3%	7.5%
Measure of Types of Assets			
(5)	Investment and other non-property assets (% of total assets)	2.9%	17.6%
Measures of Employees Hours and Salaries and Benefits			
(6)	Salaries + wages / FTE	$39,497	$ 37,270
(7)	Benefits / FTE	$7,966	$6,522
(8)	Total paid hours per adjusted patient day	34.7	28.7

Source: Department of Health hospital annual reports.

Table 2: Hospitals' Financial Data by Type of Ownership – Calendar Year 2005

		Hospital Type	
Item#	**Description**	**Nonprofits**	**For-Profit**
Measures of Sources of Revenue and Economic Performance			
(1)	Net patient revenue per adjusted patient day	$2,615	$1,898
(2)	Outpatient revenue as percent of total patient revenue	43.5%	37.1%
(3)	Net patient revenue (% of total revenue)	94.3%	97.9%
(4)	Operating margin (%)	5.2%	11.9%
Measure of Types of Assets			
(5)	Investment and other non-property assets (% of total assets)	9.5%	10.9%
Measures of Employees Hours and Salaries and Benefits			
(6)	Salaries + wages/ FTE	$57,109	$57,534
(7)	Benefits / FTE	$14,384	$12,217
(8)	Total paid hours per adjusted patient day	34.9	26.4

Source: Department of Health hospital annual reports.

In further examining the patient revenue by different ownership type, it is revealed in 1996 that for-profit hospitals received a larger share of their total patient revenue from outpatient care at 44 percent of total patient revenue as opposed to nonprofit hospitals that received 38 percent of their revenue from outpatient revenue. Ten years later, the opposite was true. Nonprofit hospitals received a larger portion of their total patient revenue from outpatient services at 44 percent versus 27 percent for private for-profit hospitals in 2005, see indicator (2) in Table 2. This reflects a shift in the types of services Washington hospitals are performing in local communities and a change of the "typical" services that hospitals are providing. The growth in outpatient services provided by nonprofit hospitals has added uncertainty surrounding which services are "exclusively" hospital services.

Indicator number (3) reveals that patient revenue is still more than 90 percent of all revenue generated by a hospital in Washington. The patient revenue as a percent of total revenue has declined slightly over the past ten years for nonprofit hospitals. In 1996, private hospitals had a slightly higher share of their total revenue that was patient revenue at 98 percent as opposed to 96 percent for nonprofit hospitals. Ten years later in 2005, net patient revenue as a percent of total revenue had declined a little more than 1 percentage point for nonprofit hospitals to 94 percent but private for-profit hospitals' share of total revenue that was patient revenue was nearly the same at 97.9 percent, only a very small decline. This indicator reveals that nonprofit hospitals are receiving a larger share of their total revenue from non-patient revenue in recent years.

Operating margins, indicator (4), have also been different depending on the ownership type. The operating margin represents the share of operating revenue after expenses are covered. It provides an indication of how profitable a business has been over a year. A high operating margin means there is a larger share of revenue in excess of expenses in a given year. It is expected that for-profit hospitals would have higher operating margins since the standard corporate goal is to maximize profits and minimize costs. The operating margins for private for-profit hospitals in 1996 and 2005 are higher than the other nonprofit hospitals. Between 1996 and 2005, the operating margins for hospitals had increased. For-profit hospitals had an average operating margin of 11.5 percent and nonprofits had an operating margin of 5.2 percent. The operating margins increased faster for for-profit hospitals than for nonprofit hospitals.

In breaking down hospitals' total assets by type, indicator (5) revealed that the share of total assets that are investments and non-property assets, has grown for nonprofit hospitals. In 1996, the non-property assets were 2.9 percent of total assets versus 9.5 percent ten years later in 2005. Private for-profit hospitals saw a decline in their share of assets as investment or non-property assets over the past ten years from 17.6 percent to 11 percent in 2005.

In comparing types of hospitals by employees' average salaries, the results of indicator (6) reveal that ten years ago, nonprofit hospitals did provide higher average salaries per full-time equivalent, FTEs, than the other hospitals in Washington. In 2005, nonprofit and for-profit hospitals have comparable average employees' salaries and benefits per FTE. In comparing employees' benefits, indicator (7), the results reveal that the average employee benefits have consistently been higher for nonprofit hospitals than for-profit hospitals. Even though over the past ten years private hospitals' salaries and wages have increased faster than nonprofit hospitals' wages, when employee benefits are also taken into consideration, nonprofit hospitals still provide higher wages and benefits than private hospitals. The difference between the two ownership types over the past ten years has been narrowing in the area of salaries and benefits. In 1996, the average employee wages and benefits was $47,463 for nonprofit hospitals as compared to $43,792 for-profit hospitals. In 2006, the average employee wages and benefits was $71,493 for nonprofit hospitals and $69,751 for private hospitals.

Indicator (8) reveals the total hours paid per adjusted patient day and this measure shows the amount of staff time employed in the hospital per patient per day. Essentially, this indicator for nonprofit and for-profit hospitals did not change much at all over the past ten years. For nonprofit, the average number of hours paid per adjusted patient day was 35 hours which was slightly higher than for-profit hospitals that ranged from 29 hours in 1996 to 26 hours by 2005. By 2005, the number of paid hours per adjusted patient day was nine hours higher for nonprofit hospitals compared to for-profit hospitals.

Based on this assessment of different financial indicators grouped by ownership type, it is not clear if the federal requirements for nonprofit charitable hospitals currently receiving this property tax exemption are meeting the expectations that the Legislature had intended for hospitals when they narrowed this tax preference to nonprofit organizations.

To what extent will continuation of the tax preference contribute to these public policy objectives?

If continued, this tax preference will continue to fulfill the public policy objective of exempting certain hospitals from the property tax base and this will continue to provide equal tax treatment to most hospitals in Washington.

It is not clear that continuing this tax preference will fulfill a public policy objective of increased charity care, more service to low-income patients, or more community services. It is also unclear if providing a tax preference to nonprofit hospitals will create financial statistics that the Legislature might anticipate from nonprofit organizations.

It is also unclear how well this tax preference will continue to target those exclusively hospital services that the Legislature intended to be tax exempt if the types of services performed by hospitals, continues to evolve. This can be seen in the growth of outpatient revenue as a percent of total patient revenue for nonprofit hospitals as this source of revenue grew from being 27.8 percent of total patient revenue ($1.9 billion) to 43.5 percent of total patient revenue ($6.9 billion) over the past ten years. It is uncertain if the tax preference is being applied uniformly so all hospitals have the same hospital services exempt under this property tax exemption. This introduces unequal tax treatment among nonprofit hospitals and decreases the transparency and understanding of the tax system.

If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment or recapture of the tax benefits?

If the Legislature intends nonprofit hospitals to provide a certain amount of services as charity or to low-income patients, then the Legislature could establish certain thresholds for these factors that the hospitals would have to meet in order to qualify for the property tax exemption.

If the Legislature intends nonprofit hospitals to be providing other community services, then the Legislature could modify the tax exemption to require hospitals to complete an inventory of their community services. The community services provided by nonprofit hospitals could then be compared to the level of community services provided by hospitals of other ownership types. In addition, the value of the tax preference could be compared to the value of the hospitals' community activities.

If the Legislature is concerned with the types of hospital services which are receiving a tax preference, then the Legislature should clarify the statue to define which hospital services should qualify for the tax preference. This clarification in statute would require additional investigation of which services are exclusively "hospital" services at different hospitals under the existing administration of this tax preference. Considerations may need to be made regarding rural versus urban nonprofit hospitals and anticipated changes in the types of services provided by hospitals.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

Forty-five nonprofit hospitals received a property tax exemption on a total of 571 parcels statewide in 2006. The majority of the nonprofit hospitals are in more urban counties like King, Snohomish, Spokane, Pierce and Thurston. There are 16 nonprofit hospitals in rural counties like

Asotin, Benton, Chelan, Cowlitz, Franklin, Grays Harbor, Kitsap, Lewis, Stevens, Whatcom, Walla Walla, and Yakima.

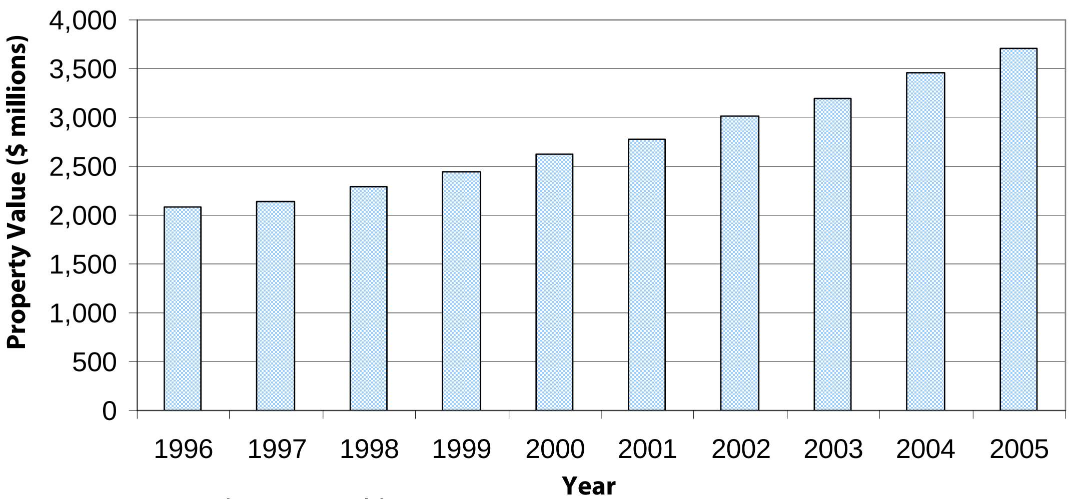
To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended?

No hospitals other than nonprofit hospitals are receiving this tax preference. The question of whether all nonprofit hospitals are meeting the expectations of hospitals that the Legislature had envisioned when limiting this tax exemption to nonprofit hospitals is a more difficult question to answer.

Revenue and Economic Impacts

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?

Figure 4: Property Plant and Equipment Value of Nonprofit Hospitals: 1996-2005



Source: Washington Health Department.

According to the Department of Revenue Tax Exemption Reports, the value of the nonprofit hospitals' taxpayer savings has grown from nearly $20 million in 1988 to more than $30 million in 2004 and 2005. The value of the taxpayer savings of this tax preference has fluctuated over those years depending on the sample of counties used to forecast the taxpayer savings of this tax preference by the Department of Revenue. In performing this review, JLARC collected the assessed value from all hospitals statewide with the exception of three counties that were not valuing exempt properties. The county assessors' hospital values were compared to the Department of Health's annual hospitals' financial reports which included the value of all plant and property. JLARC determined that the Department of Health's financial reports for hospitals' plant and property was more up-to-date and accurate. Figure 4 illustrates DOH plant and equipment value for nonprofit hospitals over the past ten years. The total value of nonprofit hospitals' property plant and equipment has increased from a little more than $2 billion in 1996 to $3.66 billion in 2005.In the most recent 2004 Tax Exemption Report, the basis for the property tax estimate of $30 million in 2005 was based on the value of the nonprofit hospitals' value of property plant and equipment from the Department of Health as well. JLARC used the Department of Health property plant and equipment value for 2005 as the basis for projecting the future taxpayer saving estimates. The 2005 DOH nonprofit hospital data excluded two specialty hospitals and estimates were made for other hospital exempt property that was not included in the DOH hospital database. Table 3 provides a forecast of the property tax savings projected for nonprofit hospitals in the future if the tax preference is continued.

Table 3: Forecast of Local and State Property Tax Savings for Nonprofit Hospitals

Year	Exempt Value ($ millions)	State Property Tax Savings ($millions)	Local Property Tax Savings ($millions)	Total Property Tax Savings ($millions)
2006-07	$4,000	$10.21	$36.55	$46.78
2007-08	$4,317	$11.00	$39.41	$50.41
2008-09	$4,654	$11.86	$42.49	$54.35
2009-10	$5,019	$12.79	$45.81	$58.60

If this tax preference was continued and the exempt property value was not added to the tax roll, then nonprofit hospitals would not pay property taxes and other local taxpayers would pay slightly higher property taxes annually. There would be a shift in the tax burden in specific locations where the nonprofit hospitals' properties are found statewide. Governments would not see a change in their overall property tax revenue due to this tax preference because of the shifting of tax liability among taxpayers, unless the taxing districts were at their maximum tax rate limit. If taxing districts are at their maximum tax rate limit, then the local governments can not fully shift the tax liability from this exemption onto other taxpayers by raising their local property tax rate.

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?

The nonprofit hospitals would lose their annual property tax savings of $47 million if this tax preference were terminated. According to Employment Security Department data, the hospital industry in Washington has been growing. For 2002, the general medical and surgical hospitals in Washington had 60,376 employees and paid $2.65 billion in wages and had an average wage of $43,892. By 2005, the general medical and surgical hospitals of the hospital industry in Washington had approximately 61,949 employees, and total wages were $3.2 billion with an average wage of $51,655. According to the Department of Health's Hospital Reports for 2005, nonprofit hospitals have 72 percent of all hospital full time equivalent (FTE) employees. Private for-profit hospitals' share of total FTEs is 3 percent. Other government run hospitals have 14 percent of all FTEs in Washington hospitals.

According to the 2004 Washington IMPLAN dataset, it is estimated that the hospital industry had total direct output of $6.82 billion in 2004. Washington hospitals purchased goods and services totaling $3 billion. The industry spent in a large number of sectors. Some of the biggest expenditures were for real estate at 15 percent, pharmaceutical and medicine manufacturing at 9 percent, securities – commodity contracts – investments at 4.6 percent, and legal services and wholesale trade were both at 3 percent of all expenditures. The top five largest hospital expenditures comprised 35.6 percent of total expenditures.

The impact from higher taxes on employment and the economy statewide due to nonprofit hospitals having to pay property taxes and other businesses and residents paying less in property taxes, would be minimal statewide. Having nonprofit hospitals pay property taxes would mean they would have to cut their spending in other areas but since the other local property owners and other businesses would have lower property taxes, they could stimulate the economy. Given the fact that there would be two counteracting effects on statewide employment and spending in the economy from the elimination of the nonprofit hospitals' property tax exemption, the overall effect on the economy would be minimal statewide.

If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes?

Due to this tax preference for nonprofit hospitals being a property tax exemption, the elimination of this tax exemption would mean that these hospitals would pay property taxes, estimated at $47 million. Other local residential taxpayers and businesses would see a reduction in their property taxes. JLARC staff estimated the effect on the distribution of liability for payment of taxes by residential and other business property owners based on the most recent Department of Health values for nonprofit hospitals' property, plant and equipment in different counties statewide, and the average local property tax rate per county. This estimate was made to illustrate the degree of shifting in tax liability from nonprofit hospitals to local residential and business taxpayers. Table 4 provides a summary of the likely changes in the local property tax rate if nonprofit hospitals' property values were added to the tax base. The county that would have the highest reduction in the local property tax rate was Asotin County with a reduction of 2 percent. Spokane County would have the second highest reduction in the local property tax rate at 1.5 percent. Most counties would see minimal reductions (less than one percent) in their local property tax rate.

Table 4: New Local Property Tax Rates from Adding Nonprofit Hospital Exempt Value

County	Average Local Property Tax Rate	New Local Property Tax Rate	% Change
Asotin	11.28	11.05	-2.01%
Benton	10.18	10.10	-0.74%
Chelan	10.12	10.05	-0.71%
Clark	9.54	9.49	-0.48%
Cowlitz	9.90	9.79	-1.13%
Franklin	11.17	11.14	-0.29%
Grays Harbor	10.82	10.77	-0.48%
King	7.89	7.85	-0.50%
Kitsap	8.06	8.04	-0.31%
Lewis	8.66	8.63	-0.38%
Pierce	10.57	10.49	-0.72%
Skagit	8.70	8.67	-0.36%
Snohomish	8.53	8.51	-0.24%
Spokane	11.74	11.57	-1.48%
Stevens	8.20	8.17	-0.36%
Thurston	9.56	9.50	-0.59%
Walla Walla	11.59	11.43	-1.38%
Whatcom	8.49	8.44	-0.55%
Yakima	9.65	9.56	-0.93%

Source: Washington Department of Revenue Nonprofit Property Tax Database.

Other States

Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

According to the JLARC CCH state survey it was found that all states have some property tax exemption specified in law for charitable organizations or property used for public charity. Forty states and the District of Columbia, have specific provisions to exempt certain hospitals from property taxes as charitable institutions. There were 11 states that did not specify hospitals as an exempt class of property, but some hospitals in those states may qualify for the property tax exemption as a charitable institution. Twenty-five states have no restrictions on the hospital property other than it must be owned by a nonprofit entity. New York is the only state with a specific restriction that all municipalities cannot tax any real property owned by corporations or organizations operating a hospital.

Various other states have different types of restrictions on the nonprofit corporations operating hospitals. For example:

- Texas has various thresholds that must be met on the amount of charity care and indigent health care provided by these nonprofit hospitals, and the charity care must equal at least 100 percent of the hospital's tax-exempt benefits or at least five percent of the hospital's net patient revenue.
- Utah requires hospitals to provide a gift to the local community by lessening the community's health care burden, with the gift greater in value than the tax benefits of the exemption.
- New Hampshire requires nonprofit hospitals to pay an in lieu of taxes to the city in which the property is located.
- States like Colorado have adopted a gross revenue test for nonprofit hospitals to meet.
- California requires nonprofit hospitals' revenue, including donations and gifts, to not exceed operating expenses by more than 10 percent.

States are beginning to require mandatory reporting of community benefits provided by hospitals. According to a state survey performed by the Minnesota Department of Health in 2006, there are 12 states with mandatory reporting of charity care, government sponsored health care or other community benefits.[21] Washington is one of those states since it mandates the reporting of charity care but not other community benefits. Idaho is a state that mandates nonprofit hospitals with over 150 patient beds to submit a community benefits report annually. Seven of the 12 states with mandatory reporting, required charity care as well as other community benefits. Another ten states had voluntary reporting of some of these community benefits.

- Some states have focused their property tax exemption on rural hospitals, such as Oregon which provides a tax exemption just for the rural hospitals. Texas and Vermont also have specific provisions for rural hospitals.

[21] "Minnesota Hospitals: Uncompensated Care, Community Benefits, and the Value of Tax Exemptions" Minnesota Department of Health, January 2007.

CHURCHES, PARSONAGES AND CONVENTS – SUMMARY

Current Law

All churches, personal property, and the land upon which churches of any nonprofit recognized religious denomination is or will be built, is exempt from property taxes. This exemption includes parsonages, convents, and buildings and improvements required to maintain and safeguard the property. One limitation is that the area of land with the church and other improvements may not exceed five acres. Undeveloped or unused land may not exceed an area equivalent to 120 feet by 120 feet (one-third of an acre) unless a larger area is required to conform to state and local codes, zoning, or licensing requirements. The property must be wholly used for church purposes, except that it may be loaned or rented to a nonprofit organization for a charitable purpose if the income from the loan or rental is reasonable and devoted to the operation and maintenance of the property.

To be exempt, the property must be owned (in fee or contract purchase) by the church. Property that is rented or leased by a church is not exempt under this statute. However, the property rented or leased by a church may be exempt if owned by an organization that has its own tax exemption, such as a school district.

While the statute states that the church must be of any "nonprofit recognized religious denomination," this term is undefined. As a practical matter the exemption centers on whether the building is used for "church purposes." "Church purposes" is defined to mean the use of real and personal property owned by a nonprofit religious organization for religious worship or related administrative, educational, eleemosynary (charitable), and social activities (RCW 84.36.800(1)).

"Convent" is defined as a house or set of buildings occupied by a community of clergy or nuns devoted to religious life under a superior (RCW 84.36.800(2)).

"Parsonage" is defined to mean a residence occupied by a member of the clergy who has been designated for a particular congregation and who holds regular services for it (RCW 84.36.800(5)).

Appendix 3 includes the current law statute, RCW 84.36.020, which provides for the property tax exemption.

Findings and Recommendations

This review of Washington's churches, parsonages and convents property tax exemption evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- The property tax exemption for property owned by religious organizations dates to the beginning of the Washington Territory – 1854.
- Restrictions on the amount of exempt land have long been in the law. In 1886, the land on which a building used for public worship could not exceed was set at one-half acre if in a city or town and five acres if outside a city or town. In 1893 this was modified to an area not to exceed 100 feet by 200 feet (0.55 acres). In 1915, another restriction was added that the amount of unoccupied area could not exceed 120 by 120 feet (one-third acre). Then in 1933 the gross amount of land that could be exempted was increased to five acres.
- A single explicit public policy objective is not clearly identified in legislation. The public policy objectives for exempting churches from property taxation may be one of several:
    - The Legislature was defining the tax base, and religious activity did not rise to the level of a taxable activity;
    - Churches perform services that lessen the burden on government, and therefore a subsidy is warranted; or
    - Churches have a longstanding recognition in our cultural history. As said, religious organizations have always been exempted from various taxes.
- In the absence of a different, clearly identified public policy objective, there is not an audit basis for recommending a change to this tax preference.
- U.S. Supreme Court decisions have established that tax exemptions for religious organizations are neither required nor prohibited under the U.S. Constitution.

Beneficiaries

- There are 5,137 churches receiving a property tax exemption in 2006.

Economic and Revenue Impacts

- The estimated property value of churches is $5.8 billion in 2006.
- The property tax savings is estimated to be $66 million in 2006-07.
- Over the next three years the tax savings is expected to increase to $70 million in 2009-10.
- The economic value of a church is not only what is tangibly produced, such as charitable and social work, but also, the intangibles – the peace and comfort that it provides to its community of believers. The economic impact of churches cannot be measured by the number of employees and wages paid (the usual proxies for the economic impact of an industry).

Other States

- Every state and the District of Columbia exempt churches from the property tax.
- Eight states, including Washington, impose size limits for the amount of land that may be exempted. Washington has one of the smaller limits on the amount of land that may be exempted.

Recommendation

The property tax exemption for churches, parsonages, and convents should be continued.

Legislation Required: None
Fiscal Impact: None

CHURCHES, PARSONAGES AND CONVENTS – REPORT DETAIL

Statutory History

The property tax exemption for property owned by religious organizations dates to the beginning of the Washington Territory in 1854. Initially all the property owned by a religious society was exempt.

The exemption became more restrictive in 1869. The building needed to be used for public worship or as a school to maintain the exemption. Any part of the building used for other purposes, such as a store or shop, was subject to taxation.

The Territorial Legislature explained and further restricted the exemption in 1886. Whereas "Religion, morality and knowledge being necessary for good government and happiness of mankind" all buildings or institutions of learning, benevolent, charitable, and scientific institutions and all buildings for public worship or Sabbath schools, with parsonages, were exempt from property taxes. With regard to a building used for public worship, the lands on which they were situated could not exceed one-half acre if in a city or town and could not exceed five acres if outside a city or town. Furthermore, if the value of the church and parsonage property exceeded $5,000, the property tax applied to the value above $5,000. Also, if the building was used for any other purpose except for public worship, it was to be taxed on the portion that was used otherwise.

Just after statehood in 1893, the Legislature removed from state law the value restriction of $5,000. The land area limitation for "churches built and supported by donations, whose seats are free to all" was modified to not exceed 100 feet by 200 feet (0.55 acres). The grounds needed to be used wholly for church purposes.

In 1915, the Legislature imposed another restriction on the amount of exempted land that could be unoccupied. The area that was not being used for churches, parsonages, and the structures and ground necessary for street access, light and ventilation could not exceed the equivalent of 120 by 120 feet (one-third acre).

In 1933, the Legislature increased the gross amount of land that could be exempted from 100 feet by 200 feet to the present five acres. The church on the land needed to be of any "recognized religious denomination."

United States Constitution and U.S. Supreme Court Decisions

The issue of whether churches may be subject to taxation is closely governed by the protection of churches offered by the U.S. Constitution and a number of U.S. Supreme Court decisions on the subject. The first amendment to the U.S Constitution pertaining to religious freedom has two clauses: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; …"

The U.S. Supreme Court has a mixed history in their interpretation of taxation and religion. Earlier cases had held that the exercise of religious freedom could not be taxed because "the power to tax the exercise of a privilege is the power to control or suppress its enjoyment."[22] In a 1970 decision, the Supreme Court, however, established that tax exemptions for religious organizations were neither required nor prohibited. [23] The Court described this balance as neither being a prohibited subsidy that was an establishment of religion, nor a prohibition on the free exercise of religion.

Since the 1970 decision, the Court has sometimes said that exemptions for churches were subsidies.[24] Although the Court has been inconsistent in the characterization of tax exemptions for churches, one test remains current. To be constitutional an exemption must meet this test: "First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion; finally, the statute must not foster an excessive government entanglement with religion."[25]

Based on these cases, it appears that, while a state may exempt churches and other religious organizations, it must do so on the basis of other similarly situated organizations, for example, on the same basis as nonsectarian nonprofit organizations.

The thought that the exemption for churches must be on the same basis as the exemption for nonsectarian nonprofit organizations raises two issues. First is the question of the acreage limitation that applies to church property but does not apply to other organizations. The Legislature had at one-time limited the amount of land that was exempt from property tax not only for churches but also for hospitals, nursing homes, and orphanages. Today the restriction only applies to churches.

The second issue concerns the matter of leased property. Property that is leased by some nonprofit organizations, but not churches, can be exempted from property taxes if the value of the exemption is passed on to the lessee. For church property to be exempt from property tax, it must be either owned by the church or owned by an organization that is entitled its own exemption.

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[22] Magnano Co. v. Hamilton, 292 US 40 (1934). *See also,* McCulloch v. Maryland, 17 US (4 Wheat) 316 (1819) (The "power to tax involves the power to destroy.") *Id* at 431; Follet v. McCormick, 321 US 573 (1944) (Taxation of engaging in religious activities would reserve "[f]reedom of religion…for those with a long purse.") *Id.* at 576.

[23] Walz v. Tax Commission, 397 US 667 1970).

[24] Regan v. Taxation with Representation, 451 US 540 (1983) ("A tax exemption has much the same effect as a cash grant to the organization").

[25] Lemon v. Kurtzman, 403 US 602, 612 (1971).

Public Policy Objectives

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?

There are three potential public purpose objectives for exempting churches from the property tax. It is not clear from the record or court decisions which of these three objectives, or combinations thereof, form the public policy objectives for exempting churches from property taxes. The three options are:

1. When the tax base was being defined, religious activity did not rise to the level of a taxable activity;
2. Churches perform services that lessen the burden on government, and therefore a subsidy is warranted; or
3. Religious organizations have always been exempted from taxes; it is the customary thing to do.

1. Tax-base Definition: There are two legal theories used to justify property tax exemptions: the base-defining theory and the subsidy theory. The base-defining theory states that charitable/religious activity does not rise to the level of taxable activity. Put another way, the Legislature had to pick out what to tax and found that wealth provided an appropriate basis for taxation. To the extent that churches and other charities do not produce wealth, they were not part of the tax base. The exemption for churches was consistent with the treatment of other educational and philanthropic organizations which also did not produce income.

Tax administrators recognized early on in the history of the property tax that some institutions, such as government and churches, served and were supported by the community. If these institutions were to be taxed, it would be the community that made contributions to these organizations that would indirectly be paying the taxes. Thus, these institutions were exempted from tax, and the community was directly taxed.

2. Subsidy Theory: The subsidy theory, at its most basic, is the theory that the state grants exemptions because the exempted organization lessens the burden on government.

In 1886, the Washington Territorial Legislature added an intent statement to the exemption making the exemption appear to be a subsidy:

> whereas 'Religion, morality and knowledge being necessary for good government and happiness of mankind,' there is further exempted all buildings or institutions of learning, benevolent, charitable, and scientific institutions…, and all buildings used exclusively for public worship or Sabbath schools, with parsonages, and the lands upon which they are situated…[26]

[26] 1886 Laws of Washington Territory, p. 47 §1.

This subsidy language did not survive the transition from territory to state. The U.S. Supreme Court has sometimes said that exemptions for churches were subsidies: "A tax exemption has much the same effect as a cash grant to the organization."[27]

In 1897, the Washington State Supreme Court discussed property tax exemptions using language that encompassed both a variation of the base-defining theory and the subsidy theory. [28] It stated:

> It is not unreasonable to conclude that in this connection they had also reference to property which is of *quasi* public nature and which it has been customary for legislatures to exempt from taxation, such as charitable institutions, public libraries, cemeteries and a similar class of properties. It cannot truthfully be said that such property is strictly private property. It does not enter into competition with private property.

After defining the exemptions as being excluded from the tax base because they were quasi-public properties, the Court then went on to justify them as properties that provide a benefit to the public and as relieving the state of expense:

> The public has an interest in such property and in its maintenance. A public library, for instance, is for the exclusive benefit of the public. Its office is to develop the more intelligent and better citizenship. Such a consummation would benefit the state even from a financial standpoint. Charitable organizations perform services which the state would otherwise frequently be called upon to discharge, and the theory upon which they are exempted is that to a certain extent they relieve the state of expenses.

3. Custom: Another rationale for exempting churches from property taxes is that it has always been done. The practice of exempting churches predates the establishment of the state. It is consistent with the general history of the U.S. and the colonies under British law, which exempted churches from various taxes as far back as the Middle Ages and had ongoing exemptions from the early 1600s. The territorial law that defined this exemption is worded consistently with other laws that arose around the 1850s across the U.S. to codify existing practice as tax codes changed from an ad hoc system toward universal, uniform taxes, levied on a regular basis. In addition, early U.S. Supreme Court decisions held that the exercise of religious freedom could not be taxed.

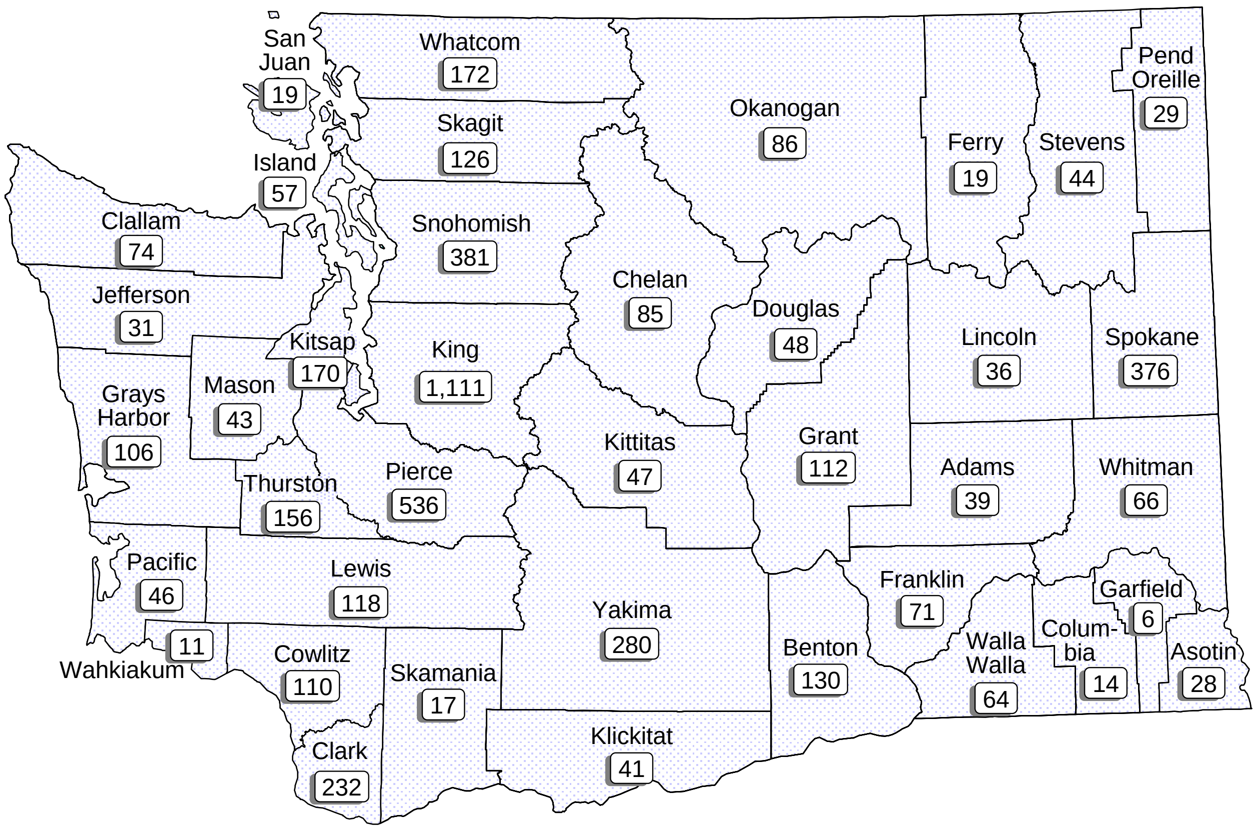
What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives?

If the public policy objective of exempting churches from the property tax was because (1) the property tax base was defined to not include churches, or (3) it has always been done, there does not need to be any evidence that the public policy objective was being met. The exemption in itself is proof that the public policy objective is being met.

[27] Regan v. Taxation with Representation, 451 US 540 (1983).

[28] Chamberlin v. Daniel, 17 Wash. 111, 113 (1897).

Figure 5: Number of Property Tax Exempt Churches in Washington



Source: Department of Revenue.

If the exemption is being granted as (2) a subsidy to churches to perform services which the state would otherwise be called upon to discharge, it is difficult to discern exactly what these services might include. The intent of "religion, morality, and knowledge being necessary for good government and the happiness of mankind" is broad and difficult to measure. Next, given the separation of church and state, one would not expect the state to perform many functions that are provided by churches; nor would churches be required to perform many services that are provided by the state. Finally, the roles and missions of a church and a church's emphasis on its many functions vary by church. The state is not in a position to define what the functions of a church should be. There is no single standard by which a church can be judged.

To what extent will continuation of the tax preference contribute to these public policy objectives?

If the public policy objective of exempting churches from the property tax was because (1) the property tax base was defined to not include churches, or (3) it has always been done, continuation of the exemption will continue to meet the objective.

If the exemption is being granted as (2) a subsidy to churches to perform services which the state would otherwise be called upon to discharge, there is no way of knowing exactly what these services are and whether the public policy objective is being met.

If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment of the tax benefits?

The public policy objectives are being met if the objective of the exemption is either (1) because churches do not belong in the property tax base or (3) because it has always been done.

If the public policy objective is to (2) grant a subsidy to churches services which the state would otherwise be called upon to discharge, we have no way to identify exactly what these services include or measure whether the objective is being met. In this case there is no basis on which to modify the exemption.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

There were 5,137 churches statewide in 2006 that are beneficiaries of the property tax exemption.

To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended?

There is no evidence that the tax preference is providing unintended benefits to other entities.

Revenue and Economic Impacts

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?

Table 5: Forecast of Local and State Property Tax Savings for Churches

Year	Exempt Value ($ millions)	State Property Tax Savings ($millions)	Local Property Tax Savings ($millions)	Total Property Tax Savings ($millions)
2006-07	$6,294	$13.6	$52.2	$65.8
2007-08	$6,609	$13.1	$51.2	$64.3
2008-09	$6,939	$13.5	$52.9	$66.4
2009-10	$7,286	$14.0	$55.7	$69.7

The estimated value of the 5,137 exempted churches in 2006 is over $6 billion. This represents an amount equal to one percent of the taxable property in the state. The tax savings for the churches is estimated to be around $66 million per year.

By exempting churches from the property tax, donations to the church can be spent on services provided by the church.

The economic value of religion is not only what is tangibly produced, such as charitable and social work, but also, the intangibles – the peace and comfort that it provides to its community of believers. In addition, there is the institutional stability that religion provides to a society. The intent statement from the 1886 property tax exemption, while using antiquated language, stated this concept: "whereas 'Religion, morality and knowledge being necessary for good government and happiness of mankind,'…" The economic impact of religion and churches cannot be measured by the number of its employees and wages paid (the usual proxies for the economic impact of an industry).[29]

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?

If the preference were to be terminated and churches were no longer exempt from the property tax, they would need to start paying about $66 million in taxes per year. These funds would need to come from one of two sources: funds that otherwise would be spent on services provided by the church or increased donations from parishioners.

If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes?

If the tax exemption for churches were to be eliminated, some $5.8 billion would be added to the property tax rolls. There would be slight increase, up to 1 percent, in revenues to some units of local government currently at their maximum levy rate. There would be a reduction in property taxes paid by other taxpayers of about $66 million. Based on an estimated statewide split of 65 percent of property taxes paid by households and 35 percent paid by business, households would see a reduction of about $43 million and businesses would have a reduction of about $23 million.

Since religious adherents make up about one-third of the state's population, some of the property tax reduction on households, perhaps around $14 million, would go to parishioners of the churches being asked to pay the increased property taxes.

Other States

Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

[29] Even if such data were available – churches are not required to file with the IRS for tax-exempt status, and employees of churches are not covered under unemployment insurance laws.

Every state and the District of Columbia exempt churches or property used exclusively for religious purposes from the property tax. Six states mandate the exemption in their state's constitution. Another three states specifically authorize the exemption in their state's constitution.

There generally is no limitation on the amount of land that is exempted, other than that the property or buildings must be used for religious worship. Washington has one of the smaller exemptions. Seven other states have acreage limitations on churches:

> Alabama: more than one mile from a city or town – 5 acres; outside but under a mile from a city or town – 1 acre; and within an incorporated city or town – no size limitation
>
> Iowa: 320 acres
>
> Montana: 15 acres
>
> New Jersey: 5 acres
>
> North Dakota: 2 acres
>
> Rhode Island: 5 acres
>
> Wisconsin: 30 acres

In addition, several other states have an acreage limitation for the parsonage.

NONPROFIT NONSECTARIAN ORGANIZATIONS – SUMMARY

Current Law

Under current law, all real and personal property of nonprofit nonsectarian organizations are exempt from property taxes. According to statute, the organizations qualifying for this tax exemption must be performing either character building, benevolent, protective or rehabilitative social services. In addition, the property must be used exclusively for the purposes of character building, benevolent, protective or rehabilitative social services. An example of a nonsectarian organization is the American Lung Association of the Northwest. In Appendix 3 is the current law statute, RCW 84.36.030(1), which provides for the property tax exemption.

Findings and Recommendations

This review of Washington's nonprofit nonsectarian organizations' property tax exemption has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- The property tax exemption for nonsectarian organizations dates back to an 1854 section exempting "benevolent, charitable, literary, or scientific" institutions, various government properties, schools, cemeteries, and public libraries from the tax base. This initial tax preference was a definition of the tax base.
- Statutory language in 1915 defined nonsectarian organizations broadly, stating they were conducted for religious purposes, not for profit and that the purposes of the organization are for the general public good. Therefore, a public policy objective of this tax preference was to provide financial support for non-profit organizations which were performing services for the general public good.
- A related public policy objective of the property tax exemption for nonsectarian organizations is to support quasi-public services. This is based on the service activities performed by these organizations as benevolent, character building, protective or rehabilitative social services.
- There is a public policy objective that the exempt property must be used exclusively for nonsectarian purposes.
- There is no statutory requirement that these organizations must have "gift giving" to the community to qualify for the preference. However, the Department of Revenue has required a gift giving rule in order to define organizations that qualify for the preference.

- This tax preference has provided property tax relief to nonprofit nonsectarian organizations that have met the gift giving test in the past.

Beneficiaries

- The beneficiaries from this property tax exemption are 651 nonprofit nonsectarian organizations statewide that received a property tax exemption in property tax year 2006-07. Those organizations claimed the exemption on 1,081 parcels statewide.
- Due to the fact that these nonsectarian organizations have to quantify their gift giving activities in order to meet the threshold outlined in administrative rule for this tax preference, there does not appear to be any unintended tax benefits to any entities.

Economic and Revenue Impacts

- In property tax year 2006-07, the nonprofit nonsectarian organizations had an annual property tax savings of approximately $17 million.
- The future property tax savings for nonprofit nonsectarian organizations over the next three years is between $17 and $18.5 million per year.

Other States

- Forty-three states, including Washington, had provisions which specified some type of benevolent, fraternal or other nonsectarian organizations. Generally, the state survey found that most other states do not have the broad statutory language like Washington. Most states that do have nonsectarian organizations specifically exempt have named the particular nonsectarian organizations that are entitled to a property tax exemption.

Due to the fact that this tax preference was originally enacted to exclude all not-for-profit nonsectarian organizations from the property tax base and the beneficiaries of the tax preference are nonsectarian organizations that meet the gift giving test in the administrative rule, this tax preference has achieved its public policy objectives in the past. It is unclear what the intentions of the Legislature were when they restricted this tax preference to nonprofits in 1973. It is clear from the legislative history that the purposes of these organizations were for general public good. Through rule, this tax preference is tied to each nonsectarian organization meeting a gift giving test, therefore this tax preference is targeting the property tax exemption to those organizations that are providing social benefits to the local communities. Since this is the only property tax exemption that requires nonprofit organizations to meet a gift giving test, there is different tax treatment among nonprofit organizations performing different charitable services. For example, nonprofit youth organizations, orphanages, nursing homes and hospitals are not required to meet a gift giving test or threshold in order to qualify for their property tax exemptions. The Legislative intent for nonsectarian gift giving is unclear.

Recommendation

If the Legislature intended all nonprofit nonsectarian organizations to meet a gift giving test to qualify for the property tax exemption, the Legislature should enact a gift giving criterion into law.

Legislation Required:	Yes
Fiscal Impact:	A change in revenue could be possible, depending on how this is implemented.

NONPROFIT NONSECTARIAN ORGANIZATIONS – REPORT DETAIL

Statutory History

The exemption for non-sectarian organizations first appears in 1915 but other language effectively exempting many non-sectarian organizations appears initially in an 1854 section stating that "benevolent, charitable, literary or scientific" institutions, churches, schools and public libraries were not to be part of the tax base. The exemption for charitable organizations predates the establishment of the state and is consistent with the general history of the U.S. and their prior existence as colonies under British law, which exempted charitable institutions from various taxes as far back as 1601. In 1897, the Washington State Supreme Court[30] determined that property can be quasi public and it has been customary for Legislatures to exempt from taxation charitable institutions. The court recognized that charitable organizations perform services which the state would otherwise be required to fulfill.

In 1915, the law specified "nonsectarian" to include the following organizations eligible for the property tax exemption:

> Other non-sectarian organizations or associations organized and conducted primarily and chiefly for religious purposes and not for profit, which shall be wholly used, or to the extent solely used for the religious purposes of such association, or for the educational, benevolent, protective or social departments growing out of, or related to, the religious work of such associations: *Provided*, Such purposes are for the general public good and such properties are devoted to the general public benefit; …

In 1973, the Legislature narrowed the property tax exemption from all nonsectarian organizations to nonprofit entities only. In addition, the Legislature also defined "nonprofit" in statute to mean that no part of the business income could be paid directly or indirectly to members, directors, stockholders, officers, or trustees except for services rendered and the salary paid to officers had to be comparable to the salary of like public officials.[31] The Legislature deleted the "primarily and chiefly" requirements of nonsectarian organizations, replaced "religious" with nonsectarian purposes, and expanded the definitions of the purposes of the organizations.

[30] Chamberlin v. Daniel, 17 Wash. 111, 113 (1897).

[31] RCW 84.36.800(4).

The following real and personal property shall be exempt from taxation:

> Property owned by nonprofit, nonsectarian organizations or associations, organized and conducted for nonsectarian purposes, which shall be solely used, or to the extent used, for character-building, benevolent, protective or rehabilitative social services directed at persons of all ages.

In 1983, the Legislature clarified that nonprofit organizations could use their exempt property to sell donated merchandise if the proceeds are devoted to the purposes of the nonsectarian organization. In 1984, the requirement that the property be used "solely" for benevolent purposes was replaced by the requirement that to qualify for the exemption, the property must be used exclusively for the purposes for which the exemption is granted.

In 2006, the Washington Legislature allowed a minimal amount of usage of the property for nonexempt purpose without losing the property tax exemption.

Administration of the Property Tax Exemption

The current administrative rule for the nonsectarian organizations' property tax exemption is found in WAC 458-16-210. This current version of the rule has been in place since 1994. WAC 458-16-210, which outlines the requirement for qualifying for this nonsectarian property tax exemption, specifies that the property must be used for and integrally related to character-building, benevolent, protective or rehabilitative social services. To be eligible for this property tax exemption, there must be an element of gift giving in the nonprofit organization activities in relation to the people it serves. The nonprofit organization must meet one of the following conditions:

- Provide goods and/or services free of charge or at a rate that is at least 20 percent below the total costs of the goods and/or services to a minimum of 15 percent of all people assisted; or
- Contribute at least 10 percent of its total annual income towards support of character-building, benevolent, protective or rehabilitative social services or programs (this can include the value of time volunteers donated to carry out services).

Under the existing statute, each nonprofit organization has to perform one or more purposes outlined in statute as character building, benevolent, protective or rehabilitative social services. This current administrative rule is requiring all nonprofit organizations to meet the gift giving test regardless of what purposes they are qualifying for under the list of exempt purposes for nonsectarian organizations. Certainly a gift giving test for benevolent organizations would be a reasonable requirement to distinguish legitimate benevolent organizations but it is not so clear why it is necessary if the nonprofit nonsectarian organization is performing protective or rehabilitative social services. It is unclear if the Legislature intended all nonprofits to be subject to a gift giving test or other charity type threshold test or just certain ones, like nonsectarian benevolent organizations. Under this same section of law pertaining to youth organizations, it states that the exempt organizations must have purposes and uses which are for the general public good. Yet, the youth property tax exemption does not require a gift giving test for those organizations in order to receive their property tax exemption.

This administrative rule for nonsectarian organizations annually is restricting a few nonprofit organizations from qualifying for the property tax exemption on the basis of meeting the gift giving test. For example, if a nonprofit hospital had a clinic that was performing rehabilitative social services to the public, they might not qualify for the nonsectarian organization property tax exemption if the clinic was not offering their services at 20 percent below costs or willing to contribute 10 percent of their revenue toward charitable purposes. According to the Department of Revenue, this gift giving test was not in the previous administrative rule, prior to 1994, for nonsectarian organizations. The previous rule language for administering the property tax exemption for nonsectarian organizations was even more difficult to administer according to the Department of Revenue. The following language is from the former administrative rule prior to 1994:

> The real and personal property owned by nonsectarian organizations is exempt from taxation, provided that: (a) The organization is nonprofit and is organized and conducted primarily for nonsectarian purposes, (b) the property is, except as provided in RCW 84.36.805 and subsections (2) and (4) of this section, used for character building, benevolent, protective, rehabilitative social services directed at persons of all ages or used by a student loan agency and (c) **if these organizations were not conducting these activities the government would provide this service.**

The former administrative rule had a requirement that nonsectarian organizations had to determine if the government would be providing their social service. That old administrative rule language caused confusion for taxpayers and led to many Board of Tax Appeals (BTA) cases. At the time of the rewrite of that administrative rule, the Department of Revenue had identified more than 20 BTA cases from nonsectarian organizations regarding their property tax exemption. During the rule-making process in 1994, the Department of Revenue did hold public hearings and gathered interested parties together to discuss this rule change. The gift giving test in the current administrative rule is a result of those discussion and negotiations during the administrative rule-making process. According to the Department of Revenue, since WAC 458-16-210 has been revised with the gift giving test, the number of BTA cases has dropped significantly.

Washington Supreme Court Cases

There are four commonly cited Supreme Court Cases surrounding the RCW 84.36.030 and the property tax exemption for nonsectarian organizations.[32] The facts in each case are dissimilar but are important with regard to the rule that it is the use to which the property is devoted that determines the question of exemption from taxation.

[32] Norwegian Lutheran Church v. Wooster, 176 Wash. 581 (1934); Pacific Northwest Conference of the Free Methodist Church of North America v. Barlow, 77 Wn. 2d 487 (1969); Yakima First Baptist Home v. Gray 82 Wn. 2d 295 (1973) ; Corporation of the Catholic Archbishop of Seattle v. Johnson 89 Wn 2d 505 (1978).

Public Policy Objectives

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?

Tax base defining theory states that at the time Legislatures are developing a tax, they will define the elements that will be subject to the tax and the elements excluded. The first Territorial Legislature enacted a single exemption clause that excluded federal, Territorial, and local government property, burial grounds and schools, as well as "All real and personal property belonging to any religious society, or to any benevolent, charitable, literary, or scientific institution, or invested for the use of the same, or held by trustees."[33] This early exemption is an exclusion from the tax base, and it appears that it would include most nonsectarian organizations. This is further supported by an additional exemption in 1871 for all "lodge buildings and furniture of any fraternity in this Territory and the grounds upon which buildings stand" and treating them the same as churches.[34] The public policy objective for this exemption for benevolent, charitable, literary and scientific institutions was consistent with a base-defining rationale.

In addition to the tax defining argument for this tax preference, it is likely that the Legislature would have exempted nonsectarian organizations for the *quasi* public nature of their social service work to the state, as stated previously in Chamberlin v. Daniel Supreme court case. The court indicated that charitable institutions are typically exempt. The subsidy theory, at its most basic, is the theory that the state grants exemptions because the exempted organization lessens the burden on government. This theory could apply to nonsectarian organizations. Given the social programs that nonsectarian organizations are conducting, they are lessening the burden on government.

Since the original language defined nonsectarian organizations broadly that they were not for profit and that the purposes of the organization are for the general public good, an objective of this tax preference was to provide an exemption for nonprofit organizations for their public services. Over time, the exemption for nonsectarian organizations has been specifically narrowed to just nonprofit entities in 1973. In 1994, the administration of this tax preference required these nonprofits to demonstrate gift giving within their organization. A public policy objective of this tax preference contained in the administrative rule has been to limit the tax exemption to those organizations that could demonstrate gift giving to local communities or that their services would otherwise have been provided by the government. The gift giving test in the current administrative rule and the prior administrative rule's requirement that nonsectarian organizations must be performing a function that the government would otherwise have to do is consistent with theory that these organizations are *quasi* public in nature. The property tax exemption's purpose is to include just those nonprofit organizations that have the purposes of

[33] 1854 Laws of Washington Territory p. 331 §2, italics added.

[34] 1871 Laws of Washington Territory p. 37 §4.

character-building, benevolent, protective or rehabilitative social services directed at persons of all ages.

A third public policy objective has been to limit the exemption to just property that is used exclusively for nonsectarian purposes. A final public policy objective of the Legislature has been to allow a limited number of days that a nonprofit nonsectarian organization's exempt property can be rented or used for pecuniary gain each year.

What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives?

After examining the Department of Revenue's property tax exemption database, the entities claiming this property tax exemption are nonsectarian organizations performing services of character building, benevolent, protective or rehabilitative social services. This tax preference has achieved its objectives of providing property tax relief to these organizations for the quasi public social services provided to local communities and for defining the tax base. The gift giving test for this tax preference targets the tax exemption to just those nonprofit organizations that are providing charity to the individuals receiving their social services. In comparison to other property tax exemptions for nonprofits, the nonsectarian property tax exemption is the strictest in terms of the gift giving requirement. This gift giving test in the administrative rules does increase the transparency of implementing this tax exemption which lowers compliance costs for nonprofit organizations. This more targeted tax preference assists in meeting the public policy objectives of nonprofit organizations extending their tax benefits to local communities.

Through this review, no evidence was uncovered that suggested the exempt property was not being used for nonsectarian purposes so that objective has been met.

To what extent will continuation of the tax preference contribute to these public policy objectives?

The public policy objectives of this tax preference are being fulfilled so continuation of this tax preference will contribute to fulfilling these public policy objectives. This tax preference has been narrowed to just those organizations that provide social benefits. In the future, if nonsectarian organizations diversify the types of services provided, there could be additional administrative difficulty in distinguishing nonsectarian exempt property.

If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment of the tax benefits?

The public policy objectives of this tax preference are being fulfilled in that the nonprofit organizations that are receiving a tax exemption are also the ones that have met a gift giving test. Under existing law for nonsectarian organizations, it is unclear whether the Legislature had intended to require all nonsectarian organizations to be subject to meeting a gift giving threshold in order to qualify for a property tax exemption. If the Legislature intended all nonprofit nonsectarian organizations to meet a charitable contribution test, then a modification to this property tax exemption statute would be necessary to clarify that a gift giving test should be applied to all nonsectarian organizations regardless of what services they are providing.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

In property tax year 2006-07, there were 651 nonsectarian organizations statewide that received a property tax exemption, based on the Department of Revenue exempt nonprofit database. These organizations had 1,080 parcels which were property tax exempt. The beneficiaries of this tax preference are in a wide variety of industry sectors that provide benevolent, character building, protective and rehabilitative social services. Some examples of nonprofit nonsectarian organizations receiving a property tax exemption are the following:

American Cancer Society
Big Brothers / Sisters
Domestic Violence and Sexual Assault Services
Good Samaritan Outreach Services
Goodwill
St. Vincent DePaul
Greenwood Home and Senior Center
Highline – West Seattle Medical Center
Kirkland Foster Home
Family YMCA
Maternity Home for Unwed Teens
Palouse River Counseling Center
Spokane Neighborhood Centers

The beneficiaries of this tax preference are located in most all counties. Table 6 presents the top ten counties with the highest number of nonsectarian organizations present. King County has 30 percent of the nonsectarian organizations statewide. Pierce County has the second highest number of nonsectarian organizations at 10 percent. The top ten counties make up 81.4 percent of all nonsectarian organizations statewide.

Table 6: Top 10 Counties with Largest Number of Nonsectarian Organizations Receiving Property Tax exemption in 2006

County	Number of Nonsectarian Organizations	% of Total Organizations
King	199	30.6%
Pierce	68	10.4%
Spokane	65	9.9%
Snohomish	45	6.9%
Yakima	36	5.5%
Clark	28	4.3%
Kitsap	26	4.0%
Thurston	22	3.4%
Whatcom	21	3.2%
Skagit	20	3.1%
Other Counties	121	18.6%
TOTAL =	**651**	**100.0%**

Source: Department of Revenue Nonprofit Property Tax Database.

To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended?

There does not appear to be any unintended tax benefits to any entities other than the nonsectarian organizations that are conducting character building, benevolent, protective or rehabilitative social services. In addition to the requirement that the exempt property must be used exclusively for the purposes of either character building, benevolent, protective or rehabilitative social services, the organizations must meet a gift giving test. The combination of all of these factors leads to only a small chance of unintended benefits going to entities other than those that the Legislature intended.

Revenue and Economic Impacts

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?

According to the Department of Revenue's Tax Exemption Reports from 1988 until 2004, this property tax exemption for nonsectarian organizations has seen the property tax savings rise from less than $5 million in 1988 to more than $11 million in 2004 and 2005. The value of the taxpayer savings of this tax preference has fluctuated over those years depending on the sample of counties used to forecast the taxpayer savings of this tax preference by the Department of Revenue. One reason for the rise in property tax savings has been the growth in the number of nonprofit nonsectarian organizations.

The forecast for the nonsectarian property tax savings is based on the 2007 Department of Revenue's exempt property tax data and county roll data of the value of nonprofits' exempt property. For property tax year 2006-07, the local and state property tax savings are estimated to be $17 million. The future property tax savings is estimated between $17 million in 2007-08 and $18.5 million in 2009-10. Table 7 summarizes the property tax savings.

If this tax preference was continued and the exempt property value was not added to the tax roll, then nonprofit nonsectarian organizations would not pay property taxes, and other local taxpayers would pay slightly higher property taxes annually. There would be a shift in the tax liability from nonprofit nonsectarian organizations to other residential and business property owners in specific locations where the nonsectarian organizations' properties are located statewide. Governments would not see a change in their overall property tax revenue due to this tax preference because of the shifting of tax liability among taxpayers, unless the taxing districts were at their maximum tax rate limit. If taxing districts are at their maximum tax rate limit, then the local governments cannot fully shift the tax liability from this exemption onto other taxpayers by raising their local property tax rate.

Table 7: Forecast of Local and State Property Tax Savings for Nonsectarian Organizations

Year	Exempt Value ($ millions)	State Property Tax Savings ($millions)	Local Property Tax Savings ($millions)	Total Property Tax Savings ($millions)
2006-07	$1,553.8	$3.1	$13.9	$17.0
2007-08	$1,615.9	$3.2	$14.1	$17.3
2008-09	$1,680.6	$3.3	$14.5	$17.8
2009-10	$1,747.8	$3.4	$15.1	$18.5

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?

If the tax preference were terminated, the negative effect on the nonprofit nonsectarian taxpayers would be $17 million. It is difficult to quantify the exact number of employees who are working for nonsectarian organizations that are receiving this tax preference because they are in many different industry sectors. Since the beneficiaries of this tax preference are all different types of nonprofit nonsectarian organizations, the most recent financial data from nonprofit organizations that are required to report to the IRS is summarized to examine the impact on the economy. There were nearly 7,700 nonprofit public charities in Washington that were required to report to the IRS in 2005. These organizations had total gross receipts of $28 billion; total revenue of $24.6 billion; total expenses of $22.8 billion; net income of $1.8 billion and total assets of $33.1 billion. Washington's nonprofits made up roughly 2 percent of all nonprofit revenue, expenses and assets in the U.S.[35]

The number of nonprofit employers in Washington State, who are identified as nonprofits by the Washington State Department of Employment Security, is sizably smaller than the total number of nonprofit firms reporting to the IRS. Several studies by the Evergreen State Society have quantified the number of nonprofit employers in different studies since 1993 with the most recent study completed in 2004.[36] For 2003, this study found that there were 3,618 nonprofit employers with more than 234,700 employees and $5.7 billion in total wages. Washington's nonprofit sector represents 8.8 percent of all employees and 5.5 percent of total wages statewide. If nonsectarian organizations had to pay property taxes, it is unlikely that they would lay off employees since most of them only employ a few people, and they depend on volunteer employees to help run their organizations.

As far as the impact from higher taxes on employment and the economy statewide due to certain nonprofit organizations having to pay property taxes and other businesses and residents paying less in property taxes, the effect on employment and the economy would be minimal statewide. Since the elimination of this tax preference would result in both higher property taxes for nonsectarian organizations as well as lower taxes for residential and other business property owners, the overall impact on the state economy would be minimal.

If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes?

If the tax preference were to be terminated, the effect on the distribution of tax liability would be a shifting of property tax liability from residential and other commercial properties to higher taxes for nonprofit organizations. The degree of tax liability shifting among taxpayers would be minimal. The largest change in average tax rate among counties throughout the state with nonsectarian organizations would be -.8 percent in Clark County. Adams County had the second largest reduction in the average property tax rate of -.5 percent and all other counties' reduction in property tax rates were below -.5 percent so the overall positive impact on the state economy from having lower property taxes to local residents where nonsectarian organizations are located would be minimal. Due to counteracting forces of nonsectarian organizations paying property taxes and other taxpayers paying lower property taxes, the overall negative impact on the statewide and regional economy would be minimal.

[35] The Nonprofit Sector in Brief Facts and Figures from the Nonprofit Almanac 2007, Urban Institute National Center for Charitable Statistics.

[36] Nonprofits in Washington 2004 The Evergreen State Society.

Other States

Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

The Commerce Clearing House (CCH) 50-state survey plus DC of property tax exemptions for nonsectarian organizations revealed that 43 states, including Washington, had some type of provision specified for benevolent, fraternal or other nonsectarian organizations. The other eight states had provisions to provide a property tax exemption generally for charitable organizations but the state did not have specific provisions for benevolent, character building, protective or rehabilitative social services. Generally, the state survey found that most other states do not have the broad statutory language like Washington that brings in a wide variety of nonsectarian organizations that fit either benevolent, character building, protective or rehabilitative social services. Most states have specified in statute which nonsectarian organizations should receive a property tax exemption. Some examples of states that specified certain nonsectarian organizations by name are: Connecticut, Delaware, Indiana, Nevada and New Hampshire. Other states, like Minnesota and Missouri, have tests that charitable organizations must meet in order to qualify for their property tax exemption. Below are some additional examples of different states' tax treatment of nonsectarian organizations' property:

Hawaii

Their nonprofit nonsectarian property tax exemption is limited to schools, churches and labor organizations. In addition, the real property of thrift stores that distribute their income to charitable organizations is also tax exempt under certain conditions.

Kentucky

Their property tax exemption for nonsectarian organizations is limited to fraternal benefit society organizations.

Louisiana

Their nonsectarian property tax exemption is for nonprofit housing for homeless persons or for the property of a lodge or club.

Michigan

Michigan has an acre limitation of 400 acres for their property tax exemption of boy or girl scout organizations, a camp fire girls organization, a 4-H club or foundation, or a YMCA or YWCA. In addition, they require the exempt organizations to have at least half of its members from the state of Michigan.

Montana

Montana limits the nonsectarian organizations that can qualify for a property tax exemption by requiring the organization to fit into one of the following three categories:

- A lodge of a nationally recognized fraternal organization;
- Furnishes services to senior citizens in daytime or evening educational or recreational activities that are recognized in the state plan on aging; or
- Primarily furnishes facilities without charge for public meetings and entertainments.

Nevada

Nevada puts a limit on the value of exempt nonsectarian property of $5,000. They also specifically name nonsectarian organizations that are property tax exempt.

Rhode Island

Rhode Island appears to limit its exemption of nonsectarian organizations to fraternal groups and organizations with services for “friendless” children and poor generally.

Wisconsin

Wisconsin places different limits on the number of acres of nonsectarian organization’s property depending on the specified purpose of the property.

CEMETERIES – SUMMARY

Current Law

State law provides that all lands, buildings, and personal property used exclusively for public burying grounds or cemeteries are exempt from the property tax. This applies to both nonprofit and for-profit cemeteries (RCW 84.36.020).

"Public burying grounds" means places actually used and dedicated for the internment or inurnment of human remains, and also includes an "abandoned cemetery," "historical cemetery," "historic grave," Native Indian burial grounds and historic graves, and nonprofit cemeteries owned or operated by any recognized religious denomination.

In addition to the exemption noted above, another statute, RCW 68.20.110, provides that nonprofit cemetery associations are authorized to hold land for the sole purpose of a cemetery which shall be exempt from taxation if intended to be used exclusively for burial purposes.

Findings and Recommendations

This review of Washington's property tax exemption for cemeteries evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following findings were determined through this audit:

Legal History and Public Policy Objectives

- The property tax exemption for cemeteries or burial grounds dates back to the origin of Washington Territory – 1854.
- All privately owned cemeteries - both nonprofit and for-profit - are exempt from property taxes. In 1881 there was a restriction for the tax exemption that the burial grounds could not be owned or controlled for speculative purposes. This restriction was dropped in 1886.
- There may be several public policy objectives for exempting cemeteries from the property tax:
    - The Legislature, when defining the tax base, chose to exempt cemeteries because they did not rise to the level of a taxable activity;
    - The Legislature wanted to provide a subsidy to cemeteries because they perform a service that otherwise the government would need to do;
    - As a matter of equity, since publicly-owned cemeteries are exempt from property taxes, it is fair to exempt privately-owned cemeteries; and
    - Since the use of cemetery property is restricted, it is not in the interest of a government to foreclose on a cemetery.

- Cemeteries are also operated by some local governments - either cemetery districts or cities and towns.

Beneficiaries

- Property tax exemptions are granted to 196 cemeteries in 2006 – 153 owned by nonprofit organizations and 43 owned by for-profit companies. In addition there are another 67 cemeteries located on tax-exempt church grounds.

Economic and Revenue Impacts

- The estimated value of the 196 cemeteries is over $700 million.
- The property tax savings in 2006-07 are estimated at $7.4 million.
- Over the next three years the savings are expected to increase to $7.9 million in 2009-10.
- The cemetery industry is captive to Washington with Washington residents primarily being served by Washington cemeteries.
- There has been a tremendous change in the disposition of the dead in Washington in the last 25 years – going from 65 percent burials and 29 percent cremation in 1980 to 31 percent burials and 65 percent cremation in 2005.

Other States

- Twenty states exempt all privately owned cemeteries - both nonprofit and for-profit - from the property tax.
- Twenty-three states exempt only nonprofit cemeteries.

Recommendation

The property tax exemption for all privately owned cemeteries should be continued.

Legislation Required: None
Fiscal Impact: None

CEMETERIES – REPORT DETAIL

Statutory History

The property tax exemption for cemeteries dates back to the origin of Washington Territory in 1854. Territorial law provided that "All real and personal property belonging to …, and all places of burial, … shall be exempt from taxation." In 1881 the Legislature added a restriction that the burial grounds not be owned or controlled for speculative purposes. In 1886 this restriction was dropped.

At statehood the exemption was continued:

> All property described in this section, to the extent herein limited, shall be exempt from taxation, that is to say—
>
> *First*, …; *second*, all lands used exclusively for public burying grounds or cemeteries, *third*, …

The Legislature added the phrase that the property tax exemption applied to all lands used exclusively for public burying grounds or cemeteries "without discrimination as to race, color, national origin or ancestry" in 1961.

Buildings required for the necessary administration and maintenance of cemeteries became exempt in 1973. All personal property required for the necessary administration and maintenance of cemeteries became exempt in 1994.

The 1973 legislation amended many property tax exemption statutes. The term "nonprofit" was inserted in many sections limiting the exemptions to nonprofit organizations. This amendment was even added to the exemption for churches, which is in the same statute as the exemption for cemeteries. The "nonprofit" amendment was not added to the exemption for cemeteries.

Cemetery Ownership

Cemeteries are operated in this state by for-profit corporations, nonprofit organizations, and local governments. Of the 196 cemeteries receiving a property tax exemption under RCW 84.36.020 in 2006, 43 are owned by for-profit corporations, and 153 are owned by religious or other nonprofit organizations. There are another 67 tax-exempt churches with cemeteries on the church grounds.

Cemetery districts are local units of government that can be organized in unincorporated areas of counties (although it may include a city or town) for the purpose of establishing and operating cemeteries (see RCW 68.52.090). There are 102 cemetery districts in the state.[37] These are junior taxing districts with elected commissioners which have an ability to levy a property tax up to 11.25 cents per $1,000 of assessed value within the district. In 2006 there were 92 cemetery

[37] "Property Tax Statistics 2006," Washington State Department of Revenue, August 2006.

districts levying a property tax collecting $2.2 million in taxes. The average levy rate was 6 cents per $1,000 of assessed valuation.

Also, every county, town, or city has the power to provide a hearse and pall for burial of the dead, and to procure and hold lands for burying grounds. They may also collect the necessary taxes for these purposes (see RCW 68.52.030). There are 87 towns and cities that had expenditures for cemetery purposes.[38] These cities and towns have reported spending $6.0 million on cemeteries in 2005.

Cemetery Board

The state Cemetery Board licenses and regulates 147 active cemeteries in the state. The regulated cemeteries do not include church or religious cemeteries; cemeteries operated by counties, cities, towns, cemetery districts, or other government entities; nor do they include abandoned or historic cemeteries.

The staff of the Cemetery Board, among other duties, audits the financial records of each cemetery relating to endowment care funds and prearrangement trust funds. The endowment care funds are the maintenance funds for the cemetery. When a cemetery sells a burial or interment right, ten percent of the gross sales price for each grave, niche, or crypt is to be deposited into an endowment care fund. The income from the endowment care fund is to be used for the general care, maintenance, and embellishment of the cemetery. Cemeteries may enter into "prearrangement contracts" with individuals for the purchase of cemetery merchandise or services. The greater of 50 percent or the wholesale cost of the merchandise and cost of services are to be deposited into a prearrangement trust fund.

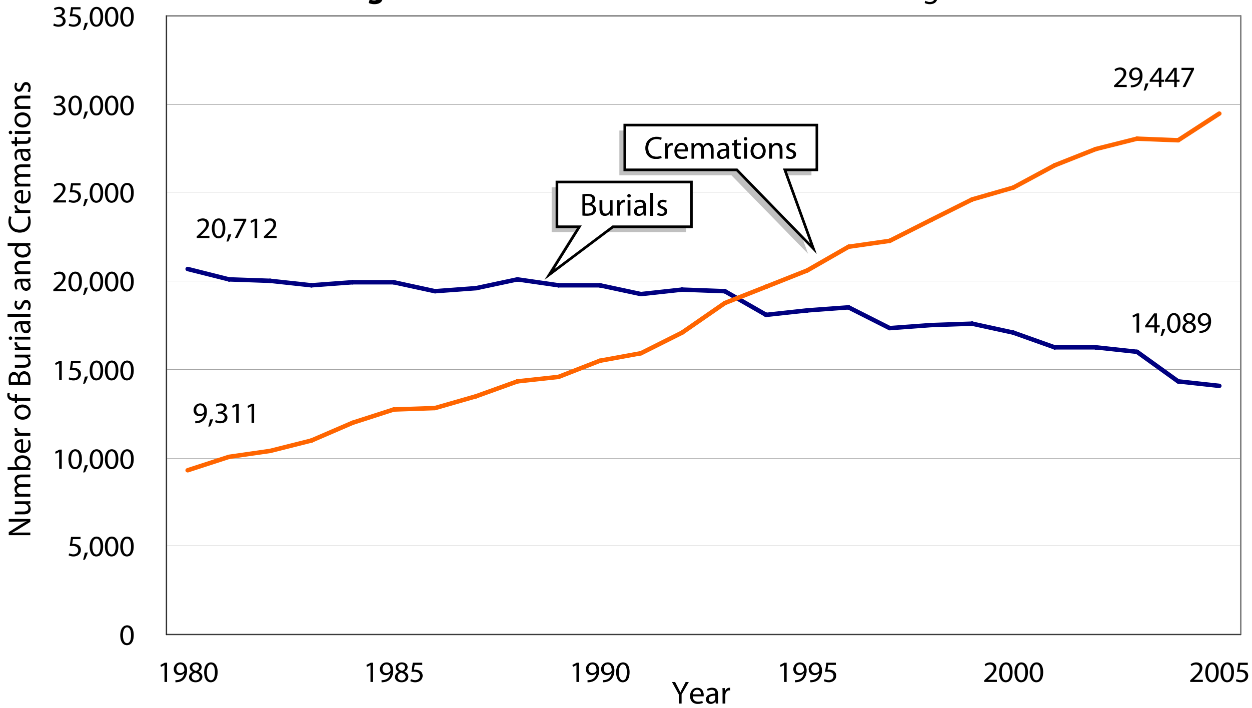
Burial Trends

There has been a tremendous change in the disposition of the dead in Washington in the last 25 years. In 1980, of the 32,000 deaths in the state, 65 percent were buried, and 29 percent were cremated.[39] In 2005 the percentages have almost reversed – of 46,000 deaths, some 31 percent were buried, and 65 percent were cremated.

[38] Local Government Financial Reporting System, Washington State Auditor's Office.

[39] Data on the disposition of the dead obtained from the Washington State Department of Health, Center for Health Statistics.

Figure 6: Burials and Cremations in Washington State



Source: Washington State Department of Health.

Public Policy Objectives

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?

There are several public policy objectives that may explain the property tax exemption for cemeteries. The possible primary objectives include (1) cemeteries were simply not to be part of the tax base, or (2) cemeteries should be provided a subsidy because they perform a service that government would otherwise need to provide.

There are two legal theories used to justify property tax exemptions: the base-defining theory and the subsidy theory. (1) The base-defining theory states that the activity does not rise to the level of a taxable activity. The Legislature has to pick out what to tax, and wealth or income generation provided an appropriate basis for taxation. To the extent that owners of the plots or burial rights, as dead persons, no longer produce wealth and cannot pay taxes, they should not be part of the tax base. Historically, the exemption for cemeteries was consistent with the treatment of other organizations that did not produce income.

(2) The subsidy theory, at its most basic, is the idea that the state grants exemptions because the exempted organization lessens the burden on government. Private cemeteries relieve governments of the expense of burying citizens and maintaining its own cemeteries.

In an 1897 State Supreme Court decision the Court appears to use both theories.[40] The Court wrote:

> …they [the Legislature] had also reference to property which is of *quasi* public nature and which it has been customary for legislatures to exempt from taxation, such as charitable institutions, public libraries, cemeteries and a similar class of properties. It cannot truthfully be said that such property is strictly private property. It does not enter into competition with private property. The public has an interest in such property and in its maintenance.
>
> Charitable organizations perform services which the state would otherwise frequently be called upon to discharge, and the theory upon which they are exempted is that to a certain extent they relieve the state of expenses.

Another public policy objective for exempting privately owned cemeteries from the property tax could be one of equity – treating persons in similar circumstances the same. Cemeteries in this state are owned by the public, by nonprofit, and by for-profit entities. They all perform basically the same service. Those cemeteries operated by local governments are tax exempt. It is equitable therefore that other entities in the same situation be treated similarly.

Finally, as a practical matter, the government has no financial incentive to take any action that could lead to a foreclosure of a cemetery. A cemetery is permanently dedicated as a cemetery and is protected from almost all threats. State law is set up to protect cemeteries in perpetuity. A foreclosure on a cemetery thus would become an immediate burden on the local government and its taxpayers as alternative uses of the property are very limited.

What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives?

If the public policy objective for exempting cemeteries from the property tax was to define the tax base, then continuing the exemption is evidence that the public policy objective is being met. There does not need to be any additional evidence.

If the public policy purpose was to provide a subsidy to private cemeteries as it lessens the burden on government, then this may have been accomplished to some extent. There are 92 cemetery districts collecting property taxes and 87 towns and cities operating cemeteries, so the burden on government has not been eliminated. However, cemetery districts do not provide services statewide, and not every city or town spends money on cemeteries. There are areas of the state where burial services are provided only by the private sector.

As to equity, entities in the same business are being treated similarly. For-profit and nonprofit cemeteries are being treated the same as publicly operated cemeteries with regard to property taxes.

[40] Chamberlin v. Daniel, 17 Wash. 111; 49 P. 243; 1897 Wash.

Finally, while all cemeteries are facing uncertainty and financial difficulties with regard to the changing disposition practices of increased cremations and declining burials, there have not been any failures.[41] Cemeteries have lost a considerable amount of business, and the smaller cemeteries have been hardest hit. An option for a failing cemetery is that a local unit of government take it over. While this does occur on occasion, it is still rare.

To what extent will continuation of the tax preference contribute to these public policy objectives?

In all cases, to meet the public policy objectives would require continuation of the property tax exemption for cemeteries.

If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment of the tax benefits?

The public policy objectives are being fulfilled.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

There are 196 cemeteries exempted from paying property tax under RCW 84.36.020 in 2006. This does not include cemeteries located on property along with a church. If the property had both a cemetery and a church, they are treated in this review as an exemption for a church. Of the 196 cemeteries, 153 are nonprofit and 43 are for-profit organizations. The nonprofit cemeteries include both religious and nonsectarian cemeteries.

[41] Interview with Dennis McPhee, Program Manager, Funeral and Cemetery Licensing, May 15, 2007.

Table 8: Cemeteries in Washington State

County	For-Profit Cemeteries	Nonprofit Cemeteries	Churches With a Cemetery	Cemetery Districts (With Levies)	Cities/Towns (With Cemetery Expenditures)	Total
	Privately Owned Cemeteries			**Publicly Operated Cemeteries**		
Adams			2	2	2	6
Asotin					1	1
Benton	1	4			1	6
Chelan				5	3	8
Clallam	1				1	2
Clark	3	6	8	4	4	25
Columbia					1	1
Cowlitz	2	1		7		10
Douglas	1	1		3	2	7
Ferry			1			1
Franklin		1	1	2	1	5
Garfield			1		1	2
Grant		3	1	2	3	9
Grays Harbor	1	2	1	1	5	10
Island		3	2	2	1	8
Jefferson	1	2	1	1		5
King	10	24	4	1	7	46
Kitsap	4	10	3		1	18
Kittitas		3	1	1	2	7
Klickitat		2	2	4		8
Lewis	1	5	4	9	2	21
Lincoln			2	5	6	13
Mason		1				1
Okanogan	1	8	2	4	5	20
Pacific		4				4
Pend Oreille			1	3	1	5
Pierce	5	17	2		7	31
San Juan		1	2	2		5
Skagit	1	3	1	6	4	15
Skamania		0		1		1
Snohomish	7	10	5		4	26
Spokane		23	5	6	1	35
Stevens		2	4		3	9
Thurston	2	4	1	2		9
Wahkiakum		1		2		3
Walla Walla	1	3			3	7
Whatcom	1	3	4	10	3	21
Whitman		1	4	7	6	18
Yakima		5	2		6	13
State Total	**43**	**153**	**67**	**92**	**87**	**442**

Source: Department of Revenue and Office of the State Auditor.

To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended?

No unintended benefits are apparent.

Revenue and Economic Impacts

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?

Table 9: Forecast of Local and State Property Tax Savings for Cemeteries

Year	Exempt Value ($ millions)	State Property Tax Savings ($millions)	Local Property Tax Savings ($millions)	Total Property Tax Savings ($millions)
2006-07	$707.3	$1.5	$5.9	$7.4
2007-08	$742.6	$1.5	$5.8	$7.3
2008-09	$779.8	$1.5	$5.9	$7.4
2009-10	$818.8	$1.6	$6.3	$7.9

The estimated value of the 196 cemeteries is over $700 million. The tax savings to the property owners by being exempted from property taxes is $7.4 million per year. Of this amount, the savings were $1.5 million in state taxes and $5.9 million in local taxes.

Total state and local property tax levies were $7.2 billion in 2006. The tax savings to the cemetery owners represent about 0.1 percent of the total tax collections.

As to its economic impact, the cemetery industry is a service industry captive to Washington. Washington residents are being served by Washington cemeteries.[42] The competition to Washington cemeteries is not cemeteries in other states but rather other forms of disposition. The single biggest change is already occurring, and that is cremation.

Nearly 1,700 people were employed in the cemeteries and crematories and the funeral homes and funeral services industries in 2005.[43] Total wages were $55 million with the average wage being $33,000.

Average wages at private for-profit cemeteries in 2005 were $34,000. At private nonprofit cemeteries the average wages were $26,000, and for cemetery districts the average wages were $7,000. The differences in wages are reflective of hiring and management practices at the various types of cemeteries. The cemetery districts had very low number of direct employees per cemetery, and the low wages are indicative of a few part-time employees with necessary services being contracted out. Several of the private for-profit cemeteries had a larger number of

[42] The amount of "removals" from the state has declined from 6 percent in 1980 (1,986 bodies) to 3 percent in 2005 (1,390 bodies).

[43] Data on employment and wages obtained from the Washington Employment Security Department.

employees (18 had more than ten employees) suggesting more work being done in-house. Only five of the nonprofit cemeteries had more than ten employees with most having fewer than five employees.

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?

If the property tax exemption for cemeteries were eliminated, it would cause an additional hardship on the privately owned cemeteries, both for-profit and nonprofit. There are two areas of concern. First is the revenue source for payment of the taxes, and second is the changing dynamics of the cemetery business.

There are two general sources of revenue that potentially could be used for the payment of taxes. One is the endowment care funds for the general care, maintenance and embellishment of the cemetery. These funds were initially set up without taking property taxes into account. To the extent that the endowment funds are spent on property taxes, there would be less money available for the care and maintenance of the cemetery.

The other source of revenue would be the current income generated from the sale of new burial rights. This leads then to the second area of concern – the changing pattern of disposition from burials to cremations. Many cemeteries have business plans that rely on new sales and the build-out of the cemetery to successfully operate. With increased competition they have needed to change their product line and pricing to remain competitive – with the smaller cemeteries facing the most difficulty.

If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes?

In general, if previously exempt property were added to the tax rolls, the assessed valuation of the taxing district would increase, levy rates would decline, other taxpayers would pay less in taxes, and possibly the taxing district may see an increase in revenues (up to its maximum levy). These impacts would vary by taxing district. Also, generally, it is estimated that the initial burden of property taxes is split with households paying about 65 percent and business about 35 percent.

If the cemeteries needed to begin paying property taxes, the expected effect on other taxpayers would be minimal. The forecasted statewide levy rate in 2008 would decline about 0.18 cents per $1,000 of assessed valuation (for a savings of $1.80 per $1 million of assessed valuation). The specific local impacts would vary by the taxing districts in which the cemeteries are located.

Other States

Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

While the public policy arguments for exempting all cemeteries from the property tax seem compelling, not all states follow that practice. Twenty states, including Washington, exempt all cemeteries. Twenty-three states and the District of Columbia exempt only nonprofit cemeteries.

Texas exempts nonprofit cemeteries and land in for-profit cemeteries if it has been sold for burial purposes. North Carolina exempts property that has been sold for burial purposes but taxes the property if it has not been sold.

Maine exempts only those burial grounds associated with a religious society. Florida does not specifically exempt any cemeteries but presumably cemeteries that are part of a religious or charitable organization are exempt.

Two states, Idaho and Indiana, tax both for-profit and nonprofit cemeteries. They exempt only government owned or managed cemeteries.

South Dakota allows an exemption for one lot in a cemetery for family use.

The largest company in the deathcare industry is Service Corporation International, a for-profit corporation. As part of their business they own 436 cemeteries in 34 states. Fourteen of these cemeteries are in Washington State. Of the total, 168 of the cemeteries are exempt from taxation; 200 are in states where they are subject to tax; and 68 are in states where the cemeteries are subject to tax until burial plot is sold. It appears that private, for-profit firms can successfully operate cemeteries even in states where they are subject to property tax.

HOUSEHOLD GOODS – SUMMARY

Current Law

State law provides a property tax exemption for household goods, furnishings, and personal effects (RCW 84.36.110(1)). Individuals and families no longer need to file with county assessors, as they once did, a listing of all their household goods, furnishings, and personal effects so that it could be taxed.

"Household goods and furnishings" as defined by rule (WAC 458-16-115) are all items of tangible personal property normally located in or about a residence and used or held to enhance the value and enjoyment of the residence. This includes furniture, appliances, food, pictures, and tools and equipment used to maintain the residence. It does not include items of personal property used independently and separately from a residence such as boats, motor vehicles, campers and travel trailers. Personal property held for sale or used for any business or commercial purpose is not exempt. "Personal effects" are defined by rule and statute (WAC 458-16-115 and RCW 84.36.120) as items of tangible property of a personal or intimate nature that usually and ordinarily accompany a person such as clothing, jewelry, toilet articles, and the like.

"Personal property" is property that is movable – it is not fixed to the land. The two types of personal property are tangible personal property – material goods – and intangible personal property – money and other financial instruments. The major categories of tangible personal property discussed in this report are household goods and business or commercial personal property. "Real property" is land and anything fixed to it.

In addition to the complete exemption of household goods and personal effects, there is another "head of household" personal property tax exemption (RCW 84.36.1010(2)).[44] This exemption is not part of this review. The head of households' exemption provides that the first $15,000 of taxable personal property for heads of households is exempt from property tax. Households typically do not have any personal property tax liability due to the household goods exemption. The effect of the head of households' exemption is that it reduces the personal property tax liability of non-corporate businesses – basically sole proprietors. Ordinarily, the property tax applies to business or commercial personal property.

Table 10: Tax Status of Personal Property

	Households & Sole Proprietors	**Business (Partnerships and Corporations)**
Household Goods	Exempt	Not applicable
Commercial Personal Property	First $15,000 exempt; taxable on amounts over $15,000	Taxable

[44] The "head of households" property tax exemption is not currently scheduled for a review because it is referenced in the state's Constitution.

Findings and Recommendations

This review of Washington's property tax exemption for household goods, furnishings and personal effects evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- The state's Constitution provides that "property" means everything, whether tangible or intangible, subject to ownership. The Constitution allows the Legislature to provide that some classes of property be exempt from property taxes.
- The "household goods" exemption subject to this review was enacted in 1935. (The "head of households" exemption dates back to 1871.)
- Prior to 1935, all households were required to provide county assessors with a detailed list of all their personal property because personal property was taxable.
- The public policy objective of exempting household goods, furnishings and personal effects from the property tax was to ease the administration of the tax and make the tax fairer. The listing of household goods was not uniformly consistent among all households, and the valuation of such property was also not consistent.

Beneficiaries

- In 2005 there were 2.4 million households in this state benefiting from this exemption.

Economic and Revenue Impacts

- The estimated value of all household goods in the state is $33 billion in 2007.
- The gross savings to households from this exemption is $341 million in fiscal year 2007.
- Over the next three years the tax savings is expected to increase from $332 million to $358 million per year.
- It is likely that the exemption of household goods has shifted taxes onto other property - household real property and business real and personal property. The net savings to households is $119 million, and the increase in taxes on business is $119 million.

Other States

- Forty-eight states either (a) exempt household goods from the property tax or (b) do not tax personal property. The other two states provide a local option for counties to exempt household goods.

Recommendation

The property tax exemption for household goods, furnishings, and personal effects should be continued.

Legislation Required: None
Fiscal Impact: None

HOUSEHOLD GOODS – REPORT DETAIL

Washington State Constitution – Uniform Taxation

With regard to property taxes, the state's Constitution reads in part:

> … all taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax and shall be levied and collected for public purposes only. The word "property" as used herein shall mean and include everything, whether tangible or intangible, subject to ownership. All real estate shall constitute one class… Such property as the legislature may by general laws provide shall be exempt from taxation.[45]

The original text of the State Constitution provided that all property in the state which was not exempt under the laws of the United States or under the state's Constitution, were to be taxed in proportion to its value. The Legislature was to provide by law a uniform and equal rate of assessment and taxation on all property in the state, according to its value in money. Every person and corporation was to pay tax in proportion to the value of his, her, or its property. The property of the United States and of the state, counties, school districts and other municipal corporations, and such other property as the legislature may by general laws provide, were to be exempt from taxation.[46]

There was a national movement in the mid-1800s that taxes should be universal (all property – real and personal, tangible and intangible – subject to tax) and uniform (all property valued and taxed alike).[47] The movement failed.[48] Several problems became apparent with the property tax. Assessment was the weakest part of property tax administration. In the early history, the common belief was that locally elected assessors would be most familiar with the value of the neighboring property. This did not hold as the economy became more complex and property more specialized. Also, there was pressure on assessors to undervalue property. Tangible personal property was another problem. It is difficult to locate and even more difficult to assess. Self listing was tried and failed woefully, even when accompanied by a "swearing of an oath" and severe penalties. Intangible property was also difficult to locate. The end result was that many types of property, including household goods, were made exempt from property taxes.

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[45] Washington Constitution, Article VII, Section 1.

[46] See Original Text, Washington Constitution, Article 7, Sections 1 and 2.

[47] Although, some commonly recognized exemptions were property used for religious, charitable, educational, and governmental purposes and sometimes, a very small exemption for widows, orphans, or others in financial distress – but even some of these were subject to debate.

[48] For an interesting discussion of the history of the property tax see "The Worst Tax? A History of the Property Tax in America," Glenn W. Fisher, University of Kansas Press, 1996.

Statutory History

The "household goods" exemption subject to this review was enacted in 1935. However, a parallel exemption dates back to 1871. The Territorial Legislature exempted from the property tax $150 worth of household furniture. All furniture needed to be reported to the assessor, and $150 was subtracted from the total value. In 1881 the exemption was increased to $200 of household furniture and all wearing apparel (in actual use) and one year's supply of food.

The first State Legislature in 1890 exempted from the property tax personal property of each householder and head of family up to an amount not exceeding $300 in value. People were still required to list all personal property with the county assessor, and the assessor was to deduct the amount of exemption from the total assessment.

In 1897 the exemption was increased to $500, and the assessor was to notify every person that he was entitled to deduct the amount of exemption from his list of personal property. Also exempted were improvements upon land of which the person was an owner, to an amount not exceeding $500. This then led to the 1897 Supreme Court decision, Chamberlin v. Daniel.[49] The provisions of the 1897 revenue law exempting each person from taxation on personal property to an amount not exceeding $500 and, also, improvements upon land to a like amount, were found to be in conflict with the state's Constitution forbidding the exemption of private property from taxation.[50]

In 1899, the Legislature exempted from taxation the personal property of each head of a family as follows: all necessary wearing apparel for himself and family, one bed and bedding for himself and one additional bed and bedding for each additional member of his family, all necessary household and kitchen furniture including stoves and kitchen utensils and all necessary tools of trade, in all not to exceed $300 in value. At the same time the Legislature proposed a constitutional amendment to provide the Legislature with the power, by appropriate legislation, to exempt personal property to the amount of $300 for each head of household. This amendment was adopted in 1900.

The "Tax Investigation Committee," appointed by Governor Hart in 1921, commented on the personal property tax exemption. They believed that both the framers of the state's Constitution and the Legislature had the intention to grant heads of families an untaxed allowance of $300 in personal property for the purposes of the home, although the law did not specifically restrict the exemption to household goods. The committee was of the opinion that it was desirable to restrict the exemption to household goods and personal apparel for three reasons: (1) the restriction of the exemption to heads of families was indicative of the desire to limit the benefits of the exemption to household goods; (2) the expense of collecting the taxes on small amounts of such property was out of all proportion to the amount of revenue returned; and (3) the exemption privilege was abused by individuals living in rented apartments, who used the exemption feature

[49] 17 Wash. 111; 49 P. 243 (1897).

[50] The court found that only public property, and that of a quasi public character, could be exempted from taxation.

to exempt other than household goods, such as automobiles, boats and other property. The committee recommended, on the assumption that it would be constitutional, that the exemption be amended to apply only to household goods and personal apparel.[51]

The 1929 "Washington Tax Investigation Commission" followed up with similar comments. They recommended that household goods should be exempted from taxation in lieu of the $300 exemption (if, and when, it became constitutional to do so). The commission objected to the listing of household goods with county assessors, since values were subjective. Also, the commission believed the cost of assessing such property was probably the highest of any type of personal property considering the amount of taxes to be collected.[52]

The voters in 1930 adopted the 14th Amendment to the state's Constitution which allowed for distinctions in the classification of personal property. The original text of the state's Constitution required that all property in the state be taxed in proportion to its value. While the Legislature could exempt some property from taxation, this was restricted by the 1897 Supreme Court decision. The 14th Amendment required that all taxes upon the same class of property were to be uniform and that all real estate was to constitute one class. This allowed different types of personal property to be classified separately.

An attempt was made by the Legislature in 1933 to repeal the $300 head of household personal property tax exemption and replace it with a blanket exemption for all household goods and furnishings. This was done at the request of the county assessors.[53] Governor Clarence Martin vetoed the change. He found that the change would allow all household goods and furnishings in actual use by the owners, no matter how valuable, to be tax exempt, while at the same time it would take away the general exemption of $300 of personal property to each head of a family.[54] A head of family who was able to pay would be allowed an exemption of all his household goods, which could "amount to a thousand or fifteen hundred dollars" and the head of a family of "the poorer class of people is only allowed the exemption of his household goods which amounts to perhaps $25 or $50."[55] The Governor believed that the new exemption was not fair to the poor and was in favor of the wealthy, so he vetoed it.

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[51] "Report of the State of Washington Tax Investigation Committee, 1921," Olympia, Washington, 1922.

[52] "Report of the Washington Tax Investigation Commission," Olympia, Washington, 1930.

[53] At the 35th Annual Meeting of the County Assessors Association held in Olympia in January 1933, the assessors adopted a resolution to "eliminate from the tax rolls the item of household furniture" (this did not apply to household furniture used by hotels, furnished apartments, etc.) and "eliminate all other personal property exemptions."

[54] The distinction between household goods and personal property is that household goods and furnishings are a subset of personal property. Personal property includes all property not fixed to the ground; including such things as vehicles, equipment and tools used in trade, livestock, etc.

[55] See Veto Message, SB 219, Ch. 155, Laws 1933, March 15, 1933.

In 1935, the Legislature adopted the current household goods and furnishings and all personal effects exemption. The $300 head of household personal property exemption (which had been re-enacted in a special session of the Legislature in 1933) was maintained. Both exemptions are contained in RCW 84.36.110; however, the $300 has been increased to $15,000.[56]

Public Policy Objectives

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?

The taxation of household goods and furnishings was difficult to administer – both in terms of obtaining compliance with the listing of property and with the valuation of the property. Taxing personal property is more difficult than taxing real property because personal property is often difficult to locate and is more difficult to asses than real property. Given the compliance problems and the assessment problems, the public policy objective for the exemption of household goods is to ease the administration of the property and make it fairer. The tax is fairer in that (a) households that complied and were paying tax are now being treated the same as households that did not comply and avoided the tax; and (b) there is no longer an issue of inconsistent assessments of similar goods.

Making the property tax less regressive or fairer to households may be an added benefit of exempting household goods. One notion of equity in public finance is the “ability to pay” principle. The ability to pay principle requires that the burdens on taxpayers be related to their ability to pay. Household income is frequently used as a measure of a household’s ability to pay. Annual expenditures on household furnishings and equipment are a larger percentage of income for households in the bottom income quintile (6.0 percent) than in the top income quintile (2.7 percent).[57] Assuming that the accumulation of household goods approximates annual spending on these items, a tax on the accumulated depreciated value of household goods would be a greater percentage of income in a lower-income household than in a higher-income household. Such a tax would be regressive.

What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives?

The historical record has many anecdotes about the difficulties in listing and valuing tangible personal property, including household goods, furnishing, and personal effects. Similar administrative difficulties continue today with the listing and valuing of business personal property. It is hard to fathom today how citizens could be enticed to list with a county assessor all their personal belongings (and have it be a public record).

[56] The Constitution was last amended to allow a $15,000 head of household exemption in November 2006.
[57] “Consumer Expenditure Survey, 2005,” U.S. Department of Labor, Bureau of Labor Statistics, February 2007.

The evidence that the household goods exemption has contributed to the public policy purpose of easing the administration of the property tax is the absence of complaints about this aspect of the property tax. With the exemption there are no compliance problems, no inherent unfairness between those who honestly list their property and those who do not, and no valuation problems. There continue to be the same historical problems with the listing of business personal property– the administrative difficulties of listing the property and then fairly valuing it.

To what extent will continuation of the tax preference contribute to these public policy objectives?

If the public policy objective is to simplify the administration of the property tax, the exemption for household goods will need to be continued. Even with the improved record keeping systems available today, county assessors already have enough difficulties with the listing of business owned personal property.

If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment of the tax benefits?

The public policy objectives of ease of administration and fairness to the taxpayers are being fulfilled.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

The primary beneficiaries of the household goods property tax exemption are the 2.4 million households in Washington State.[58]

To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended?

There are no apparent unintended beneficiaries.

Revenue and Economic Impacts

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?

[58] Estimate from Office of Financial Management for 2005.

Table 11: Forecast of Local and State Property Tax Savings for Household Goods

Year	Exempt Value ($ millions)	State Property Tax Savings ($millions)	Local Property Tax Savings ($millions)	Total Property Tax Savings ($millions)
2006-07	$32,591.5	$70.2	$270.5	$340.7
2007-08	$34,168.6	$67.9	$264.6	$332.5
2008-09	$35,736.8	$69.8	$272.4	$342.2
2009-10	$37,433.4	$72.2	$286.1	$358.3

The estimated depreciated value of furniture and household equipment in Washington is $33 billion.[59] The tax savings to households from this exemption is $341 million. The savings in state property tax is $70 million and $271 million in local property taxes.

The removal of $33 billion from the property tax rolls is significant – an amount equivalent to five percent of total assessed valuation in the state. The impact is felt in every taxing district statewide. However, the impact has been absorbed over the last 72 years that the exemption has been in place. The likely impact has been a shift in taxes – away from owners of household goods to owners of real and other personal property. Households are paying less in taxes on household goods but are paying more in taxes on real property. Business is also paying more on both real and personal property.

Households are currently estimated to pay 65 percent of the property tax and businesses pay 35 percent. A $341 million shift of taxes would mean a shift to households of $222 million and a shift to business of $119 million. The combination of saving $341 million in taxes on household goods and paying $222 million more in taxes on real property has a net effect of a tax reduction for households of $119 million.

The economic impacts of this tax preference are of two types: the positive impact of increased expenditures or savings by households due to the net tax savings; and the negative impact of business paying an increased amount of taxes.

The net savings to households of $119 million in lower property taxes has led to higher consumption, a positive impact on the economy. If the entire mount was spent by households, it would generate about 1,700 jobs in the state economy.[60]

As to the increased taxes on business, the conventional economic theory on the incidence of the property tax on business is that it is shifted to the owners of capital.[61] The effect is the same as that of a corporate income tax as it lowers the rate of return on investments. In the long-term, a lower rate of return would lead to a relatively lower amount of investment and less economic

[59] These are durable goods items owned by consumers that were purchased by households for their nonbusiness use and have a life expectancy of at least three years.

[60] Using a jobs multiplier derived from the "1997 Washington Input-Output Tables," Office of Financial Management, July 2004. There are 18.2 total jobs for every $1 million ($1997) of personal consumption expenditures.

[61] See Joseph A. Pechman, "Who Paid the Taxes, 1966-85," The Brookings Institution, 1985.

growth. An increase of $119 million in business property taxes represents 4.5 percent of estimated business property tax payments. A tax increase of this size could cause a reduction in the rate of return in the order of 0.05 percent (e.g., from 15.00 percent to 14.95 percent).

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?

If the tax exemption for household goods were to be eliminated, there may be no negative effects on households due to the administrative difficulties in collecting the tax. Households may fail to comply.

However, if $33 billion of household property were to suddenly appear on the tax rolls, levy rates would fall, owners of real and business personal property would see lower tax bills, and some units of local government would see up to a one percent increase in levy amounts. The net increase of taxes on households could be $119 million.

If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes?

If the tax exemption for household goods were to be eliminated, there may be no effect on the distribution of tax liability due to the administrative difficulties in collecting the tax. Households may fail to comply.

If the tax exemption on household goods were to be eliminated and it were possible to get households to report all their personal belongings to the county assessor for purposes of valuation, then homeowners would pay $341 million in personal property taxes. This would be partially offset by a reduction of $222 million in real property taxes on residential property. Business would see a reduction of $119 million in property taxes due to lower levy rates. Some units of local government currently at their maximum levy rates may see an increase of tax collections up to 1 percent.

Other States

Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

Tangible personal property essentially consists of household goods and business personal property (e.g., equipment and furnishings). Thirty-six states, including Washington, and the District of Columbia exempt household goods and personal effects from property taxation.[62]

[62] Primary source: "2007 State Tax Handbook," CCH, 2006.

Another 12 states have no or a limited property tax on any tangible personal property – including both household goods and business property. The other two states, Oklahoma and Virginia, provide a local option for counties to exempt household goods and personal effects.

Of the 12 states that exclude all or significant amounts of tangible personal property – including business personal property – from the tax base, six states do not have a property tax on any personal property. These are Delaware, Hawaii, Illinois, New Hampshire, New York, and Pennsylvania. Iowa exempts most personal property. North Dakota and South Dakota tax only the personal property of certain centrally assessed entities. New Jersey taxes only business personal property used by specified utilities and petroleum refineries. Minnesota technically taxes tangible personal property but then exempts virtually all categories.[63] Ohio is phasing out the personal property tax on business inventory, machinery and equipment used in business, and furniture and fixtures.

To consider exempting all personal property from taxation in Washington, similar to 12 other states, involves another sizable portion of the tax base. In Washington, taxable business personal property constitutes 4.9 percent of all taxable property. In 2005, the value of taxable personal property was $35 billion. King County had the greatest amount of taxable personal property at $15 billion where it was 5.3 percent of the tax base. The counties where taxable personal property exceeded ten percent of total taxable property included Adams, Ferry, Lewis, Lincoln, Stevens and Whitman counties. The counties with the least amount of taxable personal property (three percent or less of total taxable property) included Clallam, Clark, Island, Jefferson, Kitsap, Mason, and San Juan counties.

[63] John L. Mikesell, "Patterns of Exclusion of Personal Property from American Property Tax Systems," Public Finance Review, 1992.

REFUND OF FUEL TAX FOR EXPORTED FUEL – SUMMARY

Current Law

The motor vehicle fuel taxes are laid out in two separate chapters of state law. Chapter 82.36 RCW pertains to motor vehicle fuel, which is basically gasoline, and Chapter 82.38 RCW pertains to special fuel, which is all combustible gasses and liquids that can propel a motor vehicle except gasoline (primarily diesel).[64]

There are two sections of law that deal with refunds of fuel tax for exported fuel: RCW 82.36.300 (motor vehicle fuel/gasoline) and RCW 82.38.180 (special fuel/diesel). In both cases, a person who has exported fuel outside of Washington, on which the fuel tax has been paid, is entitled to a refund of the fuel taxes. Fuel taxes are imposed when fuel is transferred from a supplier to a distributor. If the distributor then exports the fuel, the distributor is entitled to a refund of the fuel taxes.

There are several other sections of law that provide an outright exemption from the motor vehicle fuel taxes for exported fuel. In this situation, the supplier is aware that the fuel will be exported and does not collect fuel tax. These sections are not considered in this review and are scheduled for review in 2008.

Findings and Recommendations

This review of the tax refund for motor vehicle fuel tax paid on exported fuel evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- Washington State first imposed the motor vehicle fuel tax in 1921 on the sale of liquid fuel for use in internal combustion engines. The tax was not imposed on liquid fuel sold for export. In 1923, the tax was changed to be a tax on fuel used to operate motor vehicles upon the public highways. Tax refunds were provided for the nonhighway use of fuel, except in motor vehicles operated or intended to be operated upon the public highways. In 1933, the Legislature provided a specific refund for taxes paid on motor vehicle fuel which was exported outside of the state.

[64] This report will use motor vehicle fuel and gasoline interchangeably, as well as special fuel and diesel. It will also refer to the motor vehicle fuel tax and the special fuel tax as fuel taxes.

- The Interstate Commerce Clause of the U.S. Constitution limits the state taxation of goods shipped among the states. There is a four-part test to determine when and how much exported goods may be taxed by a state. It is possible that the complete exemption of exported fuel from the motor vehicle fuel tax is broader than it needs to be. In other words, a partial exemption could be provided and likely be consistent with the U.S. Constitution.
- There are three possible public policy objectives for granting refunds for fuel taxes paid on exported fuel:
- To comply with the U.S. Constitution;
- To support the business of exporting fuel; or
- To promote equity – (a) subjecting to the fuel tax only fuel used on Washington's public highways; and/or (b) treating taxed fuel that is exported similarly to tax-exempt fuel that is exported.
- The primary objective that is being met is currently equity.

Beneficiaries

- In 2007, the likely beneficiaries are 57 licensed gasoline distributors and 85 licensed diesel distributors who do not have an exporter's license and who may, from time-to-time, purchase taxed fuel and eventually sell it out of state.

Economic and Revenue Impacts

- Tax refunds for exported fuel are very minor, especially when compared to the amount of fuel that is exported tax-exempt. In 2006, claimants received $1.3 million of refunds for taxes paid on fuel that was exported. Exports of taxed motor vehicle fuel totaled 89 refund claims for 4.2 million gallons of fuel.
- Over the next three years the amount of refunds is expected to range from $1.6 million to $1.8 million per year.

Other States

- All states grant fuel tax exemptions or refunds to distributors on export sales.

Recommendation

The motor vehicle fuel tax and special fuel tax refunds for exported fuel should be continued.

Legislation Required: None
Fiscal Impact: None

REFUND OF FUEL TAX FOR EXPORTED FUEL – REPORT DETAIL

Statutory History

Washington State first imposed the motor vehicle fuel tax in 1921. The tax was one cent per gallon imposed on the sale of liquid fuel – gasoline and other fuel for use in internal combustion engines. The tax was not imposed on liquid fuel sold for exportation. Revenues were credited to the Motor Vehicle Fund. The Motor Vehicle fund was a fund dedicated to, among other things, "paving and general road construction of the state primary highways."

In 1923, the Legislature raised the tax to two cents per gallon, and the tax base was more narrowly drawn. The tax was now on sales of liquid fuel to everyone who used liquid fuel for the purpose of operating motor vehicles upon the public highways. Tax receipts were still credited to the Motor Vehicle Fund. The Legislature also provided several refunds for non-highway use of fuel. The 1923 changes clarified that if fuel was used in vehicles operated upon the public highways, that fuel was subject to the fuel tax, and the tax receipts were dedicated to the Motor Vehicle Fund. If the fuel was used for some other purpose, the consumer could apply for a tax refund if the taxes had previously been paid.

In 1933, the Legislature added a specific provision for anyone who exported motor vehicle fuel outside of the state, and who had paid any tax on the fuel, to be reimbursed for the amount of the tax.

In 1944, the voters passed the 18th Amendment to the State Constitution. This constitutional provision states that "… all excise taxes collected … on the sale, distribution or use of motor vehicle fuel … shall be … placed in a special fund to be used exclusively for highway purposes." One of the specified "highway purposes" includes "refunds authorized by law for taxes paid on motor vehicle fuels." The 18th Amendment constitutionally dedicated motor vehicle fuel tax receipts to highway purposes and prevented the Legislature from using the tax receipts for other purposes. It still allowed the Legislature to provide for tax refunds.

Other Relevant Background

Export Exemptions: In addition to the refund statutes, fuel exported by a licensed exporter is exempt from the fuel taxes. A licensed exporter can obtain fuel for export without paying tax:

- RCW 82.36.020: The motor vehicle fuel tax is imposed when motor vehicle fuel is removed from a terminal unless the removal is to a licensed exporter for direct delivery to a destination outside of the state.
- RCW 82.36.230: The provisions of the motor vehicle fuel tax statutes requiring the payment of taxes do not apply to motor vehicle fuel exported from this state by a licensee.

- RCW 82.38.030: Taxes are imposed on special fuel removed from a terminal unless the removal is to a licensed exporter for direct delivery to a destination outside of the state.
- These tax preferences are scheduled for review in 2008.

Tax Incidence: The fuel tax system is based on a four-tiered distribution chain. Fuel enters the distribution chain when it is delivered to a "terminal rack" from a refinery, pipeline or barge. At the terminal rack, fuel is transferred from the supplier to distributors or licensed exporters. The vast majority of fuel taxes are imposed when fuel is removed from a terminal rack.[65] No fuel tax is imposed if the fuel is sold to a licensed exporter for direct delivery outside the state. The supplier is responsible for submitting fuel taxes to the Department of Licensing. The distributors distribute the fuel to retailers (gas stations) and bulk fuel users. The retailers sell the fuel to the end users or consumers.

Public Policy Objectives

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?

There are several possible public policy objectives that provide a justification for the tax exemption for exported fuel: (1) comply with the U.S. Constitution; (2) promote business activity in Washington; (3) promote equity.

(1) U.S. Constitution: Providing refunds for taxes paid on exported fuel may be seen as an attempt to comply with the U.S. Constitution. The Commerce Clause is generally read as prohibiting states from taxing exports and imports from other states and nations. However, it is possible that a state could tax an exported good if it provides a credit against the tax for any tax paid in another state.

The Commerce Clause of the U.S. Constitution limits the state taxation of goods shipped among the states. The U.S. Supreme Court has created a four-part test for testing state taxes under the Commerce Clause.[66] Under this test, a state tax must:

- Be applied to an activity that has substantial nexus with the state;
- Be fairly apportioned to activities in the state;
- Not discriminate against interstate commerce; and
- Be fairly related to services provided by the state.

A state tax must not discriminate against interstate commerce and must avoid double taxation of a good. It is possible that the exemption for exported fuel is written more broadly than it needs

[65] There are several other instances that can trigger the imposition of the tax, such as, importing fuel into the state outside of the bulk-transfer terminal system.

[66] "Complete Auto Transit v. Brady," 430 U.S. 274 (1977).

to be. It could be narrowed and still be permissible under the Commerce Clause if a credit were allowed for fuel taxes paid in other states.[67]

(2) Promote business activity: Washington is a net exporter of petroleum products. It is home to five major refineries that employ 1,800 people and that pay $172 million in wages in a year. Not taxing the export of refineries products could easily be seen as an attempt to lower the costs of the product and make Washington more competitive in the national and international market.

(3) Equity: There are two notions of equity discussed in public finance literature.[68] One is the "ability to pay principle" and the other is the "benefits received principle." The ability to pay principle requires that burdens on taxpayers be related their ability to pay. The benefits received principle states that the burden on taxpayers should be related to the benefits they receive. These principles cannot identify one tax policy as more equitable than another, but they do aid in clarifying and supporting value judgments about equity. For example, the gas tax could be considered inequitable under the ability to pay principle as it is regressive. However, under the benefits received principle the gas tax is equitable because the people who pay the tax (drivers) are the same taxpayers who receive the benefits.

From the beginning of the fuel tax in 1921, together with the 1923 and ensuing exemptions/refunds and the 18th Amendment to the state's constitution, it appears that:

- Fuel used in motor vehicles on public highways is to be taxed by the motor vehicle or special fuel taxes;
- Fuel not used on public highways is not to be taxed by the motor vehicle or special fuel taxes; and
- Fuel tax revenues are dedicated for highway purposes.

Because the tax is imposed at the top of the distribution chain, before the end use of the fuel is known, the only way to "exempt" the fuel from taxation is to provide a refund or credit to the end user. Exported fuel is not used on Washington's highways. To provide equity under the benefits received principle it is necessary to refund any fuel taxes that were previously paid on the exported fuel.

Also, when establishing the tax base for the liquid fuel tax in 1921, the Legislature specifically did not impose the tax on fuel sold for export. Equity also calls for taxpayers in similar situations to be taxed similarly. Licensed exporters can obtain fuel, export it, and never need to pay fuel tax on the fuel. To provide equity a distributor who obtains fuel on which the tax has been paid, who then exports the fuel, should be able to obtain a refund of the tax.

---

[67] Conversation with Cindy Evans, Assistant Attorney General, March 14, 2007.

[68] For example, see "Public Finance and the American Economy, Second Edition," Neil Bruce, Addison-Wesley Longman, Inc., 2001 or "Understanding the Tax Reform Debate: Background, Criteria, & Questions," U.S. Government Accountability Office, September 2005.

What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives?

There are three possible public policy objectives for granting refunds for taxes paid on fuel that is exported:

(1) Comply with the U.S. Constitution: As discussed above, there is a question about whether the refund would need to be for the full amount of Washington taxes or just the amount of taxes paid in the destination state. It may be possible to provide less than a full refund and still comply with the U.S. Constitution.

(2) Promote business activity: Motor vehicle fuel distributors made 89 refund claims in 2006 for $1.3 million of fuel taxes paid on 4.2 million gallons of fuel. In that year refineries sold 4.0 billion gallons of motor vehicle fuel in Washington.[69] The limited amount of exported fuel for which refunds are being claimed has no impact on Washington production of petroleum products. The evidence does not indicate that this public policy objective is being met.

(3) Equity: The public policy objective of equity is legally being met. The opportunity exists for taxpayers to seek a refund of fuel tax paid on fuel that is not used on the public highways in Washington. Also, the opportunity exists for these taxpayers to be treated similarly to tax-exempt exporters. There is no evidence that taxpayers in this situation are not seeking or not being granted refunds.

To what extent will continuation of the tax preference contribute to these public policy objectives?

(1) U.S. Constitution: Continuing the tax preference leaves no doubt the tax system complies with the U.S Constitution.

(2) Promote business activity: Continuing the tax preference has no impact on promoting business activity.

(3) Equity: Continuation of this tax preference does contribute to the public policy objective of equity. With a public policy objective of equity, both to (a) collect fuel on fuel used on the public highways and not to collect fuel tax on fuel not used on the public highways and (b) treat all exported fuel similarly, it is necessary to continue this tax preference.

If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment of the tax benefits?

The public policy objectives of compliance with the U.S. Constitution and equity are being fulfilled.

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[69] "Petroleum Marketing Annual 2006, Preliminary Report," Energy Information Administration, U.S. Department of Energy, May 2007.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

Distributors seeking tax refunds for exported fuel in almost all instances do not have an exporter's license. Distributors with an exporter's license may purchase motor vehicle fuel tax exempt under other sections of law.

Currently, there are 83 licensed gasoline distributors and 116 licensed diesel distributors in this state. Of this group, there are 57 gasoline distributors who do not also have an exporter's license and 85 diesel distributors who do not also have an exporter's license. Distributors made 89 refund claims in 2006.

To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended?

There are no unintended beneficiaries.

Revenue and Economic Impacts

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?

The estimate of the fiscal impact of the refund for exported fuel as provided in the "Tax Exemptions – 2004" report prepared by the Department of Revenue actually included information on both refunded motor vehicle fuel tax and exported motor vehicle fuel. The vast majority of fuel is exported tax exempt. Refunds are provided to a few distributors who do not have an exporter's license. The fiscal impact of only the exported fuel refunds would qualify this for an expedited review; however, a full review has been made.

Table 12: Refunds for Exported Fuel

	# of Claims	Refundable Gallons	Net Refund Amount
Gasoline			
2003	19	906,685	$228,529
2004	29	1,383,350	$387,338
2005	37	2,712,180	$785,708
2006	39	2,685,261	$854,373
Diesel			
2003	19	885,116	$220,040
2004	26	748,412	$209,499
2005	49	1,974,988	$564,274
2006	50	1,551,864	$483,109
Total			
2003	38	1,791,801	$448,569
2004	55	2,131,762	$596,837
2005	86	4,687,168	$1,349,982
2006	89	4,237,125	$1,337,481

Source: Washington Department of Licensing Database.

The amount of refunds provided of fuel taxes paid on fuel that was exported were $1.3 million per year in 2006. The number of gallons was 4.2 million in 2006.

Given the wide variation in the recent history claims and refunds for taxes paid on exported fuel, a forecast is pure speculation at best. Some of the change is due to changes in the tax rate. The Department of Transportation does forecast a broad category of refunds for off-road use of motor vehicle fuel, of which exported fuel is a component.[70] Using this forecast as a base, the expectation is that the level of refunds of taxes on exported fuel will increase to $1.8 million in fiscal year 2010.

Table 13: Forecast of Refunds for Exported Fuel

Year	Refunds ($millions)
2007-08	$1.6
2008-09	$1.7
2009-10	$1.8

Distributors: There were 83 "petroleum merchant wholesalers" reported by the Employment Security Department in 2005. These firms employed 1,254 people and paid wages of $51 million in 2005. The level of employment has remained fairly constant from 2000 to 2005. Average wages paid per employee has increased slightly from $37,000 per year in 2000 to $41,000 in 2005

[70] "March 2007 Forecasts," Transportation Revenue Forecast Council.

(not adjusted for inflation). The average firm size is 15 employees. These firms are located all around the state.

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?

If the tax refunds for exported fuel were to be terminated, it would have a direct impact on the distributors who do not have an exporter's licenses and who sometimes export fuel. These distributors then could either (a) cease to export taxed fuel, (b) obtain an exporter's license and purchase fuel tax exempt, or (c) continue to export taxed fuel and either not recoup the tax or attempt to pass it on to the customer. Overall, the amount of refunds now being obtained amount to 2.6 percent of the total wages paid by fuel distributors. This is significant enough that it could change the behavior of the distributors.

As to the overall economy, removing the tax refund would have no impact. First, there is an option to initially avoid the tax – exported fuel is exempt from tax and no tax is collected at the rack. Next, the amount of fuel for which refunds are granted is insignificant compared to either overall fuel production or the amount that is exported.

The price of gasoline in Washington has fluctuated widely in the past several years. The retail price of gasoline (all grades, including taxes) in Washington has gone from $1.68 per gallon in 2003 to $2.75 in 2006.[71] During this time, gross fuel consumption in Washington increased slightly from 3.356 billion gallons to 3.441 billion gallons. This increase tends to confirm the studies that fuel use is "price inelastic – demand for gasoline is not greatly affected by its price."[72] Being price inelastic means that a tax increase can be passed forward onto consumers without a proportionate loss in sales. Production of gasoline in this state would not decline if this refund of fuel taxes on exported fuel were ended.

If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes?

In fiscal year 2008, the motor vehicle fuel taxes are expected to be $1.2 billion at a fuel tax rate of 36 cents per gallon.[73] The annual amount of refunds for fuel that is exported amounts to $1.3

[71] Source: Energy Information Administration.

[72] "Price elasticity of demand" measures the consumers' sensitivity to price changes and is the change in a products demand compared to a change in its price. If a 10 percent increase in the price of a good leads to a 10 percent decrease in demand, the price elasticity of demand is one. A good with a price elasticity greater than one is price "elastic" – demand decreases faster than the price increases. A price "inelastic" good is one where the demand decreases at a slower rate than the price increase. Generally, goods that are essential to everyday living and have fewer substitutes are price inelastic.

[73] Transportation Revenue Forecast Council, March 2007 forecasts.

million. The refunds amount to one-tenth of one percent of the total. On a penny basis, the amount of refunds amount to four percent of a penny, or 0.04 cents. An amount this small would not result in any shifting of tax liability to other taxpayers.

Other States

Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

All states grant exemptions or refunds to distributors on export sale.

APPENDIX 1 – SCOPE AND OBJECTIVES

2007 TAX PREFERENCE PERFORMANCE REVIEWS

SCOPE AND OBJECTIVES

MARCH 2007

STATE OF WASHINGTON
JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE

STUDY TEAM

Gary Benson
Lizbeth Martin-Mahar

LEGISLATIVE AUDITOR

RUTA FANNING

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MANDATE

Engrossed House Bill 1069 (2006) 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 bill also directed the Joint Legislative Audit and Review Committee (JLARC) to conduct the periodic reviews.

BACKGROUND

Tax preferences are 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. The state has more than 500 tax preferences.

Recognizing the need to assess the effectiveness of these tax preferences in meeting their intended objectives, and an orderly process to do so, the Legislature established the Citizen Commission for Performance Measurement of Tax Preferences. The role of the commission is to develop a schedule for the performance review of all tax preferences at least once every ten years. The ten year schedule is to be revised annually.

Omitted from review are several categories of tax preferences identified by statute (e.g., tax preferences required by constitutional law). Any tax preference that the commission determines is a critical part of the structure of the tax system may also be omitted. The commission may recommend an expedited review process for any tax preference that has an estimated biennial fiscal impact of $10 million or less.

JLARC is to review tax preferences according to the schedule developed by the commission, and consistent with guidelines set forth in statute. For each tax preference JLARC is to provide recommendations to (1) continue, (2) modify, (3) add an expiration date and conduct another review prior to the expiration date, or (4) terminate the preference. JLARC may also recommend accountability standards for future reviews of tax preferences.

FULL STUDY SCOPE

This tax preference performance review will include the tax preferences identified by the Citizen Commission to be reviewed prior to August 30, 2007. These tax preferences were recommended by the Citizen Commission as being subject to full review:

Brief Description	RCW Citation	Year Enacted
1. Cemeteries	84.36.020	1854
2. Churches, parsonages and convents	84.36.020	1854
3. Household goods	84.36.110(1)	1871
4. Nonprofit hospitals	84.36.040(1e)	1886
5. Nonsectarian organizations	84.36.030(1)	1915
6. Refund of fuel tax for exported fuel	82.36.300; 82.38.180(2)	1923

FULL STUDY OBJECTIVES

In response to the legislative directive, the study will answer, for each tax preference, the following 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))

Other States:

10. 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(j))

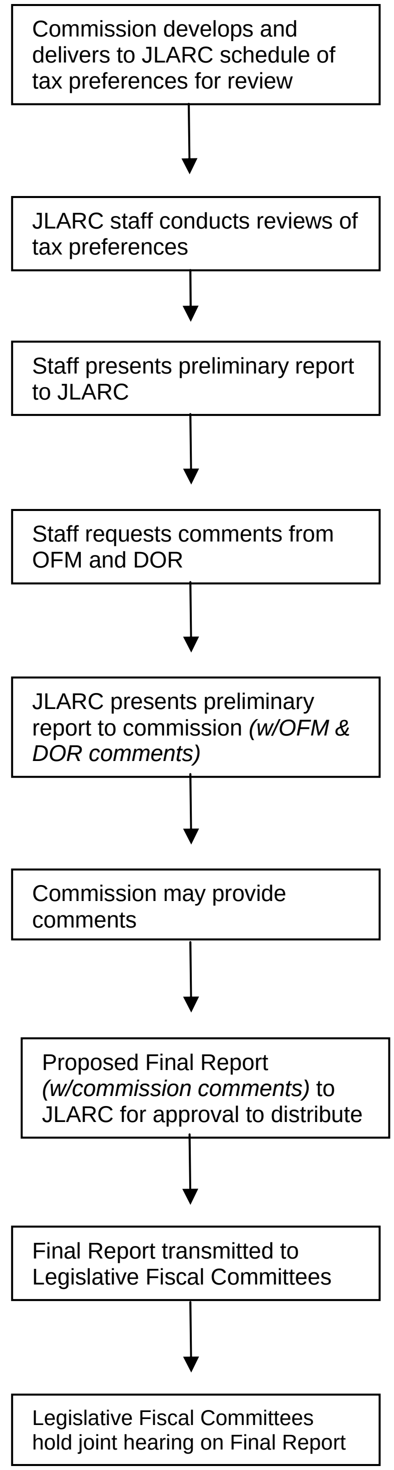
Timeframe for the Study

A preliminary audit report will be presented at the July 2007 JLARC meeting and at the August 2007 meeting of the commission. A final report will be presented to JLARC in November 2007.

JLARC Staff Contact for the Study

Gary Benson (360) 786-5618 benson.gary@leg.wa.gov
Lizbeth Martin-Mahar (360) 786-5123 martin-mahar.lizbeth@leg.wa.gov

Tax Preference Review Process



APPENDIX 2 – TAX PREFERENCE COMMISSION AND AGENCY RESPONSES

- Citizen Commission for Performance Measurement of Tax Preferences
- Office of Financial Management, Department of Revenue, and Department of Licensing
- Department of Licensing

State of Washington

E-mail: hennessy.lisa@leg.wa.gov
www.citizentaxpref.wa.gov

Citizen Commission for Performance Measurement of Tax Preferences

November 14, 2007

To: Joint Legislative Audit and Review Committee

From: William A. Longbrake, Chair William A. Longbrake
Citizen Commission for Performance Measurement of Tax Preferences

Subject: 2007 Tax Preference Reviews

Thank you for the opportunity to comment on the 2007 Tax Preference Review Preliminary Reports. The Commission endorses the recommendations in the report. Our comments are as follows:

JLARC RECOMMENDATION	COMMISSION POSITION AND ADOPTED COMMENTS	EXPLANATION OF COMMISSION COMMENTS
Nonprofit Hospitals		
Recommendation 1: If the Legislature intended to provide a nonprofit hospital property tax exemption under the assumption that these organizations were providing more charity or low-income care than other hospitals, then the Legislature should modify the property tax exemption to be dependent on meeting a threshold of charity or low-income care.	Endorses with the following additional comments: The Legislature should determine whether the nonprofit hospital property tax exemption is intended to be available to hospitals that provide more charity or low-income care than other hospitals, and if necessary, amend the exemption to ensure that it carries out its intended purpose.	The Commission intends their comments to be more directive than JLARC staff by stating the Legislature should definitively clarify their intent.
Recommendation 2: If the Legislature wants additional information on community service activities performed by hospitals, then it should require hospitals to report an annual community services inventory.	Endorses with the following additional comments: The Legislature should determine whether it should require information on community service activities performed by nonprofit hospitals, and if so, it should amend the exemption to require nonprofit hospitals to report an annual community service inventory.	
Recommendation 3: The Legislature should clarify which specific services provided by nonprofit hospitals qualify for a property tax exemption.	Endorses	

JLARC RECOMMENDATION	COMMISSION POSITION AND ADOPTED COMMENTS	EXPLANATION OF COMMISSION COMMENTS
Nonprofit Nonsectarian Organizations Recommendation: If the Legislature intended all nonprofit nonsectarian organizations to meet a gift giving test to qualify for the property tax exemption, then the Legislature should enact a gift giving criterion into law.	Endorses with the following additional comments: The Legislature should determine whether it intends nonprofit nonsectarian organizations to meet a gift giving test to qualify for the property tax exemption, and if so, it should enact a gift giving criterion into law.	
Nonprofit Nursing Homes Recommendation 1: If the Legislature intended to provide the nonprofit nursing home property tax exemption under the assumption that these organizations were providing more charity or low-income care than other nursing homes, then the Legislature should modify the property tax exemption to be dependent on meeting a threshold of charity or low-income care. Recommendation 2: If the Legislature wants information on community service activities performed by nursing homes, then it should require nursing homes to report an annual community service inventory.	Endorses with the following additional comments: The Legislature should determine whether the nonprofit nursing home property tax exemption is intended to be available to nursing homes that provide more charity or low-income care than other nursing homes, and if necessary, amend the exemption to ensure that it carries out its intended purpose. Endorses with the following additional comments: The Legislature should determine whether it should require information on community service activities performed by nursing homes, and if so, it should amend the exemption to require nursing homes to report an annual community service inventory.	The Commission intends their comments to be more directive than JLARC staff by stating the Legislature should definitively clarify their intent.
Nonprofit Orphanages Recommendation: If the Legislature is concerned with providing uniform and equitable tax treatment to all nonprofit organizations providing similar housing and care for children, the Legislature should terminate the orphanage property tax exemption and allow the orphanages to qualify for the nonsectarian property tax exemption like other similar nonprofit organizations.	Endorses with the following additional comments: The Commission recommends that nonprofit orphanages continue to qualify for tax exempt status.	The Commission intends to ensure that nonprofit orphanages continue to qualify for tax exempt status.

JLARC RECOMMENDATION	COMMISSION POSITION AND ADOPTED COMMENTS	EXPLANATION OF COMMISSION COMMENTS
Membership Dues and Fees Recommendation: The Legislature should clarify which clubs should qualify for the tax preference and provide a simple method to value this deduction.	Endorses	
Horse Racing Recommendation: If the Legislature had a public policy objective to avoid double taxation for all horse racing, then this business and occupation tax exemption should be adjusted to tie qualifying for this exemption to actually paying the pari-mutuel tax. If the Legislature had a public policy objective to avoid double taxation only for businesses operating class 1 horse racing meets, then the Legislature should continue the business and occupation tax exemption.	Endorses	The Commission agrees the Legislature should clarify the purpose of this preference.
Refunded Fuel Tax for Nonhighway Use Recommendation: In an effort to maintain equity in the treatment of fuel taxes, the Legislature should review its policy of restricting the amount of fuel taxes that may be refunded to programs for off-road recreational users of motor vehicle fuel.	Endorses	
Churches, Parsonages, and Convents Recommendation: The property tax exemption for churches, parsonages, and convents should be continued.	Endorses	
Cemeteries Recommendation: The property tax exemption for all privately owned cemeteries should be continued.	Endorses	
Household Goods Recommendation: The property tax exemption for household goods, furnishings, and personal effects should be continued.	Endorses	The Commission determined that this is a critical part of the structure of the tax system. The Commission stated that this preference should no longer be subject to review.

JLARC RECOMMENDATION	COMMISSION POSITION AND ADOPTED COMMENTS	EXPLANATION OF COMMISSION COMMENTS
Refund of Fuel Tax for Exported Fuel Recommendation: The motor vehicle fuel tax refunds for exported fuel should be continued.	Endorses	
Nonprofit Libraries Recommendation: The property tax exemption for nonprofit libraries should continue.	Endorses	
Fire Companies Recommendation: The property tax exemption for fire companies should continue.	Endorses	
Growing Crops Recommendation: The Legislature should continue to exclude the value of growing crops from the farmland value.	Endorses	
Humane Societies Recommendation: The property tax exemption for humane societies should continue.	Endorses	
Collections and Museums Recommendation: The property tax exemption for collections, museums, and historical societies should continue.	Endorses	
Veterans Organizations Recommendation: The property tax exemption for war veteran organizations should continue.	Endorses	
Nonprofit Youth Organizations Recommendation: The property tax exemption for nonprofit youth organizations should continue.	Endorses	
Contributions and Donations Recommendation: The business and occupation tax deduction for donations and contributions should continue.	Endorses	
Boxing and Wrestling Matches Recommendation: The business and occupation tax exemption for promoters of boxing, wrestling and martial arts matches should continue.	Endorses	

JLARC RECOMMENDATION	COMMISSION POSITION AND ADOPTED COMMENTS	EXPLANATION OF COMMISSION COMMENTS
Lost or Destroyed Fuel Recommendation: The refund of fuel taxes for lost or destroyed fuel should be continued.	Endorses	
Historic Auto Museums Recommendation: The retail sales and use tax deferral for historic auto museums should continue.	Endorses	

c: Commission Members
Ruta Fanning
Keenan Konopaski
Gary Benson
Lizbeth Martin-Mahar
Cindy Evans

STATE OF WASHINGTON

August 13, 2007

TO: Ruta Fanning, Legislative Auditor
Joint Legislative Audit and Review Committee

FROM: Victor A. Moore, Director
Office of Financial Management

V.A.M.

Cindi Holmstrom, Director
Department of Revenue

Cindi Holmstrom

Liz Luce, Director
Department of Licensing

Liz Luce

SUBJECT: JLARC PRELIMINARY REPORTS ON 2007 TAX PREFERENCE PERFORMANCE REVIEW

Thank you for the opportunity to review and comment on the Joint Legislative Audit and Review Committee's (JLARC) preliminary reports on 2007 Tax Preference Performance Reviews.

We appreciate the efforts of JLARC and the Citizens Commission for Performance Measurement of Tax Preferences (Commission) to identify current tax preference legislation for further review by the Legislature. Informed discussion about the original intent and assumptions underlying current tax preferences – and legislative debate about their continuing effectiveness and relevance – can help state government maintain a fair and equitable tax system.

We believe your work could improve the fairness of current tax preferences and add to our capacity to evaluate their impact on an ongoing basis. In examining these issues further, it may help to look at the administrative burdens borne by both taxpayers and state agencies that result from administering a particular tax preference. It also may be useful to look at what possible new burdens could come along with a proposed reform. In addition, it is possible that there could be pressures on state expenditures if changes are made to a specific exemption (such as a change to tax exemptions now provided to non-profit hospitals and non-profit nursing homes that results in pressure to replace the exemption with a budget item).

Again, we appreciate your effort to continuously review and analyze the state's structure of tax liabilities and exemptions. Please continue to consult with the Office of Financial Management, Department of Revenue, and other agencies that would be affected by possible changes to tax preference legislation.

STATE OF WASHINGTON
DEPARTMENT OF LICENSING
PO Box 9020 • Olympia, Washington 98507-9020

August 16, 2007

Ruta Fanning, Legislative Auditor
Joint Legislative Audit and Review Committee
Post Office Box 40910
Olympia, Washington 98501-2323

Dear Ruta,

The Department has reviewed the draft report regarding tax preference performance reviews conducted by JLARC. The tax preferences reviewed included off highway fuel tax refunds, refunds of exported fuel and refunds of fuel reported lost or destroyed. From a tax collection perspective the Department of Licensing does not have any concerns regarding the administration of the proposals included in the report.

Together with OFM and DOL, we are offering additional perspectives concerning the tax preference reviews in a separate communication.

Thank you,

Sharon L Whitehead for
Liz Luce
Director

AH:kj

cc:

APPENDIX 3 – CURRENT LAW

Nonprofit Day Care Centers, Libraries, Orphanages, Homes for the Sick or Infirm, Hospitals and Outpatient Dialysis Facilities

RCW 84.36.040

(1) The real and personal property used by nonprofit (a) day care centers as defined pursuant to RCW 74.15.020 (b) free public libraries; (c) orphanages and orphan asylums; (d) homes for the sick or infirm; (e) hospitals for the sick; and (f) outpatient dialysis facilities, which are used for the purposes of such organizations shall be exempt from taxation: PROVIDED, That the benefit of the exemption inures to the user.
(2) The real and personal property leased to and used by a hospital, owned and operated by a public hospital district established under chapter 70.44 RCW, for hospital purposes is exempt from taxation. The benefit of the exemption must inure to the user.
(3) To be exempt under this section, the property must be used exclusively for the purposes for which exemption is granted, except as provided in RCW 84.36.805.

Churches, Parsonages and Convents

Cemeteries

RCW 84.36.020

The following real and personal property shall be exempt from taxation:

All lands, buildings, and personal property required for necessary administration and maintenance, used, or to the extent used, exclusively for public burying grounds or cemeteries without discrimination as to race, color, national origin or ancestry;

All churches, personal property, and the ground, not exceeding five acres in area, upon which a church of any nonprofit recognized religious denomination is or shall be built, together with a parsonage, convent, and buildings and improvements required for the maintenance and safeguarding of such property. The area exempted shall in any case include all ground covered by the church, parsonage, convent, and buildings and improvements required for the maintenance and safeguarding of such property and the structures and ground necessary for street access, parking, light, and ventilation, but the area of unoccupied ground exempted in such cases, in connection with church, parsonage, convent, and buildings and improvements required for the maintenance and safeguarding of such property, shall not exceed the equivalent of one hundred twenty by one hundred twenty feet except where additional unoccupied land may be required to conform with state or local codes, zoning, or licensing requirements. The parsonage and convent need not be on land contiguous to the church property. To be exempt the property must be wholly used for church purposes: PROVIDED, That the loan or rental of property otherwise exempt under this paragraph to a nonprofit organization, association, or corporation, or school for use for an eleemosynary activity shall not nullify the exemption provided in this paragraph if the rental income, if any, is reasonable and is devoted solely to the operation and maintenance of the property.

Nonsectarian Organizations

RCW 84.40.030(1)

The following real and personal property shall be exempt from taxation:

(1)(a) Property owned by nonprofit organizations or associations, organized and conducted for nonsectarian purposes, which shall be used for character-building, benevolent, protective or rehabilitative social services directed at persons of all ages.

(b) The sale of donated merchandise shall not be considered a commercial use of the property under this section if the proceeds are devoted to the furtherance of the purposes of the selling organization or association as specified in this subsection (1).

(c) In a county with a population of less than twenty thousand, the rental or use of property, owned by a nonprofit organization or association described in (a) of this subsection, by a person, group, or organization in one of the following ways shall not nullify the exemption:

(i) The property may be rented or used for pecuniary gain or for business activities or by individuals, groups, and organizations for private purposes if the rental or use:

(A) Does not exceed fifteen days each assessment year;

(B) No comparable private for-profit facility exists within ten miles of the property that could be used for the same purpose for which the property is loaned or rented; and

(C) All income from the rental or use of the exempt property is used for capital improvements to the exempt property, maintenance and operation of the exempt property, or for exempt purposes; or

(ii) The property is rented or used by a nonprofit community group or other nonprofit organization that might not qualify for exemption if it owned the property as long as the rental or use of the property:

(A) Does not exceed fifteen days each assessment year;

(B) Does not result in pecuniary gain;

(C) Does not involve business activities;

(D) Is always for the general public good; and

(E) All income from the rental or use of the exempt property is used for capital improvements to the exempt property, maintenance and operation of the exempt property, or for exempt purposes.

……

(7) To be exempt under this section, the property must be used exclusively for the purposes for which exemption is granted, except as provided in RCW 84.36.805.

(8) For the purposes of this section, "general public good" means members of the community derive a benefit from the rental or use of the property by the nonprofit community group or organization.

Household Goods

RCW 84.36.110

The following property shall be exempt from taxation:

(1) All household goods and furnishings in actual use by the owner thereof in equipping and outfitting his or her residence or place of abode and not for sale or commercial use, and all personal effects held by any person for his or her exclusive use and benefit and not for sale or commercial use.

(2) The personal property, other than specified in subdivision (1) hereof, of each head of a family liable to assessment and taxation of which such individual is the actual and bona fide owner to an amount of three thousand dollars of actual values: PROVIDED, That this exemption shall not apply to any private motor vehicle, or mobile home, and: PROVIDED, FURTHER, That if the county assessor is satisfied that all of the personal property of any person is exempt from taxation under the provisions of this statute or any other statute providing exemptions for personal property, no listing of such property shall be required; but if the personal property described in this subsection exceeds in value the amount allowed as exempt, then a complete list of said personal property shall be made as provided by law, and the county assessor shall deduct the amount of the exemption authorized by this subsection from the total amount of the assessment and assess the remainder.

Refund of Fuel Tax for Exported Fuel

82.36.300

Every person who shall export any motor vehicle fuel for use outside of this state and who has paid the motor vehicle fuel excise tax upon such motor vehicle fuel shall be entitled to and shall receive a refund of the amount of the motor vehicle fuel excise tax paid on each gallon of motor vehicle fuel so exported. For the purposes of this section, motor vehicle fuel distributed to a federally recognized Indian tribal reservation located within the state of Washington is not considered exported outside this state.

RCW 82.38.180 as amended by SB 5272 (2007)

Any person who has purchased special fuel on which tax has been paid ((a special fuel tax either directly or to the vendor from whom it was purchased)) may file a claim with the department for a refund of the tax ((so paid and shall be reimbursed and repaid the amount of))for:

(1) ((Any)) Taxes previously paid on special fuel used for purposes other than for the propulsion of motor vehicles upon the public highways in this state.

(2) ((Any)) Taxes previously paid on special fuel exported for use outside of this state. Special fuel carried from this state in the fuel tank of a motor vehicle is deemed to be exported from this state. Special fuel distributed to a federally recognized Indian tribal

reservation located within the state of Washington is not considered exported outside this state.

(3) ((Any)) Tax, penalty, or interest erroneously or illegally collected or paid.

(4) ((Any)) Taxes previously paid on all special fuel which is lost or destroyed, while ((applicant)) the licensee shall be the owner thereof, through fire, lightning, flood, wind storm, or explosion.

(5) ((Any)) Taxes previously paid on all special fuel of five 2 hundred gallons or more which is lost or destroyed while ((applicant)) the licensee shall be the owner thereof, through leakage or other casualty except evaporation, shrinkage, or unknown causes.

(6) ((Any)) Taxes previously paid on special fuel that is inadvertently mixed with dyed special fuel.

Recovery for such loss or destruction under either subsection (4), (5), or (6) of this section must be susceptible to positive proof thereby enabling the department to conduct such investigation and require such information as ((they)) it may deem necessary. In the event that the department is not satisfied that the fuel was lost, destroyed, or contaminated as claimed because information or proof as required hereunder is not sufficient to substantiate the accuracy of the claim, ((they)) it may deem such as sufficient cause to deny all right relating to the refund or credit for the excise tax paid on special fuel alleged to be lost or destroyed. No refund or claim for credit shall be approved by the department unless the gallons of special fuel claimed as nontaxable satisfy the conditions specifically set forth in this section and the nontaxable event or use occurred during the period covered by the refund claim. Refunds or claims for credit ((by sellers or users of special fuel)) shall not be allowed for anticipated nontaxable use or events.

APPENDIX 4 – PROPERTY TAX ESTIMATION PROCEDURE

The following procedure was used for the following property tax exemptions for 2007: churches, cemeteries, nonsectarian organizations, youth organizations, nonprofit nursing homes, humane societies, nonprofit museums and collections, war veterans and orphanages. The value for all the exempt parcels for fire companies, nonprofit libraries and hospitals were attempted to be collected by all counties that quantified assessed value for those properties.

The Department of Revenue (DOR) requires certain taxpayers, in particular nonprofits, to file an application for a property tax exemption, which does not include information on the value of the property. DOR reviews and approves the property tax exemption for these taxpayers and then transfers the identified exempt parcel numbers to the county assessors. For exempt property in Washington, the county assessors are required by law to place a value on the county tax rolls, with only certain exemptions.[74] DOR does not require the county assessors to report the value of the exempt value to them annually.

In order to estimate the assessed value of property tax preferences for nonprofits, the procedure by DOR in the past and JLARC in 2007 has been to get a sample of county tax roll data and match that data with DOR's nonprofit property exempt database. There were 14 counties that were included in this sample of counties used to estimate the value of the tax exemptions for the 2007 reviews.[75] The exempt parcels in these 14 counties represented 60 percent of all exempt parcels in DOR nonprofit database. The real market value per exempt parcel by different types of exemptions was calculated for the sampled counties. Then, the sampled counties were divided into rural and urban counties. Counties with population of less than 100/sq. mile were considered rural and counties with population greater than 100/sq. mile were urban. The total value and parcels matched were calculated and the average value per exempt parcel was found for rural and urban counties for each type of property tax exemption. The average real market value per parcel was calculated for each county. The average value per exempt parcel was compared to the average value of all parcels in the county. A ratio was calculated as the average exempt value to the countywide value per parcel. This ratio representing the average exempt value per parcel to the overall countywide average real market value per parcel was created for each type of tax preference in urban and rural counties. For the remaining counties, not included in the sample, the countywide average real market value per parcel was calculated and multiplied by either the urban or rural ratio of average value per exempt parcel to countywide average value per parcel

[74] RCW 84.40.175.

[75] The counties included in the 2007 tax preference review study were the following: Asotin, Clark, Cowlitz, Ferry, Grant, Grays Harbor, King, Okanogan, Pierce, Spokane, Thurston, Walla Walla, Whitman and Yakima.

for each tax preference. This procedure resulted in each county having an average value for each exempt parcel and this was multiplied by the total number of exempt parcels in each county for every type of tax preference. The average local property tax rate for each county was multiplied by the total exempt property by county for each tax preference to get the estimates for the taxpayer savings. The state taxpayer savings estimates were calculated from a spreadsheet model from DOR which estimates the amount of state taxes loss due to the tax rate limit. This model also estimated that on average statewide the amount of local property taxes loss to local governments was 20 percent of the total value of the tax preference. The remaining 80 percent of the value of the tax preference is a shift in local property tax rates onto other taxpayers. This percentage breakdown in the value of the tax preference indicates that for each tax preference there is some local government loss but the majority of the exemption is paid for by other non-exempt taxpayers. The amount of this tax loss to local governments is likely to be felt by junior districts that are at their maximum tax rate limits. These local government losses vary widely in each county throughout the state.

For nonprofit libraries and fire companies, all counties' values for each exempt parcel were obtained to estimate the exempt value and taxpayer savings for these tax preferences. For nonprofit hospitals, JLARC attempted to obtain each exempt parcel's county value but three small counties indicated that they do not place a value on exempt value. Due to this data limitation on certain county tax rolls, the Department of Health data for hospitals was used. One statistic submitted to the Department of Health by all hospitals is the value of their real and personal property. This was used to make the estimates for the property tax exemption for nonprofit hospitals because the county total value reported was significantly less and may not have included the personal property of hospitals which is also exempt under this tax preference.