

**2009 Full Tax  
Preference  
Performance  
Reviews  
Report 09-11**

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STATE OF WASHINGTON

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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 580 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 the 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.

The Commission has identified three categories of review, based on each tax preference's estimated biennial fiscal impact:

1. Full reviews (over \$10 million)
2. Expedited reviews (between \$2 million and \$10 million)
3. Expedited light reviews (\$2 million or less)

However, at their discretion, the Commission may elect to subject a tax preference with a fiscal impact of \$2 million or less to the expedited review process.

In September 2008, the Commission adopted its third ten-year schedule for the tax preference reviews. The schedule for 2009 includes a total of 25 tax preferences under the business and occupation tax, public utility tax, sales tax, use tax, aircraft excise tax, and the insurance premiums tax. Of these 25 tax preferences, the law required 12 tax preferences to have a full review process, which are included in this report.

### ***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 of the 12 tax preferences scheduled by the Commission for full review. Thirteen expedited tax preference reviews are included in a separate report.

### **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? (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))

**Methodology**

JLARC staff analyzed the following evidence in conducting these full reviews: 1) legal and public policy history of the tax preferences; 2) beneficiaries of the tax preferences; 3) government data pertaining to the utilization of these tax preferences and other relevant data; 4) economic and revenue impact of the tax preferences; and 5) 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 Transportation). These parties provided data on the value and usage of the tax preference and the beneficiaries. JLARC staff also obtained data from other state and federal agencies to which the beneficiaries are required to report. In a few cases, beneficiaries and other agencies provided additional information.

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

**Summary of the Results from JLARC's Reviews**

The table beginning on page 5 provides a summary of the recommendations from JLARC's analysis of the tax preferences scheduled for full review in 2009. JLARC provides analysis of tax preferences scheduled for expedited review in 2009 in an additional volume. Of the 12 tax preferences included in this volume, this report recommends that the Legislature continue 11 tax preferences as they are. The full report raises issues for the Legislature's consideration for one of the current tax preferences.

## **Organization of This Report**

This report includes 12 separate chapters. Each chapter consists of a review of one or more tax preferences. There are three chapters (Motor Fuel and Special Fuel, Newspapers, and Tuition and Fees) which contain an evaluation of multiple related tax preferences. The chapter on cash discounts includes the deductions from B&O tax, sales and use taxes, and public utility tax.

Each chapter begins with a summary of the findings and recommendations from JLARC's analysis of the tax preferences. Then, each chapter provides additional detail, including additional information supporting the answers to the questions outlined in the law. Appendices provide the Scope and Objectives, agency and Tax Commission comments, and the text of current law for each preference.

Report Summary

**2009 Full Reviews**

Year Enacted	# of Claimants in 2008 (\$ amount)	JLARC Recommendation	Comments by Citizen Commission for Performance Measurement of Tax Preferences	Related Legislation as of 2009
<b>JLARC recommendation: Legislature should continue the tax preference</b>				
Motor Vehicle and Special Fuel/ 82.08.0255(1)(d); 82.12.0256(2)(d)				
1935	5 million (\$709 million)	Continue	Endorses without comment	Unknown until after 2010 session
Joint Utility Services/ 82.16.050(3)				
1935	551 (\$9.7 million)	Continue	Endorses without comment	Unknown until after 2010 session
Tuition and Fees/ 82.04.4282(5); 82.04.4332				
1935	557 (\$18 million)	Continue	<p>Does not endorse and comments as follows: The Commission recommends that the Legislature clarify the intended public policy purpose of the Tuition and Fees Deductions from B&amp;O tax and define more precisely the term “education institution” for purposes of determining which institutions are entitled to the B&amp;O tax deduction.</p> <p>Commissioner Stephen Miller voted in agreement with the Commission and submitted the following minority report: Any loss of private school opportunities due to the elimination of this tax preference can be made up for with growth in public school attendance, so there is no net loss of education in Washington State. As there is no public benefit to the preference, I encourage the Legislature to consider eliminating the preference entirely.</p>	Unknown until after 2010 session
Cash Discounts/ 82.04.4283; 82.08.010; 82.16.050(4)				
1935	10,000 (\$46 million)	Continue	Endorses without comment	Unknown until after 2010 session

## 2009 Full Reviews

<b>Year Enacted</b>	<b># of Claimants in 2008 (\$ amount)</b>	<b>JLARC Recommendation</b>	<b>Comments by Citizen Commission for Performance Measurement of Tax Preferences</b>	<b>Related Legislation as of 2009</b>
<b>Investments by Nonfinancial Firms/ 82.04.4281</b>				
1935	Unknown (\$310 million)	Continue	Endorses with comments: The Legislature should consider whether investment income should be taxed by some means other than the B&O gross receipts tax.	Unknown until after 2010 session
<b>Income of Employees/ 82.04.360</b>				
1935	3.2 million (\$2.3 billion)	Continue	Endorses without comment	Unknown until after 2010 session
<b>Motor Fuel Taxes/ 82.04.4285</b>				
1935	2,400 (\$23.2 million)	Continue	Endorses without comment	Unknown until after 2010 session
<b>Casual Sales/ 82.08.0251</b>				
1935	Unknown (\$25.6 million)	Continue	Endorses without comment	Unknown until after 2010 session
<b>Janitorial Services/ 82.04.050(2)(d)</b>				
1935	Unknown (\$33 million)	Continue	The Commission does not endorse the JLARC recommendation, and recommends the State Legislature terminate this preference.	Unknown until after 2010 session
<b>Feed and Seed/ 82.04.050(9)</b>				
1935	40,000 (\$57 million)	Continue	Endorses without comment	Unknown until after 2010 session

**2009 Full Reviews**

Year Enacted	# of Claimants in 2008 (\$ amount)	JLARC Recommendation	Comments by Citizen Commission for Performance Measurement of Tax Preferences	Related Legislation as of 2009
General Aviation/ 82.48.110				
1949	5,900 (\$10.8 million)	Continue	Endorses with comments: The Commission endorses the recommendation because it meets the Legislature’s objective of avoiding double taxation; however, the Legislature should consider whether the current excise fees should be raised and whether the level of these excise fees should more closely correspond to the Legislature’s apparent original intent of approximately one percent of value.	Unknown until after 2010 session
<b>JLARC recommendation: Legislature should re-examine or clarify the intent of the tax preference</b>				
Newspapers/ 82.08.0253; 82.12.0345				
1935	2.3 million (\$9.5 million)	The Legislature should clarify the current intent of the retail sales and use tax exemptions for newspapers, because a number of circumstances have changed since the original tax preference enactment.  The Department of Revenue should update its administrative rule for newspapers to reflect current law, because the administrative rule uses a content-based definition.	Endorses without comment	Unknown until after 2010 session

