2009 Expedited Tax Preference Performance Reviews

Report 09-12

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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