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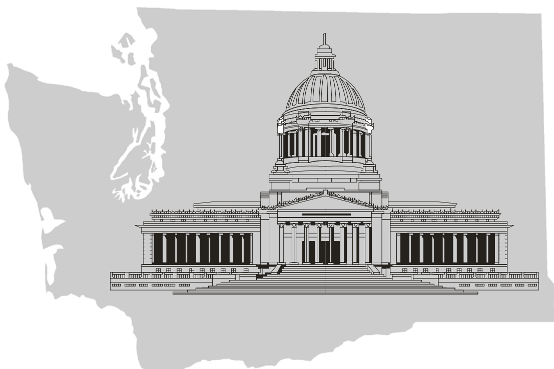

2009 Expedited Tax Preference Performance Reviews

Report 09-12

January 5, 2010

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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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Committee Approval

On January 5, 2010, this report was approved for distribution by the Joint Legislative Audit and Review Committee.

2009 Expedited Tax Preference Performance Reviews

Report 09-12

January 5, 2010

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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 allowed 13 tax preferences to have an expedited 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 13 tax preferences scheduled by the Commission for expedited review. Twelve full 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 expedited tax preference reviews, JLARC has evaluated the answers to a set of four questions for each tax preference:

- **Public Policy Objectives:**
  1) What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?
  2) Is there any readily available evidence related to the achievement of any of these public policy objectives?
- **Beneficiaries:**
  3) Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?
- **Revenue and Economic Impacts:**
  4) What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

Methodology

JLARC staff analyzed the following evidence in conducting these expedited 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; and 4) revenue impacts of the 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, and Board of Tax Appeals decisions relevant to each tax preference. Staff interviewed the agencies that administer the tax preferences (primarily the Department of Revenue, the Department of Transportation, and the Office of the Insurance Commissioner). 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 expedited review in 2009. JLARC provides analysis of tax preferences scheduled for full review in 2009 in an additional volume. Of the 13 tax preferences included in this volume, this report recommends that the Legislature continue three tax preferences as they are, and continue two other tax preferences by modifying their expiration dates. The expedited report raises issues for the Legislature's consideration for four of the current tax preferences. The report recommends that the Legislature allow four tax preferences to expire.

Organization of This Report

This report includes 13 separate chapters. Each chapter consists of a review of one or more related tax preferences. There are three chapters (Rural County Software and Help Desk Firms, Field Burning Equipment, and Aluminum Industry) which contain an evaluation of multiple related tax preferences. The other 10 chapters review a single tax preference.

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

2009 Expedited 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
JLARC recommendation: Legislature should continue the tax preference				
Municipal Utilities/ RCW 82.16.050(1)				
1935	Unknown ($700,000)	Continue	Endorses without comment	Unknown until after 2010 session
Commercial Aircraft/ RCW 82.48.100				
1949	Unknown ($700,000)	Continue	Endorses without comment	Unknown until after 2010 session
Aircraft Held for Sale / Aircraft Owned by Non-Residents/ RCW 82.48.100				
1955	Unknown Unknown	Continue	Endorses without comment	Unknown until after 2010 session
JLARC recommendation: Legislature should continue the tax preference and modify the expiration date				
Electricity for Electrolyte Firms/ RCW 82.16.0421				
2004	2 ($2.2 million)	The Legislature should continue the public utility tax preference for electrolytic processing firms, for the purpose of sustaining the industry's competitiveness.	The Commission endorses the JLARC recommendation, and further recommends that the current expiration date of June 30, 2019, be considered the final date for this preference. In addition, the Legislature should explore other alternative means of achieving the goal of preserving family wage jobs.	The Legislature continued the tax preference in the 2009 Legislative Session under SHB 1062 with an expiration date of 2019.
Aluminum Industry/ RCW 82.04.4481; RCW 82.12.022(5); RCW 82.08.805; RCW 82.12.805; RCW 82.04.2909				
2004	3 ($3.6 million)	The Legislature should extend the expiration date for the aluminum smelter tax preferences because the public policy goal of preserving family wage jobs is being maintained, and because the high energy prices that brought about the tax preference are higher and more volatile than when the incentives were originally enacted.	The Commission endorses the recommendation to extend the expiration date, and further recommends that the Legislature should consider establishing a final expiration date. In addition, the Legislature should explore other alternative means of achieving family wage jobs in rural communities.	Unknown until after 2010 session

2009 Expedited 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
JLARC recommendation: Legislature should re-examine or clarify the intent of the tax preference				
Fraternal Benefit Societies/ RCW 48.36A.240				
1911	24 ($1.1 million)	The Legislature should clarify the public purpose being served by the tax preference for fraternal benefit societies, because it is unclear whether the objective or rationale for the exemption changed with the re-enactments in 1947 and 1987.	Endorses without comment	Unknown until after 2010 session
Kidney Dialysis, Nursing Homes, and Hospice/ RCW 82.04.4289				
1945	96 ($2.5 million)	The Legislature should clarify the intended public policy objective for the B&O tax preference for kidney dialysis, hospice, and nursing homes. Now that nonprofit hospitals pay tax on their services, it is not clear what other types of services the Legislature intends to exempt.	Does not endorse and comments as follows: The Commission recommends that the Legislature eliminate the B&O tax deduction for nursing homes, kidney dialysis facilities, and hospice centers.	Unknown until after 2010 session
Ocean Marine Insurance/ RCW 48.14.020(3)				
1947	51 ($2.2 million)	The Legislature should clarify the public policy purpose for providing a lower insurance premium rate and tax base for ocean marine and foreign trade insurance. Clarification is required because there is a lack of a clearly stated public policy objective and changing conditions since earlier enactments.	Endorses without comment	Unknown until after 2010 session

2009 Expedited 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
Manufacturers of Flour and Oil/ RCW 82.04.260(1)(a)				
1949	11 ($400,000)	Recommendation 1		
		The Legislature should continue a preferential B&O tax rate for manufacturers of flour and oil to provide relief for these industries with prices set in national markets; and	Endorses without comment	Unknown until after 2010 session
		Recommendation 2		
		The Legislature should review the preferential B&O tax rate for manufacturers of flour and oil to ensure the level of the rate is still appropriate.	Endorses without comment	Unknown until after 2010 session
JLARC recommendation: Legislature should allow the tax preference to expire				
Rural Electric Utility Contributions/ RCW 82.16.0491				
1999	17 ($330,000)	The Legislature should allow the credit for rural electric utility contributions to expire on June 30, 2011. While the credit has been utilized, there is not evidence to show that the exemption should be continued beyond the most recent target expiration date.	Endorses with comments: The Legislature should consider requesting that an economic impact study be conducted by December 31, 2010, which is enabled by relevant data gathering. Such a study would provide a more informed basis for determining whether to let this preference expire as scheduled, whether to extend the expiration date, or whether to modify the preference and extend the expiration date.	Unknown until after 2010 session

2009 Expedited 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
Rural County Software Development and Help Desk Firms/ RCW 82.04.4483; RCW 82.04.4484				
2004	68 ($250,000)	The Legislature should allow the tax preferences to expire on January 1, 2011, because the incentives are not achieving the public policy objectives for which they were enacted. The best available data show few new jobs have been created and that rural/urban disparity in high technology jobs has not been mitigated by the incentives.	Endorses without comment	Unknown until after 2010 session
Field Burning Equipment/ RCW 82.08.841; RCW 82.12.841				
2005	Unknown ($2 million)	The Legislature should allow the sales and use tax exemption for field burning equipment to expire, because the transition to reduced air emissions from agriculture burning has occurred.	Endorses without comment	Unknown until after 2010 session
Patient Lifting Devices/ RCW 82.04.4485				
2006	67 ($2.3 million)	The Legislature should allow the B&O tax credit for patient lifting devices to expire on December 30, 2010, because the credit was intended to ease the financial hardship of purchasing patient lifting devices, and was limited both in duration and in the amount of credit to be taken.	Endorses without comment	Unknown until after 2010 session

FRATERNAL BENEFIT SOCIETIES EXEMPTION FROM INSURANCE PREMIUMS TAX – SUMMARY

Current Law

Current law imposes a premiums tax on insurance companies. Fraternal benefit societies that provide insurance to their members have never been subject to this tax. To qualify as a fraternal benefit society, an organization must function solely for the benefit of its members and their beneficiaries, be not-for-profit, operate on a lodge system with a ritualistic form of work, have a representative form of government, and provide benefits in accordance with the law.

See page A3-1 in Appendix 3 for the current statute, RCW 48.36A.240 and RCW 48.36A.010.

Legal History and Public Policy Objectives

1891 The Legislature imposed a tax on all insurance companies at the rate of 2 percent on premiums collected less losses paid. Fraternal benefit societies were not considered insurance companies and did not pay the insurance premiums tax.

1895 Legislation was enacted that expressly exempted fraternal benefit societies from the insurance premiums tax.

1901 The Legislature enacted a series of laws to regulate fraternal benefit societies, orders, and associations.

1909 An act regulating the business of life insurance took effect altering the measure of the premiums tax. The act specifically provided, however, that its provisions did not apply to fraternal benefit societies.

By 1909, it is clear the Legislature intended to treat fraternal benefit societies differently than other insurance companies. The public policy objective appears to be an acknowledgement that these were charitable organizations providing benefits to a large class of people who otherwise would not carry any insurance, and any tax on these organizations would reduce the benefits they could provide.

1911 The Legislature adopted Washington's first insurance code. The new code continued the treatment of fraternal benefit societies as something different than insurance companies. The new code included the tax exemption language for fraternal benefit societies that remains fundamentally unchanged today.

1947 The Legislature repealed the 1911 insurance code and adopted a new one. It included the exact same tax exemption for fraternal benefit societies as in the 1911 code.

1987 The Legislature repealed the 1947 insurance code and adopted a new one. This new code included an updated chapter regulating fraternal benefit societies, along with the tax exemption that was first adopted in 1911.

By re-enacting the 1911 exemption with updated insurance codes in 1947 and 1987, it is clear the Legislature wanted to continue the tax exemption for fraternal benefit societies. However, while the exemption has remained the same, the role and function of fraternal benefit societies has changed. It is unclear whether the objective or rationale for the exemption changed with the re-enactments in 1947 and 1987 to adjust to these changing conditions.

Beneficiaries

- The beneficiaries for this tax preference are the 24 fraternal benefit societies registered with the Office of the Insurance Commissioner.
- The focus of the work of these beneficiaries has changed over time. The early fraternal benefit societies assisted poor, working class members who could not afford to purchase insurance through other means. Today, the focus of the work of fraternal benefit societies has shifted to donating funds in support of benefits to members (e.g., social activities, adoptions and burials) and charitable contributions.

Revenue Impacts

- JLARC estimates the taxpayer savings resulting from the exemption on insurance premiums paid to fraternal benefit societies is $1.1 million per year. In 2007, fraternal benefit societies sold $46 million in life insurance and $10 million in accident and health insurance in Washington.

Recommendation

The Legislature should clarify the public purpose being served by the tax preference for fraternal benefit societies, because it is unclear whether the objective or rationale for the exemption changed with the re-enactments in 1947 and 1987.

Legislation Required:	Yes.
Fiscal Impact:	A change in revenue could be possible depending on action taken by the Legislature.

FRATERNAL BENEFIT SOCIETIES EXEMPTION FROM INSURANCE PREMIUMS TAX – REPORT DETAIL

Current Law

Current law imposes a 2 percent premiums tax on insurance companies. Fraternal benefit societies that provide insurance to their members have never been subject to this tax. To qualify as a fraternal benefit society, the organization must function solely for the benefit of its members and their beneficiaries, be not-for-profit, operate on a lodge system with a ritualistic form of work, have a representative form of government, and provide benefits in accordance with the law.

See page A3-1 in Appendix 3 for the current statute, RCW 48.36A.010.

Legal History

1891 The Legislature imposed a tax on all insurance companies at the rate of 2 percent on premiums collected less losses paid. Fraternal benefit societies were not considered insurance companies and did not pay the insurance premiums tax.

1895 Legislation specifically exempted "secret or fraternal societies, lodges or councils" and mutual or benefit associations from the provisions of the insurance statutes including the premiums tax.

1901 The Legislature enacted a series of laws to regulate fraternal benefit societies, orders, and associations. The statute provides that such associations "shall have a lodge system, with a ritualistic form of work and a representative form of government, and shall make provision for the payment of benefits in case of sickness, temporary or permanent physical disability, either as the result of disease, accident or old age" (Laws of 1901, ch. 174, §1). The law further provided that the associations fund these benefits from assessments or dues collected from their members.

1909 An act regulating the business of life insurance took effect altering the measure of the premiums tax. The act specifically provided, however, that its provisions did not apply to fraternal benefit societies.

1911 The state adopted its first insurance code. The code included the provisions governing fraternal beneficial societies and provided that:

> Every fraternal benefit society organized or licensed under this chapter is hereby declared to be a charitable and benevolent institution, and all of its funds shall be exempt from all and every state, county, district, municipal, and school tax, other than taxes on real estate and office equipment (Laws of 1911, ch. 49, §236).

1947 The Legislature repealed the existing insurance provisions and enacted a new insurance code. While the provisions relating to fraternal benefits societies were re-organized in the new code, the language relating to the taxation of these entities remained the same. The new code did provide that benefits were to be paid from rates received from issuing "benefit certificates" to its members rather than from assessments or dues. An additional change stated that the fraternal benefit societies were not subject to the provisions of the insurance laws unless expressly so declared.

1987 In response to a model insurance code adopted by the National Fraternal Conference of America in 1983, the Legislature revised the state's fraternal code. The Senate considered, but did not adopt, an amendment that would have denied tax exempt status to any organization that prohibits membership based on race or sex. The Legislature's only change to the tax exemption section was to delete the words "fraternal benefit" and leave the word "society." In a separate section the bill defined "society" as a fraternal benefit society.

Other Relevant Background

What Are Fraternal Benefit Societies?

On the floor of the Washington House of Representatives in 1987, during discussion of an amendment regarding the taxation of fraternal benefit societies, a state representative asked the sponsor of the amendment whether the amendment would apply to the Elks and the Lions. The reply was that neither the Lions nor the Elks were fraternal benefit societies, and this would not apply to those organizations.

Similarly, neither the Masons nor the Oddfellows are considered fraternal benefit societies because they do not sell insurance. A "fraternal benefit society" is a non-profit, mutual aid organization that 1) insures members and their families against death, disease, and disability, and 2) maintains an active lodge system. Under Washington law, to be a fraternal benefit society, an incorporated society must be:

- Conducted solely for the benefit of its members and their beneficiaries;
- Not-for-profit;
- Operated on a lodge system with a ritualistic form of work;
- Have a representative form of government; and
- Provide benefits (e.g., medical, disability, death, annuity, etc.) in accordance with Chapter 48.36A RCW of the Insurance Code.

At the beginning of the 20th century, when these organizations first became regulated by the Insurance Commissioner, the largest fraternal benefit societies in Washington included:

- Woodmen of the World;
- Modern Woodmen of America;
- Ancient Order of United Workers;
- Women of Woodcraft;
- Brotherhood of American Yeomen; and
- Knights of Maccabees.

Currently, there are 24 fraternal benefit societies registered with the Office of the Insurance Commissioner. Two of the societies are based in Washington; 21 are based elsewhere in the United States, and one is based in a different country. Twenty of these companies, none based in Washington, sell life insurance. Twelve of these companies sell accident and health insurance. The two Washington-based companies sell only property and casualty insurance. Exhibit 1 shows the largest fraternal benefit societies selling life insurance in Washington today.

Exhibit 1 – Thrivent Financial for Lutherans is the Major Fraternal Benefit Society in Washington

Fraternal Life Insurance Premiums – 2007 (Dollars in Millions)		
Company Name	**Life Insurance**	**Share of total**
Thrivent Financial for Lutherans	$31.7	69.2%
Knights of Columbus	$6.8	14.8%
Independent Order of Foresters	$3.1	6.8%
Modern Woodmen of America	$1.8	3.9%
Sons of Norway	$1.2	2.6%
Remaining 15 Other Societies	$1.2	2.6%
Total	**$45.8**	**100.0%**

Source: 2007 Annual Report, Office of the Insurance Commissioner.

In 1910, fraternal benefit societies sold 24 percent of the life insurance in Washington, as measured by premiums received. In 2007, their share had fallen to 1.6 percent of the Washington market.

What Was the Original Role of Fraternal Benefit Societies?

Fraternal benefit societies were formed so people with a common bond – typically religious, ethnic or occupational – could help one another when tragedy struck. In the late 19th century, North America experienced an influx of people from all over the world, particularly Europe. Many people were relegated to living in unsanitary conditions and performing hazardous jobs for poor pay. Fraternal benefit societies provided opportunities for people to socialize and help recent immigrants acclimate to America. Members belonged to local "lodges" or meeting places where they could come together as a community and celebrate their common bond. Also, fraternal societies offered their members a wide variety of social services, from orphanages to sickness benefits to life insurance. In the early days, members "passed the hat" to assist families of deceased members.

Fraternal benefit societies operated as a type of mutual benefit organization. Initially, the benefits they provided were not insured benefits, but were benefits provided according to the available resources of the group whenever need arose.

The first true fraternal insurance association, the Ancient Order of United Workmen, was organized in Meadville, Pennsylvania, in 1868. It provided an assessment plan of insurance. Upon initiation, each member paid $1 to the Insurance Fund. Upon notice of the death of a member, another $1 was assessed each member; if there were more than 2,000 members, a pro-rata amount was assessed so that each beneficiary received a $2,000 death claim.[1] The fraternal benefit societies could "assist the poor man in protecting those dependent upon him by offering him insurance for premiums in small payments."

The subject of fraternal insurance came up at the national meeting of State Insurance Commissioners in 1909. The Commissioners acknowledged the "splendid results" accomplished by the legitimate fraternal associations for a large class of people, who otherwise would not carry any insurance whatever. The Commissioners also noted that the societies were largely patronized by the "masses" and the money that had built them up represented "much toil and is paid in by our laboring classes at great personal sacrifice for the protection of those dependent on them."

Participation in fraternal insurance organizations reached a maximum height around 1920 and then rapidly declined following World War II.

What is the Role of Fraternal Benefit Societies Today?

To explore this question, JLARC focused on the current activities of Thrivent Financial for Lutherans. As shown in Exhibit 1, Thrivent Financial accounted for 69 percent of the life insurance premiums written by fraternal benefit societies in Washington in 2007.

Thrivent Financial is one of the largest financial services providers in the country and offers a broad range of financial products and services including life insurance, annuities, mutual funds, disability income insurance, and bank products. This organization is similar to other life insurance companies, with the exception that purchasers of Thrivent Financial life insurance need to become a member of a local Thrivent chapter. Some of the financial products offered by Thrivent, such as mutual funds and banking products, are available to nonmembers.

As a fraternal benefit society, Thrivent Financial serves a specific group of people with a common bond, Lutheranism. To keep that bond, each individual applying for membership must demonstrate a Lutheran connection and support of the mission.[2]

Thrivent Financial is also a not-for-profit organization. Significant resources generated by the sale of insurance are directed to charitable causes and organizations.[3] In 2006, these grants came to $140 million.

In 1993, the U.S. Treasury Department released a report that examined the economic rationale for the federal tax exemption for fraternal benefit societies. Requested by Congress as part of the Tax Reform Act of 1986, the report provided the following two policy options for taxation of fraternal benefit societies:

1) Make no change to the current federal tax exempt treatment of insurance income from these organizations;

[1] By 1885, the A.O.U.W. had 152,000 members and had "emptied into the laps of our widows over $18,500,000.00, which in silver would be more than 450 two-horse teams could draw." (from "A Brief History of the A.O.U.W.," by Keith L. Yates, 1966).

[2] Their mission: "Thrivent Financial for Lutherans is a faith-based membership organization called to improve the quality of life of its members, their families, and their communities by providing unparalleled solutions that focus on financial security, wellness and caring for others."

[3] "Who is Thrivent Financial for Lutherans?" obtained from www.thrivent.com.

2) Modify the current federal tax treatment by imposing a tax on the insurance income but providing special treatment for these entities' charitable expenses, such as raising the charitable deduction limitation.

To date, Congress has not changed the tax exempt treatment of fraternal benefit societies. This report was not released until after the Washington State Legislature last considered the state tax exemption for fraternal benefit societies in 1987.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

The legal history demonstrated that the Legislature has deliberately retained this tax preference. Another important question to explore is the Legislature's rationale for establishing and retaining this tax preference. By exempting fraternal benefit societies from the insurance premiums tax, what activity performed by the societies was the Legislature attempting to encourage?

- Is the rationale for the tax exemption tied to what fraternal benefit societies were in the late 1800s and early 1900s when the Legislature first exempted the societies from the insurance premiums tax? At this time, fraternal benefit societies served the insurance needs of immigrants and other underserved groups before the days of government and employer-based health care and retirement programs; or
- Is the rationale for the tax exemption tied to what fraternal benefit societies became by the time that the Legislature last enacted the exemption in 1987? By this time, fraternal benefit societies had evolved into organizations that make donations to charitable causes.

In the late 19th and early 20th centuries, fraternal benefit societies provided a "safety net" to lower-paid workers and their families. The state Insurance Commissioners in 1909 acknowledged the work of the societies in providing benefits to a large class of people who otherwise would not carry any insurance. The Legislature may have exempted fraternal benefit societies from the insurance premiums tax because these societies were charitable organizations that provided benefits to widows and orphans, and any tax on these organizations would reduce the amount of benefits going to these widows and orphans. Fraternal benefit societies were not in the same class of business as stock insurance companies that made profits and provided dividends to stockholders.

Today, the public policy objective is less clear. Fraternal benefit societies act much like traditional insurance companies. No longer do they primarily target their insurance products to lower-class, immigrant populations. Instead of using their "profits" for benefits to the widows and orphans of the workers being insured, fraternal benefit societies act like foundations that provide grants to charitable organizations.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

The public policy objective in the late 19th and early 20th centuries of exempting fraternal benefit societies from the insurance premiums tax appears to be 1) they were not like other insurance companies, and 2) they were mutual aid associations that targeted the lower-class working communities by offering them necessary services that could not or would not be obtained otherwise. If this is the rationale for the tax exemption, then these objectives are no longer being met, and there are now other insurance options available for these communities.

If 1987 is to be used as the base year for determining the rationale for the tax exemption, then the public policy objective of exempting fraternal benefit societies from the insurance premiums tax is less clear.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

- The beneficiaries for this tax preference are the 24 fraternal benefit societies registered with the Office of the Insurance Commissioner.
- The focus of the work of these beneficiaries has changed over time. The early fraternal benefit societies assisted poor, working class members who could not afford to purchase insurance through other means. Today, the focus of the work of fraternal benefit societies has shifted to donating funds in support of benefits to members (e.g., social activities, adoptions and burials) and charitable contributions.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

JLARC estimates the taxpayer savings resulting from the exemption on insurance premiums paid to fraternal benefit societies is $1.1 million per year. In 2007, fraternal benefit societies sold $46 million in life insurance and $10 million in accident and health insurance in Washington.

Exhibit 2 – Taxpayer Savings Resulting from Exempting Fraternal Benefit Societies from the Insurance Premiums Tax (Dollars in Millions)

Year	Untaxed Premiums	Taxpayer Savings
2006	$55.4	$1.1
2007	$55.9	$1.1
2008	$56.3	$1.1
2009	$56.7	$1.1
2010	$57.1	$1.1
2011	$57.5	$1.1

Source: Office of the Insurance Commissioner.

Note: Figures for 2009 through 2011 are estimates.

Recommendation

The Legislature should clarify the public purpose being served by the tax preference for fraternal benefit societies, because it is unclear whether the objective or rationale for the exemption changed with the re-enactments in 1947 and 1987.

Legislation Required:	Yes.
Fiscal Impact:	A change in revenue could be possible depending on action taken by the Legislature.

KIDNEY DIALYSIS, HOSPICE, AND NURSING HOMES DEDUCTION FROM B&O TAX – SUMMARY

Current Law

Nonprofit kidney dialysis facilities, nonprofit hospice agencies, and nursing homes and homes for unwed mothers operated as religious or charitable organizations are entitled to a business and occupation (B&O) tax deduction for the income derived from services to patients. These institutions also receive a deduction for income from the sales of prescription drugs furnished as an integral part of services provided to patients. In order to qualify for these deductions, no part of the net earnings may benefit persons other than the institution entitled to the deduction.

This review is limited to the deduction for private payments for services to patients and prescription drugs, and does not include Medicare and Medicaid payments, which are covered by another deduction scheduled for review in 2013.

The B&O tax is based on the value of products, gross proceeds of sales, or gross income of a business except for activities that are specifically granted a deduction or exemption. Under current law, for most companies, B&O tax rates range from 0.138 percent to 1.5 percent. The B&O tax is applied each time there is income from a business transaction. The tax rate for health care services that are ineligible for the deduction is 1.5 percent, the catch-all "service and other" rate.

See page A3-1 in Appendix 3 for the current statute, RCW 82.04.4289.

Legal History and Public Policy Objectives

This deduction from the B&O tax has been alternately narrowed and expanded over its 75 year history.

1935 The Legislature excluded hospitals from the B&O tax.

1936 The Tax Commission's implementing rule contained provisions to narrow the application to hospitals by listing services that hospitals perform. It distinguished between 1) clinics, homes for the aged, doctor's offices, resorts or spas, which were not excluded from the B&O tax, and 2) "bona fide" hospitals. The Commission defined hospitals by their services: "medical, obstetrical, psychiatrical or surgical attention and nursing" services.[4]

1937 The Legislature denied the tax exclusion to facilities "organized for profit or where the income inures for the benefit of any physician, surgeon, stockholder, or individual by virtue of ownership or control."

1941 The Legislature expanded the tax exclusion to include nonprofit clinics.

1945 The Legislature changed the exclusion to a deduction from income for amounts derived from services rendered to patients. It eliminated the exclusion for nonprofit clinics retroactive to 1941.

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[4] Washington State Tax Commission, 6th Biennial Report, 1936.

1960 Tax Commission excluded nursing homes from the deduction by rule.

1961 The Legislature specifically included religious or charitable nursing homes and homes for unwed mothers in the deduction. The Legislature also strengthened the distinction between hospitals and clinics by requiring hospitals to meet the definition in Chapter 70.41RCW. That statute lists functions that hospitals perform: accommodations for 24 hours or longer for observation, diagnosis and care or for conditions that require obstetrical, medical, or surgical services.

1967 The Washington State Supreme Court ruled that separate clinics did not qualify for the deduction even though they might be owned by a nonprofit hospital because they did not provide traditional hospital services. The clinics in the lawsuit "provided that type of medical service…that one would expect to find and receive in the average private physician's office or clinic. They are open only during regular business hours [and] provide no domiciliary care or overnight facilities…"[5]

1979 The Legislature expanded the deduction to include sales of prescription drugs furnished as an integral part of services rendered to patients.

1981 The Legislature expanded the deduction to include nonprofit kidney dialysis facilities.

1993 The Legislature excluded public and nonprofit hospitals from the deduction and instead taxed them to help pay for health care reform.

1998 The Legislature expanded the deduction to include nonprofit hospice agencies.

Through most of the deduction's 75-year history, the public policy objective was to benefit facilities that:

- Performed services that traditionally have been performed in hospitals; and
- Did not earn a profit.

The public policy objective became less clear in 1993 when hospitals themselves were removed from the deduction. As a result hospitals are taxed, but services traditionally provided in hospitals are not. Therefore, the objective that the Legislature wants to currently achieve is unclear.

[5] 72 Wn.2d 422, 1967.

Beneficiaries

There are 48 nonprofit nursing homes in Washington in 2007 compared to 175 for-profit nursing homes. There are 34 nonprofit kidney dialysis facilities in the state compared to 30 for-profit facilities. There are 14 nonprofits hospice centers compared to 17 for-profit hospice centers. There are no known existing homes for unwed mothers.

Revenue Impacts

Estimated taxpayer savings from the deduction are $3.0 million annually. Nursing homes receive 76 percent of the benefit from the tax preference.

Recommendation

The Legislature should clarify the intended public policy objective for the B&O tax preference for kidney dialysis, hospice, and nursing homes. Now that nonprofit hospitals pay tax on their services, it is not clear what other types of services the Legislature intends to exempt.

Legislation Required:	Yes.
Fiscal Impact:	A change in revenue could be possible depending on clarification.

KIDNEY DIALYSIS, HOSPICE, AND NURSING HOMES DEDUCTION FROM B&O TAX – REPORT DETAIL

Current Law

Nonprofit kidney dialysis facilities, nonprofit hospice agencies, and nursing homes and homes for unwed mothers operated as religious or charitable organizations are entitled to a business and occupation (B&O) tax deduction for the income derived from services to patients. These institutions also receive a deduction for income from the sales of prescription drugs furnished as an integral part of services provided to patients. In order to qualify for these deductions, no part of the net earnings may benefit persons other than the institution entitled to the deduction.

This review is limited to the deduction for private payments for services to patients and prescription drugs, and does not include Medicare and Medicaid payments, which are covered by another deduction scheduled for review in 2013.

The B&O tax is based on the value of products, gross proceeds of sales, or gross income of a business except for activities that are specifically granted a deduction or exemption. Under current law, for most companies, B&O tax rates range from 0.138 percent to 1.5 percent. The B&O tax is applied each time there is income from a business transaction. The tax rate for health care services that are ineligible for the deduction is 1.5 percent, the catch-all "service and other" rate.

See page A3-1 in Appendix 3 for the current statute, RCW 82.04.4289.

Legal History

This deduction from the B&O tax has been alternately narrowed and expanded over its 75 year history.

1935 The Legislature excluded hospitals from the B&O tax.

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1937 The Legislature denied the tax exclusion to facilities "organized for profit or where the income inures for the benefit of any physician, surgeon, stockholder, or individual by virtue of ownership or control."

1941 The Legislature expanded the tax exclusion to include nonprofit clinics.

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[6] Washington State Tax Commission, 6th Biennial Report, 1936.

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1967 The Washington State Supreme Court ruled that separate clinics did not qualify for the deduction even though owned by a nonprofit hospital because they did not provide traditional hospital services. The clinics in the lawsuit "provided that type of medical service…that one would expect to find and receive in the average private physician's office or clinic. They are open only during regular business hours [and] provide no domiciliary care or overnight facilities…"[7]

1979 The Legislature expanded the deduction to include sales of prescription drugs furnished as an integral part of services rendered to patients.

1981 The Legislature expanded the deduction to include nonprofit kidney dialysis facilities.

1993 The Legislature excluded public and nonprofit hospitals from the deduction and instead taxed them to help pay for health care reform.

1998 The Legislature expanded the deduction to include nonprofit hospice agencies.

Other Relevant Background

The current B&O deduction for patient services and prescription drugs applies to the following entities:

Kidney Dialysis Facility: A free-standing health care facility providing individuals who have chronic kidney failure with dialysis services to compensate for lost kidney function. To be eligible for the deduction, a kidney dialysis facility must be operated as a nonprofit.

Hospice Agency: As defined by state law, a "hospice agency" means "a person administering or providing hospice services directly or through a contract arrangement to individuals in places of temporary or permanent residence under the direction of an interdisciplinary team composed of at least a nurse, social worker, physician, spiritual counselor, and a volunteer" (RCW 70.127.010(11)). "Hospice services" means "symptom and pain management provided to a terminally ill individual, and emotional, spiritual, and bereavement support for the individual and family in a place of temporary or permanent residence, and may include the provision of home health and home care services for the terminally ill individual" (RCW 70.127.010(13)). To be eligible for the deduction, the hospice agency must be operated as a nonprofit.

Nursing Home: As defined by state law, "nursing home" means "any home, place or institution which operates or maintains facilities providing convalescent or chronic care, or both, for a period in excess of twenty-four consecutive hours for three or more patients not related by blood or

[7] 72 Wn.2d 422, 1967.

marriage to the operator, who by reason of illness or infirmity, are unable properly to care for themselves. Convalescent and chronic care may include but not be limited to any or all procedures commonly employed in waiting on the sick, such as administration of medicines, preparation of special diets, giving of bedside nursing care, application of dressings and bandages, and carrying out of treatment prescribed by a duly licensed practitioner of the healing arts. It may also include care of mentally incompetent persons. It may also include community-based care" (RCW 18.51.010). To be eligible for the deduction, the facility must be operated for religious or charitable purposes.

Home for Unwed Mothers: There is no definition provided in state or federal law or rule. No known facility exists in Washington.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

Through most of the deduction's 75-year history, the public policy objective was to benefit facilities that:

- Performed services that traditionally have been performed in hospitals; and
- Did not earn a profit.

The public policy objective became less clear in 1993 when hospitals themselves were removed from the deduction. As a result hospitals are taxed, but services traditionally provided in hospitals are not. Therefore, the objective that the Legislature wants to currently achieve is unclear.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

The same nonprofit criterion exists in current statute as it did in 1937. However, the Legislature now treats hospitals and hospital-like activities inconsistently.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

There are 48 nonprofit nursing homes in Washington in 2007 compared to 175 for-profit nursing homes. There are 34 nonprofit kidney dialysis facilities in the state compared to 30 for-profit facilities. There are 14 nonprofits hospice centers compared to 17 for-profit hospice centers. There are no known existing homes for unwed mothers.

Exhibit 3 – Number of For-Profit and Nonprofit Facilities by Type and Ownership

	Total	For-profit	Nonprofit	Percent Nonprofit
Nursing Homes	223	175	48	22%
Kidney Dialysis Facilities	63	30	34	54%
Hospice Agencies	31	17	14	45%
Homes for Unwed Mothers	Unknown	Unknown	Unknown	Unknown

Source: Department of Social and Health Services Cost Reports, Department of Health, Secretary of State/Charities, and The Foundation Center, Center for Medicaid and Medicare Services.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

Estimated taxpayer savings from the deduction are $3.0 million annually. Nursing homes receive 76 percent of the benefit from the tax preference.

Exhibit 4 – Estimate of Taxpayer Savings from Tax Preference

Fiscal Year	Nursing Homes	Kidney Dialysis & Hospice Agencies	Total Tax Savings
2006	$1,700,000	$500,000	$2,200,000
2007	$1,800,000	$500,000	$2,300,000
2008	$1,900,000	$600,000	$2,500,000
2009	$2,000,000	$600,000	$2,600,000
2010	$2,100,000	$600,000	$2,700,000
2011	$2,300,000	$700,000	$3,000,000

Source: Department of Social and Health Services Cost Reports, Department of Health, Secretary of State/Charities, and Internal Revenue Service Form 990 (Returns for Organizations Exempt from Income Tax), and Department of Revenue records.

Note: Figures are estimates projected to 2011 based on forecasts by the Centers for Medicaid and Medicare Research.

Recommendation

The Legislature should clarify the intended public policy objective for the B&O tax preference for kidney dialysis, hospice, and nursing homes. Now that nonprofit hospitals pay tax on their services, it is not clear what other types of services the Legislature intends to exempt.

Legislation Required: Yes.

Fiscal Impact: A change in revenue could be possible depending on clarification.

MUNICIPAL UTILITIES DEDUCTION FOR PROPERTY TAXES COLLECTED – SUMMARY

Current Law

The public utility tax is based on gross income from the operation of public and privately-owned utilities and public service companies. These utilities and public service companies provide services in the area of energy, water, communications, and transportation. Five different rates apply depending on the specific utility or public service activity ranging from 0.642 percent to 5.029 percent.

Municipalities that own or operate a utility may deduct taxes they collect from their gross income for public utility tax purposes if those taxes are for the support or maintenance of the utility. Although not explicitly stated in statute, the only taxes currently eligible for the deduction are property taxes collected by the municipal utility to pay for capital improvements. For example, a city may own and operate a water distribution system, and the city may be using a certain portion of the property tax revenues it collects within its service area to pay for the capital costs of improving the water system in that area. The city would not have to pay the public utility tax on these property tax revenues.

See page A3-1 in Appendix 3 for the current statute, RCW 82.16.050(1).

Legal History and Public Policy Objectives

1933 The Legislature faced a revenue shortfall as it convened in January 1933. In response, lawmakers adopted a temporary tax imposed on the privilege of engaging in business activities. The new tax applied to a wide range of business activities, including utility and public service businesses.

With regard to the utility and public service businesses, the Legislature indicated its intent to tax municipally-owned or operated businesses the same as privately-owned businesses. The sole exception was that revenues the municipalities received from taxes were not to be included in computing the income upon which the tax was based.

1935 To address a continuing revenue shortfall, the Legislature passed the Revenue Act of 1935. As part of the act, the Legislature created a separate public utility tax. The utility and public service business activities previously taxed under the 1933 act were included under the new public utility tax.

The Legislature again provided a deduction to exempt municipalities from paying the tax on property tax collections. The exemption was only provided for taxes used to pay for the support or maintenance of the utility.

1937 The Legislature narrowed this tax preference by excluding from the deduction any service charges that were spread on the property tax rolls and collected as taxes. Service charges include the actual charge to a customer for the sale or distribution of utility services such as water, gas, or electricity. The 1937 change restricted the deduction to taxes used to support or maintain the utility such as taxes to finance construction of capital facilities, installation labor, and connection fees, but not service charges.

The Legislature's public policy objective in providing this exception for the revenues municipalities receive from taxes may have been two-fold:

1) To provide consistency and equity. No other government entity pays taxes on the revenues it collects under the property tax; and
2) To avoid double taxation of utility customers who pay property taxes to the utility.

Beneficiaries

The beneficiaries of this tax preference are municipalities that own or operate utilities and that finance utility capital construction through assessments or taxes levied on property.

Revenue Impacts

Municipalities that own or operate utilities received about $700,000 in taxpayer savings during 2008 due to this tax preference. Local governments reported nearly $48 million in total special assessments that year. While not all of these assessments were for utilities, JLARC estimates about $16.5 million of that amount was for special assessments for utility purposes, resulting in estimated taxpayer savings of about $700,000.

Recommendation

The Legislature should continue allowing municipalities that own or operate utilities to exclude tax collections from the public utility tax for equity purposes and to avoid double taxation of customers.

Legislation Required: No.

Fiscal Impact: None – No change to status quo.

MUNICIPAL UTILITIES DEDUCTION FOR PROPERTY TAXES COLLECTED – REPORT DETAIL

Current Law

The public utility tax is based on gross income from the operation of public and privately-owned utilities and public service companies. These utilities and public service companies provide services in the area of energy, water, communications, and transportation. Five different rates apply depending on the specific utility or public service activity ranging from 0.642 percent to 5.029 percent.

Municipalities that own or operate a utility may deduct taxes they collect from their gross income for public utility tax purposes if those taxes are for the support or maintenance of the utility. Although not explicitly stated in statute, the only taxes currently eligible for the deduction are property taxes collected by the municipal utility to pay for capital improvements. For example, a city may own and operate a water distribution system, and the city may be using a certain portion of the property tax revenues it collects within its service area to pay for the capital costs of improving the water system in that area. The city would not have to pay the public utility tax on these property tax revenues.

See page A3-1 in Appendix 3 for the current statute, RCW 82.16.050(1).

Legal History

The Legislature faced a revenue shortfall as it convened in January 1933. In response, lawmakers adopted a temporary tax imposed on the privilege of engaging in business activities. The tax was to be in place from August 1933 through July 1935. The new tax applied to a wide range of business activities, including public service and utility businesses. Public service and utility businesses included light and power companies, telephone and telegraph companies, water companies (except irrigation companies), steam and street railways, and highway transportation companies.

Multiplying the gross income of a business by the statutorily established rates determined the amount of the tax. The 1933 legislation taxed public service and utility activities at rates ranging from 0.4 percent to 3 percent. The 1933 law also stated that "moneys received from tax sources shall not be included in computing the gross proceeds of sales or gross income upon which such tax shall be based."

The Legislature continued to face a significant revenue shortfall as it convened in 1935. To raise necessary revenue, the Legislature passed the Revenue Act of 1935. As part of the 1935 act, the Legislature created the public utility tax. The public service and utility business activities previously taxed under the 1933 act were included under the new public utility tax, using four basic rates ranging from 0.5 percent to 3 percent. The 1935 act also included specific deductions from this new tax. One such deduction applied specifically to municipally owned or operated utilities:

> In computing tax there may be deducted from the gross operating revenue the following items: a) amounts derived by municipally owned or operated public service businesses, directly from taxes levied for the support or maintenance thereof.

In 1937, the Legislature narrowed this tax preference by excluding from the deduction any service charges that were spread on the property tax rolls and collected as taxes. Service charges include the actual charge to a customer for the sale or distribution of utility services such as water, gas, or electricity. The 1937 change restricted the deduction to taxes used to support or maintain the utility such as to finance construction of capital facilities, installation labor, and connection fees, but not including service charges.

Current law uses five public utility tax rates ranging from 0.642 percent to 5.029 percent based on the specific utility or public service activity.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

The Legislature's public policy objective in providing this exception for the revenues municipalities receive from property taxes may have been two-fold:

1) Consistency or equity purposes: Generally, no other government entity pays taxes on the revenues it collects under the property tax; and
2) To avoid double taxation: By including this deduction, municipalities do not pay taxes on taxes previously paid.

In 1933, when the Legislature wrote the temporary business activities tax, it included a clear statement of intent regarding the taxation of municipally-owned utilities. The 1933 legislation stated:

> The terms of this subdivision shall apply with equal force to any municipal corporation or district engaging in any of the business activities herein mentioned; provided, however, that moneys received from tax sources shall not be included in computing the gross proceeds of sales or gross income upon which such tax shall be based. This paragraph shall be so interpreted as to give effect to the intent of this act which is declared to be to impose upon municipally owned and/or operated utilities and businesses coming within the purview of this subdivision an excise at the same rate as is herein imposed upon privately owned utilities or business of the same type (Laws of 1933, ch. 191, §2(2)(e)).

The intent was to tax municipally-owned utilities the same as privately-owned utilities. The sole exception was that revenues the municipalities received from taxes were not to be taxed. The Legislature provided a similar deduction when it created the public utility tax in 1935.

1) **Consistency or equity purposes** – Local governments that levy property taxes are generally not taxed on their property tax receipts. For example, counties, cities, schools, library and fire districts do not pay B&O taxes on their property tax receipts.

2) **Avoid double taxation** – Because most municipal utilities operate without competition, they have some ability to shift their costs onto their customers. If municipalities had to pay the public utility tax on the property tax revenues they collected from customers in their service areas, the municipalities would likely pass these costs directly on to their customers in the form of higher utility charges. This would result in double taxation of utility customers that also paid property taxes.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

By providing this deduction for municipally-owned or operated utilities, the Legislature has structured the public utility tax to accomplish these objectives. The tax preference has remained in place in essentially the same form since 1937.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

The beneficiaries of this tax preference are municipalities that own or operate utilities and that finance utility capital construction through assessments or taxes levied on property.

As shown in Exhibit 5, there are a number of different types of utilities and public service businesses in Washington. The primary utilities operated by municipal governments are water and sewer utilities. Statewide in FY 2008, 349 municipal water utilities and 275 municipal sewer collection utilities reported to the Department of Revenue. Not all of these utilities used special assessments to finance capital projects. In 2007, some 130 cities and counties reported to the State Auditor's Office the collection of special assessments. Not all special assessments are for water or sewer projects, as other improvements, such as street and sidewalk projects, can also be financed in this manner.

Exhibit 5 – Number of Municipally-Owned Utilities by Type (FY 2008)

Type of Utility/Service	Number
Water Distribution	349
Sewer Collection	275
Power	55
Urban Transportation	16
Railroad/Motor Transportation	12
Gas Distribution	3
Other Public Service Business	20

Source: Department of Revenue.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

Most municipally-owned utilities do not appear to be taking an explicit deduction from income for property tax levies.[8] Most likely, the municipal utilities using special assessments are instead simply not reporting the tax proceeds as income.

Exhibit 6 – Revenues from Local Government Special Assessments (Dollars in Millions)

Assessment Category	2005	2006	2007
Operating Special Assessments	$41.2	$40.7	$39.0
Capital Special Assessments	$10.3	$9.4	$8.8
Total Special Assessments	$51.4	$50.1	$47.8

Source: Local Government Financial Reporting System, State Auditor's Office.

Local governments report to the Local Government Financial Reporting System in the State Auditor's Office. Local governments reported $48 million in 2007 for operating and capital assessments. Assessments can be made for either direct payment for a capital facility or for debt service (which would be an operating expenditure). Not all of these collections are for water and sewer facilities, as there are special assessments also for street, curb, and sidewalk projects.

Exhibit 7 – Estimated Taxpayer Savings (Dollars in Millions)

Fiscal Year	Estimated Amount of Special Assessments for Utility Purposes	Estimated Taxpayer Savings
2006	$16.5	$0.7
2007	$15.8	$0.7
2008	$16.5	$0.7
2009	$16.5	$0.7
2010	$16.5	$0.7
2011	$16.5	$0.7

Source: Local Government Financial Reporting System, State Auditor's Office and JLARC estimates. Note: Figures for 2008-2011 are estimates.

JLARC assumed that one-third of local government special assessments for local improvement districts and utility local improvement districts are for sewer and water projects.[9] The range for

[8] This observation is based on a review of electronically filed tax returns to the Department of Revenue. For deductions other than those specifically listed on the tax return, taxpayers are to provide an explanation. "Sales for resale" is a common explanation. Only one city referenced "bond payments" as the reason for taking a deduction.

[9] In the extreme case that 100 percent of special assessments are for water and sewer projects, the taxpayer savings would be increased by a factor of three to $2.1 million per year.

individual cities or counties is from zero to 100 percent. The annual taxpayer savings from not having to pay public utility tax on these assessments is about $700,000 per year.

Recommendation

The Legislature should continue allowing municipalities that own or operate utilities to exclude property tax collections for capital facilities from the public utility tax for equity purposes and to avoid double taxation of customers.

Legislation Required: No.

Fiscal Impact: None – No change to status quo.

OCEAN MARINE INSURANCE TAX PREFERENCES – SUMMARY

Current Law

The ocean marine and foreign trade insurance industry receives two tax preferences:

1) A preferred tax rate; and
2) A deduction for insurance company losses.

The insurance premiums preferred tax rate is 0.95 percent on the gross underwriting profit (simply stated, premiums minus losses paid) of ocean marine and foreign trade insurers. Typically, the insurance premiums tax rate is 2.0 percent applied to premiums, without a deduction for losses.

See pages A3-2 and A3-3 in Appendix 3 for the current statute, RCW 48.14.020, 48.11.050 and 48.11.105.

Legal History and Public Policy Objectives

1891 The Legislature imposed a tax on all insurance companies, including those providing marine insurance, at a rate of 2.0 percent of gross premiums collected less insurance company losses.

1911 The Legislature increased the tax rate on all insurance premiums, including marine insurance, to 2.25 percent and eliminated the deduction for losses. The Legislature also provided new deductions for re-insurance and refunds of premiums returned to policyholders.

1929 The Legislature made substantial changes to treat marine insurance differently than other types of insurance. It increased the tax rate to 5 percent while narrowing the tax base to annual underwriting profit (premiums minus losses and other expenses) averaged over three years.

1945 The Legislature lowered the general tax rate on insurance premiums from 2.25 percent to 2 percent. This rate change did not apply to marine insurance.

1947 As part of an entirely new insurance code, the Legislature provided separate categories of "ocean marine and foreign trade" insurers and "marine and transportation" insurers. The Legislature continued the preferential treatment for ocean marine and foreign trade insurers by lowering the rate to 0.75 percent, but also broadened the base to include other expenses previously excluded in 1929. The tax rate for other insurance premiums, including those of marine and transportation insurers, remained at 2 percent.

1982 The Legislature increased the tax rate on ocean marine and foreign trade insurance to 0.91 percent.

1983 The Legislature increased the tax rate on ocean marine and foreign trade insurance to 0.95 percent. The tax rate has not been changed since.

Public policy objectives for the two tax preferences for ocean marine and foreign trade insurance are not clear. While the Legislature treated these insurance companies differently than other insurance companies for more than 80 years, statutes provide no explicit statement of legislative intent. However, the Legislature often treats businesses differently for tax purposes in order to stimulate business activity and to create tax equity among similar businesses.

Beneficiaries

In 2007, 51 companies paid taxes under Washington's basic ocean marine and foreign trade insurance taxation system and benefited from the two tax preferences described above. These companies collected $127 million in premiums and reported $76 million in losses in 2007.

Washington insurance law contains a retaliatory provision (RCW 48.14.040) which provides for higher tax rates on companies headquartered in another state or country if those states or countries charge a higher tax rate on Washington-based insurance companies doing business in their jurisdictions. Another 18 companies that provided ocean marine and foreign trade insurance in Washington were subject to retaliatory taxation. While these companies paid a higher tax rate than the other 51 companies, they still may have lower taxes than other types of insurers subject to the premium tax.

Revenue Impacts

In 2007, ocean marine and foreign trade insurance tax preferences resulted in an estimated $2.1 million in savings for insurance companies doing business in Washington. The estimate does not include adjustments for retaliatory taxation. Had data been available to make this adjustment, taxpayer savings likely would have been somewhat smaller.

Recommendation

The Legislature should clarify the public policy purpose for providing a lower insurance premium rate and tax base for ocean marine and foreign trade insurance. Clarification is required because there is a lack of a clearly stated public policy objective and changing conditions since earlier enactments.

Legislation Required:	Yes.
Fiscal Impact:	A change in revenue could be possible depending on clarification.

OCEAN MARINE INSURANCE TAX PREFERENCES – REPORT DETAIL

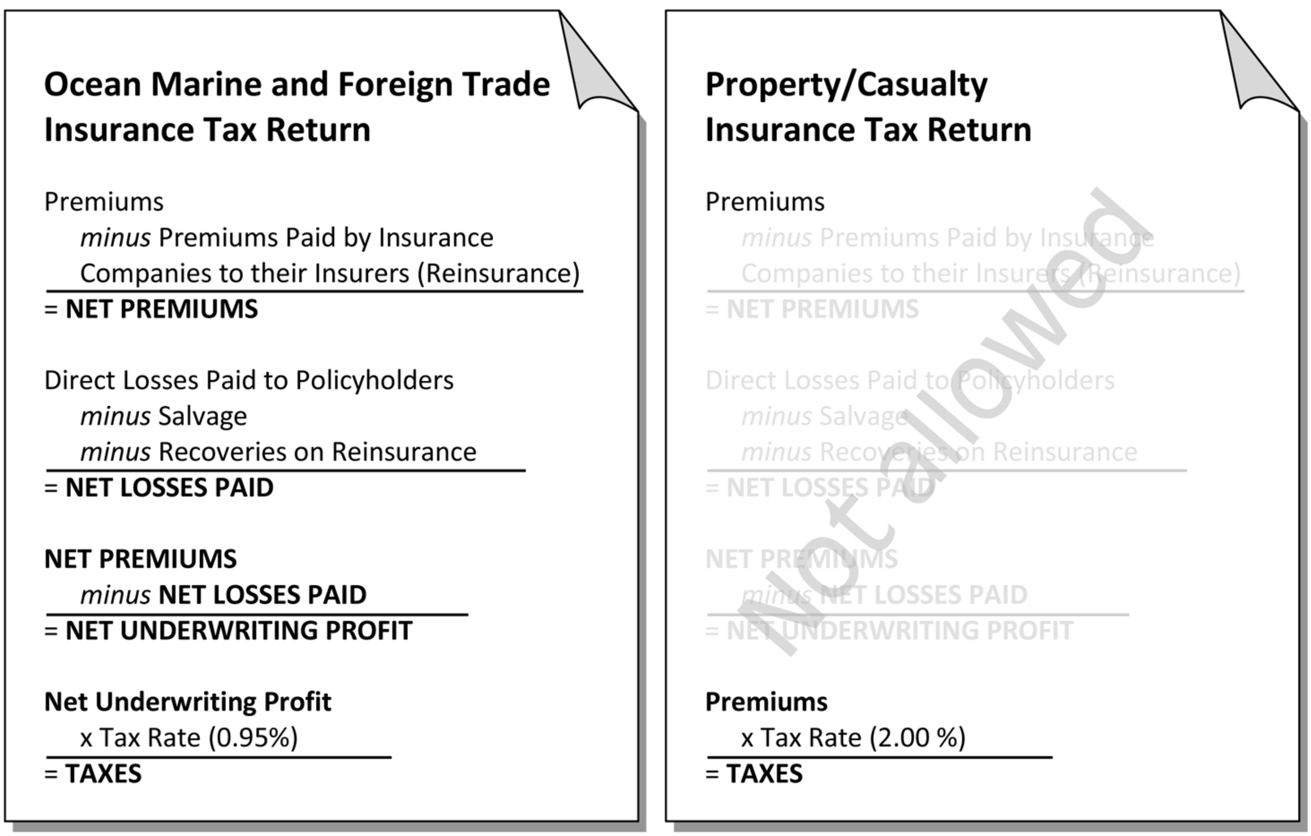
Current Law

The ocean marine and foreign trade insurance industry receives two tax preferences:

1) A preferred tax rate; and
2) A deduction for insurance company losses.

The preferred tax rate for insurance premiums is 0.95 percent on the gross underwriting profit of ocean marine and foreign trade insurers. Gross underwriting profit equals net premiums with a deduction for net losses paid. Generally, the insurance premiums tax rate is 2.0 percent applied to premiums, without a deduction for losses. (See Exhibit 8 for explanation of these terms and the difference in taxation by type of insurance.) See pages A3-2 and A3-3 in Appendix 3 for the current statutes, RCW 48.14.020, 48.11.050 and 48.11.105.

Exhibit 8 – Tax Rate and Tax Base Are Less for Ocean Marine & Foreign Trade Insurance Than for Other Property and Casualty Insurance



Source: Tax returns from the Office of the Insurance Commissioner.

Legal History

1891 The Legislature imposed a tax on all insurance companies, including those providing marine insurance, at a rate of 2.0 percent of gross premiums collected less insurance company losses.

1911 The Legislature increased the tax rate on all insurance premiums, including marine insurance, to 2.25 percent and eliminated the deduction for losses. The Legislature also provided new deductions for re-insurance and refunds of premiums returned to policyholders.

1929 The Legislature made substantial changes to treat marine insurance differently than all other types of insurance. It increased the tax rate to 5 percent while narrowing the tax base to average annual underwriting profit (premiums minus losses and "other expenses") averaged over three years.

The other expenses included all commissions, agency expenses, taxes, licenses, loss-adjustment expenses, and general expenses such as overhead expenses including salaries of officers and employees. The deduction for expenses incurred was capped at 40 percent of gross premiums.

1945 The Legislature lowered the general tax rate on insurance premiums from 2.25 percent to 2 percent. This rate change did not apply to marine insurance.

1947 As part of an entirely new insurance code, the Legislature provided separate categories of "ocean marine and foreign trade" insurers and "marine and transportation" insurers. Historically "marine insurance" had included both ocean-going vessels and domestic transportation which often occurred over the inland waterways. The introduction of railroads and other land transportation methods changed the nature of domestic transportation. The marine insurance covering land transportation was more similar to fire and casualty insurance. Many states, including Washington, thus created different categories for marine (sometimes called inland marine) and transportation insurance as opposed to ocean marine and foreign trade insurance which addressed issues unique to sea-going vessels.

The Legislature continued the preferential treatment for ocean marine and foreign trade insurers by lowering the rate to 0.75 percent but also broadened the base to include other expenses previously excluded in 1929. The tax rate for other insurance premiums, including those of inland marine and transportation insurers, remained at 2 percent.

1982 The Legislature increased the tax rate on ocean marine and foreign trade insurance to 0.91 percent.

1983 The Legislature increased the tax rate on ocean marine and foreign trade insurance to 0.95 percent. The tax rate has not been changed since.

Other Relevant Background

The 1929 change in the taxation of marine insurance followed the enactment of the U.S. Merchant Marine Act of 1920. The federal act created a national policy to encourage the development of the American marine insurance market as an instrument to foster the foreign commerce of the United States. Also, the chairman of the Congressional Subcommittee on the Merchant Marine and Fisheries sent a letter to every governor and state insurance commissioner suggesting the taxation of marine insurance should be on net profits, as was done in England, rather than on gross premiums. "Gross premium taxation has created a real disability for American companies, whereas the substitution of a tax on net profits would do much toward placing them on an equal footing with their foreign competitors."[10]

The Legislature did not include an explicit statement of its purpose when it made the 1947 revisions. These changes, however, were part of the adoption of any entirely new insurance code. In the late 1940s many states were adopting new insurance codes in response to two recent United States Supreme Court cases.[11] The first case provided that the states could regulate insurance activity while the second case held that insurance was commerce[12] and thus subject to the restrictions of the authority of the federal government under the Commerce Clause of the federal constitution[13].

Also, during the 1930s, the state Supreme Court consistently ruled a net income tax to be unconstitutional.[14] An income tax allows deductions for expenses and costs of goods sold. The tax base of the marine premiums tax similarly allowed such deductions. In 1947, the Legislature changed the tax base for ocean marine and foreign trade insurance by including previously deducted expenses into the tax base.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preferences? Is the purpose or intent of the tax preferences clear?

Public policy objectives for the two tax preferences for ocean marine and foreign trade insurance are not clear. While the Legislature treated these insurance companies differently than other insurance companies for more than 80 years, statutes provide no explicit statement of legislative intent. However, the Legislature often treats businesses differently for tax purposes in order to 1) stimulate business activity and 2) to create tax equity among similar businesses:

1) Lower taxes on insurance premiums reduce costs for marine carriers. This has the effect of stimulating business for Washington-based companies, for out-of-state companies that sell goods in Washington, and for Washington ports, warehouses, and other sectors that provide for shipment and storage of goods.

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[10] Marine Insurance, Solomon S. Huebner, 1920.

[11] Inland Marine and Transportation Insurance, William A. Rodda at p.504-05 (2d ed. 1958).

[12] Parker v. Brown, 317 US 341 (1943).

[13] United States v. South-Eastern Underwriters Assoc., 322 US 533 (1944).

[14] See Aberdeen Savings & Loan Assn. V. Chase, 157 Wash. 351 (1930) and Culliton v. Chase, 174 Wash 363 (1933) for a discussion of how income is property, income taxes are property taxes, and they are subject to the uniformity clause of Article VII, Section 1 of the State's Constitution which includes the phrase that "All taxes shall be uniform upon the same class of property…".

2) The Legislature has also provided preferential tax treatment for businesses operating in competitive markets in order to create tax equity between similar businesses. Ocean marine and foreign trade insurers operate in national and international markets and this competition limits their ability to adjust their premium rates to reflect the cost of a gross receipts tax. Their profit margins in the past have been lower than other casualty and property insurers, although conditions have changed in more recent years.

   Professional literature raises many concerns related to the fairness of taxes based on gross receipts, such as Washington's insurance premium tax. [15] This includes concerns about the effect of this form of taxation on economic activity and whether the burden of the tax rests on the business that initially pays the tax, or is shifted to other households in the community. Whether or not a tax can be shifted depends on, among other things, the geographic territory of the tax, the geographic territory of the market, the effect of price increases on consumer demand, and the presence of competition among the sellers.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

It is not known whether the tax preferences achieved the two possible public policy objectives.

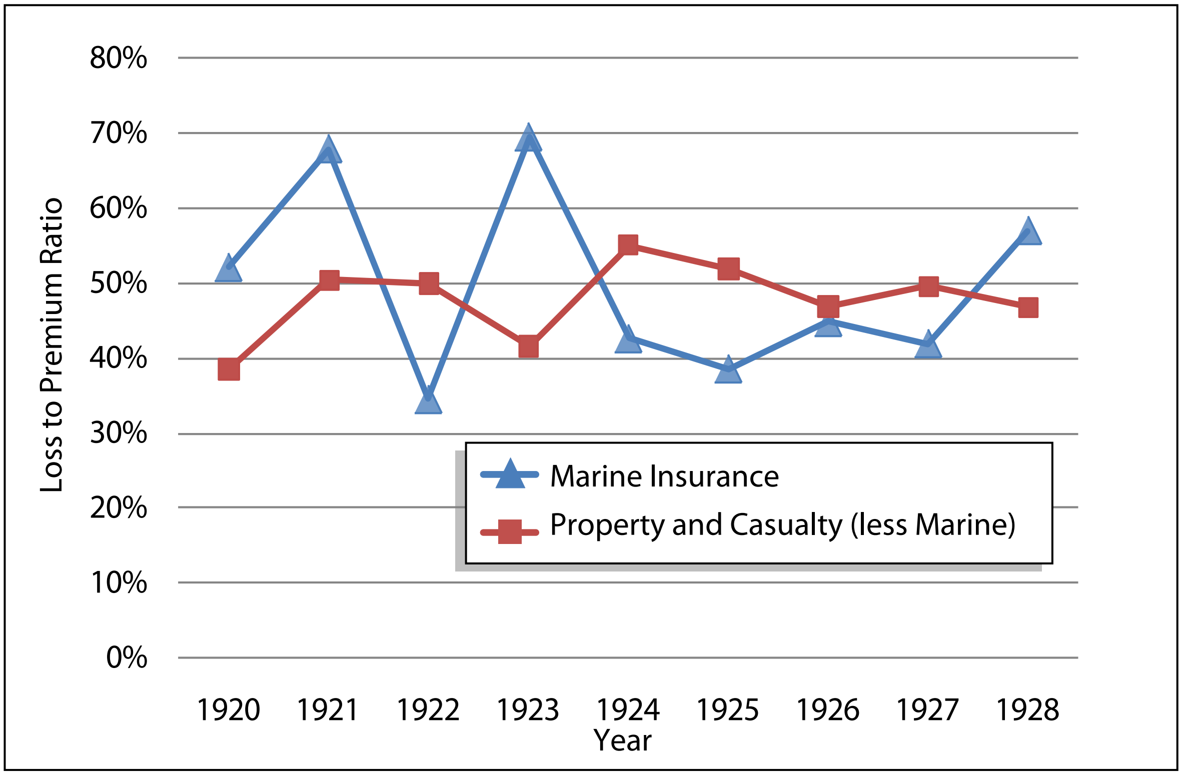
1. Evidence is not available to conclude that the tax preferences stimulated trade because there is no comparative data to test economic activity with and without the tax preference.
2. Ocean marine and foreign trade insurers continue to operate in national and international markets as they did when the Legislature enacted the preferences. However, profit margins for the industry have become comparable to other property and casualty insurance businesses and have become more stable than in the early years of the tax preference.

JLARC compared the ratio of losses to premiums for ocean marine and foreign trade insurance with the same ratio for other property and casualty insurance. These ratios have converged over time and do not currently support the concept of an entirely different tax rate and base for ocean marine and foreign trade insurance versus other property and casualty insurance.

Exhibit 9 shows the ratio of losses to premiums for ocean marine and foreign trade insurers for their policies in Washington compared to other property and casualty insurance. The exhibit includes the years leading up to the Legislature's first major revision to ocean marine insurance taxation in 1929. It shows the loss ratio for marine insurance was more volatile but generally tracked to that for other property and casualty insurance. Exhibits 10 and 11 show similar tracking patterns and even less volatility for the years preceding the second major revision to ocean marine insurance statutes in 1947 and currently. Overall, review of loss ratios does not support the concept of an entirely different tax rate and base for ocean marine and foreign trade insurance and other property and casualty insurance.

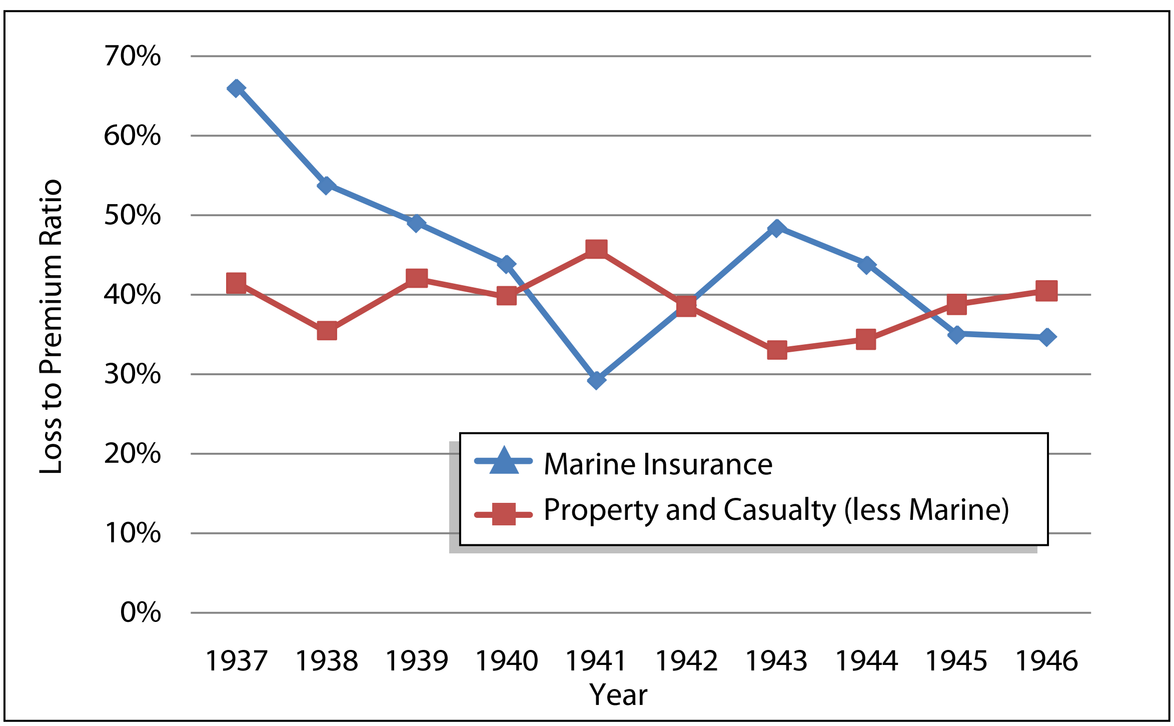
[15] For a more thorough discussion of this subject, see "General Sales or Turnover Taxation," National Industrial Conference Board, New York, 1929.

Exhibit 9 – Comparison of Marine Insurance to Other Types of Insurance in the 1920s



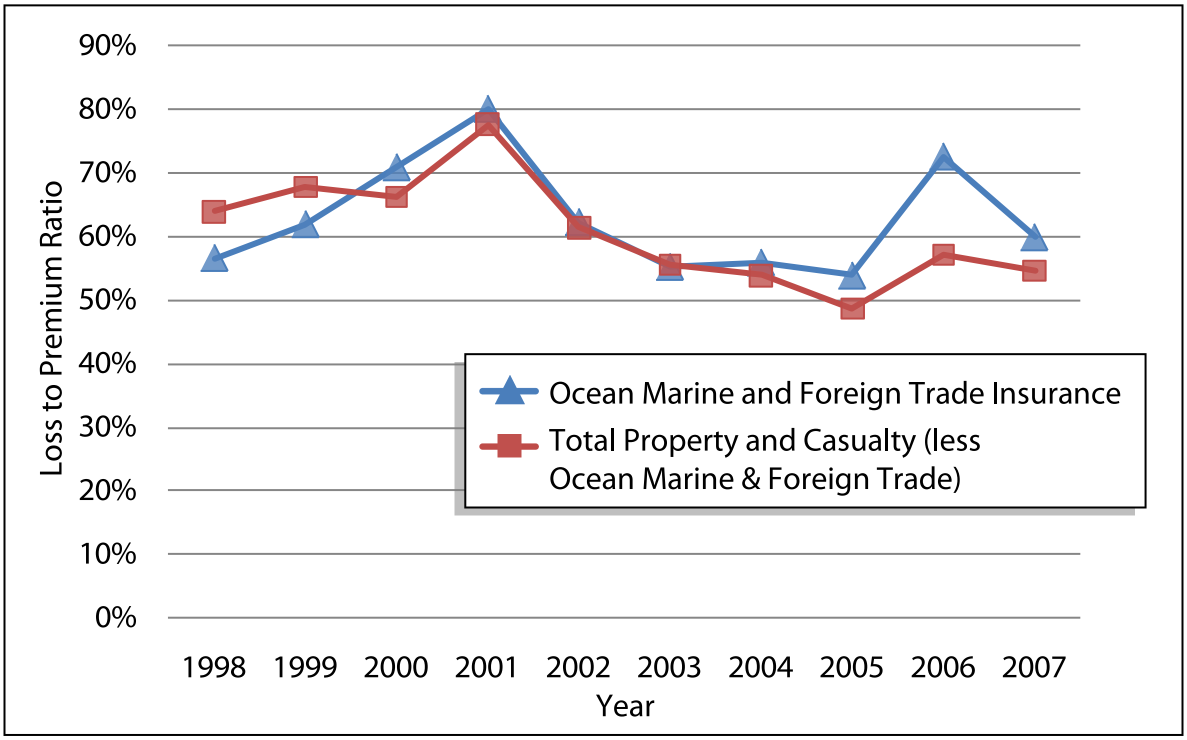
Source: JLARC Analysis based on Data from the Office of the Insurance Commissioner.

Exhibit 10 – Comparison of Marine Insurance to Other Types of Insurance in the 1940s



Source: JLARC analysis based on data from the Office of the Insurance Commissioner.

Exhibit11– Comparison of Ocean Marine and Foreign Trade Insurance to Other Types of Insurance Currently



Source: JLARC analysis based on data from the Office of the Insurance Commissioner.

Note: The tax preference applied to ocean marine and foreign trade insurance in 1947. Previously, the preference applied to marine insurance.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preferences?

In 2007, 51 companies that paid taxes under Washington's basic ocean marine and foreign trade insurance taxation system and benefited from the two tax preferences described above. These companies collected $127 million in premiums and reported $76 million in losses in 2007.

Washington insurance law contains a retaliatory provision (RCW 48.14.040) which provides for higher tax rates on companies headquartered in another state or country if those states or countries charge a higher tax rate on Washington-based insurance companies doing business in their jurisdictions. Another 18 companies that provided ocean marine and foreign trade insurance in Washington were subject to retaliatory taxation.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preferences to the taxpayer and to the government if it is continued?

In 2007, ocean marine and foreign trade insurance tax preferences resulted in an estimated $2.1 million in savings for companies doing business in Washington. The estimate does not include adjustments for retaliatory taxation. Had data been available to make this adjustment, taxpayer savings likely would have been somewhat smaller.

Exhibit 12 – Marine Insurance Premiums Tax (dollars in millions)

Calendar Year	Premiums	Losses	0.95% Tax on Gross Profits	2.0% Tax on Premiums	Taxpayer Savings
2006	$118	$85	$0.3	$2.4	$2.0
2007	**$127**	**$76**	**$0.5**	**$2.5**	**$2.1**
2008	$133	$80	$0.5	$2.7	$2.2
2009	$140	$84	$0.5	$2.8	$2.3
2010	$147	$88	$0.6	$2.9	$2.4
2011	$154	$92	$0.6	$3.1	$2.5

Source: Office of Insurance Commissioner (OIC) and JLARC analysis.

Note: Data for calendar years 2009 through 2011 are estimates based on a 5 percent growth rate.

Recommendation

The Legislature should clarify the public policy purpose for providing a lower insurance premium rate and tax base for ocean marine and foreign trade insurance. Clarification is required because there is a lack of a clearly stated public policy objective and changing conditions since earlier enactments.

Legislation Required: Yes.

Fiscal Impact: A change in revenue could be possible depending on clarification.

COMMERCIAL AIRCRAFT EXEMPTION FROM AIRCRAFT EXCISE TAX – SUMMARY

Current Law

Washington imposes an annual excise tax for the privilege of using an aircraft in the state. There is, however, an exemption from the aircraft excise tax for aircraft engaged in commercial flying. The exemption also applies to aircraft operated for testing and training purposes. Under Washington statutes, most aircraft that are exempt from the aircraft excise tax are subject to the personal property tax.[16] These aircraft are listed and assessed by the Department of Revenue, and the tax is collected by county treasurers. While owners of commercial aircraft and aircraft operated for testing and training purposes are exempt from the aircraft excise tax, they pay significantly more in taxes because personal property is taxed at a higher rate.

See pages A3-3 through A3-5 in Appendix 3 for the current statutes, RCW 82.48.020, RCW82.48.100, and RCW 82.48.110.

Legal History and Public Policy Objectives

Pre-1949	Commercial aircraft were subject to personal property taxes.
1949	The Legislature imposed the aircraft excise tax on the privilege of using an aircraft in the state. This legislation included an exemption for aircraft engaged principally in commercial flying. The exemption also applied to aircraft owned by the manufacturer while being operated for test or experimental purposes, or for crew training. The law further provided that if aircraft were exempt from the excise tax, they generally were subject to property tax.

The current law exemption language is exactly the same as it was originally passed 60 years ago.

The apparent public policy objective for this exemption was to continue taxing these aircraft under the existing property tax system, as they had been prior to 1949.

Beneficiaries

The beneficiaries of this aircraft excise tax exemption are the airlines that own commercial aircraft and aircraft operated for testing and training purposes. However, because of the exemption, these aircraft are subject to the property tax, which involves a significantly greater amount of taxes.

[16] See also JLARC tax preference reviews of nonresident aircraft and aircraft held for sale (2009 Expedited Report, page 51) and general aviation aircraft exempt from the property tax (2009 Full Report, page 123).

Revenue Impacts

By virtue of commercial aircraft and aircraft operated for testing and training purposes being exempt from the aircraft excise tax, the state is foregoing up to $700,000 per year in aircraft excise taxes and fees. However, the owners of these aircraft are instead paying the state and local governments about $10.3 million per year in property taxes, for a net gain to government of about $9.6 million annually.

Recommendation

The Legislature should continue the aircraft excise tax exemption for commercial aircraft and aircraft operated for testing and training purposes, in order to continue taxing them under the existing property tax scheme.

Legislation Required: None.

Fiscal Impact: None – No change in the status quo.

COMMERCIAL AIRCRAFT EXEMPTION FROM AIRCRAFT EXCISE TAX – REPORT DETAIL

Current Law

Washington imposes an annual excise tax for the privilege of using an aircraft in the state. There is, however, an exemption from the aircraft excise tax for aircraft engaged in commercial flying. The exemption also applies to aircraft operated for testing and training purposes. As shown in Exhibit 13, under Washington statutes, most aircraft that are exempt from the aircraft excise tax are subject to the personal property tax.[17] These aircraft are listed and assessed by the Department of Revenue, and the tax is collected by county treasurers. While owners of commercial aircraft and aircraft operated for testing and training purposes are exempt from the aircraft excise tax, they pay significantly more in taxes because personal property is taxed at a higher rate.

See pages A3-3 through A3-5 in Appendix 3 for the current statutes, RCW 82.48.020, RCW82.48.100, and RCW 82.48.110.

Exhibit 13 – Tax Status of Aircraft in Washington:
The Aircraft Excise Tax Works in Concert With the Property Tax

Type of Aircraft	Aircraft Excise Tax	Property Tax
Commercial aircraft used in interstate/foreign commerce and manufacturer-owned aircraft operated for testing or training purposes	Exempt	Taxable
General aviation aircraft	Taxable	Exempt

Source: RCW 82.48.100 and RCW 82.48.110.

The aircraft excise tax consists of an annual fee based on the type of aircraft:

- Single engine, fixed wing $50
- Small multi-engine, fixed wing $65
- Large multi-engine, fixed wing $80
- Turboprop multi-engine, fixed wing $100
- Turbojet multi-engine, fixed wing $125
- Helicopters $75
- Sailplanes, lighter-than-air, home-built $20

[17] See also JLARC tax preference reviews of nonresident aircraft and aircraft held for sale (2009 Expedited Report, page 51) and general aviation aircraft exempt from the property tax (2009 Full Report, page 123).

Legal History

Pre-
1949 Commercial aircraft were subject to personal property taxes.

1949 The Legislature imposed the aircraft excise tax on the privilege of using an aircraft in the state. The legislation included an exemption for aircraft engaged principally in commercial flying. The exemption also applied to aircraft owned by the manufacturer while being operated for test or experimental purposes, or for crew training. The law further provided that if aircraft were exempt from the excise tax, they generally were subject to property tax.

The current exemption language is exactly the same as it was originally passed 60 years ago.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

The apparent public policy objective for this exemption was to continue taxing these aircraft under the existing property tax system, as they had been prior to 1949.

Today, the amount of property taxes paid on commercial aircraft is about $10 per $1,000 of depreciated value (1 percent). This is far in excess of the aircraft excise tax; the maximum excise tax is $125 per year with an additional $15 registration fee.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

Today, commercial aircraft and aircraft operated for testing and training purposes are still taxed as they were prior to 1949, as the Legislature designed.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

The beneficiaries of this aircraft excise tax exemption are the airlines that own commercial aircraft and aircraft operated for testing and training purposes. However, because of the exemption, these aircraft are subject to the property tax, which involves a significantly greater amount of taxes.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

The revenue impact of this exemption from the aircraft excise tax is a net gain to government and not a savings to the owners of the aircraft. By virtue of commercial aircraft and aircraft operated for testing and training purposes being exempt from the aircraft excise tax, the state is foregoing up to $700,000 per year in aircraft excise taxes and fees. However, the owners of these aircraft are instead paying the state and local governments about $10.3 million per year in property taxes, for a net gain to government of about $9.6 million annually.

Exhibit 14 – Valuation of Aircraft Transportation Companies in Washington
(Dollars in Millions)

Year Taxes Are Due	Assessed Value All Airline Property	Estimated Valuation of Aircraft	Property Taxes Due
2006	$1,618	$769	$8.7
2007	$1,834	$871	$9.1
2008	$2,100	$998	$10.3
2009	$2,081	$988	$10.5
2010	$2,102	$998	$10.7
2011	$2,123	$1,008	$10.6

Source: Department of Revenue and airline corporation financial records; estimates and forecast prepared by JLARC.

Note: Figures for 2009 through 2011 are JLARC estimates. Figures do not include valuation of aircraft used for testing and training purpose as data is not available.

Recommendation

The Legislature should continue the aircraft excise tax exemption for commercial aircraft and aircraft operated for testing and training purposes, in order to continue taxing them under the existing property tax scheme.

Legislation Required: None.

Fiscal Impact: None – No change in the status quo.

NONRESIDENT AIRCRAFT AND AIRCRAFT HELD FOR SALE EXEMPTION FROM EXCISE TAX – SUMMARY

Current Law

Washington imposes an annual excise tax for the privilege of using an aircraft in the state. Two exemptions from the aircraft excise tax are:

1) Aircraft that are owned by nonresidents and registered in another state. The length of stay requirement in Washington is less than 90 days per year in order to qualify for the aircraft excise tax exemption; and
2) Aircraft that are being held for sale, exchange, delivery, test, or demonstration purposes solely as stock in trade of a licensed aircraft dealer.

This review contains evaluations of both tax preferences noted above.[18]

See pages A3-3 through A3-5 in Appendix 3 for the current statute, RCW 82.48.100.

Legal History and Public Policy Objectives

1949 The Legislature imposed the aircraft excise tax on the privilege of using an aircraft in the state. The legislation included an exemption for aircraft that are owned by a nonresident, registered in another state, and in Washington for less than 90 days per year.

The public policy objective was to exempt non-resident aircraft in Washington for only a limited amount of time (less than 90 days).

1955 The Legislature added an exemption for aircraft held for sale, exchange, delivery, test, or demonstration.

The Legislature provided no clear statement of public policy intent when it enacted the exemption in 1955. However, the Legislature has provided similar tax treatment to other property held for sale.

Beneficiaries

- For the exemption for nonresident aircraft in Washington for less than 90 days, the beneficiaries are the owners of aircraft that fly in Washington and who do not stay for an extended period of time. It is not known how much of this activity takes place.
- For the exemption for aircraft held for sale, there are 52 licensed aircraft dealers in Washington. As of April 3, 2009, they held 98 aircraft for sale.

[18] See also JLARC tax preference reviews of commercial aircraft exempt from aircraft excise tax (2009 Expedited Report, page 45) and general aviation aircraft exempt from the property tax (2009 Full Report, page 123).

Revenue Impacts

- For the exemption for nonresident aircraft in Washington for less than 90 days, the overall level of activity is not known, and therefore, the taxpayer savings cannot be estimated.
- For the exemption for aircraft held for sale, JLARC estimates the revenue impact of exempting aircraft held for sale from the aircraft excise tax is about $5,400 in 2009. That estimate is based on 98 aircraft being held for sale. The aircraft excise tax rates are between $20 and $120 per aircraft. In 2007, the Department of Revenue estimated the taxpayer savings for this preference to be about $4,500 for that year.

Recommendation

The Legislature should continue the aircraft excise tax exemptions for:

1) **Aircraft owned by a nonresident, registered in another state, and in Washington for less than 90 days for the purpose of providing a time-limited exemption.**
2) **Aircraft held for sale for the purpose of treating this property similar to the tax treatment of other types of property held for resale.**

Legislation Required: No.

Fiscal Impact: None – No change to status quo.

NONRESIDENT AIRCRAFT AND AIRCRAFT HELD FOR SALE EXEMPTION FROM EXCISE TAX – REPORT DETAIL

Current Law

Washington imposes an annual excise tax for the privilege of using an aircraft in the state. Two exemptions from the aircraft excise tax are:

1) Aircraft that are owned by nonresidents and registered in another state. The length of stay requirement in Washington is less than 90 days per year in order to qualify for the aircraft excise tax exemption; and
2) Aircraft that are being held for sale, exchange, delivery, test, or demonstration purposes solely as stock in trade of a licensed aircraft dealer.

This review contains evaluations of both tax preferences noted above.[19]

See pages A3-3 through A3-5 in Appendix 3 for the current statute, RCW 82.48.100.

Legal History

1949 The Legislature imposed the aircraft excise tax on the privilege of using an aircraft in the state. The legislation included an exemption for aircraft that are owned by a nonresident, registered in another state, and in Washington for less than 90 days per year.

1955 The Legislature added an exemption for aircraft held for sale, exchange, delivery, test, or demonstration.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

For the exemption for nonresident aircraft in Washington for less than 90 days: The public policy objective was to exempt non-resident aircraft in Washington for only a limited amount of time (less than 90 days). Federal and state law require that, for tangible personal property to acquire a taxing status in a state other than the domicile of its owner, such property must regularly and continuously enjoy the benefits conferred by such a state. The principle is that the power of taxation is exercised based on the assumption of value given to the taxpayer in the protection of his property. If the taxing power is not in position to give such services, or otherwise benefit the property taxed, then the taxation of such property is beyond the power of the state. Court interpretations of the federal constitution require some exemption in state law based on the amount of time a nonresident-owned aircraft is located in a state.[20]

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[19] See also JLARC tax preference reviews of commercial aircraft exempt from aircraft excise tax (2009 Expedited Report, page 45) and general aviation aircraft exempt from the property tax (2009 Full Report, page 123).
[20] Washington AGO 51-53 No. 184.

For the exemption for aircraft held for sale: The Legislature provided no clear statement of public policy intent when it enacted the exemption in 1955. However, the Legislature has provided similar tax treatment to other property held for sale. Other types of property held for sale are not taxed under the property tax and under other taxes based on the valuation of the property.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

For the exemption for nonresident aircraft in Washington for less than 90 days: The Attorney General issued an opinion in 1951 that identified the requirement that an aircraft be in, or based in, the state for some minimum time before the state may tax it. This exemption complies with this requirement.

The exact minimum amount of time that any article of tangible personal property needs to be within a state before it can taxed by the state varies by the type of property. A snowmobile is subject to registration in this state if the snowmobile is physically located in Washington for a period of more than 15 consecutive days. A recreational boat has 60 days before the owner must register the boat in Washington (however, the owner, on or before the 61^{st} day in this state, can obtain an extension up to six months by purchasing an identification document from the state). Once registered, these types of property are taxable. A commercial vessel needs to be in Washington waters a minimum 120 days before it is taxed by Washington. Washington does not require a motor vehicle owned by a nonresident to be registered if the vehicle is properly licensed in the owner's state and that state grants a similar privilege to Washington residents.

For the exemption for aircraft held for sale: The exemption for aircraft held for sale is consistent with the theory requiring tax equity, or treating similar types of property the same for tax purposes. Business inventories of finished goods held for sale are exempt from the property tax. Vessels owned and held for sale by a dealer and not rented are exempt from the watercraft excise tax. Travel trailers and campers are exempt from the travel trailer and camper excise tax.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

For the exemption for nonresident aircraft in Washington for less than 90 days: The beneficiaries of exempting nonresident-owned aircraft from the aircraft excise tax are the owners of such aircraft who fly into Washington and do not stay for an extended period of time. It is not known how much of this activity takes place.

For the exemption for aircraft held for sale: There are 52 licensed aircraft dealers in Washington. As of April 3, 2009, they held 98 aircraft for sale.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

For the exemption for nonresident aircraft in Washington for less than 90 days: The overall level of activity is not known.

For the exemption for aircraft held for sale: JLARC estimates the revenue impact of this exemption is about $5,400 in 2009. This is based on 98 aircraft being held for sale. The aircraft excise tax rates are between $20 and $120 per aircraft. In 2007, the Department of Revenue estimated the taxpayer savings for this preference to be about $4,500 for that year.

Recommendation

The Legislature should continue the aircraft excise tax exemptions for:

1) **Aircraft owned by a nonresident, registered in another state, and in Washington for less than 90 days for the purpose of providing a time-limited exemption.**
2) **Aircraft held for the purpose of treating this property similar to the tax treatment of other types of property held for resale.**

Legislation Required: No.

Fiscal Impact: None – No change to status quo.

MANUFACTURERS OF FLOUR AND OIL PREFERENTIAL TAX RATE – SUMMARY

Current Law

Current law provides a preferential business and occupation (B&O) tax rate of 0.138 percent for manufacturers of wheat flour, pearl barley, soybean oil, canola oil, canola meal, canola byproducts, and sunflower oil. The regular manufacturing B&O rate is 0.484 percent.

See page A3-5 in Appendix 3 for the current statute, RCW 82.04.260(1)(a).

Legal History and Public Policy Objectives

1933 Faced with a revenue shortfall, the Legislature adopted a temporary tax on the privilege of engaging in business activities. The legislation set the tax rate for manufacturers (including manufacturers of flour) at 0.25 percent.

1935 To address a continuing revenue shortfall, the Legislature established the B&O tax on the gross receipts of businesses. The legislation used a tax rate of 0.25 percent for all businesses, including manufacturers of flour.

1949 The Legislature halved the B&O tax rate for manufacturers of flour from the basic rate of 0.25 percent to 0.125 percent.

1979 The Legislature extended this reduced rate to manufacturers of soybean oil and sunflower oil.

1983 The Legislature increased this lower rate of 0.125 percent to the current rate of 0.138 percent.

1987 The Legislature included manufacturers of pearl barley in this lower rate.

1995 The Legislature made a final addition for manufacturers of canola oil.

The public policy objective for the preferred tax on manufacturers of flour and oil is to recognize industries that have their prices set in national markets and are unable to pass on to consumers the cost of their B&O tax.

Beneficiaries

- Washington has 11 manufacturers of flour, soybean oil, sunflower oil, and canola products that are paying B&O taxes at the preferential rate of 0.138 percent.

Revenue and Economic Impacts

- JLARC estimates taxpayer savings from the preferential treatment of flour and oil manufacturers is over $400,000 per year. This amount represents the difference between what taxpayers pay at the reduced rate of 0.138 percent and the standard manufacturing tax rate of 0.484 percent.

Recommendation

1. **The Legislature should continue a preferential B&O tax rate for manufacturers of flour and oil to provide relief for these industries with prices set in national markets; and**

2. **The Legislature should review the preferential B&O tax rate for manufacturers of flour and oil to ensure the level of the rate is still appropriate.**

Legislation Required: No legislation is required to continue the preference at the current level. Legislation would be required if the Legislature decided to adjust the amount of the preference.

Fiscal Impact: A change in revenue could be possible depending on action taken by the Legislature.

MANUFACTURERS OF FLOUR AND OIL PREFERENTIAL TAX RATE – REPORT DETAIL

Current Law

Current law provides a preferential business and occupation (B&O) tax rate of 0.138 percent for manufacturers of wheat flour, pearl barley, soybean oil, canola oil, canola meal, canola byproducts, and sunflower oil. The regular manufacturing B&O rate is 0.484 percent.

See page A3-5 in Appendix 3 for the current statute, RCW 82.04.260(1)(a).

Legal History

1933 The Legislature faced a revenue shortfall as it convened in January 1933. In response, lawmakers adopted a temporary tax imposed on the privilege of engaging in business activities. The tax was to be in place from August 1933 through July 1935. The new tax applied to a wide range of business activities, including manufacturing, wholesaling, retailing, and utilities. Multiplying the gross income of a business by the statutorily established rates determined the amount of the tax. The 1933 bill had several differing tax rates on particular types of business activities. For example, retailers paid 0.5 percent, wholesalers paid 0.2 percent, and manufacturers (including manufacturers of flour) paid 0.25 percent.

1935 The Legislature continued to face a significant revenue shortfall as it convened in 1935. To raise additional revenue, the Legislature passed the Revenue Act of 1935. As part of the 1935 act, the Legislature created the B&O tax. Most business activities included in the 1933 act were included in the new B&O tax. The 1935 legislation used a tax rate of 0.25 percent on gross receipts for all businesses including manufacturers of flour. Over time, the Legislature has developed a number of specialized tax rates for particular types of business activities.

1949 The Legislature halved the rate for manufacturers of flour to 0.125 percent.

1979 The Legislature extended the preferential rate of 0.125 percent to manufacturers of soybean and sunflower oil.

1983 The Legislature increased the rate for manufacturers of flour and oil to 0.138 percent.

1987 The Legislature added manufacturers of pearl barley to those receiving the lower rate.

1995 The Legislature included manufacturers of canola oil to those receiving the lower rate.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

Differential B&O tax rates are often provided for equity purposes. Some industries have their prices set in national markets and are unable to adjust the price of their products to reflect the cost of a gross receipts tax. Preferential tax rates can provide a tax break to industries that have relatively low profit margins and that are unable to pass on to the consumer the cost of the gross receipts B&O tax. The Legislature has recognized several high grossing, low margin manufacturers that operate in competitive national and international markets, including manufacturers of flour and oil.

Professional literature raises many concerns related to the fairness of gross receipt taxes, such as Washington's B&O tax. [21] This includes concerns about the effect of this form of taxation on economic activity and whether the burden of the tax rests on the business that initially pays the tax, or is shifted to households. Whether or not a tax can be shifted depends on, among other things, the geographic territory of the tax, the geographic territory of the market, consumer reaction to price change, and the presence of competition among the sellers.

In the years since the initial enactment of the B&O tax, there have been numerous adjustments to the tax's rate structure. Many of these adjustments have been made to accommodate the circumstances of a specific industry. The B&O tax rate for wheat-flour milling, soybean, and other oilseed processing has been reduced for this same reason.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

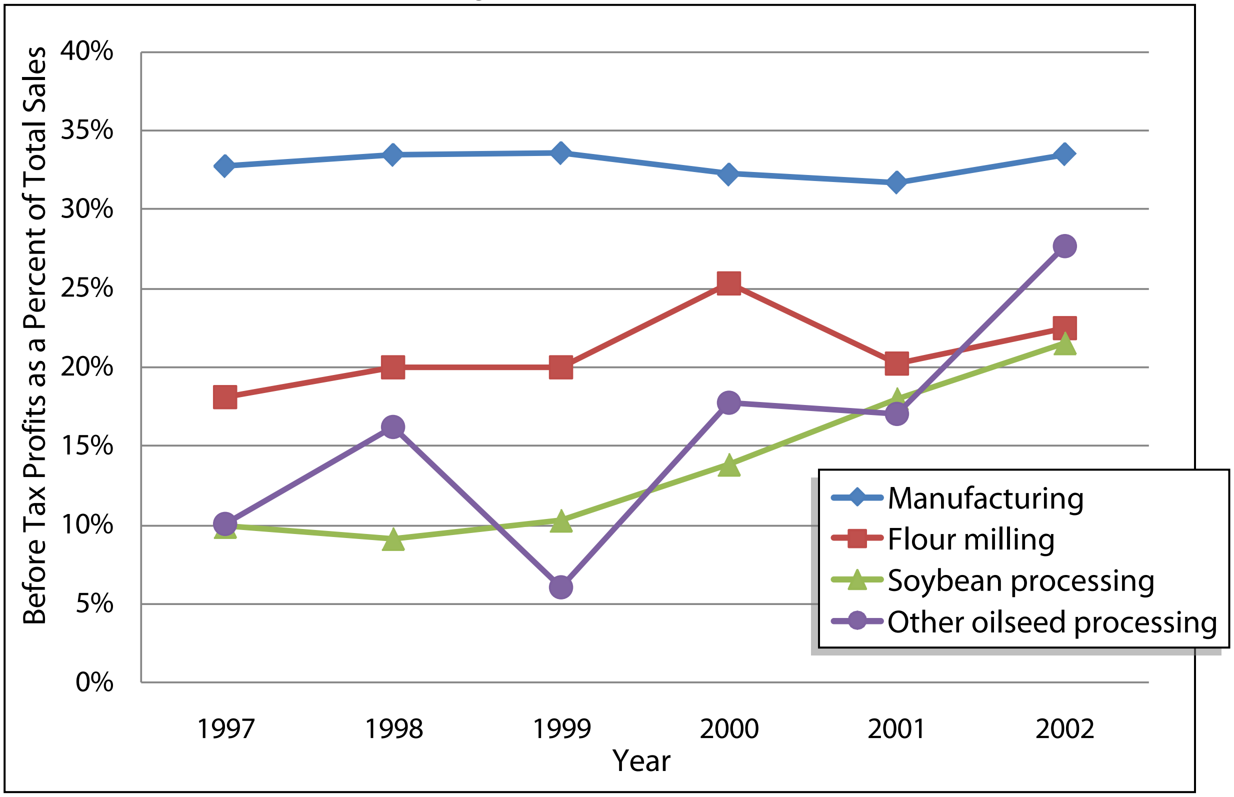
In order to examine the economic justification for the tax preferences provided to manufacturers of flour and oil, JLARC compared the gross margins for flour milling, soybean processing, and other oilseed processing to the gross margin for manufacturers as a whole. This analysis supports the concept of a preferential rate for Washington's flour and oil manufacturers because their margins are lower than other manufacturers. However, the Legislature may want to reconsider whether the current preferential rate is still set at an appropriate level and whether a uniform rate is appropriate for all processors.

Manufacturers in the business of flour milling, soybean processing, and other oilseed processing continue to have lower gross margins than other manufacturers.[22] Therefore, millers and processors are less able than other manufacturers to maintain competitive profits after they pay B&O taxes. As shown in Exhibit 15, for the years 1997-2002, U.S. manufacturers as a whole had gross margins of between 32 and 34 percent. During the same period, the flour milling industry had gross margins of 18 to 25 percent; soybean processors had gross margins of 9 to 22 percent; and other oilseed processors had gross margins of 6 to 28 percent. This evidence supports the concept that flour and seed processors are receiving a preferential B&O tax rate due to low margins.

[21] For a more thorough discussion of this subject, see "General Sales or Turnover Taxation," National Industrial Conference Board, New York, 1929.

[22] "Gross margins," as used here, is "value-added" less compensation costs, or essentially profits before taxes. "Value-added" is equal to total receipts for shipments less the cost of merchandise sold.

Exhibit 15 – Manufacturers of Flour, Soybean Oil, and Other Oilseed Products Have Lower Gross Margins Than Manufacturers as a Whole



Source: 2002 Economic Census, U.S. Census Bureau.

If a preferential rate is provided to low-profit industries for equity purposes, then the Legislature is faced with determining an appropriate preferential rate. The gross margins for flour milling and soybean and other oilseed processing have been less than for manufacturers as a whole. However, this difference is not proportional to the difference in B&O tax rates. In other words, while these manufacturers are less profitable than manufacturers as a whole, the preferred tax rate they receive is disproportionately lower than other manufacturers' rates.

Currently, the standard manufacturing B&O rate is 0.484 percent, the flour and seed processers pay 0.138 percent or about one-quarter of the standard manufacturing rate. While the gross margins for the specialized millers and processors vary from year-to-year, they generally exceed this ratio. For the period 1997 to 2002, flour milling gross margins were 55 to 79 percent of the gross margins for manufacturing as a whole; soybean gross margins were 27 to 64 percent of those for manufacturing as a whole; and other oilseed processing margins were 18 to 83 percent of those for manufacturing as a whole. In recent years, their margins have been proportionately closer to other manufacturers.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

In Washington, 11 manufacturers of wheat into flour, soybeans into soybean oil, sunflower seeds into sunflower oil, and canola into canola products pay taxes at the preferential tax rate of 0.138 percent.

On the Department of Revenue's combined excise tax return, three separate business activities report on the tax line providing the 0.138 percent tax rate: (1) manufacturing wheat into flour, soybean and canola processing; (2) raw seafood products; and (3) slaughtering, breaking and processing perishable meat – wholesale. In total, over 300 taxpayers report on this line. The estimate of 11 companies benefitting from the tax preference provided by RCW 82.04.260(1)(a) is based on the number of companies classified as being in grain or oilseed milling, crop production, miscellaneous food manufacturing, grain and field bean merchant wholesalers, and confectionary merchant wholesalers.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

The taxpayer savings resulting from providing the manufacturers of wheat into flour, soybeans into soybean oil, sunflower seeds into sunflower oil, and canola into canola products is currently over $400,000 per year. As shown in Exhibit 16, the taxpayer savings are the difference between what the taxpayers pay at a tax rate of 0.138 percent compared to what would have been owed at the standard manufacturing rate of 0.484 percent. Forecasting future savings depends on the future price of wheat, which is volatile. This forecast uses 2008 prices.

Exhibit 16 – Taxpayer Savings From Preferential Tax on Wheat and Seed Processing (Dollars in Thousands)

Fiscal Year	Taxable Income	Tax at 0.138%	Tax at 0.484%	Taxpayer Savings
2006	$74,092	$102	$359	$257
2007	$89,528	$124	$433	$309
2008	$120,226	$166	$582	$416
2009	$120,226	$166	$582	$416
2010	$120,226	$166	$582	$416
2011	$120,226	$166	$582	$416

Source: Department of Revenue taxpayer records.

Note: Figures for 2009 through 2011 are estimates based on 2008 actuals.

Recommendation

1. **The Legislature should continue a preferential B&O tax rate for manufacturers of flour and oil to provide relief for these industries with prices set in national markets; and**
2. **The Legislature should review the preferential B&O tax rate for manufacturers of flour and oil to ensure the level of the rate is still appropriate.**

Legislation Required:	No legislation is required to continue the preference at the current level. Legislation would be required if the Legislature decided to adjust the amount of the preference.
Fiscal Impact:	A change in revenue could be possible depending on action taken by the Legislature.

RURAL ELECTRIC UTILITY CONTRIBUTIONS PUBLIC UTILITY TAX CREDIT – SUMMARY

Current Law

This tax preference provides a public utility tax credit to a rural light and power business equal to 50 percent of contributions that the business makes to a rural economic development revolving fund. The light and power business must:

- Be located in a rural county or in a geographic area that serves 12,000 or fewer customers;
- Create a rural economic development revolving fund; and
- Appoint a board or designate an existing local board to oversee the revolving fund.

Statute identifies a broad range of "qualifying projects" that the contributed funds may be used for, including projects designed to create jobs, retain businesses, or upgrade nonelectrical infrastructure or health and safety facilities. The credit is limited to $25,000 each fiscal year for each light and power business, and the credit can be carried forward until used. The maximum credit for all firms is $350,000 a year. The goals of the incentive are met when $4.75 million or more in investment is made within a five-year period. The right to earn credits expires on June 30, 2011.

See pages A3-5 through A3-7 in Appendix 3 for the current law statute RCW 82.16.0491.

Legal History and Public Policy Objectives

1997 The Corporation for Enterprise Development released a study using an "urban/rural disparity index," which measured growth, employment, and earnings to compare all U.S. urban and rural counties. The study ranked all of the states using the index, giving Washington the second worst disparity score in the nation.[23]

1998 The Governor held two rural economic development summits. A Joint Legislative Task Force on Rural Land Use and Economic Development held four public hearings to gather ideas to spur economic development in rural areas. Emerging themes included local control, infrastructure development, and leveraging of existing loan programs.

1999 The Legislature adopted a "tool kit" of measures intended to stimulate economic development in rural areas. The tool kit included this tax preference.[24] The Legislature defined "rural" counties as counties with a population less than 100 persons per square mile. The definition included 31 counties. The credit expired on December 31, 2005.

2004 The Legislature extended the right to earn the public utility tax credit until June 30, 2011. New language set an investment goal of $4.75 million or more over a five-year period.

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[23] Corporation for Enterprise Development, 1997 Development Report Card for the States, p. 78.

[24] The 1999 legislation included additional tax preferences that are described in this volume of tax preference reviews. See page 93 for a review of the tax credits for rural help desks and software manufacturers.

2008 Island County was added to the definition of rural county bringing the total to 32 out of 39 counties.

The Legislature intended this tax preference to address the rural/urban economic disparity by encouraging rural economic development and job creation, and to meet a specific investment goal of $4.75 million over a five-year period.

- Absent a data-gathering mechanism such as the annual surveys and annual reports required of other targeted tax incentives, it is difficult to know the extent to which the funding projects have created jobs and promoted economic development. Statute allows for a broad range of "qualifying projects."
- It is unclear whether the investment goal is being reached. Given the $350,000 maximum credit allowed per year, the investment target of $4.75 million cannot be reached using utility contributions alone. Additional mechanisms such as interest earnings and repayment of loans, and leveraging other funding sources would be required to make up the difference. However, the responses from a survey conducted for this tax preference review indicate that most investments from the funds have been in the form of interest-free loans and outright grants to both public and private entities.

Beneficiaries

Altogether, 17 private, nonprofit, and municipal utilities have received the credit, according to Department of Revenue records. An additional 23 similar utilities are located in rural counties or serve 12,000 or fewer customers but do not claim the credit. Participating utilities are close to meeting the $350,000 annual cap each year. There is no limit to the number of years an entity can claim the credit; seven utilities have participated for the full 10 years the tax preference has been in place.

Revenue Impacts

Since enactment, $2.7 million in credit has been taken. The total contribution to rural economic development revolving funds that have been matched by the state credit is $5.4 million over 10 years. The tax credit is expected to be about $330,000 a year through June 2011 when the program expires.

Recommendation

The Legislature should allow the credit for rural electric utility contributions to expire on June 30, 2011. While the credit has been utilized, there is not evidence to show that the exemption should be continued beyond the most recent target expiration date.

Legislation Required: No.

Fiscal Impact: None – 2011-13 Biennial budgets assume the preference is expiring.

Rural Electric Utility Contributions Public Utility Tax Credit – Report Detail

Current Law

This tax preference provides a public utility tax credit to a rural light and power business equal to 50 percent of contributions that the business makes to a rural economic development revolving fund. The light and power business must:

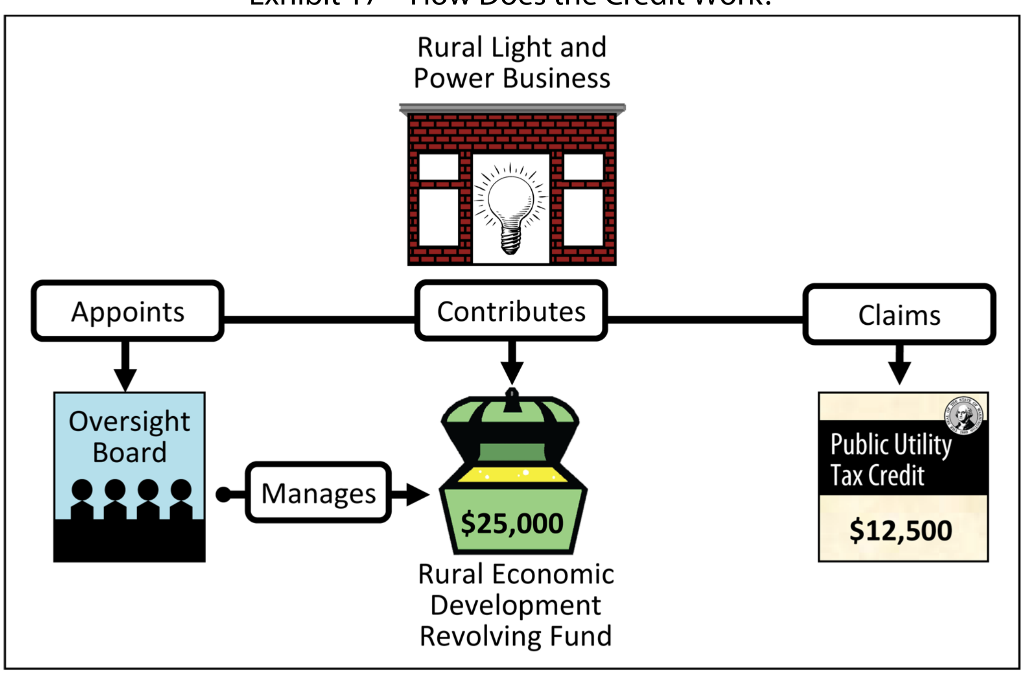
- Be located in a rural county or in a geographic area that serves 12,000 or fewer customers;
- Create a rural economic development revolving fund; and
- Appoint a board or designate an existing local board to oversee the revolving fund.

Statute identifies a broad range of "qualifying projects" that the contributed funds may be used for. These include projects designed to:

- Create or retain jobs;
- Add or upgrade nonelectrical infrastructure;
- Add or upgrade health and safety facilities;
- Accomplish energy and water use efficiency improvements, including renewable energy development; or
- Add or upgrade emergency services in any designated qualifying rural area.

The credit is limited to $25,000 each fiscal year for each light and power business. A utility that contributes $25,000, receives half of the contribution ($12,500) back in the form of a tax credit. (See Exhibit 17.)

Exhibit 17 – How Does the Credit Work?



Source: JLARC analysis of RCW 82.16.0491.

The maximum annual statewide credit of $350,000 would equate to $700,000 in contributions to the rural economic development revolving fund.

The goal of the incentive is met when at least $4.75 million in capital investment is made within a five-year period. The right to earn credits expires on June 30, 2011.

Statute defines a rural county as a county with a population density of less than 100 persons per square mile, or an area of less than 225 square miles. Currently, 32 counties meet the definition of rural county; Clark, King, Kitsap, Pierce, Snohomish, Spokane, and Thurston counties are not eligible for this incentive. (See Exhibit 18 below for the location of rural counties.)

See pages A3-5 through A3-7 in Appendix 3 for the current law statute RCW 82.16.0491.

Exhibit 18 – 32 Washington Counties Meet the Definition of "Rural" County

Source: Department of Revenue.

Legal History

1997 The Corporation for Enterprise Development released a study using an "urban/rural disparity index," which measured growth, employment, and earnings to compare all U.S. urban and rural counties. The study ranked all of the states using the index, giving Washington the second worst score in the nation.[25]

1998 The Governor held two rural economic development summits. A Joint Legislative Task Force on Rural Land Use and Economic Development held four public hearings to gather ideas to spur economic development in rural areas. Emerging themes included local control, infrastructure development, and leveraging of existing loan programs.

[25]Corporation for Enterprise Development, 1997 Development Report Card for the States, p. 78.

1999 The Legislature adopted a "tool kit" of measures intended to stimulate economic development in rural areas. The tool kit included this tax preference.[26] The legislature defined "rural" counties as counties with a population less than 100 persons per square mile. The definition included 31 counties. The credit expired on December 31, 2005.

2004 The Legislature extended the right to earn the public utility tax credit until June 30, 2011. New language set an investment goal of $4.75 million or more over a five-year period.

A new intent section stated that: "accountability and effectiveness are important aspects of setting tax policy. In order to make policy choices regarding the best use of limited state resources the legislature needs information to evaluate whether the stated goals of legislation were achieved." However, the statute lacked provisions for collecting such information.

2008 Island County was added to the definition of rural county bringing the total to 32 out of 39 counties.

This tax preference is also notable for a provision that is *not* in current law. While the Legislature indicated that it needs information in order to evaluate the stated goals of the legislation, the statute has never included provisions requiring the reporting of this information to the state. Currently, each individual local board directs the use of the contributed funds, and each contributing rural light and power business appoints the board members. There is no centralized collection of information on how the funds have been used.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

Providing assistance to rural areas has been a policy of the legislature ever since the logging, aluminum, mining and other natural resource-dependent industries began to decline. These industries tend to be based in rural counties. At the time of the 1999 Legislative Session, a national study that received much attention ranked the state as the second worst in the nation in disparity between rural and urban areas in income and employment.[27]

The 1999 Legislature intended this tax preference to address the rural/urban economic disparity by encouraging rural economic development and job creation. In 2004, the Legislature provided a specific investment goal of $4.75 million over a five-year period.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

Absent a data-gathering mechanism such as the annual surveys and annual reports required of other targeted tax incentives, it is difficult to know the extent to which the funding projects have created jobs and promoted economic development. The Association of Washington Cities and the Washington Public Utility District Association polled their members for this review, but only nine out of the 17 participating light and power businesses responded within the limited time available.

[26] The 1999 Legislation included additional tax preferences that are described in this volume of tax preference reviews. See page 91 for a review of the tax credits for rural help desks and software manufacturers.

[27] Corporation for Enterprise Development, 1997.

Economic Development and Job Creation: The categories of qualifying investment projects are very broad, and may allow some projects that marginally or only indirectly lead to new jobs and economic development. The nine responding rural utilities provided lists of projects financed with money from the revolving fund. These are grouped by the statutory categories as follows:

- Job creation or business retention and non-electric infrastructure—a micro-loan program, purchase of business inventory, downtown building renovations, broadband internet access, industrial park site development, and projects related to tourism and retail promotion such as turn-of-the-century downtown building facades, sports facilities, music in the park, and local festivals;
- Health and safety facilities—refurbishing of a medical facility to attract rural physicians;
- Energy and water use efficiency improvements—new doors for a county courthouse, energy-efficient windows for a city hall and water system improvements; and
- Emergency services—fire district equipment, defibrillators, a radio repeater, and a search and rescue vehicle.

Investment Goal: It is unlikely that the investment goal is being reached. Given the $350,000 maximum credit allowed per year, the investment target of $4.75 million cannot be reached using utility contributions alone. Additional mechanisms such as interest earnings and repayment of loans, and leveraging other funding sources would be required to make up the difference. However, the responses from a survey conducted for this tax preference review indicate that most investments from the funds have been in the form of interest-free loans and outright grants to both public and private entities.

The Legislature intended the rural economic development revolving fund to complement grants and loans from private, state and federal sources. Proponents testified that a rural revolving fund would be used to match the U.S. Department of Agriculture rural loan funds available through local electric utilities.[28]

The statute providing the tax preference does not define "revolving fund." However, in other context in state statute, a revolving fund is replenished by earnings such as interest or fees for services provided by the fund so that the fund remains intact. (see RCW 43.88.020). The revolving fund could be replenished by repayment of interest and principal on loans.

The public policy objective is met when the investment target is reached or exceeded over five years. From the best available evidence supplied by the utilities, neither mechanism for leveraging or replenishing the rural funds has been used. Therefore it is unlikely that the investment target has been met.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

[28]Aaron Jones, Director of Washington Rural Electric Cooperative Association, testimony on ESHB 2260, February 23, 1999.

Altogether, 17 private, nonprofit, and municipal utilities have received the credit, according to Department of Revenue records. (See Exhibit 19.) An additional 23 similar utilities are located in rural counties or serve 12,000 or fewer customers but do not claim the credit. Participating utilities are close to meeting the $350,000 annual cap each year. There is no limit to the number of years an entity can claim the credit; seven utilities have participated for the full ten years the tax preference has been in place.

Exhibit 19 – Qualifying Light and Power Businesses

	Public Utility Districts	City Utilities	Rural Electric Cooperatives	Total
Participating	7	6	4	17
Not Participating	7	9	7	23
Total Qualifying	14	15	11	40

Source: U.S. Energy Information Administration.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

Since enactment, $2.7 million in credit has been taken (See Exhibit 20.) The total contribution to rural economic development revolving funds that have been matched by the state credit is $5.4 million over ten years. The tax credit is expected to be about $330,000 a year through June 2011 when the program expires.

Exhibit 20 – Credits for Contributions to Economic Development Revolving Fund

Fiscal Year	Tax Credit Taken
2000	$252,616
2001	$292,529
2002	$272,275
2003	$242,159
2004	$235,000
2005	$280,000
2006	$280,000
2007	$209,190
2008	$330,000
2009	$330,000
2010	$330,000
2011	$330,000

Source: Washington Department of Revenue tax records. Note: Figures for 2009-11 are estimates.

Recommendation

The Legislature should allow the credit for rural electric utility contributions to expire on June 30, 2011. While the credit has been utilized, there is not evidence to show that the exemption should be continued beyond the most recent target expiration date.

Legislation Required:	No.
Fiscal Impact:	None – 2011-13 Biennial budgets assume the preference is expiring.

ELECTRICITY FOR ELECTROLYTE FIRMS EXEMPTION FROM PUBLIC UTILITY TAX – SUMMARY

Current Law

Sales of electricity to chlor-alkali and sodium chlorate electrolytic processing businesses are exempt from the 3.873 percent public utility tax. Light and power businesses taking the exemption must pass the savings on to electrolytic processors. The exemption became effective on July 1, 2004, and terminates on June 30, 2019, for all sales of power on or before December 31, 2018. At the time the Tax Preference Commission scheduled this review, the preference was scheduled to expire in 2011. This tax preference recognizes that electrolytic processing is highly energy intensive, with electricity comprising 50 to 60 percent of production costs.

In order to receive the exemption, the following conditions must be met:

- The electrolytic processor must use more than ten average megawatts of electricity per month;
- The electrolytic processor must not be a direct service industrial customer of the Bonneville Power Administration;
- The electricity used in the electrolytic process must be separately metered; and
- The price of the sale of electricity to the processor must be reduced by the amount of the tax exemption that the light and power business receives.

The electrolytic processor must pay back the amount of the tax exemption if the exemption is disallowed. The exemption does not apply to electricity that is resold by the electrolytic processor.

The beneficiaries of the tax preference must file an annual report with the Department of Revenue by March 31 providing details on employment, wages, and employer-provided health and retirement benefits at the manufacturing site for the previous calendar year. In addition, the businesses must include information on production levels and employee reductions. Information in the report may be disclosed to the public.

See pages A3-7 and A3-8 in Appendix 3 for the current statute, RCW 82.16.0421.

Legal History and Public Policy Objectives

2004 The Legislature provided this public utility tax exemption for electrolytic processors, stating two public policy objectives in statute:

1) To retain family wage jobs by enabling electrolytic processing businesses to maintain production at employment levels at least 75 percent of industry jobs as of January 1, 2004; and
2) To sustain the Washington electrolytic processing industry so that it will be positioned to preserve and create new jobs when the anticipated reduction of energy costs occurs.

2009 The Legislature extended the expiration date from 2011 to 2019, and modified the second objective, removing the reference to an anticipated reduction of energy costs in the future. Now the second goal of the preference is to allow the electrolytic processing industries to continue production in Washington so the industries will remain competitive.

Both public policy objectives are being met. The two electrolytic processors in the state currently employ 95 workers in Washington, exceeding the target level of 23 jobs. The industry is continuing production at higher levels than before passage of the legislation (58,000 tons of product in 2003 compared to 190,000 tons in 2008) despite continuing high energy costs.

Beneficiaries

As of 2008, there are two beneficiaries of this tax exemption. EKA Chemicals began operation in Moses Lake in 1990, and currently employs 33 workers. Equa-Chlor LLC began full production in 2007, and employs 62 workers at their facility in Longview.

Revenue Impacts

The exemption has saved the electrolytic processors $2.2 million in public utility taxes since its inception in 2004. The annual impact in future years is estimated at $780,000.

Recommendation

The Legislature should continue the public utility tax preference for electrolytic processing firms, for the purpose of sustaining the industry's competitiveness. Note: the Legislature continued the tax preference in the 2009 Legislative Session under SHB 1062.

Legislation Required: No.

Fiscal Impact: None.

ELECTRICITY FOR ELECTROLYTE FIRMS EXEMPTION FROM PUBLIC UTILITY TAX – REPORT DETAIL

Current Law

Sales of electricity to chlor-alkali and sodium chlorate electrolytic processing businesses are exempt from the 3.873 percent public utility tax. Light and power businesses taking the exemption must pass the savings on to electrolytic processors. The exemption became effective on July 1, 2004, and terminates on June 30, 2019, for all sales of power on or before December 31, 2018. At the time the Tax Preference Commission scheduled this review, the preference was scheduled to expire in 2011. This tax preference recognizes that electrolytic processing is highly energy intensive, with electricity comprising 50 to 60 percent of production costs.

In order to receive the exemption, the business must meet the following conditions:

- The electrolytic processor must use more than ten average megawatts of electricity per month;
- The electrolytic processor must not be a direct service industrial customer of the Bonneville Power Administration;
- The electricity used in the electrolytic process must be separately metered; and
- The price of the sale of electricity to the processor must be reduced by the amount of the tax exemption that the light and power business receives.

The electrolytic processor must pay back the amount of the tax exemption if the exemption is disallowed. The exemption does not apply to electricity that is resold by the electrolytic processor.

The beneficiaries of the tax preference must file an annual report with the Department of Revenue by March 31 providing details on employment, wages, and employer-provided health and retirement benefits at the manufacturing site for the previous calendar year. In addition, the businesses must include information on production levels and employee reductions. Information in the report may be disclosed to the public.

See pages A3-7 and A3-8 in Appendix 3 for the current statute, RCW 82.16.0421.

Legal History

2004 The Legislature provided this public utility tax exemption for electrolytic processors. The Legislature stated two public policy objectives in statute:

1) To retain family wage jobs by enabling electrolytic processing businesses to maintain production at employment levels at least 75 percent of industry jobs as of January 1, 2004; and
2) To sustain the Washington electrolytic processing industry so that it will be positioned to preserve and create new jobs when the anticipated reduction of energy costs occurs.

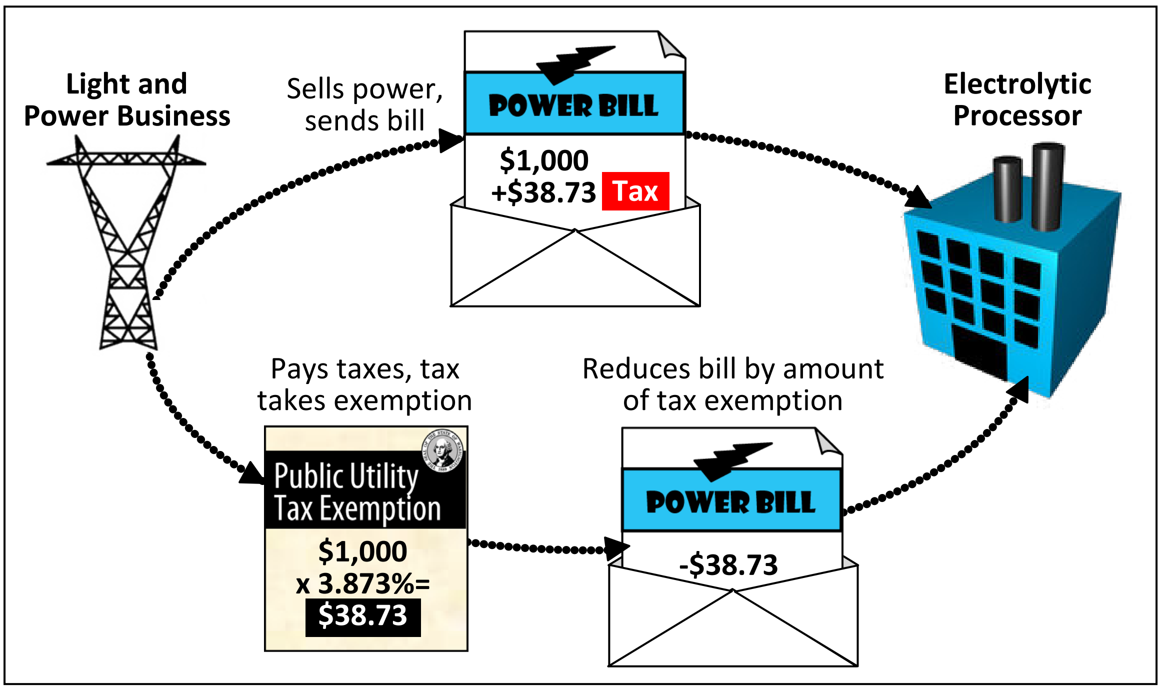
2009 The Legislature extended the expiration date from 2011 to 2019, and modified the second objective, removing the reference to an anticipated reduction of energy costs in the future. Now the second goal of the preference is to allow the electrolytic processing industries to continue production in Washington so the industries will remain competitive.

Other Relevant Background

Chlor-alkali and sodium chlorate electrolytic processors make bleach products by separating the chemicals in brine to make chlorine and sodium chlorate. These products are primarily used in bleaching pulp and in water treatment.

The value of the tax preference is equal to the sale of power to the electrolytic processor multiplied by the public utility tax rate of 3.873 percent. The light and power business subtracts the tax exemption from the amount of tax due on its state tax return, and reduces the customer's power bill by the amount of the tax exemption (See Exhibit 21.)

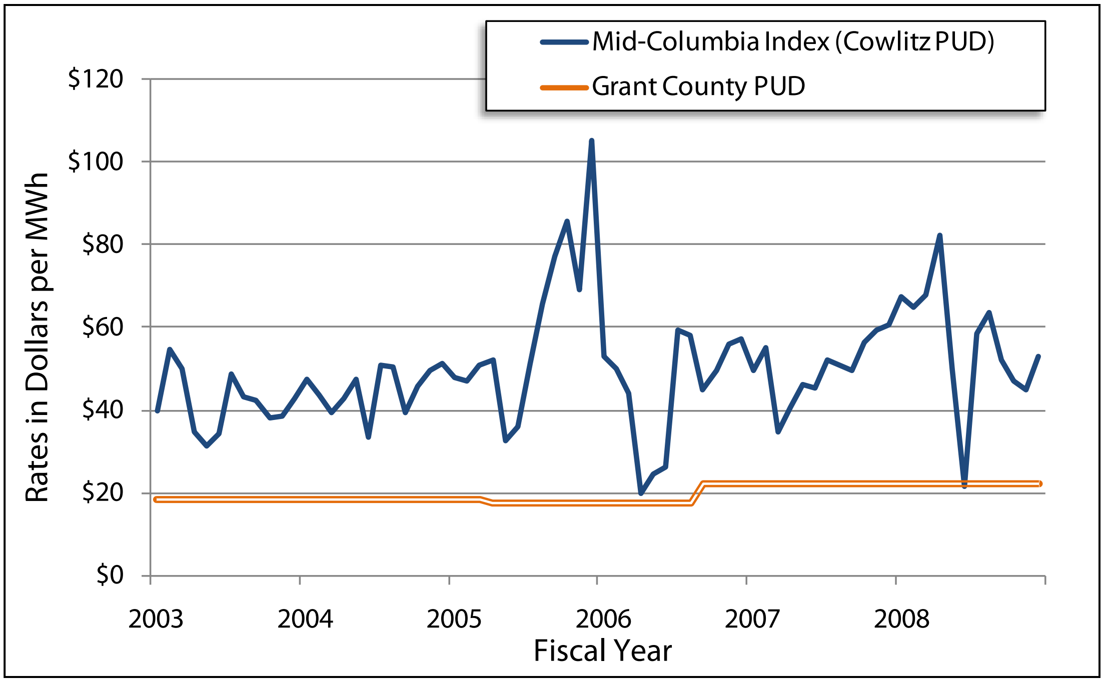
Exhibit 21 – Light and Power Business Must Pass on Tax Savings to Customer



Source: JLARC analysis of tax statute.

The industry is highly energy intensive—electricity is between 50 to 60 percent of production costs. EKA Chemicals purchases electricity from Grant County PUD #2. Grant County produces its own hydropower from its own dams and charges EKA an average of $22.30 per megawatt hour (MWh). The rate is set by the Grant County PUD commissioners and has remained relatively stable. Equa-Chlor purchases its electricity from Cowlitz County PUD District #2. Cowlitz County must pay the wholesale price which has fluctuated dramatically in the last several years and is trending upward. Rates for 2004 (the year of enactment) electricity prices averaged $45 per MWh. Prices averaged $56 per MWh in 2008. (See Exhibit 22.)

Exhibit 22 – Mid-Columbia Power Rates are Higher and More Volatile Than Grant County PUD Rates



Source: Northwest Power and Conservation Council and Grant County PUD.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

The Legislature has stated the following two public policy objectives in statute:

1) To retain family wage jobs by enabling electrolytic processing businesses to maintain production at employment levels at least 75 percent of industry jobs as of January 1, 2004; and
2) To sustain the Washington electrolytic processing industry so that it will remain competitive and be positioned to preserve and create new jobs.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

There is readily available information to show that both public policy objectives are being met. The two electrolytic processors in the state currently employ 95 workers in Washington, exceeding the target level of 23 jobs. The industry is continuing production at higher levels than before passage of the legislation (58,000 tons of product in 2003 compared to 190,000 tons of product in 2008) despite continuing high energy costs.

Retain Family Wage Jobs

The industry continues to meet the goal of retaining family wage jobs at above 75 percent of the jobs on the payroll as of January 1, 2004. At the time of enactment, only EKA Chemical qualified for the exemption. EKA employed 31 workers in its manufacturing operation. The target employment level is therefore 23.25 employees, or 75 percent of 31. The Washington processors now include both EKA and Equa-Chlor which together employed 95 workers in 2007. Although "family wage" jobs are not defined in statute, JLARC assumes that these are jobs that pay wages and benefits comparable to other Washington manufacturing jobs.

Jobs provided by Washington electrolytic processors compare favorably with other production jobs in Washington. The median hourly wage for Washington production workers is $15.63 an hour, while EKA and Equa-Chlor pay most of their production workers between $20 and $30 an hour (See Exhibit 23.)

Exhibit 23 – Wage Rates for Electrolytic Processors are Higher than Average

Year	WA Production Occupations	WA Electrolytic Production Occupations	
		Low	High
2007	$15.63	$20.01	$30.00

Source: Bureau of Labor Statistics, Occupational Employment Statistics; DOR Annual Reports.

The Legislature requires the beneficiaries of the exemption to report annually on their health and retirement benefits. EKA has been filing annual reports since the enactment of the tax incentive. Equa-Chlor began filing for its activity in 2007 when the company began production.

The benefits that electrolytic processors offer to workers can be compared with the information in the Washington Benefits Survey conducted annually by the Employment Security Department. Both electrolytic processors provide similar levels of benefits. Both offer health benefits to all employees and their dependents, comparing favorably with the Washington manufacturers as a whole, as well as all other industries. Both EKA and Equa-Chlor pay a greater share of monthly premiums than other industries. Both offer retirement plans to all their employees compared to much lower levels among other manufacturing businesses. (See Exhibit 24.)

Exhibit 24 – Health and Retirement Benefits for Electrolytic Processors are Higher Than Other Industries

	WA Electrolytic Processors	WA Manufacturers	All WA Industries
Medical Plans Offered			
Percent of employees eligible	100%	93%	85%
Percent of part-time employees eligible	100%	16%	20%
Average monthly premium paid by employer	$650-900	$469	$474
Percent of dependents eligible	100%	91%	76%
Retirement Plans Offered			
Defined Benefit – percent of employees eligible	0%	8%	7%
Defined Contribution – percent of employees eligible	100%	48%	39%
No Plan	0%	44%	56%

Source: Department of Revenue Annual Reports, 2007, and Washington State Employee Benefits Report, Labor Market and Economic Analysis, March 2008.

Allow the Processors to Continue Production

Levels of production and employment before the public utility tax exemption are considerably lower than current levels (See Exhibit 25.) Since Equa-Chlor began production in 2007, the industry has seen an expansion of employment and an increase in the volume of production. The number of workers employed in the industry has increased from 31 before enactment in 2004 to 95 in 2007, the latest year for which information is available. Production has increased from 58,000 tons before enactment of the legislation to almost 190,000 tons in 2008.

Exhibit 25 – Chemical Production and Employment has Increased Since 2007

Year	Production (Tons)	Employees (Count)
2003	57,933	31
2004	62,918	32
2005	64,932	30
2006	65,422	30
2007	190,746	95
2008	189,619	NA

Source: Department of Revenue Annual Reports.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

Two firms currently qualify for the exemption. EKA Chemicals is owned by AkzoNobel headquartered in Amsterdam, the Netherlands, and operates in 80 countries. Equa-Chlor, LLC is a Portland, Oregon, based company. A third company in the chlor-alkali industry, Pioneer Americas located at the Port of Tacoma, shut down its operation prior to passage of the exemption, but testified in favor of the 2004 legislation in hopes of re-opening.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

The electrolytic processors saved $2.2 million in taxes since the enactment of the tax preference through Fiscal Year 2008 based on information they provided to JLARC. The significant growth in 2007 is attributable to the entry of Equa-Chlor into the market. Future tax savings and are not expected to grow due to uncertainty in the chlorine manufacturing industry. The estimated annual revenue loss to the state general fund from this public utility tax exemption is $780,000, or $8,200 per job per year.

Exhibit 26 – Electrolytic Processor Tax Savings

Fiscal Year	Savings	Cumulative Savings To Date
2004	$164,000	$164,000
2005	$213,000	$377,000
2006	$309,000	$686,000
2007	$687,000	$1,373,000
2008	$778,000	$2,151,000
2009	$780,000	NA
2010	$780,000	NA
2011	$780,000	NA

Source: EKA Chemicals and Equa-Chlor; Note: Companies provided waivers to JLARC for use of this confidential information. Figures for 2009 through 2011 are estimates.

Recommendation

The Legislature should continue the public utility tax preference for electrolytic processing firms, for the purpose of sustaining the industry's competitiveness. Note: the Legislature continued the tax preference in the 2009 legislative session under SHB 1062.

Legislation Required: No.
Fiscal Impact: None.

ALUMINUM INDUSTRY TAX PREFERENCES – SUMMARY

Current Law

In 2004, the aluminum manufacturing industry received a package of incentives designed to keep it operating during a period of high energy costs and falling aluminum prices. In order to take the tax preferences, a firm must be a direct service industrial customer which means it must have purchased electricity from the Bonneville Power Administration (BPA) for direct consumption as of May 8, 2001. The incentives were scheduled to expire on January 1, 2007, but they were renewed by the 2006 Legislature. Provisions of the legislation for the aluminum industry are:

- Sales and use tax credits are allowed for personal property, construction materials, and labor and services performed on buildings and property at an aluminum smelter. The credits are taken for the state sales and use taxes at 6.5 percent. The credits apply to purchases made before January 1, 2012.
- An exemption is allowed on brokered natural gas use tax on purchases delivered through a pipeline. The exemption expires on January 1, 2012.
- A business and occupation (B&O) tax credit is allowed for the amount of property taxes paid on property owned by a direct service industrial customer. Customers can take the credit for property taxes paid after July 1, 2004, and through Calendar Year 2011. Unused credits may be carried over for one year.
- A reduced B&O rate is allowed for manufacturers, wholesalers of aluminum that are also manufacturers, and processors for hire of aluminum. The Legislature reduced the rate from 0.484 percent to 0.2904 percent. The reduced rate expires on January 1, 2012.
- Utilities may take B&O and public utility tax credits for sales of electricity, natural gas, or manufactured gas to an aluminum smelter if the savings are passed on to the aluminum smelter (RCW 82.04.4482 and RCW 82.16.0498). These tax preferences have been scheduled for review by JLARC in 2016.
- Annual reports are due by March 31 for firms benefiting from the incentives. The reports must include information on full-time, part-time and temporary employment, wages by wages bands, and health care and retirement benefits. The information in the annual report may be disclosed to the public.
- Legislative fiscal committee staff must prepare reports to the Legislature and must address effectiveness of the tax incentives in retaining jobs. Legislative staff prepared reports in 2005 and 2007. Additional legislative reports are due in 2010 and 2015.

See pages A3-8 through A3-10 in Appendix 3 for the current statutes, RCW 82.08.805, RCW 82.12.805, RCW 82.12.022(5), RCW 82.04.4481, and RCW 82.04.2909.

Legal History and Public Policy Objectives

The aluminum industry is located in the Northwest because of inexpensive, abundant hydropower and because the Bonneville Power Administration offered to serve the industry reliable power under long-term contracts at very low rates. At their peak in the 1970s, seven aluminum smelters employing 10,000 workers located in Washington. At full capacity, they purchased more than 2,000 megawatts of power directly from the BPA.

The aluminum smelters in Washington hit economic difficulties during 2000 and 2001 due to a combination of factors including sharp increases in the price of electricity driven by the western electricity crisis, a declining price in the world market for aluminum, and expiration of long-term electricity contracts with the BPA. They began to close down operation and lay off employees. In reaction, the Legislature in 2004 provided aluminum industry tax preferences for a two-and-a-half year period. Before their expiration, the 2006 Legislature reenacted the incentives and set a new expiration date of January 1, 2012.

To receive the incentives, the company must have been a direct service industrial customer of the BPA prior to May 8, 2001. The public policy objectives are to retain family wage jobs in rural areas at target levels and to sustain the industry through the period of high energy prices. These objectives are discussed below.

Retain Family Wage Jobs in Rural Areas

The Legislature specified a target of 75 percent of the jobs on the payroll as of January 1, 2004, adjusted for publicly announced reductions before November 30, 2003. In Calendar Year 2007, the industry employed 1,033 workers exceeding the target employment level of 716 jobs. The Legislature also wanted to preserve "family wage" jobs in rural areas. The two remaining smelters are located in counties defined in statute as rural, Whatcom and Chelan counties. The smelter jobs pay wages comparable to those of other Washington manufacturing occupations and offer above average health and retirement benefits.

Sustain the Industry through the Period of High Energy Prices

Another goal of the legislation is to sustain the industry through 2012 when higher energy prices were expected to subside. Between 2004 and 2008, energy prices were volatile and have generally increased. The mid-Columbia index, which is an index of the wholesale market price of energy, averaged $45 per megawatt per hour in 2004 and averaged $56 per megawatt per hour in 2008. The availability of BPA power to sell to smelters has diminished, and the available power is not as favorably priced as in the past.

Despite continued high energy prices, the aluminum smelters have increased production from 134,000 metric tons in the year before enactment of the incentives to 282,000 metric tons in 2008. This was due in part to the world market price of aluminum which increased from about 80 cents per pound in 2004 to between $1.20 and $1.40 per pound in 2006 through 2008.

Beneficiaries

- In 2007, three aluminum companies filed annual reports with the Department of Revenue on their activities for the preceding calendar year: Intalco Aluminum Corporation in Ferndale, Evergreen Aluminum LLC in Vancouver, and Alcoa Inc. near Wenatchee. The two active smelters, Alcoa and Intalco, are both owned by Alcoa Inc. Evergreen Aluminum LLC, benefits from the tax incentives because the company meets the definition of direct service industrial customer in state statute even though it no longer produces aluminum.
- Of the two smelters in operation, only Intalco still contracts with BPA. However, instead of receiving power from BPA for direct consumption, the smelter receives a subsidy (or "monetization") through September 2009 and must purchase power on the wholesale market. The BPA has proposed to sell power to DSIs at the industrial power rate. The contract amount is yet to be specified.

Revenue Impacts

Through Fiscal Year 2008, the aluminum industry has received $10.7 million in savings from these tax preferences. Future taxpayer savings are expected to be about $7.3 million in the 2009-11 Biennium assuming the industry continues producing despite recent sharp declines in aluminum prices, high energy costs, and reduced market demand for aluminum.

Recommendation

The Legislature should extend the expiration date for the aluminum smelter tax preferences because the public policy goal of preserving family wage jobs is being maintained, and because the high energy prices that brought about the tax preference are higher and more volatile than when the incentives were originally enacted.

Legislation Required:	Yes.
Fiscal Impact:	$3.9 million loss to the general fund in the 2011-13 Biennium.

ALUMINUM INDUSTRY TAX PREFERENCES – REPORT DETAIL

Current Law

In 2004, the aluminum manufacturing industry received a package of incentives designed to keep it operating during a period of high energy costs and falling aluminum prices. In order to take the tax preferences, a firm must be a direct service industrial customer which means it must have purchased electricity from the Bonneville Power Administration (BPA) for direct consumption as of May 8, 2001. The incentives were scheduled to expire on January 1, 2007, but they were renewed by the 2006 Legislature. Provisions of the legislation for the aluminum industry are:

- Sales and use tax credits are allowed for personal property, construction materials, and labor and services performed on buildings and property at an aluminum smelter. The credits are taken for the state sales and use taxes at 6.5 percent. The credits apply to purchases made before January 1, 2012.
- An exemption is allowed on brokered natural gas use tax on purchases delivered through a pipeline. The exemption expires on January 1, 2012.
- A business and occupation (B&O) tax credit is allowed for the amount of property taxes paid on property owned by a direct service industrial customer. Customers can take the credit for property taxes paid after July 1, 2004, and through Calendar Year 2011. Unused credits may be carried over for one year.
- A reduced B&O rate is allowed for manufacturers, wholesalers of aluminum that are also manufacturers, and processors for hire of aluminum. The Legislature reduced the rate from 0.484 percent to 0.2904 percent. The reduced rate expires on January 1, 2012.
- Utilities may take B&O and public utility tax credits for sales of electricity, natural gas, or manufactured gas to an aluminum smelter if the savings are passed on to the aluminum smelter (RCW 82.04.4482 and RCW 82.16.0498). These tax preferences have been scheduled for review by JLARC in 2016.
- Annual reports are due by March 31 for firms benefiting from the incentives. The reports must include information on full-time, part-time and temporary employment, wages by wages bands, and health care and retirement benefits. The information in the annual report may be disclosed to the public.
- Legislative fiscal committee staff must prepare reports to the Legislature and must address effectiveness of the tax incentives in retaining jobs. Legislative staff prepared reports in 2005 and 2007. Additional legislative reports are due in 2010 and 2015.

See pages A3-8 through A3-10 in Appendix 3 for the current statutes, RCW 82.08.805, RCW 82.12.805, RCW 82.12.022(5), RCW 82.04.4481, and RCW 82.04.2909.

Legal History

2004 The Legislature provided aluminum industry tax preferences. The act became effective on July 1, 2004 and was scheduled to expire on January 1, 2007.

2006 The Legislature reenacted the sales and use tax credits for purchases, the B&O credit for property taxes paid, the brokered natural gas use tax exemption, and the reduced B&O rate. The incentives expire on January 1, 2012.

Other Relevant Background:

1930s The aluminum industry located in the Pacific Northwest primarily because of the inexpensive and abundant hydroelectric power made available by federal hydropower development on the Columbia River. Aluminum Company of America (ALCOA) became the first direct service industrial customer of BPA just prior to World War II.

1940s Entry of the United States into the war heightened the demand for aluminum needed to build war material. With the construction of smelters in Longview, Mead, Tacoma, and Spokane, Washington became a national leader, producing 30 percent of U.S. aluminum by 1945.[29]

1970s Seven aluminum smelters operated at near capacity producing over 1.3 million metric tons of aluminum a year during the 1970s. Smelters employed over 10,000 workers and purchased over 2,000 megawatts of electricity directly from BPA at rates as low as $3 per megawatt hour.

1980 The 1980 Northwest Power Act authorized BPA to sign 20-year contracts with the direct service industrial customers for industrial firm power.

2001 Power contracts expired during the peak of the 2000-2001 energy crisis. The BPA initially signed new contracts with those companies that wanted them but for only 1500 annual megawatts for the entire region. The BPA then bought the contracts out in the expectation that the cash would enable the smelters to survive until economic conditions improved. All the aluminum companies except ALCOA eventually shut down, laid off employees, and sold properties.

2004 ALCOA's Wenatchee smelter reopened after being closed for more than three years.

2006 BPA signed contracts with the DSIs that provided subsidy (or "monetized benefits) beginning October 2006.

2008 The 9th Circuit Court of Appeals affirmed BPA's long-term authority to make power sales to DSIs and ruled that subsidies through monetization of the benefits were legal if they were based on the BPA's industrial power rate.[30] An upcoming rate case will establish the industrial power rate for October 2009 through September 2011.

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[29] A 50-Year Perspective of Employment Trends in Washington State – Primary Metals, Labor Market and Economic Analysis, Employment Security Department, May 1998.

[30] Pacific Northwest Generation v. Department of Energy, 9th Circuit Court of Appeals, December 2008.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

The Legislature clearly stated its public policy objectives in statute as follows:

Retain Family Wage Jobs in Rural Areas

The Legislature specified a target of 75 percent of the jobs on the payroll as of January 1, 2004, adjusted for publicly announced reductions before November 30, 2003. Employment Security Department data shows 1,055 jobs on the payroll as of January 1, 2004. Goldendale Aluminum Company announced 100 layoffs before November 30 of that year bringing the base to 955 jobs. Multiplying the base by 75 percent equals a target goal of 716 jobs. The Legislature also wanted to preserve "family wage" jobs in rural areas. Both smelters are located in counties defined in statute as rural—Whatcom and Chelan counties. Although "family wage" jobs are not defined in statute, these are assumed to be jobs that pay wages and benefits comparable to other Washington manufacturing jobs.

Sustain the Industry through the Period of High Energy Prices

Another goal of the legislation is to sustain the industry through 2012 when higher energy prices were expected to subside.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

Evidence relating to achieving public policy objectives is readily available through annual reports submitted by the beneficiaries to the Department of Revenue; state employment, wage and benefits data; and other sources.

Retain Family Wage Jobs in Rural Areas

Evidence shows that the goal to retain family wage jobs in rural areas at target levels is being met. Jobs at aluminum smelters have increased since the legislation became effective in 2004. Wages and benefits are comparable to wages and benefits offered to other manufacturing employees.

The Legislature required the beneficiaries of the exemption to report annually on their average wages in wage bands. Median wages for all production occupations in Washington is $15.63 an hour. Median hourly wages for smelter employees are comparable to those of all Washington production occupations. Wages of smelter production employees are between $15 and $20 an hour. (See Exhibit 27.)

Exhibit 27 – Median Hourly Wage Rates of Smelter Employees Are Comparable

Year	All WA Manufacturing Production Occupations	WA Aluminum Smelter Production Occupations	
		Low	High
2004	$14.14	$10.01	$15.00
2005	$14.91	$15.01	$20.00
2006	$15.42	$15.01	$20.00
2007	$15.63	$15.01	$20.00

Source: Bureau of Labor Statistics, Occupational Employment Statistics; DOR Annual Reports.

Benefits offered by both of the active smelters exceed benefits offered by the Washington manufacturing industry as a whole. Both operating smelters offer health benefits to all their full- and part-time employees and their dependents, comparing favorably with the Washington manufacturing sector. Both smelter employers pay a greater share of monthly premiums than manufacturing employers in general. All smelter employees are offered retirement benefits compared to 56 percent of all manufacturing employees (See Exhibit 28.)

Exhibit 28 – Aluminum Industry Health and Retirement Benefits Are Above Average

	Alcoa	Intalco	WA Manufacturing Employees
Medical Plans Offered			
Percent of employees eligible	100%	100%	93%
Percent of part-time employees eligible	100%	100%	16%
Average percent premium paid by employee	12%	19%	16%
Average monthly premium paid by employer	$651	$347	$469
Percent of dependents eligible?	100%	100%	91%
Retirement Plans Offered			
Defined Benefit – percent of employees eligible	100%		8%
Defined Contribution – percent of employees eligible	100%	100%	48%
No Plan	0%	0%	44%

Source: WA Benefits Survey 2008, Employment Security Department; Department of Revenue annual reports.

The industry continues to meet the jobs goal. The target employment level established by the provisions of the legislation is 716 jobs. The beneficiaries reported a total of 1,030 jobs at the end of Calendar Year 2007. In January 2009, ALCOA announced plans to cut 80 jobs at its Intalco smelter in Ferndale and 26 jobs at its ALCOA smelter near Wenatchee. Even this reduction of 106 jobs will leave the industry ahead of the target.

Sustain the Industry through the Period of High Energy Prices

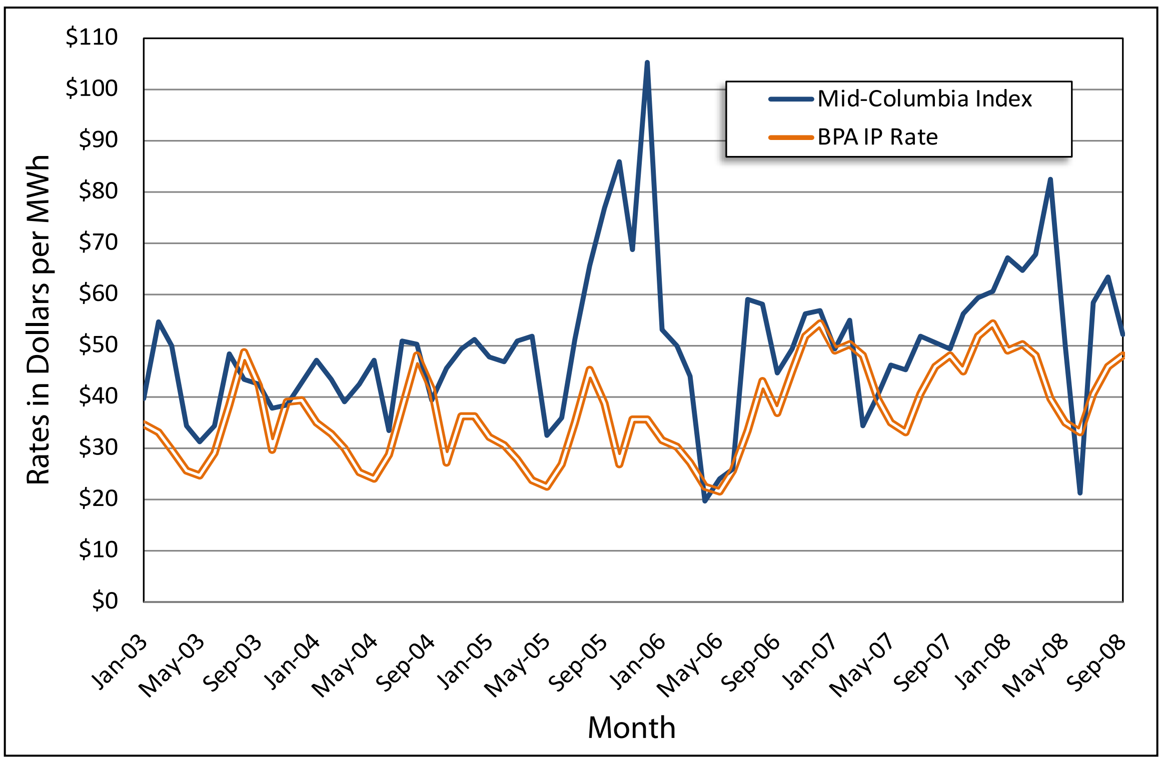
Another goal of the legislation is to sustain the industry through 2012 when the exemption expires and higher energy prices were expected to subside. Aluminum production has increased since the incentives became law from 134,000 metric tons to 282,000 metric tons per year (See Exhibit 29.) This was due in part to the world market price of aluminum which increased from 80 cents per pound in 2004 to $1.20 to $1.40 per pound in 2006 through 2008. The smelters must now pay the market price for power which is more variable than the previous long-term contract rates with the BPA. The mid-Columbia index, which is an index of the wholesale market price of energy, averaged $45 per megawatt per hour in 2004 and averaged $56 per megawatt per hour in 2008. The availability of BPA power to sell to smelters has diminished, and the available power is not as favorably priced as in the past. (See Exhibit 30.)

Exhibit 29 – Aluminum Production of WA Smelters Has Increased

Year	Metric Tons
2004	134,379
2005	182,336
2006	197,399
2007	282,160

Source: 2007 Aluminum Smelter Tax Incentives, Progress Report, Legislature Fiscal Committees; DOR annual reports from aluminum smelters.

Exhibit 30 – Power Rates Paid by Smelters Are Volatile



Source: Northwest Power and Conservation Council and the Bonneville Power Administration.

Beneficiaries

- In 2007, three aluminum companies filed annual reports with the Department of Revenue on their activities for the preceding calendar year: Intalco Aluminum Corporation in Ferndale, Evergreen Aluminum LLC in Vancouver, and ALCOA Inc. near Wenatchee. The two active smelters, Alcoa and Intalco, are both owned by Alcoa Inc. Evergreen Aluminum LLC, benefits from the tax incentives because the company meets the definition of direct service industrial customer in state statute even though it no longer produces aluminum.

- Of the two smelters in operation, only Intalco still contracts with BPA. However, instead of receiving power from BPA for direct consumption, the smelter receives a subsidy (or "monetization") through September 2009 and must purchase power on the wholesale market. The BPA has proposal to sell power to DSIs at the industrial power rate. The contract amount is yet to be specified.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

The aluminum industry tax savings have grown from $2 million per year in 2006 to $3.6 million in 2008 as shown in Exhibit 31. Future revenue impact is expected to slow until 2011 when the Economic and Revenue Forecast Council predicts a general recovery. The current economic recession has reduced worldwide demand for aluminum; aluminum prices have recently dropped by more than 50 percent; and the outcome of upcoming contracts for power with BPA is uncertain.[31] The projection in Exhibit 31 is based on the assumption that the industry will recover from these conditions. The estimate for the 2009-11 Biennium is $7.3 million, or $3,500 per job per year.

Exhibit 31 – Taxpayer Savings for Aluminum Smelters (Dollars in Thousands)

FY	Sales & Use Tax Credit	Use tax exemption on natural gas	Property Tax Credit	Preferential Rate	Total
2006	$41.2	$295.8	$948.2	$692.6	$1,977.9
2007	$94.7	$403.3	$1,520.7	$738.8	$2,757.5
2008	$82.9	$545.2	$1,952.8	$1,062.5	$3,643.4
2009	$75.5	$400.0	$2,007.2	$980.9	$3,463.6
2010	$76.2	$425.4	$2,029.7	$1,031.5	$3,562.9
2011	$80.8	$435.8	$2,058.8	$1,117.4	$3,692.9

Source: Department of Revenue records, industry-provided data, and the U.S. Energy Information Administration.
Note: The aluminum smelters provided waivers to JLARC for the release of their confidential information. Fiscal Year figures 2009 through 2011 are forecasts based on the Economic Revenue and Forecast Council growth rates.

[31] "Intaco says BPA's offer not good enough to keep Ferndale smelter running," The Bellingham Herald, May 2, 2009.

Recommendation

The Legislature should extend the expiration date for the aluminum smelter tax preferences because the public policy goal of preserving family wage jobs is being maintained, and because the high energy prices that brought about the tax preference are higher and more volatile than when the incentives were originally enacted.

Legislation Required:	Yes.
Fiscal Impact:	$3.9 million loss to the general fund in the 2011-13 Biennium.

RURAL COUNTY SOFTWARE DEVELOPMENT AND HELP DESK B&O TAX CREDITS – SUMMARY

Current Law

Businesses engaged in software manufacturing and development, or providing computer help desk services are entitled to one of two credits against the business and occupation (B&O) tax if the businesses are located in rural counties. Both tax credits have been in place since 1999 and are scheduled to expire on January 1, 2011. The credits are:

- A $1,000 tax credit for each new job created by software manufacturers and developers located in rural counties. Businesses may take the credit for up to five years, as long as the job remains on the payroll. The legislation allows sole proprietors operating as software manufacturers with no employees to take a new job credit for one position. Businesses moving employees from urban counties may take the new jobs credit. Businesses that relocate employees from one rural county to another may only take the credit if they add a new job.

  The new jobs credit is not allowed if the business takes a jobs credit as a rural manufacturer or research and development business (RCW 82.62), as an international services business (RCW 82.04.4452), or as a help desk service business (RCW 82.04.4484).

- A 100 percent credit against the full amount of B&O tax owed for businesses providing help desks services in rural counties to third parties. For example, a help desk business that contracts with a software or hardware manufacturer (second party) to provide services for the manufacturer's customer (third party) is eligible for the credit.

Businesses taking the credits must report by January 30 each year to the Department of Revenue on the activity of the business, positions for which the job credit is being taken (new jobs credit), employment level (help desk credit), and length of time the business has been located in the rural area (both credits). However, failure to file a report does not result in loss of eligibility.

See pages A3-10 through A3-13 in Appendix 3 for the current statutes, RCW 82.04.4483 and RCW 82.04.4484.

Legal History and Public Policy Objectives

1997 The Corporation for Enterprise Development released a study using an "urban/rural disparity index," which used growth, employment, and earnings measures to compare all U.S. urban and rural counties. The study ranked all of the states using the index, giving Washington the second worst disparity score in the nation.[32]

1998 The Governor held two rural economic development summits. A Joint Legislative Task Force on Rural Land Use and Economic Development held seven public hearings to gather ideas to spur economic development in rural areas. Emerging themes included local control,

[32]Corporation for Enterprise Development, 1997 Development Report Card for the States, p. 78.

infrastructure development, leveraging of existing loan programs, and expanding the number of counties previously eligible for receiving assistance.

1999 The Legislature adopted a "tool kit" of measures intended to stimulate economic development in rural areas. The tool kit included these two tax preferences.[33] The two tax credits became law on August 1, 1999, and initially expired on December 30, 2003.

2004 The Legislature extended the incentives after they expired on December 31, 2003. Firms unable to use full credits were allowed to complete their remaining eligible credits for jobs created prior to December 31, 2003. The Legislature broadened the rural county definition to include Island County.

The new enactment added the requirement that the Department of Revenue contact beneficiaries that did not file their annual report, and added the intent that "data and information necessary to measure the program's effectiveness is maintained."

The credits now expire on January 1, 2011.

The Legislature intended these two B & O tax credits to achieve the following public policy objectives:

- Attract and retain a high technology workforce in rural areas; and
- Address the rural/urban economic disparity.

Available evidence suggests that these public policy objectives have not been fulfilled.

Attract and Retain a High Technology Workforce: According to information provided by the beneficiaries, a total of 39 jobs have been created using these credits in 12 out of 32 eligible rural counties. Although the word "workforce" is not defined in statute, the low number of jobs created in fewer than half of the eligible rural counties suggests the goal of attracting a rural high technology "workforce" has not been accomplished.

Address the Rural/Urban Disparity: Additionally, computer services employment and average wages have not improved in rural counties relative to urban counties since enactment of these two tax credits. Rural employment in the computer services sector remains very small at about 5 percent of statewide employment in the computer services sector. Similarly, rural wages in this sector continue to lag significantly behind urban wages. In 2006, computer services jobs located in urban counties paid an average of $75,500 a year compared to the same jobs in rural counties that paid an average of $47,400 a year.

Beneficiaries

- In 2007, 68 firms claimed the rural credits for a total of $267,000 in taxpayer savings. Most of the beneficiaries are very small—half of them are single owner-operator firms with no employees. Most of the credit (70 percent) is claimed by four firms.

[33] The 1999 legislation included an additional tax preference that is described in this volume of tax preference reviews. See page 63 for a review of the tax credit for contributions made by light and power businesses to rural economic development revolving funds.

- Descriptions in annual reports filed with the Department of Revenue suggest most of the help desk businesses provide network, internet, and other technical support to their own customers and are not contracted through third parties. This is inconsistent with the statute which includes a requirement for a third party contract.

Revenue Impacts

Given the difficult economic conditions predicted to last through Fiscal Year 2010 (see March 19 Washington State Revenue Forecast), rural employment in software and help desk services is not expected to grow. The estimate for these credits is expected to continue at $250,000 a year in tax savings.

Recommendation

The Legislature should allow the tax preferences to expire on January 1, 2011, because the incentives are not achieving the public policy objectives for which they were enacted. The best available data show few new jobs have been created and that rural/urban disparity in high technology jobs has not been mitigated by the incentives.

Legislation Required:	No.
Fiscal Impact:	None – 2009-11 Biennial budgets assume preferences are expiring.

Rural County Software Development and Help Desk B&O Tax Credits – Report Detail

Current Law

Under current law, businesses engaged in software manufacturing and development, or providing computer help desk services are entitled to one of two credits against the business and occupation (B&O) tax if the businesses are located in rural counties. Both tax credits have been in place since 1999 and are scheduled to expire on January 1, 2011. The credits are:

- A $1,000 tax credit for each new job created by software manufacturers and developers located in rural counties. Businesses may take the credit for up to five years, as long as the job remains on the payroll. The legislation allows sole proprietors operating as software manufacturers with no employees to take a new job credit for one position. Businesses moving employees from urban counties may take the new jobs credit. Businesses that relocate employees from one rural county to another may only take the credit if they add a new job.

  The new jobs credit is not allowed if the business takes a jobs credit as a rural manufacturer or research and development business (RCW 82.62), as an international services business (RCW 82.04.4452), or as a help desk service business (RCW 82.04.4484).

- A 100 percent credit against the full amount of B&O tax owed for businesses providing help desks services in rural counties to third parties. For example, a help desk business that contracts with a software or hardware manufacturer (second party) to provide services for the manufacturer's customer (third party) is eligible for the credit.

Statute defines a rural county as a county with a population density of less than 100 persons per square mile or a county smaller than 225 square miles. Currently 32 counties meet the definition of a rural county: Clark, King, Kitsap, Pierce, Snohomish, Spokane, and Thurston counties are not eligible for the rural county incentives. (See Exhibit 32 on page 97 for the location of rural counties.)

Businesses taking the credits must to report by January 30 each year to the Department of Revenue on the activity of the business, positions for which the job credit is being taken (new jobs credit), employment level (help desk credit), and length of time the business has been located in the rural area (both credits). However, failure to file a report does not result in loss of eligibility.

See pages A3-10 through A3-13 in Appendix 3 for the current statutes, RCW 82.04.4483 and RCW 82.04.4484.

Legal History

1997 The Corporation for Enterprise Development released a study using an "urban/rural disparity index," which used growth, employment, and earnings measures to compare all

U.S. urban and rural counties. The study ranked all of the states using the index, giving Washington the second worst score in the nation.[34]

1998 The Governor held two rural economic development summits. A Joint Legislative Task Force on Rural Land Use and Economic Development held seven public hearings to gather ideas to spur economic development in rural areas. Emerging themes included local control, infrastructure development, leveraging of existing loan programs, and expanding the number of counties eligible for receiving assistance.

1999 The Legislature adopted a "tool kit" of measures intended to stimulate economic development in rural areas. The tool kit included these two tax preferences.[35] The two tax credits became law on August 1, 1999, and initially expired on December 30, 2003. Earlier economic development incentives had been targeted to "distressed" counties characterized by high unemployment. The Legislature broadened the eligible areas to include all rural counties at the time of this legislation.

The Legislature stated their intent to address the rural/urban disparity by attracting and retaining "high technology-based businesses," and creating "a high technology work force in rural counties" with these preferences.

2004 The Legislature extended the incentives after they expired on December 31, 2003. Firms unable to use full credits were allowed to complete their remaining eligible credits for jobs created prior to December 31, 2003.

The new enactment added the requirement that the Department of Revenue contact beneficiaries that did not file their annual report, and added the intent that "data and information necessary to measure the program's effectiveness is maintained."

The credits now expire on January 1, 2011.

The Department of Revenue has difficulty obtaining annual reports from the beneficiaries. The law contains no enforcement mechanisms to improve the response rate for the reports. Because beneficiaries tend to be small businesses, they are not often audited. However, the Department did deny the help desk credit in the case of one internet service provider ruling that its help desk services provided to its own customers did not constitute third party services.[36]

[34]Corporation for Enterprise Development, 1997 Development Report Card for the States, p. 78.

[35]The 1999 legislation included an additional tax preference that is described in this volume of tax preference reviews. See page 65 for a review of the tax credit for contributions made by light and power businesses to rural economic development revolving funds.

[36] Det. No. 02-0174, 22 WTD 218 (2003).

Exhibit 32 – Washington State's Rural Counties

Source: The Department of Revenue.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

The public policy objectives for the incentives are laid out clearly in statute:

Attract and Retain a High Technology Workforce in Rural Counties. The Legislature intended to "attract and retain technology-based businesses in rural counties" and to "create a high-technology workforce." [37]

Address the Rural/Urban Disparity. The Legislature expressed concern for the rural/urban economic disparity during the time of enactment. In the 1999 bill, the Legislature found that there are "in effect two Washingtons: One afflicted by inadequate infrastructure to support and attract investment, another suffering from congestion and souring housing prices." Accordingly, the Legislature specifically targeted rural counties for economic development incentives and allowed the jobs credit to businesses moving jobs from an urban to a rural county.

[37] Chapter 311, Laws of 1999, §301.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

The information to determine if the tax preference is achieving its public policy objective is not readily available because only 23 out of 68 beneficiaries have reported to the Department of Revenue.

Neither of the objectives of creating a high-technology workforce and narrowing the rural/urban disparity are being met.

Attract and Retain a High Technology Workforce.

The Legislature does not define "workforce" in statute. However, when the software developer's tax preference was first adopted in 1999, the Legislature assumed job creation would be much higher than was realized. The Legislature budgeted $1.3 million for the new jobs credit, and the fiscal note estimated that the credit would create 430 new jobs per year. Instead, firms benefiting from the jobs credit took $19,000 in credit for the 1999-2001 Biennium, the equivalent of 19 new jobs. The budget assumption for the 2004 statute reflected the lower utilization of the credit. (See Exhibit 33 below.)

Exhibit 33 – Original Budget Estimates for Software Developers Jobs Credits are Higher than Actual Usage

	Original Enactment 1999		Enactment 2004	
	Budget 1999-2001	**Actual Credits 1999-2001**	**Budget 2003-2005**	**Actual Credits 2003-2005**
Software developers ($1,000 new jobs credit)	$1,300,000	$19,000	$35,000	$39,000

Source: Department of Revenue fiscal notes and state biennial budget notes.

Software developers reported 39 jobs in 2007 including jobs that were created over the previous five years. These jobs are located in 12 of the 32 rural counties. While statute doesn't define what levels constitute "attracting and retaining" a workforce, the number of jobs are well below original expectations.

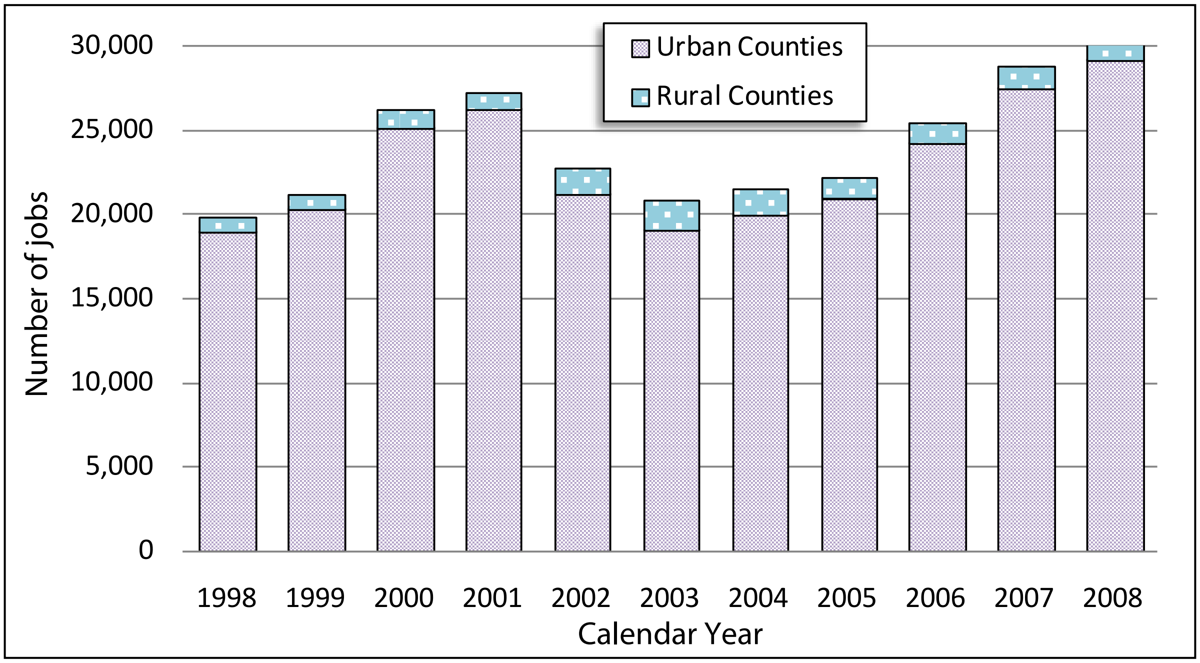
Help desks are not required to create new jobs in order to take the B&O tax credit.

Address Rural/Urban Disparity

Reduction in the rural/urban disparity can be measured by relative growth in employment and average wages. The best available measure of employment by industry and county is the Local Employment Dynamics data provided by the Census Bureau. Software developers and help desks are generally found in the computer systems design and related services sector.

Computer services jobs in Washington are found almost exclusively (95 percent) in urban counties. Employment levels are growing statewide, but the urban counties dominate the industry. For the 2nd quarter of 2008, the most recent quarter available, there are 1,400 computer services jobs in rural counties compared to over 29,000 jobs in urban counties. (See Exhibit 34.)

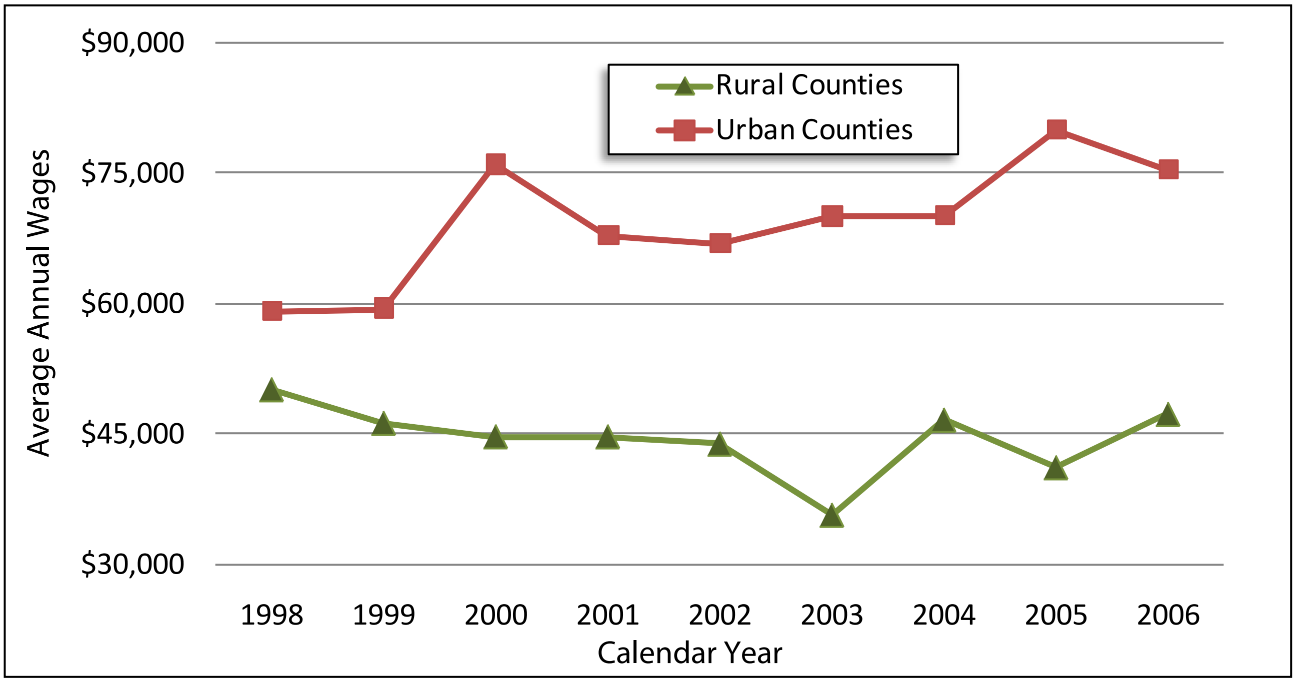
Exhibit 34 – Growth in Computer Services Employment is Higher in Urban Counties



Source: U.S. Census Bureau, Local Employment Dynamics.

Average wages of employees in rural counties have not kept pace with those of urban county employees in computer services occupations. Average wages for urban occupations in this sector are $75,500 a year compared with average rural wages of $47,400 a year. (See Exhibit 35.)

Exhibit 35 – Growth in Computer Service Wages is Higher in Urban Counties



Source: U.S. Census Bureau, Local Employment Dynamics.

The exhibits show a lack of growth in computer services jobs and wages in rural counties relative to urban counties during the years when the tax preference has been in place. It is likely that stronger economic forces drive employment rather than the tax preferences.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

Businesses benefiting from the incentives are required to report positions for which the credit is taken (new jobs credit) or the number of employees at the site (help desk credit), and the number of years the business has been in the county (both credits). However, of the 68 firms that claimed the credit in 2007, 23 filed annual reports. The Department is required to contact the taxpayer who fails to file a report, but may not assess the tax for failure to file.

Exhibit 36 – Software Manufacturers Taking B&O Credit and Filing Annual Report

CY	Number of Firms Claiming Software Credit	Number of Firms Filing Software Report	Software Positions Reported	Software Credit Tax Savings
2004	13	1	1	$17,416
2005	23	2	2	$29,369
2006	31	15	24	$34,814
2007	36	19	39	$74,881

Source: Department of Revenue annual reports of software manufacturers and help desk services.

Exhibit 37 – Help Desks Taking B&O Credit and Filing Annual Report

CY	Number of Firms Claiming Help Desk Credit	Number of Firms Filing Help Desk Report	Help Desk Positions Reported	Help Desk Credit Tax Savings
2004	18	5	10	$183,452
2005	23	17	59	$229,260
2006	28	21	89	$215,352
2007	32	4	28	$191,801

Source: Department of Revenue annual reports of software manufacturers and help desk services.

In 2007, beneficiaries claimed a total of $267,000 in tax savings for both tax credits. Most of the beneficiaries are very small—half of them are single owner-operator firms with no employees. Most of the credit (70 percent) is claimed by four firms. Beneficiaries are typically in the business of providing computer system design and related services.

Some firms taking the help desk credit are unintended beneficiaries. Help desks must contract with third parties in order to receive the credit. For example, a third party transaction is where help desk A contracts with computer hardware firm B to provide service to customer C. It appears from self-descriptions in the annual reports filed with the Department of Revenue that most of the help desk businesses provide network, internet, and other technical support and training to their own customers. In only a few cases do they appear to be contracting with third parties.[38]

[38] Annual reports filed by businesses benefiting from the rural helpdesk and software developers credits, 2004-2007.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

Given the difficult economic conditions predicted to last through Fiscal Year 2010 (see March 19 Washington State Revenue Forecast), rural employment in software and help desk services is not expected to grow. The estimate for these credits is expected to continue at $250,000 a year in tax savings.

Recommendation

The Legislature should allow the tax preferences to expire on January 1, 2011 because the incentives are not achieving the public policy objectives for which they were enacted. The best available data show few new jobs have been created and that rural/urban disparity in high technology jobs has not been mitigated by the incentives.

Legislation Required:	No.
Fiscal Impact:	None – 2009-11 Biennial budgets assume preferences are expiring.

FIELD BURNING EQUIPMENT EXEMPTIONS FROM SALES AND USE TAXES – SUMMARY

Current Law

Farmers sometimes burn crop stubble to control for pests, disease, and weeds, and to expose the root of the plant in order to increase yields. However, burning harvest stubble causes air pollution and respiratory ailments in near-by populations.[39] Current law provides sales and use tax exemptions for farm machinery and equipment used as an alternative to burning agricultural land, and for labor and services in constructing hay sheds. Alternatives to burning include using equipment to rake and bale the stubble, to plow the stubble to prepare for planting, and to drill the seed into the stubble crust. In order to qualify for these exemptions, a farmer must:

- Have more than 50 percent of the farm's tillable acres in cereal grains or in field or turf grass grown for seed,
- Farm in a county where cereal grain production is more than 15,000 acres,
- Farm land that either belongs to the farmer or in which the farmer has the present right of possession, and
- Be in the business of growing, raising, or producing agricultural products to be sold.

Currently, eligible counties include Adams, Asotin, Benton, Columbia, Douglas, Franklin, Garfield, Grant, Klickitat, Lincoln, Spokane, Stevens, Walla Walla, Whatcom, Whitman, and Yakima. The law specifies types of equipment to be exempt including no-till and minimum-till drills, swathers, mowers, balers, and plows. Combines do not qualify except for combine components for handling straw such as chaff spreaders and straw choppers. Tractors qualify if the engine is at least 250 horsepower (designed for the steep terrain of the Palouse).

The exemption expires on January 1, 2011.

See pages A3-13 and A3-14 in Appendix 3 for the current statutes, RCW 82.08.841 and RCW 82.12.841.

Legal History and Public Policy Objectives

1998 As a result of state and federal clean air act requirements and concerns over air emissions, the Department of Ecology phased out most field grass and turf grass burning by 1998.

1999 Wheat growers, wishing to avoid the complete curtailment of field burning for their industry, voluntarily reached an agreement with the Department of Ecology and the Department of Agriculture in 1999 to reduce their emissions by 50 percent over a seven-year period.[40]

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[39] U.S. Environmental Protection Agency, Particulate Matter Research Program: Five Years of Progress, 2004.

[40] Wheat Stubble Burning – Chronology, Department of Department of Ecology. See also Historically Speaking, An Oral History in Celebration of the first 35 years, 1970-2005, Department of Ecology.

2000 The Legislature provided retail sales and use tax exemptions for equipment used as an alternative to agricultural burning. The Legislature also declared its intent to "provide tax exemptions … to encourage alternatives to field burning." The legislation was intended to help growers overcome the financial hardship that the transition from field burning entailed. The sales and use tax exemptions were originally set to expire on January 1, 2006.

2005 The Legislature replaced these sales and use tax exemptions before they expired. The statutory language for the new exemptions made it more difficult to qualify by specifying the types of qualifying equipment, and by limiting eligibility to certain farmers and to certain counties. The Legislature also exempted materials, labor, and services for constructing hay sheds. The exemptions currently expire on January 1, 2011.

2006 The Department of Ecology replaced its expired 1999 agreement with wheat growers with a system of monitoring and permitting of agricultural burning when environmental conditions allow. The program is carried out by the Department of Ecology and local air quality authorities. Clean air advocates have released a report deeming the program to be a success.[41]

Today, the burning of acreage planted in cereal grains has been reduced by 40 percent from levels in 1998. The public policy objective of helping growers transition away from field burning to alternative means of crop management has been achieved.

Beneficiaries

The beneficiaries of the incentive are primarily dry land wheat growers in the Palouse region predominantly in Adams, Lincoln, and Whitman Counties. A total of 2.5 million acres are planted in cereal grains in Washington State. Less than 5 percent of that acreage is burned for crop management purposes.

Over the 11-year life of the tax preference from March 22, 2000, to January 1, 2011, beneficiaries will have purchased an estimated $500 million in farm equipment and will have saved over $16 million in state sales and use taxes.

Revenue Impacts

The estimated revenue impact is about $2 million a year in state sales and use taxes and about $660,000 in local sales and use taxes.

Recommendation

The Legislature should allow the sales and use tax exemption for field burning equipment to expire, because the transition to reduced air emissions from agriculture burning has occurred.

Legislation Required:	No.
Fiscal Impact:	None – 2009-11 Biennial budgets assume preferences are expiring.

[41]Review of the Department of Ecology's Implementation of Agricultural Burning Rules for Cereal Grains, Tim Connor for "Save our Summers," 2006 and 2007.

FIELD BURNING EQUIPMENT EXEMPTIONS FROM SALES AND USE TAXES – REPORT DETAIL

Current Law

Farmers sometimes burn crop stubble to control for pests, disease, and weeds, and to expose the root of the plant in order to increase yields. However, burning harvest stubble causes air pollution and respiratory ailments in near-by populations.[42] Current law provides sales and use tax exemptions for farm machinery and equipment used as an alternative to burning agricultural land, and for labor and services in constructing hay sheds. Alternatives to burning include using equipment to rake and bale the stubble, to plow the stubble to prepare for planting, and to drill the seed into the stubble crust. In order to qualify for these exemptions, a farmer must:

- Have more than 50 percent of the farm's tillable acres in cereal grains or in field or turf grass grown for seed,
- Farm in a county where cereal grain production is more than 15,000 acres,
- Farm land that either belongs to the farmer or in which the farmer has the present right of possession, and
- Be in the business of growing, raising, or producing agricultural products to be sold.

Currently, eligible counties include Adams, Asotin, Benton, Columbia, Douglas, Franklin, Garfield, Grant, Klickitat, Lincoln, Spokane, Stevens, Walla Walla, Whatcom, and Whitman. The law specifies types of equipment to be exempt including no-till and minimum-till drills, swathers, mowers, balers, and plows. Combines do not qualify except for combine components for handling straw such as chaff spreaders and straw choppers. Tractors qualify if the engine is 250 horsepower or more (designed for the steep terrain of the Palouse).

The exemption expires on January 1, 2011.

See pages A3-13 and A3-14 in Appendix 3 for the current statutes, RCW 82.08.841 and RCW 82.12.841.

Legal History

The following is a chronology of the history of key legal events relating to agricultural burning and efforts to curtail air pollution and the harmful health effects.[43]

1973 Modifications to Washington's Clean Air Act required the regulation of the burning of field grass and turf grasses grown for seed. The law required the Department of Ecology to issue permits and to collect a fee for field burning, with the fee revenues to be used for research

[42] U.S. Environmental Protection Agency, Particulate Matter Research Program: Five Years of Progress, 2004.

[43] For a history of involvement by the Department of Ecology see Wheat Stubble Burning – Chronology, Department of Ecology, and Historically Speaking, An Oral History in Celebration of the first 35 years, 1970-2005, Department of Ecology.

into economic and practical alternatives to burning. The act banned the practice of burning seed grass fields once the Department of Ecology certified reasonable alternatives.

1991 Washington Clean Air legislation created a task force to identify best management practices for reducing air emissions from agricultural burning. The act funded research into alternative ways of reducing agricultural burning.

1996 The Department of Ecology started a three-year phase out of grass burning reducing the number of acres to be burned by a third each year.

1998 The Department of Ecology certified methods to be used as alternatives to grass burning, nearly eliminating the practice for grass growers.

1999 The Department of Ecology, the Washington State Department of Agriculture, and the Washington Association of Wheat Growers signed a Memorandum of Understanding (MOU) in February, 1999.[44] This voluntary agreement outlined a plan to reduce emissions from burning cereal grain stubble by 7 percent per year. The goal was to reduce emissions from cereal grain field burning by 50 percent by 2006.

2000 The Legislature provided three tax incentives intended to encourage reduction of field burning and improve air quality:

1) Retail sales and use tax exemptions for equipment used to dispose of straw and straw-based products in an alternative manner to burning and for certain retail services such as installing, constructing, repairing, cleaning, decorating, altering or improving eligible structures or machinery and equipment;
2) A credit against state B&O tax for up to half of the cost of building structures or acquiring equipment eligible for the exemption. The credit is intended for businesses that remove and process stubble for the farmer (repealed in 2005); and
3) A property tax exemption for personal property eligible for the sales and use tax exemption (repealed in 2005).

The Legislature declared its intent to "provide tax exemptions and credits to encourage alternatives to the field burning." The statute became effective on March 22, 2000, and expired on January 1, 2006.

During implementation of the exemption, Department of Revenue staff conducting audits in agricultural areas observed a high level of implement dealers allowing the exemption for unqualified equipment. The Department recommended that the Legislature address this misuse statutorily.

2005 The Legislature replaced these sales and use tax exemptions before they expired. The statutory language for the new exemptions made it more difficult to qualify by specifying the types of qualifying equipment, and by limiting eligibility to certain farmers and to certain counties. The Legislature also exempted materials, labor, and services for constructing hay sheds. The exemptions currently expire on January 1, 2011. Department of Revenue

[44] Cereal Grain Stubble Burning Memorandum of Understanding and Agreement (MOU), February 1999.

auditors report a large reduction in misuse of the exemptions, which they attribute to these 2005 modifications.

The current law limits the use of the exemption by specifically identifying the eligible equipment, listed in Exhibit 38 and the eligible counties, listed in Exhibit 39.

Exhibit 38 – Statute Specifies Farm Equipment Eligible for the Tax Exemptions

bale handlers	power rakes	shredders	plows
mowers	combine components:	sprayers	tractors (250 hp or more)
balers	chaff spreaders	cultivators	harrows
no-till drills	strippers	swathers	transplanters
chisels	straw choppers	discs	minimum-till drills

Source: RCW 82.08.841(1)(a) and RCW 82.12.841(1)(a).

Exhibit 39 – Farmers in 16 Counties are Eligible for the Exemptions

Source: RCW 82.08.041(2)(b).

Other Relevant Background

Field burning is one of the major causes of air pollution in Washington and is known to be the source of health problems in neighboring communities. According to the U.S. Environmental Protection Agency, scientific studies have linked exposure to particulate matter pollution to respiratory ailments, decreased lung function, chronic bronchitis, and premature death in people with heart or lung disease.

By 1998, the Department of Ecology phased out most field grass and turf grass burning over a three-year period because of concerns over the air emissions. The wheat growers wished to avoid the complete curtailment of field burning for their industry and voluntarily reached an agreement with the Department of Ecology and the Department of Agriculture in a 1999 memorandum of understanding to reduce their emissions by 50 percent over a seven-year period.

Exhibit 40 below shows annual figures for cereal grain acres burned and related air emissions beginning with the 1998 baseline. Although growers have exceeded the 50 percent reduction target, agricultural burning and air emissions have declined from the 1998 baseline. On September 1, 2006, after the memorandum of understanding expired, a new Department of Ecology rule set up a permitting and monitoring system to manage agricultural burning. This new rule replaced the earlier agreement.[45]

Exhibit 40 – Burning and Emissions Declined from 1998 Baseline

	Crop Year	Acres Burned	Emissions (in Tons PM2.5)
Memorandum of Understanding 7-Year Period	1998	229,837	2,884
	1999	166,560	1,950
	2000	177,052	2,164
	2001	109,256	1,237
	2002	112,758	1,274
	2003	144,565	1,581
	2004	152,640	1,587
	2005	140,565	1,736
	50% Targets	114,500	1,442
Post MOU	2006	187,740	2,238
	2007	139,514	1,709

Source: Department of Ecology.

Over the last ten years, both air emissions and the number of acres burned have been reduced overall by 40 percent. Save our Summers, a Spokane clean air advocacy group, studied the program in 2006 and 2007 and found that: "Department of Ecology's burn decisions are well in synch

[45] WAC 173-430-040 Agricultural burning requirements.

with…protecting air quality while accommodating agricultural burning where it is deemed necessary…[T]he program is succeeding in ways that should make it a model for the nation."[46]

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

The incentive had its origins in 1973 with new federal air quality standards and the resulting Washington Clean Air Act. In the 1991 modifications to the state's act, the Legislature found that "ambient air pollution is the most serious environmental threat in Washington State" and directed the Department of Ecology and local air pollution control authorities to implement programs and regulations to control air pollution. In creating the tax incentive, the Legislature intended to encourage alternatives to field burning and to help the growers overcome the financial hardship that the transition from field burning entailed.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

Today, field grass and turf grass field burning has been nearly eliminated. Rather than restricting the number of burned acreage for the wheat and other cereal grain growers, the Department of Ecology and local air quality authorities now monitor air quality and allow burning when the environmental conditions allow.

The original six-year tax exemption plus the extension in 2005 has allowed for 11 years of tax relief. The inclusion of expiration dates implies the Legislature intended the tax relief as a temporary measure to allow farmers to make the transition to alternative land management practices.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

The primary beneficiaries of the incentive are wheat growers in Washington who attempt to reduce burning by purchasing equipment to use as an alternative method of crop management. Less than 5 percent of the total crop acreage is burned. Adams, Lincoln, and Whitman counties located in the dry-land wheat region of the Palouse contain the most acreage planted in wheat. See Exhibit 41 for acreage planted in cereal grains by qualifying county.

The Department of Revenue is currently revising its list of qualifying counties to reflect the most recent agricultural statistics.

[46] Review of the Department of Department of Ecology's Implementation of the Agricultural Burning Rules for Cereal Grains for Calendar Year 2007, Tim Connor for Save our Summers.

Exhibit 41 – 2007 Acres Planted in Cereal Grains by Qualifying County

County	Wheat	Corn	Barley	Total
Adams	283,200		2,400	285,600
Asotin	20,500		3,000	23,500
Benton	92,700			92,700
Columbia	90,000		11,000	101,000
Douglas	174,900		3,100	178,000
Franklin	68,800	24,200		93,000
Garfield	75,400		15,000	90,400
Grant	103,300	56,800		160,100
Klickitat	46,200			46,200
Lincoln	368,800		45,800	414,600
Spokane	139,600		25,500	165,100
Stevens	4,300		4,000	8,300
Walla Walla	219,700		5,000	224,700
Whatcom		16,600		16,600
Whitman	450,400		108,500	558,900
Yakima	17,300	42,900		60,200
Total acres	**2,155,100**	**140,500**	**223,300**	**2,518,900**

Source: U.S. Department of Agriculture, National Agricultural Statistics Service.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

The estimated taxpayer savings was $2 million a year in state sales and use taxes and $620,000 in local sales and use tax in Fiscal Year 2008. (See Exhibit 42.) Over the 11-year life of the tax preference from March 22, 2000, to January 1, 2011, beneficiaries will have purchased an estimated $500 million in farm equipment and will have saved over $16 million in state sales and use taxes.

Exhibit 42 – Estimated Annual Taxpayer Savings

Fiscal Year	State Sales and Use Taxes	Local Sales and Use Taxes
2006	$1,710,000	$500,000
2007	$2,110,000	$620,000
2008	$2,110,000	$620,000
2009	$2,080,000	$610,000
2010	$2,110,000	$620,000
2011	$1,120,000	$330,000

Source: All figures are estimates based Department of Revenue tax records.

Recommendation

The Legislature should allow the sales and use tax exemption for field burning equipment to expire, because the transition to reduced air emissions from agriculture burning has occurred.

Legislation Required: No.

Fiscal Impact: None – 2009-11 Biennial budgets assume preferences are expiring.

PATIENT LIFTING DEVICES CREDIT FOR B&O TAX – SUMMARY

Current Law

Hospitals are entitled to a business and occupation (B&O) tax credit for the purchase of mechanical and other types of devices used to lift patients. The credit is equal to 100 percent of the cost of the lifting devices up to a maximum per hospital of $1,000 for each acute care available inpatient bed. The credit may be carried forward against future years' taxes until fully used. The credits are available on a first-come, first-serve basis, but they may not exceed a statewide total of $10 million. Hospitals can claim the tax credit for equipment purchases made after June 7, 2006, but before December 30, 2010.

The Department of Revenue (DOR) must bill hospitals that have taken credits in excess of the $10 million limitation.

See pages A3-15 through A3-17 in Appendix 3 for the current statute, RCW 82.04.4485 and RCW 70.41.390.

Legal History and Public Policy Objectives

In 2006, the state enacted legislation that included the B&O tax credit for hospital purchases of patient lifting devices. The bill requires each hospital to establish a program for the safe lifting of patients. In addition, by January 30, 2010, each hospital must complete, at a minimum, acquisition of:

- One readily available lift per acute care unit on the same floor unless the hospital safe patient handling committee determines a lift is unnecessary in the unit;
- One lift for every ten acute care available inpatient beds; or
- Equipment for use by lift teams.

While imposing these requirements, the Legislature did not want to "place an undue financial burden on hospitals." To this end, the Legislature provided up to $10 million in statewide tax relief or $1,000 for each acute care available inpatient bed for each qualifying hospital, whichever is fewer. As of December 2008, hospitals have taken a total of $5,277,585 in credits.

Based on a total of 10,864 acute care available inpatient beds as of 2007, the lifetime statewide credit is limited to $10 million (the lesser of $10,864,000 and $10,000,000). Hospitals implementing safe patient handling programs also receive a reduced workers' compensation premium.

Beneficiaries

- There are 90 eligible hospitals in Washington, including public hospital districts, private for-profit hospitals, nonprofit hospitals, and three state hospitals with a total of 10,864 acute care available inpatient beds.

- According to DOR tax records, as of December 2008, 67 of the eligible hospitals have claimed $5.3 million in credit. Twenty hospitals have taken the maximum amount of credit for which they are entitled. The cost of equipment purchased totaled $7.6 million. Hospitals taking the credit range in size from small rural hospitals with 25 or fewer acute care available inpatient beds to large metropolitan hospitals with 300 to 600 acute care available inpatient beds.

Revenue Impacts

The tax savings to hospitals is estimated to total $10 million in credit over the life of the tax preference.

Recommendations

The Legislature should allow the B&O tax credit for patient lifting devices to expire on December 30, 2010, because the credit was intended to ease the financial hardship of purchasing patient lifting devices, and was limited both in duration and in the amount of credit to be taken.

Legislation Required: No.

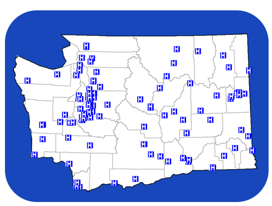
Fiscal Impact: No – 2009-11 Biennial budgets assume the preference is expiring.

PATIENT LIFTING DEVICES B&O TAX CREDIT – REPORT DETAIL

Current Law

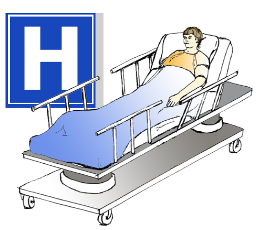
Hospitals are entitled to a business and occupation (B&O) tax credit for the purchase of mechanical and other types of devices used to lift patients. The credit is equal to 100 percent of the cost of the lifting devices up to a maximum per hospital of $1,000 for each acute care available inpatient bed. The credit may be carried forward against future years' taxes until fully used. The credits are available on a first-come, first-serve basis, but they may not exceed a statewide total of $10 million. Hospitals can claim the tax credit for equipment purchases made after June 7, 2006, but before December 30, 2010.

Exhibit 43 – B&O Credit for Patient Lifting Devices is Limited in Two Ways



Statewide Limit:

- Lifetime cap of $10 million
- First-come first-serve
- Department of Revenue disallows credits that exceed cap and notifies hospitals



Hospital Limit:

- Lifetime cap of $1,000 for per acute care available bed

Source: JLARC analysis of tax statute and administration of the credit.

The Department of Revenue (DOR) must bill hospitals that have taken credits in excess of the $10 million limitation.

See pages A3-15 through A3-17 in Appendix 3 for the current statute, RCW 82.04.4485 and RCW 70.41.390.

Legal History

OSHA Guidelines

In 2003, the federal Occupational Safety & Health Administration (OSHA) issued Guidelines for Nursing Homes. The guidelines focused on practical recommendations for employers to reduce the number and severity of workplace ergonomic injuries. OSHA recommended that all facilities minimize, if not eliminate, manual lifting of residents.

Department of Labor and Industries Report

- In 2006, the state Department of Labor and Industries issued a report to the House Commerce and Labor Committee on patient lifting in health care environments. The report's conclusions include the following:
- Manual handling of patients has been recognized as hazardous for caregivers and patients.
- The hazards of manual handling can be reduced by a programmatic approach that includes:
    - Policies for risk assessment and control;
    - Having adequate types and quantities of equipment and staffing;
    - Ongoing patient handling training;
    - Management commitment and staff involvement; and
    - Incident investigation, follow-up, and communication.
- A literature review of no-lift programs has shown reduced injuries to patients and staff, reduced lost time, reduced costs, and reduced staff turnover. Sustainability of such a program depends on management and employee stability (decreased turnover).
- All hospitals and nursing homes visited recognized the importance of implementing no-lift programs on reducing staff and patient injuries and were working to do so.
- Employer and employee associations have worked together effectively in other jurisdictions to implement no-lift type programs, often with government support.
- One of the barriers is lack of funding to purchase mechanical lifting equipment. Other countries are providing funding for the purchase of equipment.
- Legislative and executive branches of government in other jurisdictions have used regulatory and financial incentives to assist in the adoption of no-manual-lift environments in health care.

In 2006, the state enacted legislation that included the B&O tax credit for hospital purchases of patient lifting devices. The bill requires each hospital to establish a safe patient handling program. In addition, by January 30, 2010, each hospital must complete, at a minimum, acquisition of:

- One readily available lift per acute care unit on the same floor unless the hospital's safe patient handling program determines a lift is unnecessary in the unit;
- One lift for every ten acute care available inpatient beds; or
- Equipment for use by lift teams.

The Legislation also required the Department of Labor and Industries to develop rules, by to provide a reduced workers' compensation premium for hospitals that implement a safe patient handling program. Labor and Industries is required to report on the results of the reduced premium, including changes in claim frequency and costs, to the appropriate committees of the Legislature by December 1, 2010, and 2012.

The findings in the legislation emphasized the benefits of mechanical lift programs for both patients and nurses, as well as improvements in nursing retention rates. The legislation also stated that the bill is not intended to place an undue financial burden on hospitals.

The versions of the bill heard in legislative committees required hospitals to bear the cost of purchasing patient lifting devices. On the House floor, a striking amendment added the B&O tax credit for hospitals to help pay the costs of purchasing patient lifting devices. The floor amendment also required the DOR to issue an annual report on the amount of credit taken for purchases of patient lifting devices by hospitals, beginning by July 1, 2008.

Other Relevant Background

The types of devices covered by this tax include portable slings, ceiling-mounted patient lifting device, beds that convert to chairs, height-adjustable bathtubs, and other equipment designed to reduce injuries for both hospital staff and patients.

DOR keeps track of eligible hospitals, the amount of credit to which they are entitled (based on $1,000 per bed), and the amount of credit taken to date. The Department is required to grant the credit on a first-come, first-serve basis and to bill hospitals for the amount of credit taken in excess of the $10 million limit.

The statute does not define "acute care available inpatient" hospital beds for the purposes of the credit limitation. However, DOR interprets the statute to mean all available beds in an acute care hospital except for skilled nursing facility beds. The Department of Health lists 10,846 total available beds in licensed hospitals in 2007.

The statute refers to the $10 million statewide limitation as an "annual" limit. However, the fiscal note on the legislation and the state budget both assumed that the credit would be limited to $10 million over the lifetime of the credit. Likewise, DOR interprets the $10 million to be a lifetime limitation.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

The Legislature required each hospital to establish a safe patient handling program to improve patient safety, nursing staff safety, and nursing retention rates in hospital settings. The Legislature included the B&O tax credit to ease the financial burden of complying with the mandate to establish a safe patient handling program.

The tax credit expires on December 30, 2010, a month before the deadline for establishing safe patient programs in hospitals. As well as imposing a deadline for taking the credit, the Legislature constrained the tax preference by setting limits based on both the amount of credit per hospital and the total amount to be taken over the lifetime of the credit. These provisions strongly suggest that the Legislature intended to ease the financial burden on hospitals as they complied with the mandate, but did not intend to completely defray the costs of purchasing patient lifting devices or to do so indefinitely.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

The financial burden of establishing a safe patient handling program has been eased since hospitals have taken $5.3 million in tax credits. However, it is unclear whether patient safety, nursing staff safety, and nursing retention rates in hospital settings have improved. The Department of Labor and Industries will be reporting in December 2010 and 2012 on the results of the reduced workers' compensation premium for hospitals that have implemented a safe patient handling program.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

- There are 90 eligible hospitals in Washington, including public hospital districts, private for-profit hospitals, nonprofit hospitals, and three state hospitals with a total of 10,846 acute care available inpatient beds. The number of beds may increase in the next year-and-a-half before the credit expires.
- According to DOR tax records, as of December 2008, 67 of the eligible hospitals have claimed $5.3 million in credit. Twenty hospitals have taken the maximum amount of credit for which they are entitled. The cost of equipment purchased totaled $7.6 million.
- Hospitals taking the credit range in size from small rural hospitals with 25 or fewer beds to large metropolitan hospitals with 300 to 600 available beds.

Exhibit 44 – Patient Lifting Device Credit Claimed on Tax Returns

Fiscal Year	Amount of Credit Claimed
2006	$24,093
2007	$2,292,520
2008	$2,290,262
2009 (through Dec 2008)	$670,709
Total	$5,277,585

Source: Department of Revenue tax records.

Revenue Impacts

What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

Hospitals will have saved an estimated $10 million over the life of the tax preference. The credit is limited by the $10 million statewide cap or $1,000 per available bed for each hospital. The number of available beds is 10,846. It is likely the credit would be limited by the $10 million statewide cap before the limit per hospital is met. (See Exhibit 45.)

Exhibit 45 – Hospitals are Assumed to Save $10 Million Over Life of Credit

Fiscal Year	Taxpayer Savings
2006	$24,093
2007	$2,292,520
2008	$2,290,262
2009	$2,300,000
2010	$2,300,000
2011	$793,125
Total Credit Amount	$10,000,000

Source: Department of Revenue tax records.

Note: Fiscal Years 2009 through 2011 are estimates.

Recommendations

The Legislature should allow the B&O tax credit for patient lifting devices to expire on December 30, 2010, because the credit was intended to ease the financial hardship of purchasing patient lifting devices, and was limited both in duration and in the amount of credit to be taken.

Legislation Required: No.

Fiscal Impact: No – 2009-11 Biennial budgets assume the preference is expiring.

APPENDIX 1 – SCOPE AND OBJECTIVES

2009 EXPEDITED TAX PREFERENCE PERFORMANCE REVIEWS

SCOPE AND OBJECTIVES

REVISED

APRIL 2009

STATE OF WASHINGTON

JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE

STUDY TEAM

Mary Welsh
Gary Benson
Stacia Hollar
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PROJECT SUPERVISOR

Keenan Konopaski

LEGISLATIVE AUDITOR

Ruta Fanning

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1300 Quince St. SE
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e-mail: neff.barbara@leg.wa.gov

Why a JLARC Study of Tax Preferences?

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 580 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 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.

This document identifies the scope and objectives for the second category: expedited tax preference reviews. 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.

Expedited Study Scope

This tax preference performance review will include the tax preferences identified by the Citizen Commission to be reviewed prior to August 30, 2009. These tax preferences were recommended by the Citizen Commission as being subject to an expedited review process:

Brief Description	RCW Citation	Year Enacted
1. Fraternal benefit societies	48.36A.240	1911
2. Nursing homes	82.04.4289	1945

Expedited Study Scope (cont'd.)

Brief Description	RCW Citation	Year Enacted
3. Municipal Utilities	82.16.050(1)	1935
4. Tax rate for ocean marine insurance	48.14.020(3)	1947
5. Commercial aircraft	82.48.100	1949
6. Aircraft held for sale / Aircraft owned by non-residents	82.48.100	1955
7. Manufacturers of flour and oil	82.04.260(1a)	1949
8. Credit for rural electric utility contributions	82.16.0491	1999
9. PUT exemption; electricity for electrolyte firms	82.16.0421	2004
10. Aluminum industry	82.04.4481 82.12.022(5) 82.08.805 82.12.805 82.04.2909	2004
11. Rural county software development and help desk firms	82.04.4483; 8204.4484	2004
12. Sales tax ex., field burning equipment	82.08.841; 82.12.841	2005
13. B&O credit for hospitals; patient lifting devices	82.04.4485	2006

Expedited Study Objectives

In response to the legislative directive, the study will answer, for each tax preference, the following questions (unless the commission determines that the preference review should be conducted as a full review):

Public Policy Objectives:

1. What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?
2. Is there any readily available evidence related to the achievement of any of these public policy objectives?

Beneficiaries:

3. Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

Revenue and Economic Impacts:

4. What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

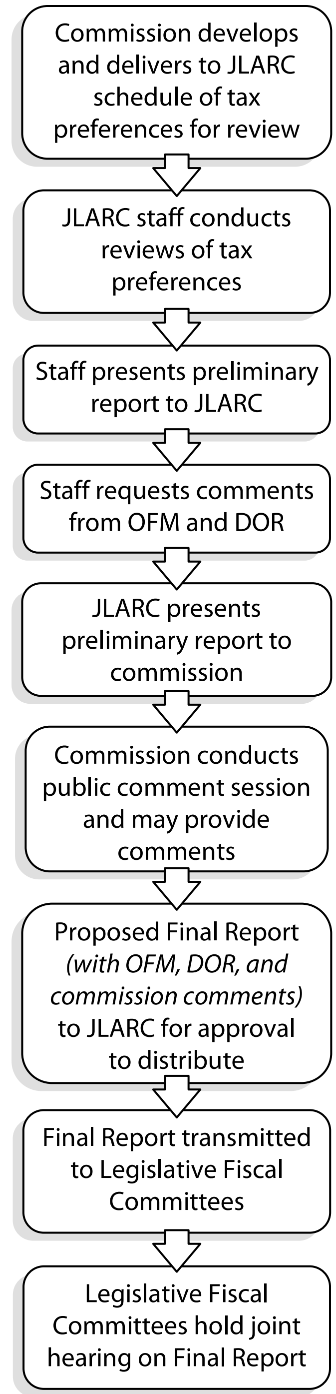
Timeframe for the Study

A preliminary audit report will be presented at the July 2009 JLARC meeting and at the August 2009 meeting of the commission. A final report will be presented to JLARC in November 2009.

JLARC Staff Contacts for the Study

Mary Welsh (360) 786-5193 welsh.mary@leg.wa.gov
Gary Benson (360) 786-5618 benson.gary@leg.wa.gov
Stacia Hollar (360) 786-5191 hollar.stacia@leg.wa.gov
David Dean (360) 786-5293 dean.david@leg.wa.gov

Tax Preference Review Process



APPENDIX 2 – AGENCY RESPONSES

- Citizen Commission for Performance Measurement of Tax Preferences
- Department of Revenue
- Department of Transportation
- Office of Financial Management
- Office of the Insurance Commissioner

State of Washington

Citizen Commission for Performance Measurement of Tax Preferences

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

October 30, 2009

Members of the Legislature:

Enclosed are recommendations to the Legislature resulting from the comprehensive review of 75 state tax preferences. These reviews have highlighted many important performance and policy issues that should be considered by the Legislature. As Chair of the Citizens Commission for Performance Measurement of Tax Preferences, I urge you to take action on the issues identified in these reviews.

At your direction, the Joint Legislative Audit and Review Committee (JLARC) has been conducting reviews of tax preferences since 2007. These reviews are being undertaken over a ten year period to determine if the preferences are meeting their intended policy purposes. In addition to JLARC's work, the Commission has heard public testimony on these reviews, and we have adopted our own comments on the preferences and JLARC recommendations. Both JLARC's recommendations and our comments are summarized in a single document we are distributing to you.

My fellow Commissioners and I would be glad to discuss our work with any of you. If you have specific questions about any of the reviews themselves, feel free to contact Ruta Fanning, Legislative Auditor (360-786-5175 or fanning.ruta@leg.wa.gov).

Sincerely,

William A. Longbrake, Chair

c: Lily Kahng, Commission Vice Chair
James Bobst, Commission Member
Paul Guppy, Commission Member
Rep. Troy Kelley, Commission Member
Stephen Miller, Commission Member
Brian Sonntag, State Auditor, Commission Member
Ruta Fanning, Legislative Auditor
Cindy Evans, Assistant Attorney General

STATE OF WASHINGTON
DEPARTMENT OF REVENUE
OFFICE OF THE DIRECTOR
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August 13, 2009

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

FROM: Cindi Holmstrom, Director
Department of Revenue

SUBJECT: **JLARC PRELIMINARY REPORTS ON 2009 TAX PREFERENCE PERFORMANCE REVIEWS (FULL AND EXPEDITED)**

Thank you for the opportunity to review and comment on the Joint Legislative Audit and Review Committee's (JLARC's) preliminary 2009 Tax Preference Performance Reviews.

We appreciate JLARC's efforts and those of 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 would like to compliment your team for the thorough and thoughtful analysis of the tax preference items selected for JLARC review. Following are a few comments on parts of the report relating to the Department of Revenue.

Recommendation to Update Administrative Rule on Newspapers – Full Review

The JLARC report recommends that the Department should update its administrative rule for newspapers to reflect current law because the rule uses a content-based definition for newspapers. I am pleased to inform you that the Department does plan to move forward with rule making to amend WAC 458-20-143 (Publishers of newspapers, magazines, periodicals). Updating the definition of "newspaper" will be one of the changes. The subject of this rule was also affected by 2009 legislation (ESHB 2075 & EHB 2122). Formal rule making action is anticipated to begin before the end of this year.

Patient Lifting Devices B&O Tax Credit – Expedited Review

The JLARC report recommends that the patient lifting device B&O tax credit be allowed to expire. The Department has no position on this recommendation. We note that the preliminary report also states that the Department of Revenue's position is that the $10 million business and

Ruta Fanning, Legislative Auditor
August 13, 2009
Page 2

occupation (B&O) tax credit cap is a cap over the entire lifetime of the program. While we believe the Legislature originally intended this to be a lifetime cap, the statute clearly establishes it as an annual cap.

I would like to clarify that the Department has taken no official position in contradiction to the statute; however, as a practical matter we believe it will have no real impact whether it is an annual cap or a lifetime cap. Based on the amount of credit actually taken up to this time, it appears unlikely that $10 million in credit will be claimed before the scheduled expiration date of December 30, 2010.

Again, we appreciate your effort to continuously review and analyze the state's numerous tax preferences. We also appreciate the opportunity to review the reports and recommendations in order to offer our comments.

Washington State Department of Transportation
Paula J. Hammond, P.E.
Secretary of Transportation

Transportation Building
310 Maple Park Avenue S.E.
P.O. Box 47300
Olympia, WA 98504-7300

360-705-7000
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August 21, 2009

Ms. Ruta Fanning,
Legislative Auditor
Joint Legislative Audit and Review Committee
1300 Quince St SE
Olympia, WA 98504-0910

Dear Ms. Fanning:

Thank you for the opportunity to review and comment on the Joint Legislative Audit and Review Committee's (JLARC) preliminary reports on the 2009 Expedited Tax Preference Performance Reviews and 2009 Full Tax Preference Performance Review.

We appreciate the opportunity to respond to Expedited Tax Preference Performance Reviews titled: *Commercial Aircraft Exemption from Aircraft Excise Tax* and *Nonresident Aircraft and Aircraft Held for Sale Exemption from Excise Tax* and the Full Tax Preferences Performance Review titled: *General Aviation Aircraft Exemption from Property Taxes*. The Department reviewed the reports and found the information to be accurate. In addition, the Washington State Department of Transportation (WSDOT) supports the recommendations for the tax preferences.

Thank you for your effort to continuously review and analyze the state's structure of tax preferences.

Sincerely,

Stephan T. Reinmuth
Chief of Staff

STR:JAD

cc: Paula Hammond, WSDOT
Bill Ford, WSDOT
John Sibold, WSDOT
Dillon Auyoung, WSDOT
Lloyd Brown, WSDOT
Lizbeth Martin-Mahar, WSDOT
Steve McKerney, WSDOT
Robin Rettew, OFM
Keenan Konopaski, JLARC
David Dean, JLARC

STATE OF WASHINGTON
OFFICE OF FINANCIAL MANAGEMENT
Insurance Building, PO Box 43113 • Olympia, Washington 98504-3113 • (360) 902-0555

August 24, 2009

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

FROM: Victor A. Moore
Director

SUBJECT: **JLARC PRELIMINARY REPORTS ON 2009 TAX PREFERENCE PERFORMANCE REVIEW**

Thank you for the opportunity to review and comment on the Joint Legislative Audit and Review Committee's (JLARC's) two preliminary reports on Tax Preference Performance Reviews: the 2009 Full Tax Preference Performance Reviews, and 2009 Expedited Tax Preference Performance Reviews.

The technical review of the materials by the Office of Financial Management (OFM) staff did not turn up any substantive errors. Some minor suggested changes were directly communicated to JLARC staff and need not be catalogued here. At this time, OFM has no position on any of the recommendations for the tax preferences reviewed.

We thank JLARC and the Citizens Commission for Performance Measurement of Tax Preferences (Commission) for your work to identify current tax preference legislation for further review by the Legislature.

Please continue to consult with the Office of Financial Management as well as other agencies that would be affected by possible changes to tax preference legislation.

MIKE KREIDLER
STATE INSURANCE COMMISSIONER

STATE OF WASHINGTON

Phone: (360) 725-7000

OFFICE OF
INSURANCE COMMISSIONER

August 21, 2009

Ruta Fanning
Legislative Auditor
Joint Legislative Audit & Review Committee
P.O. Box 40910
Olympia, WA 98504

Re: 2009 Annual Reports on Tax Preference Reviews - Preliminary Reports

Dear Ms. Fanning,

Please accept this letter as the formal response of the Office of the Insurance Commissioner (OIC) to the findings in the 2009 Expedited Tax Preference Performance Reviews, which was presented to Joint Legislative Audit & Review Committee (JLARC) on July 23, 2009.

The OIC is responding to the findings in the report on insurance premium tax preferences for fraternal benefit societies and ocean marine insurance. The report recommends that the legislature reexamine or clarify the intent of these tax preferences. We accept that recommendation and commend your staff on the thoroughness of their work.

Thank you for the opportunity to respond to the 2009 Expedited Tax Preference Performance Reviews. Please do not hesitate to contact me if you have any questions.

Sincerely,

Mary Clogston

Mary Clogston
Deputy Commissioner for Policy and Legislative Affairs
(360) 725-7037

Mailing Address: P.O. Box 40258 • Olympia, WA 98504-0258
Street Address: Insurance Building • 302 14th Avenue SW • Olympia, WA 98504

APPENDIX 3 – CURRENT LAW

Fraternal Benefit Societies Exemption from Insurance Premiums Tax

RCW 48.36A.010

Any incorporated society, order, or supreme lodge, without capital stock, including one exempted under the provisions of RCW 48.36A.370(1)(b) whether incorporated or not, conducted solely for the benefit of its members and their beneficiaries and not for profit, operated on a lodge system with ritualistic form of work, having a representative form of government, and which provides benefits in accordance with this chapter, is hereby declared to be a fraternal benefit society.

[1987 c 366 § 1.]

RCW 48.36A.240

Every society organized or licensed under this chapter is hereby declared to be a charitable and benevolent institution, and all of its funds shall be exempt from all and every state, county, district, municipal, and school tax, other than taxes on real estate and office equipment.

[1987 c 366 § 24.]

Kidney Dialysis, Hospice, and Nursing Homes Deduction for Property Taxes Collected

RCW 82.04.4289

This chapter does not apply to amounts derived as compensation for services rendered to patients or from sales of drugs for human use pursuant to a prescription furnished as an integral part of services rendered to patients by a kidney dialysis facility operated as a nonprofit corporation, a nonprofit hospice agency licensed under chapter 70.127 RCW, and nursing homes and homes for unwed mothers operated as religious or charitable organizations, but only if no part of the net earnings received by such an institution inures directly or indirectly, to any person other than the institution entitled to deduction hereunder. "Prescription" and "drug" have the same meaning as in RCW 82.08.0281.

[2003 c 168 § 402; 1998 c 325 § 1; 1993 c 492 § 305; 1981 c 178 § 2; 1980 c 37 § 10. Formerly RCW 82.04.430(9).]

Municipal Utilities Deduction for Property Taxes Collected

RCW 82.16.050(1)

In computing tax there may be deducted from the gross income the following items:

(1) Amounts derived by municipally owned or operated public service businesses, directly from taxes levied for the support or maintenance thereof. This subsection may not be construed to exempt service charges which are spread on the property tax rolls and collected as taxes;

[2007 c 330 § 1; 2006 c 336 § 1; 2004 c 153 § 308; 2000 c 245 § 1; 1994 c 124 § 12; 1989 c 302 § 103; 1987 c 207 § 1; 1982 2nd ex.s. c 9 § 3; 1977 ex.s. c 368 § 1; 1967 ex.s. c 149 § 25; 1965 ex.s. c 173 § 22; 1961 c 15 §82.16.050 . Prior: 1959 ex.s. c 3 § 18; 1949 c 228 § 11; 1937 c 227 § 12; 1935 c 180 § 40; Rem. Supp. 1949 § 8370-40.]

Ocean Marine Insurance Tax Preferences

RCW 48.14.020(3)

(3) Each authorized insurer shall with respect to all ocean marine and foreign trade insurance contracts written within this state during the preceding calendar year, on or before the first day of March of each year pay to the state treasurer through the commissioner's office a tax of ninety-five one-hundredths of one percent on its gross underwriting profit. Such gross underwriting profit shall be ascertained by deducting from the net premiums (i.e., gross premiums less all return premiums and premiums for reinsurance) on such ocean marine and foreign trade insurance contracts the net losses paid (i.e., gross losses paid less salvage and recoveries on reinsurance ceded) during such calendar year under such contracts. In the case of insurers issuing participating contracts, such gross underwriting profit shall not include, for computation of the tax prescribed by this subsection, the amounts refunded, or paid as participation dividends, by such insurers to the holders of such contracts.

[1986 c 296 § 1; 1983 2nd ex.s. c 3 § 7; 1982 2nd ex.s. c 10 § 1; 1982 1st ex.s. c 35 § 15; 1979 ex.s. c 233 § 2; 1969 ex.s. c 241 § 9; 1947 c 79 § .14.02; Rem. Supp. 1947 § 45.14.02.]

RCW 48.11.050

"Marine and transportation insurance" is:

(1) Insurance against loss of or damage to:

(a) Vessels, craft, aircraft, vehicles, goods, freights, cargoes, merchandise, effects, disbursements, profits, moneys, securities, choses in action, evidences of debt, valuable papers, bottomry, and respondentia interests and all other kinds of property and interests therein, in respect to, appertaining to or in connection with any and all risks or perils of navigation, transit or transportation, or while being assembled, packed, crated, baled, compressed or similarly prepared for shipment or while awaiting shipment, or during any delays, storage, transshipment, or reshipment incident thereto, including war risks, marine builder's risks, and all personal property floater risks.

(b) Person or property in connection with or appertaining to a marine, transit or transportation insurance, including liability for loss of or damage to either incident to the construction, repair, operation, maintenance or use of the subject matter of such insurance (but not including life insurance or surety bonds nor insurance against loss by reason of bodily injury to any person arising out of the ownership, maintenance, or use of automobiles).

(c) Precious stones, jewels, jewelry, precious metals, whether in course of transportation or otherwise.

(d) Bridges, tunnels and other instrumentalities of transportation and communication (excluding buildings, their furniture and furnishings, fixed contents and supplies held in storage); piers, wharves, docks and slips, and other aids to navigation and transportation, including dry docks and marine railways, dams and appurtenant facilities for the control of waterways.

(2) "Marine protection and indemnity insurance," meaning insurance against, or against legal liability of the insured for, loss, damage, or expense incident to ownership, operation, chartering, maintenance, use, repair or construction of any vessel, craft or instrumentality in use in ocean or inland waterways, including liability of the insured for personal injury, illness or death or for loss of or damage to the property of another person.

[1947 c 79 § .11.05; Rem. Supp. 1947 § 45.11.05.]

RCW 48.11.105

For the purposes of this code other than as to chapter 48.19 RCW "ocean marine and foreign trade insurances" shall include only:

(1) Insurances upon vessels, crafts, hulls, and of interests therein or with relation thereto;

(2) Insurance of marine builders' risks, marine war risks, and contracts of marine protection and indemnity insurance;

(3) Insurance of freights and disbursements pertaining to a subject of insurance coming within this definition;

(4) Insurance of personal property and interests therein, in course of exportation from or importation into any country, or in course of transportation coastwise, including transportation by land, water, or air from point of origin to final destination, in respect to, appertaining to, or in connection with, any and all risks or perils of navigation, transit, or transportation, and while being prepared for and while awaiting shipment, and during any delays, storage, transshipment, or reshipment incident thereto.

[2007 c 80 § 5.]

Commercial Aircraft Exemption from Aircraft Excise Tax

Nonresident Aircraft / Aircraft Held for Sale Exemption from Excise Tax

RCW 82.48.020

(1) An annual excise tax is hereby imposed for the privilege of using any aircraft in the state. A current certificate of air worthiness with a current inspection date from the appropriate federal agency and/or the purchase of aviation fuel shall constitute the necessary evidence of aircraft use or intended use. The tax shall be collected annually or under a staggered collection schedule as required by the secretary by rule. No additional tax shall be imposed under this chapter upon any aircraft upon the transfer of ownership thereof, if the tax imposed by this chapter with respect to such aircraft has already been paid for the year in which transfer of ownership occurs. A violation of this subsection is a misdemeanor punishable as provided under chapter 9A.20 RCW.

(2) Persons who are required to register aircraft under chapter 47.68 RCW and who register aircraft in another state or foreign country and avoid the Washington aircraft excise tax are liable for such unpaid excise tax. A violation of this subsection is a gross misdemeanor.

The department of revenue may assess and collect the unpaid excise tax under chapter 82.32 RCW, including the penalties and interest provided in chapter 82.32 RCW.

(3) Except as provided under subsections (1) and (2) of this section, a violation of this chapter is a misdemeanor punishable as provided in chapter 9A.20 RCW.

[2000 c 229 § 4; 1999 c 277 § 7; 1993 c 238 § 5; 1992 c 154 § 1; 1987 c 220 § 6; 1983 c 7 § 27; 1979 c 158 § 240; 1967 ex.s. c 149 § 27; 1967 ex.s. c 9 § 2; 1961 c 15 § 82.48.020. Prior: 1949 c 49 § 2; Rem. Supp. 1949 § 11219-34.]

RCW 82.48.100

This chapter shall not apply to:

Aircraft owned by and used exclusively in the service of any government or any political subdivision thereof, including the government of the United States, any state, territory, or possession of the United States, or the District of Columbia, which are not engaged in carrying persons or property for commercial purposes;

Aircraft registered under the laws of a foreign country;

Aircraft which are owned by a nonresident and registered in another state: PROVIDED, That if any such aircraft shall remain in and/or be based in this state for a period of ninety days or longer it shall not be exempt under this section;

Aircraft engaged principally in commercial flying which constitutes interstate or foreign commerce; and aircraft owned by the manufacturer thereof while being operated for test or experimental purposes, or for the purpose of training crews for purchasers of the aircraft;

Aircraft being held for sale, exchange, delivery, test, or demonstration purposes solely as stock in trade of an aircraft dealer licensed under Title 14 RCW;

Aircraft owned by a nonresident of this state if the aircraft is kept at an airport in this state and that airport is jointly owned or operated by a municipal corporation or other governmental entity of this state and a municipal corporation or other governmental entity of another state, and the owner or operator of the aircraft provides the department with proof that the owner or operator has paid all taxes, license fees, and registration fees required by the state in which the owner or operator resides.

[1999 c 302 § 3; 1965 ex.s. c 173 § 28; 1961 c 15 § 82.48.100. Prior: 1955 c 150 § 12; 1949 c 49 § 10; Rem. Supp. 1949 § 11219-42.]

RCW 82.48.110

The first tax to be collected under this chapter shall be for the calendar year 1968. No aircraft with respect to which the excise tax imposed by this chapter is payable shall be listed and assessed for ad valorem taxation so long as this chapter remains in effect, and any such assessment heretofore made except under authority of section 13, chapter 49, Laws of 1949 and section 82.48.110, chapter 15, Laws of 1961 is hereby directed to be canceled: PROVIDED, That any aircraft, whether or not subject to the provisions of this chapter, with respect to which the excise tax imposed by this chapter will not be paid or has not been paid for any year shall be listed and assessed for ad valorem taxation in that year, and the ad valorem tax liability resulting from such listing and assessment shall be collected in the same manner as though this chapter had not been passed: PROVIDED FURTHER, That this chapter shall not be construed to affect any ad valorem tax based upon assessed valuations made in 1948 and/or any preceding year for taxes payable in 1949 or any preceding year, which ad valorem tax liability tax for any such years shall remain payable and collectible in the same manner as though this chapter had not been passed.

[1967 ex.s. c 9 § 6; 1961 c 15 § 82.48.110. Prior: 1949 c 49 § 13; Rem. Supp. 1949 § 11219-43.]

Manufacturers of Flour and Oil Preferential Tax Rate

RCW 82.04.260 (1)(a)

(1) Upon every person engaging within this state in the business of manufacturing:

(a) Wheat into flour, barley into pearl barley, soybeans into soybean oil, canola into canola oil, canola meal, or canola byproducts, or sunflower seeds into sunflower oil; as to such persons the amount of tax with respect to such business shall be equal to the value of the flour, pearl barley, oil, canola meal, or canola byproduct manufactured, multiplied by the rate of 0.138 percent;

[2008 c 296 § 1; 2008 c 81 § 4. Prior: 2007 c 54 § 6; 2007 c 48 § 2; prior: 2006 c 354 § 4; 2006 c 300 § 1; prior: 2005 c 513 § 2; 2005 c 443 § 4; prior: 2003 2nd sp.s. c 1 § 4; 2003 2nd sp.s. c 1 § 3; 2003 c 339 § 11; 2003 c 261 § 11; 2001 2nd sp.s. c 25 § 2; prior: 1998 c 312 § 5; 1998 c 311 § 2; prior: 1998 c 170 § 4; 1996 c 148 § 2; 1996 c 115 § 1; prior: 1995 2nd sp.s. c 12 § 1; 1995 2nd sp.s. c 6 § 1; 1993 sp.s. c 25 § 104; 1993 c 492 § 304; 1991 c 272 § 15; 1990 c 21 § 2; 1987 c 139 § 1; prior: 1985 c 471 § 1; 1985 c 135 § 2; 1983 2nd ex.s. c 3 § 5; prior: 1983 1st ex.s. c 66 § 4; 1983 1st ex.s. c 55 § 4; 1982 2nd ex.s. c 13 § 1; 1982 c 10 § 16; prior: 1981 c 178 § 1; 1981 c 172 § 3; 1979 ex.s. c 196 § 2; 1975 1st ex.s. c 291 § 7; 1971 ex.s. c 281 § 5; 1971 ex.s. c 186 § 3; 1969 ex.s. c 262 § 36; 1967 ex.s. c 149 § 10; 1965 ex.s. c 173 § 6; 1961 c 15 §82.04.260 ; prior: 1959 c 211 § 2; 1955 c 389 § 46; prior: 1953 c 91 § 4; 1951 2nd ex.s. c 28 § 4; 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

Rural Electric Utility Contributions Credit for Public Utility Tax

RCW 82.16.0491

(1) The following definitions apply to this section:

(a) "Qualifying project" means a project designed to achieve job creation or business retention, to add or upgrade nonelectrical infrastructure, to add or upgrade health and safety facilities, to accomplish energy and water use efficiency improvements, including renewable energy development, or to add or upgrade emergency services in any designated qualifying rural area.

(b) "Qualifying rural area" means:

(i) A rural county as defined in RCW 82.14.370; or

(ii) Any geographic area in the state that receives electricity from a light and power business with twelve thousand or fewer customers.

(c) "Electric utility rural economic development revolving fund" means a fund devoted exclusively to funding qualifying projects in qualifying rural areas.

(d) "Local board" is (i) a board of directors with at least, but not limited to, three members representing local businesses and community groups who have been appointed by the sponsoring electric utility to oversee and direct the activities of the electric utility rural economic development revolving fund; or (ii) a board of directors of an existing associate development organization serving the qualifying rural area who have been designated by the sponsoring electrical utility to oversee and direct the activities of the electric utility rural economic development revolving fund.

(2) A light and power business shall be allowed a credit against taxes due under this chapter in an amount equal to fifty percent of contributions made in any fiscal year directly to an electric utility rural economic development revolving fund. The credit shall be taken in a form and manner as required by the department. The credit under this section shall not exceed twenty-five thousand dollars per fiscal year per light and power business. The credit may not exceed the tax that would otherwise be due under this chapter. Refunds shall not be granted in the place of credits. Expenditures not used to earn a credit in one fiscal year may not be used to earn a credit in subsequent years, except that this limitation does not apply to expenditures made between January 1, 2004, and March 31, 2004, which expenditures may be used to earn a credit through December 30, 2004.

(3) The right to earn tax credits under this section expires June 30, 2011.

(4) To qualify for the credit in subsection (2) of this section, the light and power business shall establish, or have a local board establish with the business's contribution, an electric utility rural economic development revolving fund which is governed by a local board whose members shall reside or work in the qualifying rural area served by the light and power business. Expenditures from the electric utility rural economic development revolving fund shall be made solely on qualifying projects, and the local board shall have authority to determine all criteria and conditions for the expenditure of funds from the electric utility rural economic development revolving fund, and for the terms and conditions of repayment.

(5) Any funds repaid to the electric utility rural economic development revolving fund by recipients shall be made available for additional qualifying projects.

(6) If at any time the electric utility rural economic development revolving fund is dissolved, any moneys claimed as a tax credit under this section shall either be granted to a qualifying project or refunded to the state within two years of termination.

(7) The total amount of credits that may be used in any fiscal year shall not exceed three hundred fifty thousand dollars in any fiscal year. The department shall allow the use of earned credits on a first-come, first-served basis. Unused earned credits may be carried over to subsequent years.

(8) The following provisions apply to expenditures under subsection (2) of this section made between January 1, 2004, and March 31, 2004:

(a) Credits earned from such expenditures are not considered in computing the statewide limitation set forth in subsection (7) of this section for the period July 1, 2004, through December 31, 2004; and

(b) For the fiscal year ending June 30, 2005, the credit allowed under this section for light and power businesses making expenditures is limited to thirty-seven thousand five hundred dollars.

[2008 c 131 § 4; 2004 c 238 § 1; 1999 c 311 § 402.]

Notes:

Finding -- 2004 c 238: "(1) The legislature finds that accountability and effectiveness are important aspects of setting tax policy. In order to make policy choices regarding the best use of limited state resources the legislature needs information to evaluate whether the stated goals of legislation were achieved.

(2) The goal of the tax credit available to light and power businesses for contributing to an electric utility rural economic development revolving fund in RCW 82.16.0491 is to support qualifying projects that create or retain jobs, add or upgrade health and safety facilities, facilitate energy and water conservation, or develop renewable sources of energy in a qualified area. The goal of this tax credit is achieved when the investment of the revolving funds established under RCW 82.16.0491 have generated capital investment in an amount of four million seven hundred fifty thousand dollars or more within a five-year period." [2004 c 238 § 2.]

Electricity for Electrolyte Firms Exemption from Public Utility Tax

RCW 82.16.0421

The Legislature amended RCW 82.16.0421 in 2009 in SHB 1062, Section 1:

Sec. 1. RCW 82.16.0421 and 2004 c 240 s 1 are each amended to read as follows:

(1) For the purposes of this section:

(a) "Chlor-alkali electrolytic processing business" means a person who is engaged in a business that uses more than ten average megawatts of electricity per month in a chlor-alkali electrolytic process to split the electrochemical bonds of sodium chloride and water to make chlorine and sodium hydroxide. A "chlor-alkali electrolytic processing business" does not include direct service industrial customers or their subsidiaries that contract for the purchase of power from the Bonneville power administration as of June 10, 2004.

(b) "Sodium chlorate electrolytic processing business" means a person who is engaged in a business that uses more than ten average megawatts of electricity per month in a sodium chlorate electrolytic process to split the electrochemical bonds of sodium chloride and water to make sodium chlorate and hydrogen. A "sodium chlorate electrolytic processing business" does not include direct service industrial customers or their subsidiaries that contract for the purchase of power from the Bonneville power administration as of June 10, 2004.

(2) Effective July 1, 2004, the tax levied under this chapter does not apply to sales of electricity made by a light and power business to a chlor-alkali electrolytic processing business or a sodium chlorate electrolytic processing business for the electrolytic process if the contract for sale of electricity to the business contains the following terms:

(a) The electricity to be used in the electrolytic process is separately metered from the electricity used for general operations of the business;

(b) The price charged for the electricity used in the electrolytic process will be reduced by an amount equal to the tax exemption available to the light and power business under this section; and

(c) Disallowance of all or part of the exemption under this section is a breach of contract and the damages to be paid by the chlor-alkali electrolytic processing business or the sodium chlorate electrolytic processing business are the amount of the tax exemption disallowed.

(3) The exemption provided for in this section does not apply to amounts received from the remarketing or resale of electricity originally obtained by contract for the electrolytic process.

(4) In order to claim an exemption under this section, the chlor-alkali electrolytic processing business or the sodium chlorate electrolytic processing business must provide the light and power business with an exemption certificate in a form and manner prescribed by the department.

(5)(a) This section does not apply to sales of electricity made after December 31, ((2010)) 2018.

(b) This section expires June 30, ((2011)) 2019.

[2004 c 240 § 1.]
[2004 c 238 § 1; 1999 c 311 § 402.]

Aluminum Industry Tax Preferences

RCW 82.04.4481

(1) In computing the tax imposed under this chapter, a credit is allowed for all property taxes paid during the calendar year on property owned by a direct service industrial customer and reasonably necessary for the purposes of an aluminum smelter.

(2) A person taking the credit under this section is subject to all the requirements of chapter 82.32 RCW. A credit earned during one calendar year may be carried over to be credited against taxes incurred in the subsequent calendar year, but may not be carried over a second year. Credits carried over must be applied to tax liability before new credits. No refunds may be granted for credits under this section.

(3) Credits may not be claimed under this section for property taxes levied for collection in 2012 and thereafter.

[2006 c 182 § 2; 2004 c 24 § 8.]

RCW 82.04.2909

(1) Upon every person who is an aluminum smelter engaging within this state in the business of manufacturing aluminum; as to such persons the amount of tax with respect to such business shall, in the case of manufacturers, be equal to the value of the product manufactured, or in the

case of processors for hire, be equal to the gross income of the business, multiplied by the rate of .2904 percent.

(2) Upon every person who is an aluminum smelter engaging within this state in the business of making sales at wholesale of aluminum manufactured by that person, as to such persons the amount of tax with respect to such business shall be equal to the gross proceeds of sales of the aluminum multiplied by the rate of .2904 percent.

(3) This section expires January 1, 2012.

[2006 c 182 § 1; 2004 c 24 § 3.]

RCW 82.08.805

The Legislature amended RCW 82.08.805 in 2009 in ESHB 2705, Section 513:

Sec. 513. RCW 82.08.805 and 2006 c 182 s 3 are each amended to read as follows:

(1) A person who has paid tax under RCW 82.08.020 for personal property used at an aluminum smelter, tangible personal property that will be incorporated as an ingredient or component of buildings or other structures at an aluminum smelter, or for labor and services rendered with respect to such buildings, structures, or personal property, is eligible for an exemption from the state share of the tax in the form of a credit, as provided in this section. A person claiming an exemption must pay the tax and may then take a credit equal to the state share of retail sales tax paid under RCW 82.08.020. The person shall submit information, in a form and manner prescribed by the department, specifying the amount of qualifying purchases or acquisitions for which the exemption is claimed and the amount of exempted tax.

(2) For the purposes of this section, "aluminum smelter" has the same meaning as provided in RCW 82.04.217.

(3) Credits may not be claimed under this section for taxable events occurring on or after January 1, 2012.

[2006 c 182 § 3; 2004 c 24 § 10.]

RCW 82.12.022(5)

The Legislature amended RCW 82.08.805 in 2009 in ESHB 2705, Section 620:

(5) The tax levied in this section shall not apply to the use of natural or manufactured gas by an aluminum smelter as that term is defined in RCW 82.04.217 before January 1, 2012.

[2006 c 182 § 5; 2004 c 24 § 12; 1994 c 124 § 9; 1989 c 384 § 3.] (History for entire RCW, not just subsection)

RCW 82.12.805

Sec. 620. RCW 82.12.805 and 2006 c 182 s 4 are each amended to read as follows:

(1) A person who is subject to tax under RCW 82.12.020 for personal property used at an aluminum smelter, or for tangible personal property that will be incorporated as an ingredient or component of buildings or other structures at an aluminum smelter, or for labor and services rendered with respect to such buildings, structures, or personal property, is eligible for an exemption from the state share of the tax in the form of a credit, as provided in this section. The

amount of the credit shall be equal to the state share of use tax computed to be due under RCW 82.12.020. The person shall submit information, in a form and manner prescribed by the department, specifying the amount of qualifying purchases or acquisitions for which the exemption is claimed and the amount of exempted tax.

(2) For the purposes of this section, "aluminum smelter" has the same meaning as provided in RCW 82.04.217.

(3) Credits may not be claimed under this section for taxable events occurring on or after January 1, 2012.

[2006 c 182 § 4; 2004 c 24 § 11.]

Rural County Software Development and Help Desk Credit for B&O Tax

RCW 82.04.4483

1) Subject to the limits and provisions of this section, a credit is authorized against the tax otherwise due under this chapter for persons engaged in a rural county in the business of manufacturing computer software or programming, as those terms are defined in this section.

(2) A person who partially or totally relocates a business from one rural county to another rural county is eligible for any new qualifying employment positions created as a result of the relocation but is not eligible to receive credit for the jobs moved from one county to the other.

(3)(a) To qualify for the credit, the qualifying activity of the person must be conducted in a rural county and the new qualified employment position must be located in the rural county.

(b) If an activity is conducted both from a rural county and outside of a rural county, the credit is available if at least ninety percent of the qualifying activity is conducted within a rural county. If the qualifying activity is a service taxable activity, the place where the work is performed is the place at which the activity is conducted.

(4)(a) The credit under this section shall equal one thousand dollars for each new qualified employment position created after January 1, 2004, in an eligible area. A credit is earned for the calendar year the person is hired to fill the position. Additionally a credit is earned for each year the position is maintained over the subsequent consecutive years, up to four years. The county must meet the definition of a rural county at the time the position is filled. If the county does not have a rural county status the following year or years, the position is still eligible for the remaining years if all other conditions are met.

(b) Participants who claimed credit under *RCW 82.04.4456 for qualified employment positions created before December 31, 2003, are eligible to earn credit for each year the position is maintained over the subsequent consecutive years, for up to four years, which four years include any years claimed under *RCW 82.04.4456. Those persons who did not receive a credit under *RCW 82.04.4456 before December 31, 2003, are not eligible to earn credit for qualified employment positions created before December 31, 2003.

(c) Credit is authorized for new employees hired for new qualified employment positions created on or after January 1, 2004. New qualified employment positions filled by existing employees are eligible for the credit under this section only if the position vacated by the existing employee is filled by a new hire. A business that is a sole proprietorship without any employees is equivalent to one employee position and this type of business is eligible to receive credit for one position.

(d) If a position is filled before July 1st, the position is eligible for the full yearly credit for that calendar year. If it is filled after June 30th, the position is eligible for half of the credit for that calendar year.

(5) No application is necessary for the tax credit. The person must keep records necessary for the department to verify eligibility under this section. This information includes information relating to description of qualifying activity conducted in the rural county and outside the rural county by the person as well as detailed records on positions and employees.

(6) If at any time the department finds that a person is not eligible for tax credit under this section, the amount of taxes for which a credit has been claimed shall be immediately due. The department shall assess interest, but not penalties, on the taxes for which the person is not eligible. The interest shall be assessed at the rate provided for delinquent excise taxes under chapter 82.32 RCW, shall be assessed retroactively to the date the tax credit was taken, and shall accrue until the taxes for which a credit has been used are repaid.

7) The credit under this section may be used against any tax due under this chapter, but in no case may a credit earned during one calendar year be carried over to be credited against taxes incurred in a subsequent calendar year. A person is not eligible to receive a credit under this section if the person is receiving credit for the same position under chapter 82.62 RCW or RCW 82.04.44525 or is taking a credit under this chapter for information technology help desk services conducted from a rural county. No refunds may be granted for credits under this section.

(8) Transfer of ownership does not affect credit eligibility. However, the successive credits are available to the successor for remaining periods in the five years only if the eligibility conditions of this section are met.

(9) A person taking tax credits under this section shall make an annual report to the department. The report shall be in a letter form and shall include the following information: Number of positions for which credit is being claimed, type of position for which credit is being claimed, type of activity in which the person is engaged in the county, how long the person has been located in the county, and taxpayer name and registration number. The report must be filed by January 30th of each year for which credit was claimed during the previous year. Failure to file a report will not result in the loss of eligibility under this section. However, the department, through its research division, shall contact taxpayers who have not filed the report and obtain the data from the taxpayer or assist the taxpayer in the filing of the report, so that the data and information necessary to measure the program's effectiveness is maintained.

(10) As used in this section:

(a) "Computer software" has the meaning as defined in RCW 82.04.215 after June 30, 2004, and includes "software" as defined in RCW 82.04.215 before July 1, 2004.

(b) "Manufacturing" means the same as "to manufacture" under RCW 82.04.120. Manufacturing includes the activities of both manufacturers and processors for hire.

(c) "Programming" means the activities that involve the creation or modification of computer software, as that term is defined in this chapter, and that are taxable as a service under RCW 82.04.290(2) or as a retail sale under RCW 82.04.050.

(d) "Qualifying activity" means manufacturing of computer software or programming.

(e) "Qualified employment position" means a permanent full-time position doing programming of computer software or manufacturing of computer software. This excludes administrative, professional, service, executive, and other similar positions. If an employee is either voluntarily or involuntarily separated from employment, the employment position is considered filled on a full-time basis if the employer is either training or actively recruiting a replacement employee. Full-time means a position for at least thirty-five hours a week.

(f) "Rural county" means the same as in RCW 82.14.370.

(11) No credit may be taken or accrued under this section on or after January 1, 2011.

(12) This section expires January 1, 2011.

[2004 c 25 § 1.]

RCW 82.04.4484

(1) Subject to the limits and provisions of this section, a credit is authorized against the tax otherwise due under this chapter for persons engaged in a rural county in the business of providing information technology help desk services to third parties.

(2) To qualify for the credit, the help desk services must be conducted from a rural county.

(3) The amount of the tax credit for persons engaged in the activity of providing information technology help desk services in rural counties shall be equal to one hundred percent of the amount of tax due under this chapter that is attributable to providing the services from the rural county. In order to qualify for the credit under this subsection, the county must meet the definition of rural county at the time the person begins to conduct qualifying business in the county.

(4) No application is necessary for the tax credit. The person must keep records necessary for the department to verify eligibility under this section. These records include information relating to description of activity engaged in a rural county by the person.

(5) If at any time the department finds that a person is not eligible for tax credit under this section, the amount of taxes for which a credit has been used is immediately due. The department shall assess interest, but not penalties, on the credited taxes for which the person is not eligible. The interest shall be assessed at the rate provided for delinquent excise taxes under

chapter 82.32 RCW, shall be assessed retroactively to the date the tax credit was taken, and shall accrue until the taxes for which a credit has been used are repaid.

(6) The credit under this section may be used against any tax due under this chapter, but in no case may a credit earned during one calendar year be carried over to be credited against taxes incurred in a subsequent calendar year. No refunds may be granted for credits under this section.

7) Transfer of ownership does not affect credit eligibility. However, the credit is available to the successor only if the eligibility conditions of this section are met.

(8) A person taking tax credits under this section shall make an annual report to the department. The report shall be in a letter form and shall include the following information: Type of activity in which the person is engaged in the county, number of employees in the rural county, how long the person has been located in the county, and taxpayer name and registration number. The report must be filed by January 30th of each year for which credit was claimed during the previous year. Failure to file a report will not result in the loss of eligibility under this section. However, the department, through its research division, shall contact taxpayers who have not filed the report and obtain the data from the taxpayer or assist the taxpayer in the filing of the report, so that the data and information necessary to measure the program's effectiveness is maintained.

(9) As used in this section:

(a) "Information technology help desk services" means the following services performed using electronic and telephonic communication:

(i) Software and hardware maintenance;

(ii) Software and hardware diagnostics and troubleshooting;

(iii) Software and hardware installation;

(iv) Software and hardware repair;

(v) Software and hardware information and training; and

(vi) Software and hardware upgrade.

(b) "Rural county" means the same as in RCW 82.14.370.

(10) This section expires January 1, 2011.

[2004 c 25 § 2.]

Field Burning Equipment Exemptions from Sales and Use Taxes

RCW 82.08.841

(1) The tax levied by RCW 82.08.020 does not apply to:

(a) Sales of the following machinery and equipment to qualified farmers: No-till drills, minimum-till drills, chisels, plows, sprayers, discs, cultivators, harrows, mowers, swathers, power rakes, balers, bale handlers, shredders, transplanters, tractors two hundred fifty horsepower and over designed to pull conservation equipment on steep hills and highly erodible lands, and combine components limited to straw choppers, chaff spreaders, and stripper headers; and

(b) Labor and services rendered in respect to constructing hay sheds for qualified farmers or to sales of tangible personal property to qualified farmers that becomes an ingredient or component of hay sheds during the course of the constructing.

(2)(a) No application is necessary for the tax exemption in this section. A person taking the exemption under this section must keep records necessary for the department to verify eligibility. The department may request from a qualified farmer, copies of farm service agency or crop insurance records for verification purposes, however information obtained from farm service agency or crop insurance records is deemed taxpayer information under RCW 82.32.330 and is not disclosable.

(b) The exemption is available only when the buyer provides the seller with an exemption certificate in a form and manner prescribed by the department. The seller shall retain a copy of the certificate for the seller's files.

(3) The definitions in this subsection apply to this section.

(a) "Qualified farmer" means a farmer as defined in RCW 82.04.213 who has more than fifty percent of his or her tillable acres in cereal grains and/or field and turf grass grown for seed in qualified counties.

(b) "Qualified counties" means those counties in Washington state where cereal grain production within the county exceeds fifteen thousand acres.

(4) This section expires January 1, 2011.

[2005 c 420 § 2.]

RCW 82.12.841

(1) The tax levied by RCW 82.12.020 does not apply in respect to:

(a) The use of the following machinery and equipment by qualified farmers: No-till drills, minimum-till drills, chisels, plows, sprayers, discs, cultivators, harrows, mowers, swathers, power rakes, balers, bale handlers, shredders, transplanters, tractors two hundred fifty horsepower and over designed to pull conservation equipment on steep hills and highly erodible lands, and combine components limited to straw choppers, chaff spreaders, and stripper headers; and

(b) The use of tangible personal property that will be incorporated as an ingredient or component of hay sheds by a qualified farmer, during the course of constructing such hay sheds.

(2) The eligibility requirements, conditions, and definitions in RCW 82.08.841 apply to this section.

(3) This section expires January 1, 2011.

[2005 c 420 § 3.]

Patient Lifting Devices Credit for B&O Tax

RCW 82.04.4485

(1) In computing the tax imposed under this chapter, a hospital may take a credit for the cost of purchasing mechanical lifting devices and other equipment that are primarily used to minimize patient handling by health care providers, consistent with a safe patient handling program developed and implemented by the hospital in compliance with RCW 70.41.390. The credit is equal to one hundred percent of the cost of the mechanical lifting devices or other equipment.

(2) No application is necessary for the credit, however, a hospital taking a credit under this section must maintain records, as required by the department, necessary to verify eligibility for the credit under this section. The hospital is subject to all of the requirements of chapter 82.32 RCW. A credit earned during one calendar year may be carried over to be credited against taxes incurred in a subsequent calendar year. No refunds shall be granted for credits under this section.

(3) The maximum credit that may be earned under this section for each hospital is limited to one thousand dollars for each acute care available inpatient bed.

(4) Credits are available on a first in-time basis. The department shall disallow any credits, or portion thereof, that would cause the total amount of credits claimed statewide under this section to exceed ten million dollars. If the ten million dollar limitation is reached, the department shall notify hospitals that the annual statewide limit has been met. In addition, the department shall provide written notice to any hospital that has claimed tax credits after the ten million dollar limitation in this subsection has been met. The notice shall indicate the amount of tax due and shall provide that the tax be paid within thirty days from the date of such notice. The department shall not assess penalties and interest as provided in chapter 82.32 RCW on the amount due in the initial notice if the amount due is paid by the due date specified in the notice, or any extension thereof.

(5) Credit may not be claimed under this section for the acquisition of mechanical lifting devices and other equipment if the acquisition occurred before June 7, 2006.

(6) Credit may not be claimed under this section for any acquisition of mechanical lifting devices and other equipment that occurs after December 30, 2010.

(7) The department shall issue an annual report on the amount of credits claimed by hospitals under this section, with the first report due on July 1, 2008.

(8) For the purposes of this section, "hospital" has the meaning provided in RCW 70.41.020.

[2006 c 165 § 5.]

RCW 70.41.390

(1) The definitions in this subsection apply throughout this section unless the context clearly requires otherwise.

(a) "Lift team" means hospital employees specially trained to conduct patient lifts, transfers, and repositioning using lifting equipment when appropriate.

(b) "Safe patient handling" means the use of engineering controls, lifting and transfer aids, or assistive devices, by lift teams or other staff, instead of manual lifting to perform the acts of lifting, transferring, and repositioning health care patients and residents.

(c) "Musculoskeletal disorders" means conditions that involve the nerves, tendons, muscles, and supporting structures of the body.

(2) By February 1, 2007, each hospital must establish a safe patient handling committee either by creating a new committee or assigning the functions of a safe patient handling committee to an existing committee. The purpose of the committee is to design and recommend the process for implementing a safe patient handling program. At least half of the members of the safe patient handling committee shall be frontline nonmanagerial employees who provide direct care to patients unless doing so will adversely affect patient care.

(3) By December 1, 2007, each hospital must establish a safe patient handling program. As part of this program, a hospital must:

(a) Implement a safe patient handling policy for all shifts and units of the hospital. Implementation of the safe patient handling policy may be phased-in with the acquisition of equipment under subsection (4) of this section;

(b) Conduct a patient handling hazard assessment. This assessment should consider such variables as patient-handling tasks, types of nursing units, patient populations, and the physical environment of patient care areas;

(c) Develop a process to identify the appropriate use of the safe patient handling policy based on the patient's physical and medical condition and the availability of lifting equipment or lift teams. The policy shall include a means to address circumstances under which it would be medically contraindicated to use lifting or transfer aids or assistive devices for particular patients;

(d) Conduct an annual performance evaluation of the program to determine its effectiveness, with the results of the evaluation reported to the safe patient handling committee. The evaluation shall determine the extent to which implementation of the program has resulted in a reduction in musculoskeletal disorder claims and days of lost work attributable to musculoskeletal disorder caused by patient handling, and include recommendations to increase the program's effectiveness; and

(e) When developing architectural plans for constructing or remodeling a hospital or a unit of a hospital in which patient handling and movement occurs, consider the feasibility of incorporating patient handling equipment or the physical space and construction design needed to incorporate that equipment at a later date.

(4) By January 30, 2010, each hospital must complete, at a minimum, acquisition of their choice of: (a) One readily available lift per acute care unit on the same floor unless the safe patient handling committee determines a lift is unnecessary in the unit; (b) one lift for every ten

acute care available inpatient beds; or (c) equipment for use by lift teams. Hospitals must train staff on policies, equipment, and devices at least annually.

(5) Nothing in this section precludes lift team members from performing other duties as assigned during their shift.

(6) A hospital shall develop procedures for hospital employees to refuse to perform or be involved in patient handling or movement that the hospital employee believes in good faith will expose a patient or a hospital employee to an unacceptable risk of injury. A hospital employee who in good faith follows the procedure developed by the hospital in accordance with this subsection shall not be the subject of disciplinary action by the hospital for the refusal to perform or be involved in the patient handling or movement.

[2006 c 165 § 2.]