

**2008 FULL  
TAX PREFERENCE  
PERFORMANCE  
REVIEWS**

**REPORT 09-3**

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STATE OF WASHINGTON

JOINT LEGISLATIVE AUDIT AND REVIEW  
COMMITTEE

**STUDY TEAM**

Lizbeth Martin-Mahar  
Gary Benson

**PROJECT SUPERVISOR**

Keenan Konopaski

**LEGISLATIVE AUDITOR**

Ruta Fanning

Copies of Final Reports and Digests are  
available on the JLARC website at:

**[www.jlarc.leg.wa.gov](http://www.jlarc.leg.wa.gov)**

or contact

Joint Legislative Audit & Review  
Committee  
1300 Quince St SE  
Olympia, WA 98504  
(360) 786-5171  
(360) 786-5180 FAX

# Report Summary

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## 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 550 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.

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

In September 2007, the Commission adopted its second ten-year schedule for the tax preference reviews. The schedule for 2008 includes a total of 37 statutes containing tax preferences: eight property tax, five public utility tax, five retail sales tax, four use tax, eleven business and occupation tax, three fuel tax, and one leasehold excise tax. Of these 37 statutes, the law required 17 tax preferences to have a full review process.

### ***JLARC Staff Conduct the Tax Preference Reviews***

JLARC's assignment from EHB 1069 is to conduct the reviews of tax preferences according to the schedule developed by the Commission and consistent with the guidelines set forth in statute. This report presents JLARC's reviews of the 17 tax preferences scheduled by the Commission for full review.

### **JLARC's Approach to the Tax Preference Reviews**

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

- **Public Policy Objectives:**

1. What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference? (RCW 43.136.055(b))
2. What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives? (RCW 43.136.055(c))
3. To what extent will continuation of the tax preference contribute to these public policy objectives? (RCW 43.136.055(d))
4. If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment of the tax benefits? (RCW 43.136.055(g))

- **Beneficiaries:**

5. Who are the entities whose state tax liabilities are directly affected by the tax preference? (RCW 43.136.055(a))
6. To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended? (RCW 43.136.055(e))

- **Revenue and Economic Impacts:**

7. What are the past and future tax revenue and economic impacts of the tax preference to the taxpayer and to the government if it is continued? (This includes an analysis of the general effects of the tax preference on the overall state economy, including the effects on consumption and expenditures of persons and businesses within the state.) (RCW 43.136.055(h))

8. If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy? (RCW 43.136.055(f))
9. If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes? (RCW 43.136.055(i))

**Other States:**

10. Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington? (RCW 43.136.055(j))

**Methodology**

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

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

Staff interviewed the agencies that administer the tax preferences (primarily the Department of Revenue and the Department of Licensing), as well as several county assessors. 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 on page 5 provides a summary of the results from JLARC's analysis of the tax preferences scheduled for full review in 2008. Of the 17 tax preferences included in this volume, this report recommends that the Legislature continue eleven tax preferences as they are, and continue two other tax preferences by extending their expiration dates with additional accountability requirements. The full report raises issues for the Legislature's consideration for four of the current tax preferences.

The table on page 6 provides a summary of JLARC's recommendations for the full reviews completed last year in 2007. Given the fact that these tax preference reviews are part of an ongoing examination of all state tax preferences in Washington, the 2007 recommendations for the full reviews are included in this 2008 full report.

## **Organization of This Report**

This report includes 14 separate chapters for review of the 17 tax preferences. Each chapter consists of a review of one tax preference except for the chapter on electric generating equipment from renewable energy resources which reviews both the retail sales and use tax preferences together. Each chapter begins with a summary of the findings and recommendations from JLARC's analysis of the tax preferences. Then, each chapter provides additional detail, including additional information supporting the answers to the questions outlined in the law. Appendices provide the Scope and Objectives, agency and Tax Commission comments, and the text of current law for each preference.

**Summary of Recommendations—2008 Full Tax Preference Reviews**

<b>Tax Preference</b>	<b>Year Enacted</b>	<b>RCW Citation</b>	<b># of Claimants in 2007 (\$ amount)</b>	<b>Summary of Recommendation</b>
Private K-12 schools (p. 7)	1925	RCW 84.36.050(1)	248 (\$16 million)	Legislature should continue the tax preference
Private colleges (p. 21)	1925	RCW 84.36.050(1)	69 (\$32 million)	
Intangibles (p. 35)	1931	RCW 84.36.070	Unknown* (\$9.9 billion)	
Commercial vessels (p. 61)	1931	RCW 84.36.080(1); RCW 84.40.036	2,500 (\$900,000)	
Other ships and vessels (p. 75)	1931	RCW 84.36.090	236,036 (\$32.8 million)	
Exported and imported fuel (p. 87)	1933	RCW 82.36.230; RCW 82.38.030	162 (\$1.2 billion)	
Real estate sales (p. 99)	1935	RCW 82.04.390	Unknown* (\$363 million)	
Credit losses (p. 121)	1935	RCW 82.04.4284	4,171 (\$5 million)	
Insurance premiums (p. 153)	1935	RCW 82.04.320	1,729 (\$360 million)	
Public utilities (p. 167)	1935	RCW 82.04.310	7,037 (\$40 million)	
Electric generating equipment; renewable resources (p. 215)	1996	RCW 82.08.02567; RCW 82.12.02567;	Unknown* (\$25 million)	Legislature should continue the tax preference, extend the expiration date, and add accountability requirement
Agricultural producers (p. 133)	1935	RCW 82.04.330; RCW 82.04.410	35,000 (\$28.8 million)	Legislature should re-examine or clarify the intent of the tax preference*
Tax rate for urban trans. & vessels (p. 183)	1935	RCW 82.16.020 (1d&e)	2,015 (\$6.2 million)	
Items used in interstate commerce (p. 201)	1949	RCW 82.08.0261	184 (\$110 million)	

\*No specific data maintained and no annual reporting requirement for preference.

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

**Summary of Recommendations – 2007 Tax Preference Reviews**

<b>Tax Preference</b>	<b>Year Enacted</b>	<b>RCW Citation</b>	<b># of Claimants in 2006 (\$ amount)</b>	<b>Summary of Recommendation</b>
Churches, parsonages and convents (p. 31)	1854	RCW 84.36.020	5,137 (\$66 million)	Legislature should continue the tax preference
Cemeteries (p. 57)	1854	RCW 84.36.020	196 (\$7.4 million)	
Household goods (p. 69)	1935	RCW 84.36.110(1)	2.4 million (\$341 million)	
Refund of fuel tax for exported fuel (p. 81)	1923	RCW 82.36.300 RCW 82.38.180(2)	89 (\$1.3 million)	
Nonprofit hospitals (p. 7)	1886	RCW 84.36.040(1)(e)	45 (\$47 million)	Legislature should re-examine or clarify the intent of the tax preference*
Nonsectarian organizations (p. 43)	1915	RCW 84.36.030(1)	651 (\$17 million)	

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