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

2010 Full Tax Preference Performance Reviews

Report 11-4

January 5, 2011

Upon request, this document is available in alternative formats for persons with disabilities.

Joint Legislative Audit and Review Committee
1300 Quince St SE
PO Box 40910
Olympia, WA 98504
(360) 786-5171
(360) 786-5180 Fax
www.jlarc.leg.wa.gov

Committee Members

Senators

Janéa Holmquist Newbry
Jeanne Kohl-Welles
Eric Oemig, *Assistant Secretary*
Linda Evans Parlette, *Vice Chair*
Cheryl Pflug
Craig Pridemore
Joseph Zarelli
Vacancy

Representatives

Gary Alexander, *Secretary*
Glenn Anderson
Kathy Haigh
Troy Kelley, *Chair*
Dan Kristiansen
Dan Roach
Deb Wallace
Vacancy

Legislative Auditor

Keenan Konopaski

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.

TABLE OF CONTENTS

Report Summary 1

Instate Portion of Interstate Transportation 11

Nonresidents' Personal Property 25

Vehicles Sold to Nonresidents 35

Through Freight in Interstate Transportation 45

Shipments to Ports For Interstate or Foreign Transportation 57

Interstate Transportation Equipment 69

Fertilizer, Spray Materials, and Chemical Sprays and Washes 83

Labor and Services Used in Construction and Repair of Public Roads 97

Sales of Breeding Livestock, Cattle, and Milk Cows 111

Title Insurance Premiums 119

Appendix 1 – Scope and Objectives A1-1

Appendix 2 – Agency Responses A2-1

Appendix 3 – Current Law A3-1

Committee Approval

Subsequent to the January 5, 2011 meeting, this report was approved for distribution by the Joint Legislative Audit and Review Committee.

2010 Full Tax Preference Performance Reviews

Report 11-4

January 5, 2011

STATE OF WASHINGTON
JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE

STUDY TEAM
Mary Welsh
Dana Lynn
Stacia Hollar
Peter Heineccius

PROJECT SUPERVISOR
Keenan Konopaski

LEGISLATIVE AUDITOR
Keenan Konopaski

Copies of Final Reports and Digests are available on the JLARC website at:
www.jlarc.leg.wa.gov
or contact
Joint Legislative Audit & Review Committee
1300 Quince St SE
Olympia, WA 98504-0910
(360) 786-5171
(360) 786-5180 FAX

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 nearly 590 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 October 2009, the Commission adopted its fourth ten-year schedule for the tax preference reviews. The schedule for 2010 includes a total of 58 tax preferences under the business and occupation tax, public utility tax, sales tax, use tax, property tax, motor vehicle fuel tax, special fuel tax, litter tax, real estate excise tax, leasehold excise tax, and the insurance premiums tax. Of these 58 tax preferences, the law required 10 tax preferences to have a full review process, which are included in this report.

JLARC Staff Conduct the Tax Preference Reviews

JLARC's assignment from EHB 1069 is to conduct the reviews of tax preferences according to the schedule developed by the Commission and consistent with the guidelines set forth in statute. This report presents JLARC's reviews of the 10 tax preferences scheduled by the Commission for full review. Ten expedited tax preference reviews are included in a separate report. A third report contains information on the remaining 38 preferences with a biennial fiscal impact of less than $2 million.

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, the Department of Transportation, the Department of Agriculture, 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 full review in 2010. JLARC provides analysis of tax preferences scheduled for expedited review and expedited light review in 2010 in additional volumes. Of the ten tax preferences included in this volume, this report recommends that the Legislature continue seven tax preferences as they are. The full report raises issues for the Legislature's consideration for one tax preference, and recommends that the Legislature terminate two tax preferences.

Organization of This Report

This report includes ten separate chapters. Each chapter consists of a review of one or more related tax preferences. 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.

2010 Full Reviews

Year Enacted	# of Claimants ($ amount)	JLARC Recommendation	Comments by Citizen Commission for Performance Measurement of Tax Preferences	Related Legislation as of 2010
JLARC recommendation: Legislature should continue the tax preference				
Nonresidents' Personal Property / RCW 82.12.0251				
1935	Unknown $4.2 billion	Continue	Endorses without comment	Unknown until after 2011 session
Vehicles Sold to Nonresidents / RCW 82.08.0264				
1935	Unknown $26.7 million	Continue	Endorses without comment	Unknown until after 2011 session
Interstate Transportation Equipment / RCW 82.08.0262; RCW 82.08.0263; RCW 82.12.0254				
1935	Unknown $2.5 billion	Continue	Endorses with comment: The Commission recommends that the Legislature consider whether to increase the qualifying threshold for motor vehicles by reviewing whether "in substantial part" should be replaced by the language "primarily used." Rationale: The Legislature considered such a change in 2010. Adoption of "primarily used" language would provide the same 50 percent interstate use threshold for both motor vehicles and other transportation equipment.	Unknown until after 2011 session
Fertilizer, Spray Materials, and Chemical Sprays and Washes / RCW 82.04.050(11)				
1943	17,500 $65.7 million	Continue	Endorses without comment	Unknown until after 2011 session
Labor and Services Used in Construction and Repair of Public Roads/ RCW 82.04.050(10); RCW 82.04.190(3)				
1943	Unknown $60.8 million	Continue	Endorses with comment: The Commission endorses the recommendations and notes that the circumstances have changed regarding the exclusion of state-owned roads from this tax preference and that the exclusion may no longer serve its original purpose. The Commission recommends that the Legislature consider revising the relevant statute to extend the tax preference to apply to labor and services for construction and repair of state-owned roads.	Unknown until after 2011 session

2010 Full Reviews

Year Enacted	# of Claimants ($ amount)	JLARC Recommendation	Comments by Citizen Commission for Performance Measurement of Tax Preferences	Related Legislation as of 2010
Sales of Breeding Livestock, Cattle, and Milk Cows / RCW 82.08.0259; RCW 82.12.0261				
1945	4,300 $9.3 million	Continue	Endorses without comment	Unknown until after 2011 session
Title Insurance Premiums / RCW48.14.020(1); RCW48.14.020(4)				
1947	Unknown $3.5 million	Continue	Endorses without comment	Unknown until after 2011 session
JLARC recommendation: Legislature should re-examine or clarify the intent of the tax preference				
Shipments to Ports For Interstate or Foreign Transportation / RCW 82.16.050(9)				
1937	Unknown $7.6 million	Since this tax preference providing a public utility tax deduction for shipments to ports is no longer required by the Constitution, the original public policy objective is no longer applicable. Statutory changes in 1949 and 1967, however, imply that the Legislature may have had additional policy objectives. Because the Legislature did not identify its objectives at those times, the Legislature should reexamine and clarify this preference to identify what, if any, public policy objectives still exist.	Endorses with comment: The Commission endorses the recommendation but suggests the Legislature conduct its reexamination of the intent of this preference in conjunction with the economic impact study that the Commission recommends for the 'Through Freight in Interstate Transportation Public Utility Tax Deduction' and 'Instate Portion of Interstate Transportation' tax preferences. The Legislature should specify that the study should be completed by December 31, 2011, to inform a decision during the 2012 Legislative Session. After the 2012 session, if the Legislature has taken no action, the Commission intends to determine whether it should schedule this preference for another review.	Unknown until after 2011 session

2010 Full Reviews

Year Enacted	# of Claimants ($ amount)	JLARC Recommendation	Comments by Citizen Commission for Performance Measurement of Tax Preferences	Related Legislation as of 2010
JLARC recommendation: Legislature should impose the public utility tax				
Instate Portion of Interstate Transportation / RCW 82.16.050(6)				
1935	Unknown $24.6 million	Because the U.S. Constitution no longer prohibits the instate portion of interstate transportation from being taxed, the public utility tax should be imposed on these activities. In order to implement this, the Legislature should provide specific authorization to the Department of Revenue to develop a method of apportioning transportation income generated from activities within the state.	Does not endorse and comments as follows: The Commission does not endorse the recommendation because it believes it is premature to authorize the Department of Revenue to develop an apportionment methodology. Although the existing preference is no longer constitutionally necessary, affected taxpayers have structured competitive activities in reliance on continuation of the preference. Because termination of the preference may have unintended deleterious consequences for taxpayers and more generally for the state, the Commission recommends that the Legislature direct either the Office of Financial Management, the Department of Revenue, or the Economic and Revenue Forecast Council conduct an economic impact study of the effects of termination on the competitiveness of affected taxpayers and the primary and secondary tax revenue impacts of termination. The Commission also recommends that the Legislature consider whether the economic impact study should identify policy options such as defining the tax base, and the revenue impacts of such options, for restructuring the public utility tax for affected taxpayers. The study should also include recommendations for how to structure an apportionment methodology that complies with the guidelines established by the U.S. Supreme Court. The Legislature should specify that the study should be completed by December 31, 2011, to inform a decision during the 2012 Legislative Session. After the 2012 session, if the Legislature has taken no action, the Commission intends to determine whether it should schedule this preference for another review.	Unknown until after 2011 session

2010 Full Reviews				
Year Enacted	**# of Claimants ($ amount)**	**JLARC Recommendation**	**Comments by Citizen Commission for Performance Measurement of Tax Preferences**	**Related Legislation as of 2010**
Instate Portion of Interstate Transportation / RCW 82.16.050(6) (continued from previous page)				
			Rationale for non-endorsement and recommendation for economic impact study. Public testimony identified the potential for significant unintended adverse economic consequences for taxpayers and possibly for the state if the preference is terminated. Although very limited factual evidence was presented, there is a possibility that termination could result in loss of employment and other sources of state tax revenue that could exceed the amount of revenue raised by the public utility tax as a result of termination. While this possibility is uncertain, public testimony indicated a high likelihood that termination could lead to potentially serious disruptive consequences. Because of the uncertainty and absence of substantial factual information about potential impacts, the Commission believes that it would be prudent to conduct an economic impact study. The Commission believes the current tax preference is outdated, but rather than terminating the preference, consideration should be given to structuring the public utility tax for the affected taxpayers in ways that are tax efficient and enable tax payers to be competitive on an interstate basis. If the Legislature prefers to have an economic impact study conducted by a neutral party, it should direct the Economic and Revenue Forecast Council to conduct the study; otherwise the study could be conducted by the Office of Financial Management or the Department of Revenue.	

2010 Full Reviews

Year Enacted	# of Claimants ($ amount)	JLARC Recommendation	Comments by Citizen Commission for Performance Measurement of Tax Preferences	Related Legislation as of 2010
JLARC recommendation: Legislature should terminate the tax preference				
Through Freight in Interstate Transportation / RCW 82.16.050(8)				
1937	Unknown Indeterminate	Because this preference is no longer constitutionally necessary, the Legislature should terminate the preference providing a public utility tax deduction tax for intrastate portions of interstate shipments of goods under a through freight rate where the shipment is stopped in Washington to store, manufacture, or process the goods, then continues to the final destination.	Does not endorse and comments as follows: The Commission does not endorse the recommendation. Although the existing preference is no longer constitutionally necessary, affected taxpayers have structured competitive activities in reliance on continuation of the preference. Because termination of the preference may have unintended deleterious consequences for taxpayers and more generally for the State, the Commission recommends that the Legislature direct either the Office of Financial Management, the Department of Revenue, or the Economic and Revenue Forecast Council to conduct an economic impact study of the effects of termination on the competitiveness of affected taxpayers and the primary and secondary tax revenue impacts of termination. The Commission also recommends that the Legislature consider whether the economic impact study should identify policy options such as defining the tax base, and the revenue impacts of such options, for restructuring the public utility tax for affected taxpayers. The Legislature should specify that the study should be completed by December 31, 2011, to inform a decision during the 2012 Legislative Session. After the 2012 session, if the Legislature has taken no action, the Commission intends to determine whether it should schedule this preference for another review.	Unknown until after 2011 session

2010 Full Reviews				
Year Enacted	**# of Claimants ($ amount)**	**JLARC Recommendation**	**Comments by Citizen Commission for Performance Measurement of Tax Preferences**	**Related Legislation as of 2010**
Through Freight in Interstate Transportation / RCW 82.16.050(8) (continued from previous page)				
			Rationale for non-endorsement and recommendation for economic impact study. Public testimony identified the potential for significant unintended adverse economic consequences for taxpayers and possibly for the state if the preference is terminated. Although very limited factual evidence was presented, there is a possibility that termination could result in loss of employment and other sources of state tax revenue that could exceed the amount of revenue raised by the public utility tax as a result of termination. While this possibility is uncertain, public testimony indicated a high likelihood that termination could lead to potentially serious disruptive consequences. Because of the uncertainty and absence of substantial factual information about potential impacts, the Commission believes that it would be prudent to conduct an economic impact study. The Commission believes the current tax preference is outdated, but rather than terminating the preference, consideration should be given to structuring the public utility tax for the affected taxpayers in ways that are tax efficient and enable tax payers to be competitive on an interstate basis. If the Legislature prefers to have an economic impact study conducted by a neutral party, it should direct the Economic and Revenue Forecast Council to conduct the study; otherwise the study could be conducted by the Office of Financial Management or the Department of Revenue.	

INSTATE PORTION OF INTERSTATE TRANSPORTATION DEDUCTION FROM PUBLIC UTILITY TAX – SUMMARY

Current Law

The public utility tax applies to the gross operating income of public service businesses, including businesses engaging in transportation. The public utility tax is in lieu of the business and occupation (B&O) tax and, similar to the B&O tax, applies to the gross receipts of a business without deduction for losses or costs of doing business.

RCW 82.16.050(6) provides a deduction from the public utility tax for income the state is constitutionally prohibited from taxing. Generally, wholly instate trips (from one point in Washington to another) are fully subject to public utility tax. However, under current practice, interstate carriers are not subject to public utility tax on the instate portion of their transportation activities. The preference applies to the instate portion of interstate transportation of goods and passengers by truck, rail, and some water transportation.

JLARC's 2010 tax preference reports also address two related tax preferences: one providing a public utility tax deduction for income from transportation under a "through freight billing" with an instate stop; and one providing a public utility tax deduction for shipments from an instate location to a Washington waterside location for shipment outside the state.

See page A3-1 in Appendix 3 for the current statute, RCW 82.16.050(6).

Legal History and Public Policy Objectives

1933 The Legislature passed a temporary business activities tax for the period August 1, 1933, through July 31, 1935. The Legislature anticipated that new taxes adopted by July 1935 would replace the temporary tax. The tax applied to the gross sales, gross income, or value of products for a wide range of activities, including transportation and utility companies.

1935 The Legislature passed the Revenue Act of 1935, which replaced the temporary business taxes imposed in 1933. Transportation and utility activities were taxed under the newly created "public utility tax." A deduction from public utility tax was provided for income from any activity the state was constitutionally prohibited from taxing. At the time, the U.S. Supreme Court's interpretation of the Commerce Clause was that a state tax on any portion of interstate transportation activities, even instate portions, was a burden on interstate commerce and unconstitutional.

1977 In *Complete Auto Transit, Inc. v. Brady*,[1] the U.S. Supreme Court clearly stated that a gross income tax on interstate transportation, such as Washington's public utility tax, was constitutional if it was apportioned to the instate portion of the transportation activity. The Court crafted a four-prong test to determine if a state tax on interstate commerce was constitutionally prohibited. All subsequent interstate transportation cases have

[1] *Complete Auto Transit, Inc., v. Brady*, 430 U.S. 274 (1977).

unanimously upheld this doctrine. Thus, instate portions of interstate trips may be subjected to Washington's public utility tax so long as the tax meets the four-prong test.

2010 During the 2010 Legislative Session, the Legislature considered a bill to tax the instate portion of interstate transportation, but the bill did not pass.

The Legislature did not state its intent when the statute was enacted as part of the Revenue Act of 1935. However, the statute recognizes that the state cannot tax amounts derived from activities it is prohibited from taxing by the federal or state Constitution. The general nature of the statute provided flexibility and administrative simplicity for the Tax Commission and later, the Department of Revenue, to adapt its rules to changes in the interpretation of constitutional requirements.

In 1935, the U.S. Supreme Court interpreted the federal Commerce Clause in the U.S. Constitution to bar a direct tax on gross receipts from activities related to interstate transportation. Consistent with constitutional analysis of Commerce Clause prohibitions at the time, the Tax Commission interpreted the statute to prohibit the state from taxing the instate portion of interstate transportation activities under the public utility tax.

Taxing the instate portion of interstate transportation activities is now recognized as constitutional, so long as the tax satisfies the four-prong *Complete Auto* test. Washington's practice of not collecting public utility tax on the instate portion of interstate transportation activities is no longer necessary to comply with Supreme Court doctrine.

Beneficiaries

The beneficiaries of this preference are trucking and motor freight, railroad, and certain waterway transportation businesses that transport goods or people in interstate transportation.

Revenue and Economic Impacts

JLARC estimates the taxpayer savings from not taxing the instate portion of interstate transportation activities at over $24.6 million in Calendar Year 2009.

If the Department of Revenue started assessing and collecting the public utility tax on the instate portion of interstate transportation activities, businesses that engage in interstate transportation activities would have a greater public utility tax burden. They would be subject to public utility tax similar to those businesses providing transportation services wholly instate.

Charges to Washington businesses and consumers that use interstate transportation services could increase since transportation companies may choose to raise their rates or add additional fees to cover their increased costs due to the public utility tax. If competition in the transportation market will not allow an increase in rates or fees, transportation providers would have to absorb the additional costs.

Other States

Unlike Washington, 45 states and the District of Columbia apportion revenue from interstate transportation and tax the instate portion in some manner. Most states apportion interstate transportation by using a ratio of the number of miles traveled instate compared with miles traveled

everywhere. All 44 states and the District of Columbia that impose a corporate net income tax require multistate businesses to apportion the income among the states. Texas is the only other state that excludes the instate portion of interstate commerce from taxation.

Recommendation

Because the U.S. Constitution no longer prohibits the instate portion of interstate transportation from being taxed, the public utility tax should be imposed on these activities. In order to implement this, the Legislature should provide specific authorization to the Department of Revenue to develop a method of apportioning transportation income generated from activities within the state.

Legislation Required: Yes.

Fiscal Impact: Yes. $59.7 million in the 2011-13 Biennium.

INSTATE PORTION OF INTERSTATE TRANSPORTATION DEDUCTION FROM PUBLIC UTILITY TAX – REPORT DETAIL

Current Law

The public utility tax applies to the gross operating income of public service businesses, including businesses engaging in transportation. The public utility tax is in lieu of the business and occupation (B&O) tax and, similar to the B&O tax, applies to the gross receipts of a business without deduction for losses or costs of doing business. There are currently eight public utility tax classifications and six statutorily prescribed rates under the public utility tax. The classifications impacted by this preference include:

- Motor transportation and railroad activities - 1.926 percent
- Urban transportation and watercraft under 65 feet - 0.642 percent
- Log hauling over public roads - 1.3696 percent (temporary rate effective 7-01-2009; reverts to 1.926 percent rate 7-01-2013)

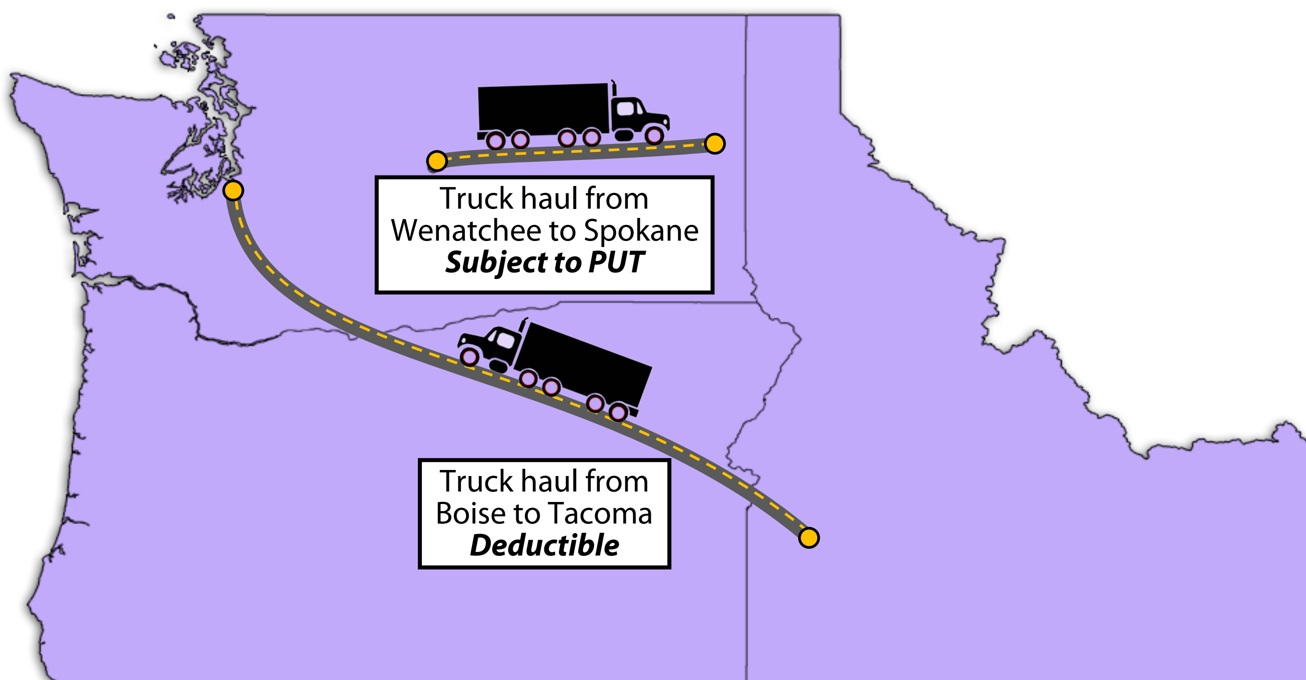
RCW 82.16.050(6) provides a deduction from the public utility tax for income the state is constitutionally prohibited from taxing. Generally, wholly intrastate trips (from one point in Washington to another) are fully subject to public utility tax. However, under current practice, interstate carriers are not subject to public utility tax on the instate portion of their transportation activities. The preference applies to the instate portion of interstate transportation of goods and passengers by truck, rail, and some water transportation.

JLARC's 2010 tax preference reports also address two related tax preferences: one providing a public utility tax deduction for income from transportation under a "through freight billing" with an instate stop; and one providing a public utility tax deduction for shipments from an instate location to a Washington waterside location for shipment outside the state.

See page A3-1 in Appendix 3 for the current statute, RCW 82.16.050(6).

Exhibit 1 illustrates which types of transportation trips are not taxed under the current interpretation of the law, compared to trips subject to public utility tax.

Exhibit 1 – Sample Truck Hauls – Taxability Under the Public Utility Tax



Source: JLARC analysis of RCW 82.16.050(6).

Legal History

1933 The Legislature passed a temporary business activities tax for the period August 1, 1933, through July 31, 1935. The Legislature anticipated that new taxes adopted by July 1935 would replace the temporary tax. The tax applied to the gross sales, gross income, or value of products for a wide range of activities, including transportation and utility companies.

1935 The Legislature passed the Revenue Act of 1935, which replaced the temporary businesses taxes imposed in 1935. Transportation and utility activities were taxed under the newly created "public utility tax." A deduction from public utility tax was provided for income from any activity the state was constitutionally prohibited from taxing. At the time, the U.S. Supreme Court's interpretation of the Commerce Clause was that a state tax on any portion of interstate transportation activities, even instate portions, was a burden on interstate commerce and unconstitutional.

1977 In *Complete Auto Transit, Inc. v. Brady,*[2] the U.S. Supreme Court clearly stated that a gross income tax on interstate transportation, such as Washington's public utility tax, was constitutional if it was apportioned to the instate portion of the transportation activity. The Court crafted a four-prong test to determine if a state tax on interstate commerce was constitutionally prohibited. All subsequent interstate transportation cases have

[2] *Complete Auto Transit, Inc., v. Brady*, 430 U.S. 274 (1977).

unanimously upheld this doctrine. Thus, instate portions of interstate trips may be subjected to Washington's public utility tax so long as the tax meets the four-prong test.

2010 During the 2010 Legislative Session, the Legislature considered a bill to tax the instate portion of interstate transportation, but the bill did not pass.

Other Relevant Background

The Commerce Clause and Import-Export Clause of the U.S. Constitution limit the taxes that states may levy on interstate and foreign commerce. The constitutionality of state taxes on interstate commerce has been debated and decided through a long history of U.S. Supreme Court decisions.

At the time Washington first enacted the public utility tax (1935), the Court strictly prohibited any state tax that potentially burdened interstate commerce. The Court's constitutional analysis and decisions evolved through the years. In 1977, the Court unanimously rejected decades of varying decisions, providing a four-prong test that remains the framework for analyzing state taxation on interstate commerce. Under the court's test, a state tax on interstate commerce was constitutional if it was:

1) applied to an activity with a substantial nexus with the taxing state;
2) fairly apportioned;
3) nondiscriminatory against interstate commerce; and
4) fairly related to the services provided by the state.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference?

The Legislature did not state its intent when the statute was enacted as part of the Revenue Act of 1935. However, the statute upon which the preference is based recognizes that the state cannot tax amounts derived from activities it is prohibited from taxing by the federal or state Constitution. The general nature of the statute provided flexibility and administrative simplicity for the Tax Commission and later, the Department of Revenue, to adapt its rules to volatile constitutional requirements.

When the statute was enacted in 1935, the U.S. Supreme Court interpreted the Commerce Clause to bar a direct tax on gross receipts from activities related to interstate transportation. Thus, the Tax Commission interpreted the statute as prohibiting the state from taxing the instate portion of interstate transportation activities under the public utility tax. This was consistent with the constitutional analysis of Commerce Clause prohibitions at the time.

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

Evidence indicates the interpretation adopted by the Tax Commission in 1935 is outdated and no longer compatible with current Commerce Clause interstate taxation doctrine. The 1930s-era interpretation that this preference prohibits the state from taxing instate activities related to interstate commerce was repudiated by the U.S. Supreme Court's 1977 *Complete Auto* decision. Since 1977, the Supreme Court has consistently upheld state taxation of activities in interstate commerce so long as the tax is: 1) applied to an activity with a substantial nexus in the state, 2) fairly apportioned, 3) not discriminatory to interstate commerce, and 4) fairly related to the services provided in the state.

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

Taxing the instate portion of interstate transportation activities is now recognized as constitutional, so long as the tax satisfies the four-prong *Complete Auto* test. Washington's practice of not collecting public utility tax on the instate portion of interstate transportation activities is no longer necessary to comply with Supreme Court doctrine allowing states to tax instate activities associated with interstate transportation activities.

Maintaining consistency across multiple preferences may be important because the 1977 *Complete Auto* case requires that a state tax cannot be discriminatory against interstate commerce. Any changes to one interstate commerce-related preference might affect the constitutionality of other preferences. (See JLARC's review of public utility tax exemptions for through freight and shipments to ports, included in separate chapters in this report.) If the tax preference covered in this review was terminated, but others were continued, an issue of discrimination could be raised. For example, if the instate portion of a shipment from out of state to a Washington port were taxed, but a shipment from instate to a Washington port were not, the constitutionality of the tax treatment may be questioned.

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

Under RCW 82.01.060(1), the Department of Revenue is required to assess, collect, and administer all taxes under its jurisdiction. It is clear the statute upon which this preference is based no longer prohibits Washington from taxing the instate portion of interstate transportation activities under the public utility tax. However, the Department of Revenue may need authority to develop an appropriate apportionment formula to ensure the *Complete Auto* test is satisfied.

Per the *Complete Auto* test, the Department of Revenue cannot constitutionally impose public utility tax on non-apportioned income derived from interstate transportation activities. This income would first need to be "fairly apportioned" to ensure that Washington "taxes only its fair share of an interstate transaction."[3] Currently, businesses are not required to apportion income from interstate

[3] *Goldberg v. Sweet*, 488 U.S. 252, 261 (1989).

transportation activities for Washington taxation purposes. Before the Department could collect this tax, therefore, a fair apportionment method would need to be created.

It is unclear whether the Department of Revenue has the authority to create this apportionment method without legislative direction. The language, interpretation, and application of the statute have remained unchanged since its enactment in the 1930s. Other court cases have questioned the appropriateness of changing long standing agency interpretation or application of taxation authority without a statutory amendment.[4]

Additionally, in other cases where an apportionment was necessary to tax interstate activities, the Legislature has provided specific authorization to the Department or has provided an apportionment methodology in the statute. For example, the Department is authorized to provide apportionment rules consistent with other states' uniform apportionment rules for income derived from financial institutions[5] and to provide by rule methods for apportioning gross income from telephone service sales.[6]

Beneficiaries

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

The beneficiaries of this preference are trucking and motor freight, railroad, and certain waterway transportation businesses that transport goods or people in interstate transportation. Federal law specifically preempts states from taxing air transportation of passengers or goods, U.S. mail delivery, interstate bus transportation of passengers, and Amtrak rail services.[7]

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

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

Revenue and Economic Impacts

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

JLARC estimates the taxpayer savings from not taxing the instate portion of interstate transportation activities at over $24.6 million in Calendar Year 2009. Although this preference is technically a deduction from the gross income subject to public utility tax, in practice, many businesses operating predominately in interstate commerce do not report this income. The Department of Revenue allows this practice, as it is less burdensome for businesses and eases tax administration.

---

[4] *Dot Foods, Inc. v. Dept. of Revenue*, 166 Wn.2d 912, 921 (2009).

[5] RCW 82.04.460(2) (1975).

[6] RCW 82.04.460(3) (1983).

[7] 49 U.S.C. § 40116(b), 49 U.S.C. § 14505, 49 U.S.C § 24301(l).

JLARC estimated taxpayer savings using data on instate miles travelled by Washington-based motor carriers and out-of-state-based motor carriers that constitute approximately 86 percent of the motor carrier traffic in Washington. JLARC also estimated the gross income attributable to rail mileage travelled in Washington as part of interstate rail traffic. (See Exhibit 2.) The estimate does not include amounts for certain instate water transportation, as they are assumed to be minimal.

Exhibit 2 – Estimated Taxpayer Savings – Washington Instate Portion of Interstate Transportation ($ in Millions)

Calendar Year	2008	2009	2010	2011	2012	2013
State Public Utility Tax	$26.7	$24.6	$24.1	$26.7	$29.1	30.6

Sources: JLARC estimate based on: 2008 WSDOL data and IRP Clearinghouse data for mileage in Washington; 2007 Association of American Railroads data; and Economic & Revenue Forecast Council growth factors.

If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy?

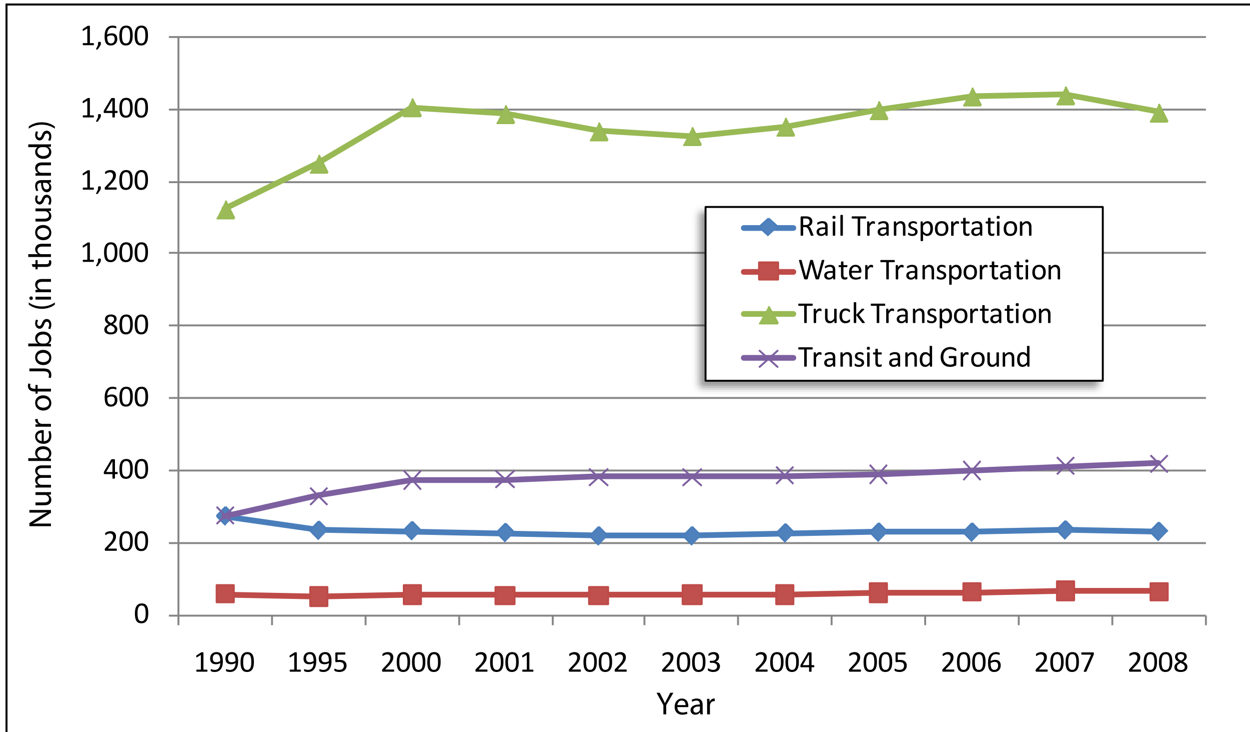
If the Department of Revenue started assessing and collecting public utility tax on the instate portion of interstate transportation activities, businesses that engage in interstate transportation activities and travel into and out of Washington would have a greater public utility tax burden. They would be subject to public utility tax in the same manner as those businesses providing transportation services wholly instate. Many transportation businesses that operate strictly in interstate transportation would need to register to do business with the Department of Revenue. Others that may currently be registered would need to begin or resume excise tax reporting.

The transportation sector is a highly competitive one. Both freight railroads and motor transportation are largely deregulated at the federal level. Rates are established primarily through competition between companies within the motor freight or rail industries and among competing transportation modes. The current federal regulation formula for freight railroads in the U.S. was established by the Railroad Revitalization and Regulatory Reform Act (4R Act) in 1976 and the Staggers Act, enacted in 1980. Federal motor carrier deregulation began with the Motor Carrier Act of 1980. In 1995, Congress preempted states from regulating entry and rates for intrastate common carriers with some exceptions for safety, insurance, and household goods. Thus, the rates charged by transportation providers are largely dictated by competition between carriers.

Charges to Washington businesses and consumers that use interstate transportation services could increase since transportation companies may choose to raise their rates to cover their increased costs due to the public utility tax.

National figures reflect that motor (truck) transportation is the single largest employer in the transportation industry. (See Exhibit 3.)

Exhibit 3 – National Employment in Transportation Services



Source: U.S. Census Bureau, 2010 Statistical Abstract, Table 1031, Employment in Transportation and Warehousing.

Total employment in the freight and specialized trucking sectors and railroads accounted for less than one percent of Washington's employment figures in 2008. The average wage earned in the trucking industry, including log trucking and charter buses, was $43,167. (See Exhibit 4.) Although 2008 wage information was not available, the 2007 average Washington railroad wage was over $73,000.

Exhibit 4 – Washington Trucking Transportation Industry Employment and Wage Data - 2008

Industry	Employment	Total Wages ($ in Millions)	Average Wages
General Freight Trucking, Local	4,579	$187	$40,794
General Freight Trucking, Long Distance	13,115	$597	$46,760
Specialized Trucking,* Local	4,046	$152	$37,566
Specialized Trucking,* Long Distance	1,728	$78	$44,852
Totals	**23,467**	**$1,013**	**$43,167**

Source: Employment Security QCEW Annual Data, 2008. * Includes log trucking.

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

There would be no change in the distribution of liability for payment of state taxes for the beneficiaries of this tax preference. If the Department of Revenue began imposing public utility tax on the instate portion of interstate transportation activities, the result would be increased public utility tax revenues. Interstate transportation providers that currently travel into and out of Washington would have to pay public utility tax on their income attributable to the Washington portion of the transportation activities in the same manner as wholly instate transportation providers.

Other States

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

Unlike Washington, 45 states and the District of Columbia apportion revenue from interstate transportation and tax the instate portion in some manner. Most states apportion interstate transportation by using a ratio of the number of miles traveled instate compared with miles traveled everywhere. Texas is the only other state that excludes the instate portion of interstate commerce from taxation. Like Washington, Texas restricts taxation to transportation that is conducted entirely instate (i.e., picked up and delivered in the state).

All 44 states and the District of Columbia that impose a corporate net income tax require multistate businesses to apportion the income among the states. Most states use a three-factor apportionment formula based on the business's property, personnel, and sales, although an increasing number of states now rely on the sales factor alone. The sales factor is based on gross revenue, which is analogous to the tax base of Washington's public utility tax.

Special apportionment rules are often required for interstate transportation services, since the location of performance spans multiple states. The Multistate Tax Commission, an organization of state governments that works with taxpayers to administer tax laws that apply to multistate enterprises, issues model apportionment regulations, as well as special rules for various transportation services. These special rules apportion transportation services based on the ratio of miles traveled within the state against the miles traveled everywhere.

Of the 44 states with a corporate net income tax, at least 37 states and the District of Columbia use a variation of the model rules to apportion transportation revenue by miles traveled within the state. The remaining states use a variety of methods to apportion the revenue derived from transportation activities in the state. Regardless of the exact method of apportionment, all of these states tax the instate portion of interstate transportation activities to some extent.

A few other states impose gross receipt taxes. Texas imposes a franchise tax on value-added (gross receipts minus the costs of wages paid and goods sold) and, like Washington, Texas does not tax the instate portion of interstate transportation activities. Unlike Washington, Ohio apportions transportation revenue by the ratio of mileage traveled in the state to the mileage traveled everywhere.

Recommendation

Because the U.S. Constitution no longer prohibits the instate portion of interstate transportation from being taxed, the public utility tax should be imposed on these activities. In order to implement this, the Legislature should provide specific authorization to the Department of Revenue to develop a method of apportioning transportation income generated from activities within the state.

Legislation Required: Yes.

Fiscal Impact: Yes. $59.7 million in the 2011-13 Biennium.

NONRESIDENTS' PERSONAL PROPERTY EXEMPTION FROM USE TAX – SUMMARY

Current Law

Washington's use tax does not apply to certain personal property belonging to nonresidents. Exempt property includes:

1) Personal property used by nonresidents while temporarily in Washington State, unless the property is used in a non-transitory business activity.
2) Motor vehicles or trailers registered or licensed to a nonresident's state of residence, and not required to be registered or licensed under the laws of Washington.
3) Household goods owned by new residents and nonresident members of the armed forces if they acquired the property more than 90 days before entering the state. This includes private motor vehicles but not motor homes.

The exemption also applies to services rendered to the exempt property while out of state and to extended warranties covering exempt property.

The use tax exemption for vehicles (RCW 82.12.0266) owned by recently discharged or released members of the armed services is reviewed separately in JLARC's 2010 Tax Preference Reports.

See page A3-1 in Appendix 3 for the current statute, RCW 82.12.0251.

Legal History and Public Policy Objectives

1935 The Legislature enacted a 2 percent sales tax and a companion use tax on all sales or use of tangible personal property within Washington. The use tax normally applied to the first use of tangible personal property purchased in another state and brought into Washington. However, Washington's use tax exempted tangible personal property brought into the state by nonresidents.

1937 The exemption was limited to nonresidents temporarily in Washington and to non-business uses.

1943 The Legislature expanded the exemption to include use of household goods and private automobiles if a new resident of Washington acquired the property while a resident in another state. The property must have been acquired at least three months before the person became a resident of Washington, and the use must have been "actual and substantial."

1944 The U.S. Congress amended the 1942 Soldiers' and Sailors' Relief Act to exempt military personnel from license fees and motor vehicle excise taxes, if they had paid such levies in their home state.

Congress was concerned about multiple-taxation of military personnel. The act had no effect in this state because Washington's existing tax exemption likely covered vehicles owned by nonresident military personnel.

1949 The Legislature added a specific provision to apply the use tax exemption to vehicles licensed in the state of residence and not required to be registered or licensed in Washington.

1951 The law limited the exemption for nonresident vehicles to those used in Washington for three months or less.

1963 The Legislature reduced the amount of time nonresidents must acquire property before moving to Washington from three months to 30 days, and removed the requirement that the use of the property out of state must be "actual and substantial."

1969 The U.S. Supreme Court ruled that the Soldiers' and Sailors' Relief Act permitted states to impose a use tax on vehicles of military personnel. However, Washington continued to provide the use tax exemption to nonresident service persons.

1983 The Legislature expanded the use tax exemption by:

- Allowing nonresident vehicles and trailers to be used instate for an unlimited amount of time; and
- Specifically exempting private automobiles owned by nonresident members of the armed forces stationed in Washington.

1985 The Legislature restricted the exemption by increasing the time that nonresidents must acquire property prior to entering Washington (30 days to 90 days).

1997 The exemption was restricted to exclude motor homes from the exemption for property brought into the state by new residents or nonresident military personnel.

2003 The exemption was again expanded to include services rendered outside of Washington to nonresident exempt property. Prior to this provision, use tax was due on repair services for nonresident tangible personal property.

2005 The Legislature applied the use tax exemption to extended warranties on nonresident exempt property. Prior to this provision, use tax was due on extended warranties for which sales tax had not been paid in Washington or another state.

2009 Nonresident exempt property was expanded to include digital goods and digital code, consistent with the broad treatment of digital goods.

The public policy objectives are to reduce the tax burden on tourists, new residents, and nonresident members of the armed forces and to reduce the administrative burden on the Department of Revenue.

Beneficiaries

The beneficiaries are tourists, business travelers, new Washington residents, and nonresident members of the armed forces stationed in Washington.

Revenue and Economic Impacts

In 2008, the beneficiaries of the tax preference saved $4.2 billion due to the use tax exemption for nonresident personal property. The savings comprise tax exemptions for state and local use tax and

the additional motor vehicle use tax of 0.3 percent. However, if the exemption was repealed, any revenue collection would likely be a small portion of the tax owed due to a potential for noncompliance and administrative difficulty in collecting the use tax from nonresidents.

Other States

There are 45 states and the District of Columbia that impose a sales tax and a corresponding use tax. At least 24 states (including Washington) and the District of Columbia provide statutory exemptions from the use tax for tangible personal property used by a nonresident. Several states place restrictions on the amount of time a nonresident may use the property in the state. The remaining state statutes are broad enough to likely cover temporary nonresidents. Almost all states, including Washington, do not allow the exemption for property used for a business purpose.

Recommendation

Because the tax preference is fulfilling its public policy objective to reduce the tax burden on tourists, new residents, and nonresident members of the armed forces and to reduce the administrative burden on the Department of Revenue, the Legislature should continue the tax preference.

Legislation Required: No.

Fiscal Impact: None.

NONRESIDENTS' PERSONAL PROPERTY EXEMPTION FROM USE TAX – REPORT DETAIL

Current Law

Washington's use tax does not apply to certain personal property belonging to nonresidents. Exempt property includes:

1) Personal property used by nonresidents while temporarily in Washington State, unless the property is used in a non-transitory business activity.
2) Motor vehicles or trailers registered or licensed to a nonresident's state of residence, and not required to be registered or licensed under the laws of Washington.
3) Household goods owned by new residents and nonresident members of the armed forces if they acquired the property more than 90 days before entering the state. This includes private motor vehicles but not motor homes.

The exemption also applies to services rendered to the exempt property while out of state and to extended warranties covering exempt property.

The use tax exemption for vehicles (RCW 82.12.0266) owned by recently discharged or released members of the armed services is reviewed separately in JLARC's 2010 Tax Preference Reports.

See page A3-1 in Appendix 3 for the current statute, RCW 82.12.0251.

Legal History

1935 The Legislature enacted a 2 percent sales tax and a companion use tax on all sales or use of tangible personal property within Washington. The use tax normally applied to the first use of tangible personal property purchased in another state and brought into Washington. However, Washington's use tax exempted tangible personal property brought into the state by nonresidents.

1937 The exemption was limited to nonresidents temporarily in Washington and to non-business uses.

1943 The Legislature expanded the exemption to include use of household goods and private automobiles if a new resident of Washington acquired the property while a resident in another state. The property must have been acquired at least three months before the person became a resident of Washington, and the use must have been "actual and substantial."

1944 The U.S. Congress amended the 1942 Soldiers' and Sailors' Relief Act to exempt military personnel from license fees and motor vehicle excise taxes, if they had paid such levies in their home state.

Congress was concerned about multiple-taxation of military personnel. The act had no effect in this state because Washington's existing tax exemption likely covered vehicles owned by nonresident military personnel.

1949 The Legislature added a specific provision to apply the use tax exemption to vehicles licensed in the state of residence and not required to be registered or licensed in Washington.

1951 The law limited the exemption for nonresident vehicles to those used in Washington for three months or less.

1963 The Legislature reduced the amount of time nonresidents must acquire property before moving to Washington from three months to 30 days, and removed the requirement that the use of the property out of state must be "actual and substantial."

1969 The U.S. Supreme Court ruled that the Soldiers' and Sailors' Relief Act permitted states to impose a use tax on vehicles of military personnel. However, Washington continued to provide the use tax exemption to nonresident service persons.

1983 The Legislature expanded the use tax exemption by:

- Allowing nonresident vehicles and trailers to be used instate for an unlimited amount of time; and
- Specifically exempting private automobiles owned by nonresident members of the armed forces stationed in Washington.

1985 The Legislature restricted the exemption by increasing the time that nonresidents must acquire property prior to entering Washington (30 days to 90 days).

1997 The exemption was restricted to exclude motor homes from the exemption for property brought into the state by new residents or nonresident military personnel.

2003 The exemption was again expanded to include services rendered outside of Washington to nonresident exempt property. Prior to this provision, use tax was due on repair services for nonresident tangible personal property.

2005 The Legislature applied the use tax exemption to extended warranties on nonresident exempt property. Prior to this provision, use tax was due on extended warranties for which sales tax had not been paid in Washington or another state.

2009 Nonresident exempt property was expanded to include digital goods and digital code, consistent with the broad treatment of digital goods.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference?

The public policy objectives are to reduce the tax burden on tourists, new residents, and nonresident members of the armed forces and to reduce the administrative burden on the Department of Revenue.

The original use tax statute adopted in 1935 exempted the personal property of nonresidents including members of the armed forces. Although the law did not articulate a specific purpose for this preference, there are two possible reasons.

To reduce the tax burden on tourists, new residents, and members of the armed forces stationed in Washington

A use tax on nonresidents would have had a dampening effect on tourism and travel in Washington. A use tax imposed on all personal property owned by new residents would have had a dampening effect on relocation to Washington. Similarly, nonresident members of the armed forces would face multiple-taxation when stationed in Washington if their vehicles had been licensed in another state.

To reduce administrative burden

Collecting use tax from nonresidents temporarily in Washington would present significant administrative burdens. As an example, a family traveling by car to the 2010 Olympic Games in British Columbia would have owed use tax for the value of their vehicle, suitcases, clothing, and other household goods they brought with them. In order to collect the tax, the Department of Revenue would have to stop the vehicle, assesses the value of the goods, and send a tax bill. Nonresidents eligible for the use tax exemption are individuals and not registered businesses; their vehicles would be licensed out of state; and the Department of Revenue would have no address on record.

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

The administrative burden is eased directly due to the tax preference. Although tourism flourishes and Washington's population is growing from in-migration, there is no conclusive evidence that links Washington's tourism and population growth to an exemption from use tax.

To reduce tax and administrative burden

The tax exemption may indirectly avoid discouraging travel to Washington. Tourism remains one of Washington's key industries. A study conducted for the Community, Trade and Economic Development Department (now Commerce Department) showed that 55.5 million visitors came to Washington in 2007 and stayed over 113 million days.

Between 2000 and 2009, the state's population grew by 13 percent, primarily due to new residents. In 2009, Department of Licensing issued 130,000 driver's licenses to new residents that moved to Washington from other states and countries.

Washington is also home to a number of active military installations. Washington ranks 7th in the nation in the number of members of the U.S. armed forces, totaling 50,000 in 2006.

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

The tax preference will allow nonresidents including tourists, new residents, and nonresident military personnel to enter the state without having to pay use tax on their household belongings and private vehicles.

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

The public policy objective of reducing the tax burden on nonresidents, new Washington residents, and members of the armed forces is achieved. As well, the objective of reducing the administrative burden on the Department of Revenue is achieved.

Beneficiaries

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

The beneficiaries are tourists and other nonresident travelers, new Washington residents, and nonresident members of the armed forces stationed in Washington.

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

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

Revenue and Economic Impacts

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

In 2008, the beneficiaries of the tax preference saved $4.2 billion due to the use tax exemption for nonresident personal property. The savings comprise tax exemptions for state and local use tax and the additional motor vehicle use tax of 0.3 percent. (See Exhibit 6 on the following page.)

Taxpayer savings are made up of three parts:

1) State use taxes at 6.5 percent of the value of property;
2) Local use tax which varies by jurisdiction, but averages 2.4 percent of the value of the property; and
3) A special motor vehicle use tax of 0.3 percent of the value of the vehicle.

Exhibit 6 – Use Tax Savings from Nonresident Personal Property Exemption ($ in Millions)

	State Use Tax	Local Use Tax	Vehicle Use Tax	Total Taxpayer Savings
Fiscal Year	Tax Rate = 6.5%	Tax Rate = 2.4% (avg.)	Tax Rate = 0.3%	
2008	$3,025	$1,109	$69	$4,203
2009	$2,697	$989	$61	$3,747
2010	$2,591	$950	$59	$3,600
2011	$2,858	$1,048	$65	$3,970
2012	$3,006	$1,102	$68	$4,177
2013	$3,146	$1,154	$71	$4,371

Source: Department of Revenue tax returns, U.S. Bureau of Transportation Statistics, Bureau of Labor Statistics' Consumer Expenditure Survey, and Community Trade and Economic Development's Washington State Travel Impacts 2001-2008.

According to the Washington State Department of Commerce, visitors to Washington spent an estimated $15.4 billion in the state, directly supporting 151,000 in travel-related jobs (3.8 percent of total state employment). Jobs included in these estimates include employment in restaurants, taverns, hotels, motels, arts and entertainment businesses, ground and air transportation, and travel agencies. Most of the travel-related jobs are in accommodations and food services, but are also in arts and entertainment, ground and air transportation, and travel agencies. Accommodations and food service jobs tend to pay lower wages on average ($16,430 a year) compared to the average state wages ($46,562 a year).

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?

Terminating the tax preference would have a negative effect on discretionary travel to Washington. Travelers who drive their vehicles into Washington would owe use tax on the current value of the vehicle upon first use in this state. The use tax would be owed on the current value regardless of the duration of the trip. Use tax would also be owed on personal processions brought into the state. Under a multi-state agreement, Washington law allows a credit for sales tax paid in other states, so this would largely impact travelers from Oregon and other states with no sales tax or lower sales tax rates. Revenue collection would be a small portion of the tax owed because of an expected high level of noncompliance and other administrative difficulties.

Nondiscretionary travelers, such as members of the military, business travelers, and new residents pursuing job opportunities in Washington would have to pay tax. They would owe use tax on the current value of their vehicles and their household goods less the amount of sales tax paid in another state.

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

There would be no shift in the distribution of the tax burden. Nonresidents, new residents, and nonresident members of the armed forces would owe use tax if the tax preference were terminated.

Other States

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

There are 45 states and the District of Columbia that impose a sales tax and a corresponding use tax. At least 24 states (including Washington) and the District of Columbia provide statutory exemptions from the use tax for tangible personal property used by a nonresident. Several states place restrictions on the amount of time a nonresident may use the property in the state. The remaining state statutes are broad enough to likely cover temporary nonresidents. Almost all states, including Washington, do not allow the exemption for property used for a business purpose.

Recommendation

Because the tax preference is fulfilling its public policy objective to reduce the tax burden on tourists, new residents, and nonresident members of the armed forces and to reduce the administrative burden on the Department of Revenue, the Legislature should continue the tax preference.

Legislation Required: No.

Fiscal Impact: None.

VEHICLES SOLD TO NONRESIDENTS SALES TAX EXEMPTION – SUMMARY

Current Law

Sales of motor vehicles, trailers, or campers to nonresidents are exempt from the Washington retail sales tax. To qualify for the exemption, the vehicle must be taken immediately outside the state under the authority of a trip permit, or the vehicle must be pre-licensed in the buyer's state of residence. If the vehicle is pre-licensed in the buyer's state of residence, the vehicle may remain in Washington for up to three months and still qualify for the exemption.

Motor vehicles include passenger cars, sports utility vehicles, pickup trucks, recreational vehicles, and motorcycles.

The seller must retain documents that verify the purchaser's residence in another state such as a voter registration card, a property tax statement, or a utility bill. The seller must also retain certification that a vehicle trip permit was issued or the vehicle was immediately registered and licensed in another state.

See page A3-2 in Appendix 3 for the current statute, RCW 82.08.0264.

Legal History and Public Policy Objectives

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure, including the retail sales tax and the companion use tax. The act provided some use tax exemptions, but none for vehicles or trailers purchased by nonresidents.

1949 The Legislature enacted a sales tax exemption for sales of motor vehicles and trailers to nonresidents. Sellers were personally liable for collecting the tax when an exemption was taken for an invalid sale.

1979 The Legislature expanded the sales tax exemption to sales of campers.

2007 The Legislature identified specific documents that relieved the seller from liability for the tax if the seller maintained certain records to verify that a purchaser was an out of state resident. With this change, the tax is currently due from the purchaser if the purchaser has provided false documents proving residency. The legislation made it more difficult for the Department of Revenue to collect taxes owed in the case of fraudulent vehicle sales. Purchasers, particularly those that have falsified their residency, are difficult to locate.

The public policy objective of the tax preference is to encourage nonresidents to purchase motor vehicles from Washington dealerships.

Beneficiaries

The beneficiaries of the tax preference are nonresident purchasers of new and used cars, recreational vehicles, trailers, campers, and motorcycles. They do not include purchasers of commercial vehicles and trailers used in interstate commerce who receive an exemption under a separate statute, RCW 82.08.0263, reviewed separately in JLARC's 2010 Tax Preference Reports.

Revenue and Economic Impacts

The nonresident purchasers of vehicles in Washington saved $26.7 million in state, local and motor vehicle sales tax in 2008.

Vehicle sales would likely decline if the Legislature imposed a sales tax on the sales of vehicles to nonresidents. Currently, sales of vehicles to nonresidents make up 3.2 percent of all vehicle sales in Washington.

Other States

At least 32 states, including Washington, provide a sales tax exemption for motor vehicles purchased by nonresidents. Most states require that the vehicle leave the state within a certain amount of time, or be registered outside of the state, or both. Some states, not including Washington, require a reciprocity agreement with the nonresident's home state for the exemption to apply.

Recommendation

Because the tax preference is meeting the objective of encouraging nonresidents to purchase vehicles in Washington, the Legislature should continue the sales tax exemption for sales of vehicles to nonresidents.

Legislation Required: No.

Fiscal Impact: None.

VEHICLES SOLD TO NONRESIDENTS SALES TAX EXEMPTION – REPORT DETAIL

Current Law

Sales of motor vehicles, trailers or campers to nonresidents are exempt from the Washington retail sales tax. To qualify for the exemption, the vehicle must be taken immediately outside the state under the authority of a trip permit, or the vehicle must be pre-licensed in the buyer's state of residence. If the vehicle is pre-licensed in the buyer's state of residence, the vehicle may remain in Washington for up to three months and still qualify for the exemption.

Motor vehicles include passenger cars, sports utility vehicles, pickup trucks, recreational vehicles, and motorcycles.

The seller must retain documents that verify the purchaser's residence in another state such as a voter registration card, a property tax statement, or a utility bill. The seller must also retain certification that a vehicle trip permit was issued or the vehicle was immediately registered and licensed in another state.

See page A3-2 in Appendix 3 for the current statute, RCW 82.08.0264.

Legal History

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure, including the retail sales tax and companion use tax. The act provided some use tax exemptions, but none for vehicles or trailers purchased by nonresidents.

1949 The Legislature enacted a sales tax exemption for sales of motor vehicles and trailers to nonresidents. Without the exemption, sellers would be personally liable for collecting the tax.

1979 The Legislature expanded the sales tax exemption to sales of campers.

2007 The Legislature identified specific documents that relieved the seller from liability for the tax if the seller maintained certain records to verify that a purchaser was an out of state resident. With this change, the tax is currently due from the purchaser if the purchaser has provided false documents proving residency. The legislation made it more difficult for the Department of Revenue to collect taxes owed in the case of fraudulent vehicle sales. Purchasers, particularly those that have falsified their residency, are difficult to locate.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference?

Based on historical records and circumstances at the time, the public policy objective of the tax preference was to encourage nonresidents to purchase vehicles from Washington car dealerships. Documentation for this purpose comes from letters to Washington auto dealers from the Washington Tax Commission. The Tax Commission supported the preference because residents of bordering states would otherwise avoid purchasing automobiles in Washington. The Tax Commission stated in a 1953 letter:

> *We are mindful of the fact that the nonresident exemption applying to purchasers of motor vehicles was written into our law primarily to benefit automobile dealers whose natural trading areas cut across the state boundaries and who were to be placed in direct competition for business with an out-of-state dealer not required to collect the sales tax.*[8]

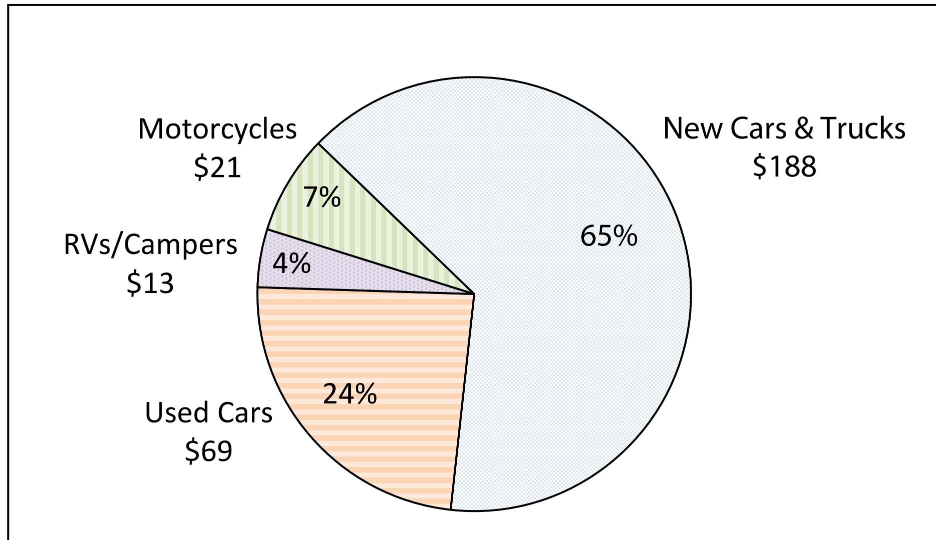
At the time of enactment, neither Oregon nor Idaho imposed a sales tax, which put Washington vehicle dealerships at a significant disadvantage. Additionally, the Washington Legislature considered increasing its sales tax by one percent in the year of enactment.

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

Nonresidents spent $291 million at Washington dealerships in 2008, including $188 million on new cars and $69 million on used cars. This amount does not include purchases of used vehicles, used motorcycles, and used campers directly from individual owners not registered as businesses. (See Exhibit 7 on the following page.)

[8] Letter from the Washington Tax Commission, May 22, 1953.

Exhibit 7 – Sales by Washington Auto Dealers to Nonresidents ($ in Millions)



Source: 2008 Department of Revenue tax returns.

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

The exemption will continue to contribute to the public policy objective by removing the price disadvantage that a sales tax would pose for Washington vehicle dealers. Because nonresidents owe no sales tax, they may continue to purchase vehicles in Washington if there is a greater selection available to them beyond their home states and the location is convenient.

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

The public policy objectives are being met.

Beneficiaries

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

The beneficiaries of the tax preference are nonresident purchasers of new and used cars, recreational vehicles, trailers, campers, and motorcycles. They do not include purchasers of commercial vehicles and trailers used in interstate commerce who receive an exemption under a separate statute, RCW 82.08.0263, reviewed separately in JLARC's 2010 Tax Preference Reports.

A nonresident is required to obtain a trip permit in order to transport the unlicensed vehicle on Washington highways unless the vehicle is pre-licensed in the buyer's state of residence and the plates are affixed at the time of sale. There are an estimated 115,000 trip permits issued each year for non-commercial vehicles by the Department of Licensing to Oregonians, the only state with which Washington has a reciprocal relationship for trip permits.

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

There is no evidence that the tax preference is providing unintended benefits to other entities. The preference is clearly written to apply only to Washington sales of vehicles to nonresidents and to exclude sales of vehicles to Washington residents.

Revenue and Economic Impacts

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

Nonresident purchasers of vehicles in Washington saved $26.7 million in state, local, and motor vehicle sales tax in 2008.

The decline in tax savings in 2009 are because the recession has made it more difficult for purchasers to obtain financing and because households and businesses are putting off new car purchases. National forecasts show a rebound in vehicles sales beginning in 2011.

Nonresidents are exempt from three kinds of sales taxes on the selling price—the state sales tax at 6.5 percent, the local sales tax which varies by jurisdiction but averages 2.4 percent, and the state motor vehicle sales tax at 0.3 percent.

Exhibit 8 – Taxpayer Savings due to Nonresident Vehicle Sales Tax Exemption ($ in Millions)

Fiscal Year	State Sales Tax =6.5%	Local Sales Tax Average = 2.4%	Motor Vehicle Sales Tax=0.3%	Total
2008	$18.9	$6.9	$0.9	$26.7
2009	$15.0	$5.5	$0.7	$21.2
2010	$17.0	$6.2	$0.8	$23.9
2011	$20.8	$7.6	$1.0	$29.4
2012	$23.6	$8.7	$1.1	$33.4
2013	$25.0	$9.2	$1.2	$35.3

Source: JLARC analysis based on Department of Revenue tax returns and the Economic Revenue and Forecast Council forecast of U.S. auto sales.

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?

Effects on the Taxpayers

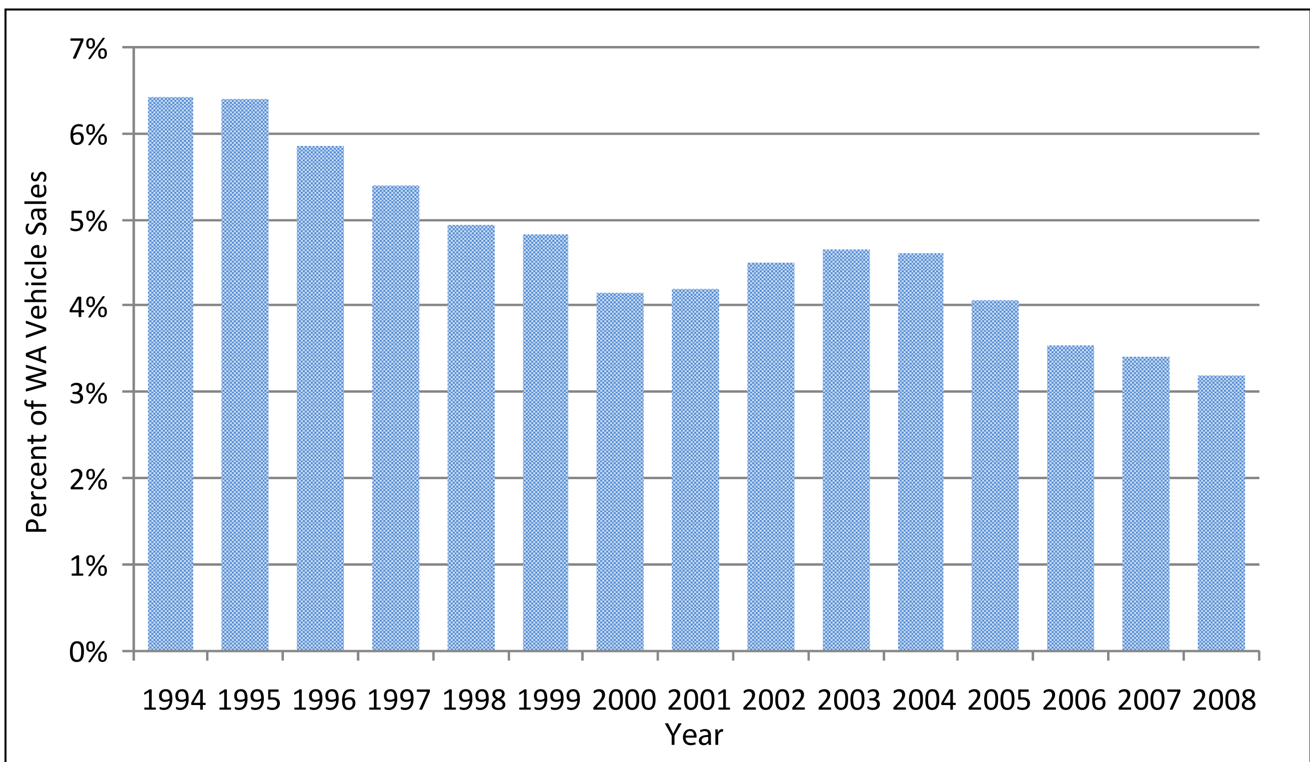
If the tax preference were terminated, nonresidents who currently benefit from the tax preference could avoid paying Washington sales tax by purchasing vehicles in another state. Of the 45 states with a sales tax, 32 provide a tax preference for motor vehicles purchased by nonresidents.

Washington shares borders with Oregon, which has no sales tax, and Idaho, which imposes a sales tax of 6 percent on resident purchases of vehicles and exempts nonresident purchases. Washington's sales taxes on vehicles are among the highest in the nation – rates vary by jurisdiction but average over 9 percent.

Effects on the Economy

Vehicle sales would likely decline if the Legislature imposed a sales tax on the sales of vehicles to nonresidents. However, nonresident vehicles sales make up a small percent of overall Washington vehicle sales. That share has declined in recent years from 6.4 percent in 1994 to 3.2 percent in 2008. (See Exhibit 9.)

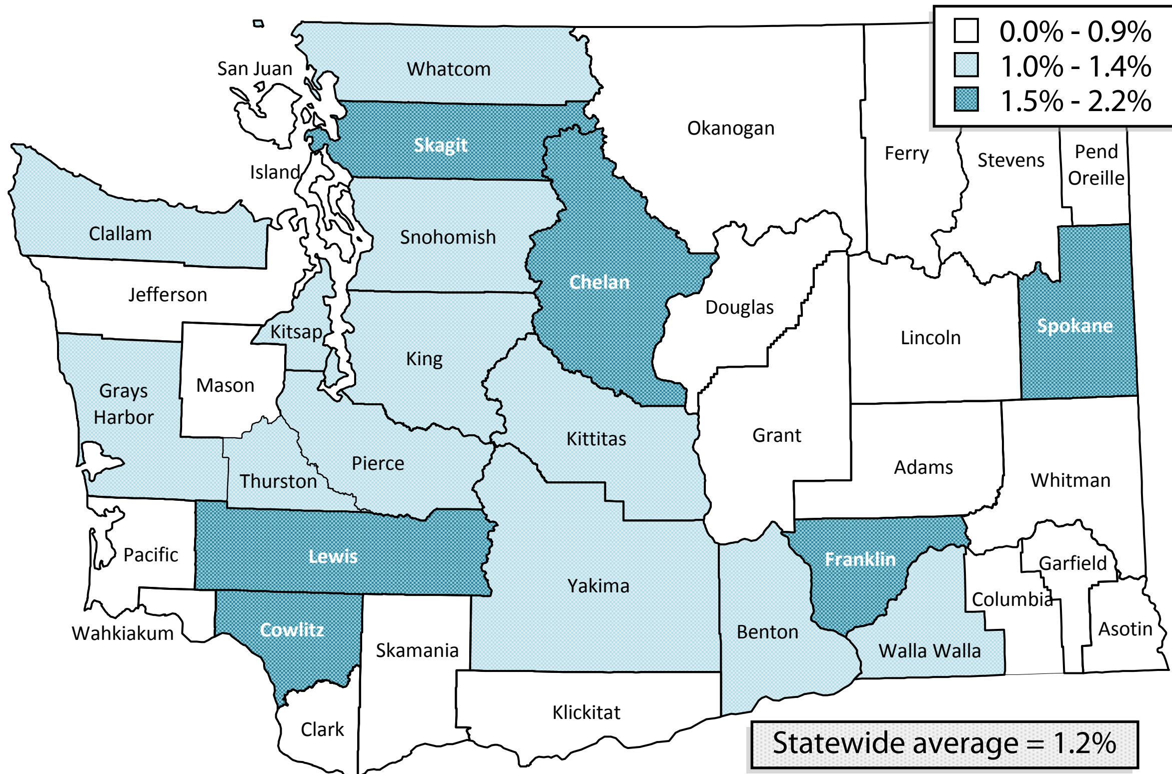
Exhibit 9 – Nonresidents Purchase 3.2 percent of Vehicles Sold in Washington



Source: Department of Revenue tax return data.

Terminating the sales tax exemption for nonresident purchases of vehicles would impact certain counties in Washington more than others. Counties along the I-5 corridor and counties close to major metropolitan areas in Oregon and Idaho have a higher percentage of employment in vehicle dealerships. The share of employment in the automotive trades in Spokane, Cowlitz, Lewis, and Franklin Counties are higher than the statewide average. Automotive trade jobs in these four counties appear to be more impacted by the recent recession than statewide—an 11 percent decline in employment compared to negligible decline statewide.

Exhibit 10 – Percent Employed at Auto Dealerships



Source: Employment Security, wage and salary employment.

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

There is no change in distribution of the tax liability if the tax preference were to be terminated. Nonresidents would begin to owe sales tax on motor vehicles, trailers and campers purchased in Washington.

Other States

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

At least 32 states, including Washington, provide a sales tax preference for motor vehicles purchased by nonresidents. Most states require that the vehicle leave the state within a certain amount of time, or be registered outside of the state, or both. Some states require a reciprocity agreement with the nonresident's home state for the exemption to apply.

Recommendation

Because the tax preference is meeting the objective of encouraging nonresidents to purchase vehicles in Washington, the Legislature should continue the sales tax exemption for sales of vehicles to nonresidents.

Legislation Required: No.

Fiscal Impact: None.

THROUGH FREIGHT IN INTERSTATE TRANSPORTATION PUBLIC UTILITY TAX DEDUCTION – SUMMARY

Current Law

The public utility tax applies to the gross operating income of public service businesses, including businesses engaging in transportation. The public utility tax is in lieu of the business and occupation (B&O) tax and, similar to the B&O tax, applies to the gross receipts of a business without deduction for losses or costs of doing business.

Generally, wholly instate trips (from one point in Washington to another) are fully subject to public utility tax. This preference provides a deduction from the public utility tax for instate portions of interstate shipments of goods where the carrier authorizes the shipper to stop the shipment in Washington to store, manufacture, or process the goods, then continues to transport the same goods or their equivalent, in the same or a converted form, to the final destination noted under a through freight rate (also known as a through bill of lading). The preference applies to transportation of goods by truck, rail, and certain water transportation.

JLARC's 2010 tax preference reports also address two related tax preferences: one that is interpreted to provide a public utility tax deduction for income from the instate portion of interstate transportation; and one providing a public utility tax deduction for shipments from an instate location to a Washington waterside location for shipment outside the state.

See page A3-3 in Appendix 3 for the current statute, RCW 82.16.050(8).

Legal History and Public Policy Objectives

1933 The Legislature passed a temporary business activities tax for the period August 1, 1933, through July 31, 1935. The Legislature anticipated that new taxes adopted by July 1935 would replace the temporary tax. The tax applied to the gross sales, gross income, or value of products for a wide range of activities, including transportation and utility companies.

1935 The Legislature passed the Revenue Act of 1935, which replaced the business taxes imposed in 1933. Transportation and utility activities were taxed under the newly created "public utility tax." Seven deductions from the public utility tax were provided in the Revenue Act of 1935, including one for income from activities the state is constitutionally prohibited from taxing. At the time, the U.S. Supreme Court's interpretation of the Commerce Clause was that a state tax on any portion of interstate transportation activities, even instate portions, was a burden on interstate commerce and unconstitutional.

1936 The Tax Commission filed suit against two railroad companies to collect public utility tax for certain transportation activities. The suit involved the transportation of goods either into or out of the state that temporarily stopped in Washington at transit stations for storage or processing. The Tax Commission sought to tax the income derived from the entirely instate

transportation between the transit station and the point of either origin or destination in Washington. The suits were withdrawn before going to trial.

1937 The Legislature added a new public utility tax deduction for income from transporting goods into or out of the state where the goods stop at "transit stations" in Washington and are subsequently forwarded "in like kind or in their original or converted form" into or out of the state.

1949 The Legislature clarified that the preference applied when the carrier granted to the shipper the privilege of instate stops "for the purpose of storing, manufacturing, milling, or other processing," where the goods were forwarded under a through freight rate from their origin to the final destination.

1977 In *Complete Auto Transit, Inc. v. Brady*,[9] the U.S. Supreme Court clearly stated that a gross income tax on interstate transportation, such as Washington's public utility tax, was constitutional if it was apportioned to reflect the instate portion of the transportation activity. The Court crafted a four-prong test to determine if a state tax on interstate commerce was constitutionally prohibited. All subsequent interstate transportation cases have upheld this doctrine.

2010 During the 2010 Legislative Session, the Legislature considered a bill to tax the instate portion of interstate transportation, but the bill did not pass.

The Legislature did not state its intent when the preference was enacted in 1937. However, the implied intent appears to be based on the 1930s-era U.S. Supreme Court's analysis and interpretation of federal Commerce Clause prohibitions. This interpretation held that taxing any portion of interstate transportation activities, even instate portions, was a burden on interstate commerce and unconstitutional.

However, this interpretation is outdated and no longer compatible with current Commerce Clause interstate taxation doctrine. Since 1977, the U.S. Supreme Court has consistently upheld state taxation of activities in interstate commerce so long as the tax is: 1) applied to an activity with a substantial nexus in the state, 2) fairly apportioned, 3) not discriminatory to interstate commerce, and 4) fairly related to the services provided in the state.

Maintaining consistency across multiples preferences may be important because the 1977 *Complete Auto* case requires that a state tax cannot be discriminatory against interstate commerce. If the tax preference covered in this review was terminated, but other interstate commerce-related tax preferences were continued, an issue of discrimination could be raised.

Beneficiaries

The beneficiaries of this preference are trucking and motor freight, railroad, and certain waterway transportation businesses that transport goods in interstate transportation.

[9] *Complete Auto Transit, Inc., v. Brady*, 430 U.S. 274 (1977).

Revenue and Economic Impacts

The Department of Revenue estimated the taxpayer savings for this preference at $16.1 million for Fiscal Year 2009. JLARC did not identify a method to estimate the taxpayer savings for this preference.

If the tax preference were terminated, interstate transportation providers that make stops in Washington to store or process the goods under a through bill of lading would have a greater public utility tax burden. Such transportation providers would be subject to public utility tax similar to those businesses providing transportation services wholly instate.

Transportation providers may choose to raise their rates or charge additional fees to cover their increased costs due to the public utility tax. If competition in the transportation market will not allow an increase in rates or fees, transportation providers would have to absorb the additional costs, which may result in decreased profits for the business or lower wages for employees.

Other States

Unlike Washington, 45 states and the District of Columbia apportion revenue from interstate transportation and tax the instate portion. Most states apportion interstate transportation by using a ratio of the number of miles traveled in state compared with miles traveled everywhere. No specific exemptions for through freight stopping for storage or processing were found in other states.

Recommendation

Because this preference is no longer constitutionally necessary, the Legislature should terminate the preference providing a public utility tax deduction tax for intrastate portions of interstate shipments of goods under a through freight rate where the shipment is stopped in Washington to store, manufacture, or process the goods, then continues to the final destination.

Legislation Required:	Yes.
Fiscal Impact:	Yes, but the amount is unknown.

THROUGH FREIGHT IN INTERSTATE TRANSPORTATION PUBLIC UTILITY TAX DEDUCTION – REPORT DETAIL

Current Law

The public utility tax applies to the gross operating income of public service businesses, including businesses engaging in transportation. The public utility tax is in lieu of the business and occupation (B&O) tax and, similar to the B&O tax, applies to the gross receipts of a business without deduction for loss or costs of doing business. There are currently eight public utility tax classifications and six statutorily prescribed rates under the public utility tax. The classifications impacted by this preference include:

- Motor transportation and railroad activities - 1.926 percent
- Urban transportation and watercraft under 65 feet - 0.642 percent
- Log hauling over public roads - 1.3696 percent (temporary rate effective 7-1-2009; reverts to 1.926 percent rate 7-01-2013)

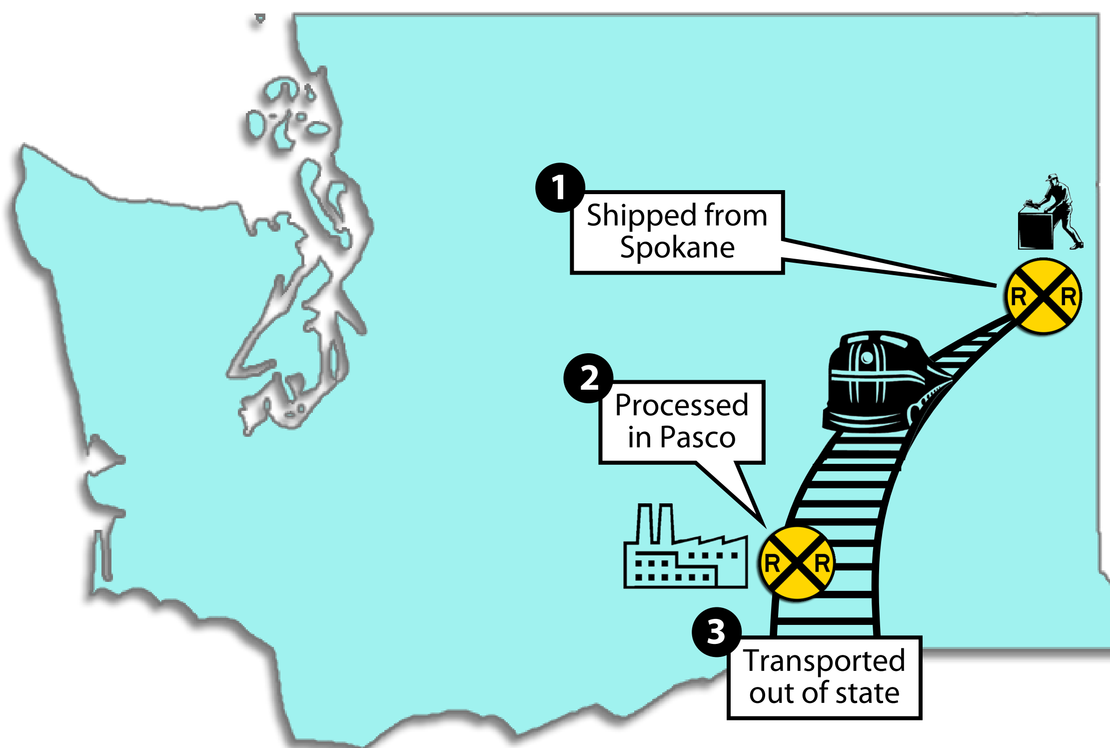
Generally, wholly instate trips (from one point in Washington to another) are fully subject to public utility tax. This preference provides a deduction from the public utility tax for instate portions of interstate shipments of goods where the carrier authorizes the shipper to stop the shipment in Washington to store, manufacture, or process the goods, then continues to transport the same goods or their equivalent, in the same or a converted form, to the final destination noted under a through freight rate (also known as a through bill of lading). A "through bill of lading" is an agreement between the carrier and shipper, specifying the carrier remains obligated to deliver the goods from their origin to their final destination. The preference applies to transportation of goods by truck, rail, and certain water transportation.

JLARC's 2010 tax preference reports also address two related tax preferences, one that is interpreted to provide a public utility tax deduction for income from the instate portion of interstate transportation; and one providing a public utility tax deduction for shipments from an instate location to a Washington waterside location for shipment outside the state.

See page A3-3 in Appendix 3 for the current statute, RCW 82.16.050(8).

Exhibit 11 illustrates the type of transportation trips not taxed under this tax preference.

Exhibit 11 – Hypothetical Through Freight Trip in Interstate Transportation



Source: JLARC illustration based on RCW 82.16.050(8).

Legal History

1933 The Legislature passed a temporary business activities tax for the period August 1, 1933, through July 31, 1935. The Legislature anticipated that new taxes adopted by July 1935 would replace the temporary tax. The tax applied to the gross sales, gross income, or value of products for a wide range of activities, including transportation and utility companies.

1935 The Legislature passed the Revenue Act of 1935, which replaced the temporary business taxes imposed in 1933. Transportation and utility activities were taxed under the newly created "public utility tax." Seven deductions from the public utility tax were provided in the Revenue Act of 1935, including one for income from activities the state is constitutionally prohibited from taxing. At the time, the U.S. Supreme Court's interpretation of the Commerce Clause was that a state tax on any portion of interstate transportation activities, even instate portions, was a burden on interstate commerce and unconstitutional.

1936 The Tax Commission filed suit against two railroad companies to collect public utility tax for certain transportation activities. The suit involved the transportation of goods either into or out of the state that temporarily stopped in Washington at transit stations for storage or processing. The Tax Commission sought to tax the income derived from the entirely instate transportation between the transit station and the point of origin or destination in Washington. The suits were withdrawn before going to trial.

1937 The Legislature added a new public utility tax deduction for income from transporting goods into or out of the state where the goods stop at "transit stations" in Washington and

are subsequently forwarded "in like kind or in their original or converted form" into or out of the state.

1949 The Legislature clarified that the preference applied when the carrier granted to the shipper the privilege of instate stops "for the purpose of storing, manufacturing, milling, or other processing," where the goods were forwarded under a through freight rate from their origin to the final destination. The Legislature detailed the nature of qualifying stops and set in place a requirement for a through bill of lading to show the instate stop was an intermediary one prior to the goods reaching their final destination.

1977 In *Complete Auto Transit, Inc. v. Brady*,[10] the U.S. Supreme Court clearly stated that a gross income tax on interstate transportation, such as Washington's public utility tax, was constitutional if it was apportioned to reflect the instate portion of the transportation activity. The Court crafted a four-prong test to determine if a state tax on interstate commerce was constitutionally prohibited. All subsequent interstate transportation cases have upheld this doctrine.

2010 During the 2010 Legislative Session, the Legislature considered a bill to tax the instate portion of interstate transportation, but the bill did not pass.

Other Relevant Background

The Commerce Clause and Import-Export Clause of the U.S. Constitution limit the taxes that states may levy on interstate and foreign commerce. The constitutionality of state taxes on interstate commerce has been debated and decided through a long history of U.S. Supreme Court decisions.

At the time this preference was enacted in 1937, the Court strictly prohibited any state tax that potentially burdened interstate commerce. The Court's Constitutional analysis and decisions evolved through the years. In 1977, the Court unanimously rejected decades of varying decisions, providing a four-prong test that remains the framework for analyzing state taxation on interstate commerce. Under the court's test, a state tax on interstate commerce was constitutional if it was:

1) applied to an activity with a substantial nexus with the taxing state;
2) fairly apportioned;
3) nondiscriminatory against interstate commerce; and
4) fairly related to the services provided by the state.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference?

The Legislature did not state its intent when the preference was enacted in 1937. However, the implied intent appears to be based on the 1930s-era U.S. Supreme Court's analysis and

[10] *Complete Auto Transit, Inc., v. Brady*, 430 U.S. 274 (1977).

interpretation of federal Commerce Clause prohibitions. This interpretation held that taxing any portion of interstate transportation activities, even instate portions, was a burden on interstate commerce and unconstitutional. The Tax Commission may have acknowledged the constitutional Commerce Clause analysis of that time when it withdrew in 1936 two lawsuits it had filed in district court against railroads, seeking to tax income derived from the entirely intrastate transportation between a transit station and another point in Washington. This preference was enacted the following year.

Clarifications made to the preference in 1949, allowing the shipper to stop the transportation services for certain storage, manufacturing, or processing activities when the goods were shipped under a through freight rate, imply the Legislature intended to narrowly construe this preference. The changes restricted the deduction to apply only to interstate trips where temporary stops are made in Washington for processing or storage, prior to the goods reaching their ultimate destination within or outside of the state.

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

Evidence indicates the interpretation adopted by the Tax Commission in 1935 is outdated and no longer compatible with current Commerce Clause interstate taxation doctrine. The 1930s-era interpretation that a state is prohibited from taxing instate activities related to interstate commerce was repudiated by the U.S. Supreme Court's 1977 *Complete Auto* decision.

Since 1977, the Court has consistently upheld state taxation of activities in interstate commerce so long as the tax is: 1) applied to an activity with a substantial nexus in the state, 2) fairly apportioned, 3) not discriminatory to interstate commerce, and 4) fairly related to the services provided in the state. Since this preference only applies to transportation conducted entirely within the state, the preference is not constitutionally required. Any constitutional concerns over taxing instate transportation between points within Washington, even if they are ultimately part of an interstate trip, are no longer valid.

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

Taxing wholly instate portions of interstate trips, where the shipper stops at a point in Washington then continues under a through bill of lading to the final destination is now recognized as constitutional. Since 1977, taxing the instate portion of an interstate transportation trip is not constitutionally prohibited.

Assuming the Legislature's intent was to comply with constitutional Commerce Clause prohibitions, this preference is no longer necessary to comply with the Constitution.

Maintaining consistency across multiples preferences may be important because the 1977 *Complete Auto* case requires that a state tax cannot be discriminatory against interstate commerce. Any changes to one interstate commerce-related preference might affect the constitutionality of other preferences. (See JLARC's review of public utility tax exemptions for through freight and shipments

to ports, included in separate chapters in this report.) If the tax preference covered in this review was terminated, but others were continued, an issue of discrimination could be raised.

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

If the Legislature's intent was to comply with constitutional Commerce Clause prohibitions, then this statute is no longer necessary and the Legislature should terminate the preference. Since 1977, states may tax the instate portion of a haul that is under a through freight rate, even when the shipment temporarily stops instate for storage or processing.

Beneficiaries

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

The beneficiaries of this preference are trucking and motor freight, railroad, and certain waterway transportation businesses that transport goods in interstate transportation. Federal law specifically preempts states from taxing air transportation of goods, U.S. mail delivery, interstate bus transportation of passengers, and Amtrak rail services.[11]

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

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

Revenue and Economic Impacts

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

The Department of Revenue estimated the taxpayer savings for this preference at $16.1 million for Fiscal Year 2009. Although the accuracy of this estimate is unclear, JLARC did not identify a method to estimate the taxpayer savings.

Although this preference is technically a deduction from the gross income subject to public utility tax, in practice, many businesses operating predominately in interstate commerce do not report this income. The Department of Revenue allows this practice, as it is less burdensome for businesses and eases tax administration.

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?

[11] 49 U.S.C. § 40116(b), 49 U.S.C. § 14505, 49 U.S.C § 24301(l).

If the tax preference were terminated, interstate transportation providers of goods that temporarily stop in Washington and continue to the destination under a through freight billing would have a greater public utility tax burden. They would be subject to public utility tax similar to those businesses providing transportation services wholly instate. Many transportation businesses that operate strictly in interstate transportation would need to register to do business with the Department of Revenue. Others that may currently be registered would need to begin or resume excise tax reporting.

The transportation sector is a highly competitive one. Both freight railroads and motor transportation are largely deregulated at the federal level. Rates are established primarily through competition between companies within the motor freight or rail industries and among competing transportation modes. The current federal regulation formula for freight railroads in the U.S. was established by the Railroad Revitalization and Regulatory Reform Act (4R Act) in 1976 and the Staggers Act, enacted in 1980. Federal motor carrier deregulation began with the Motor Carrier Act of 1980. In 1995, Congress preempted states from regulating entry and rates for instate common carriers with some exceptions for safety, insurance, and household goods. Thus, the rates charged by transportation providers are largely dictated by competition between carriers.

Washington businesses that ship goods under a through bill of lading and that request the carrier to stop at an instate location for storage, manufacturing, or processing of the goods could experience an increase in transportation costs. Transportation businesses may choose to raise their rates or add additional fees to cover their increased costs due to the public utility tax. If the competitive transportation market will not allow an increase in rates or fees, transportation providers would have to absorb the additional costs, which may result in decreased profits for the business or lower wages for employees.

Total employment in the freight and specialized trucking sectors and railroads accounted for less than one percent of Washington's employment figure in 2008. The average wage earned in the trucking industry, including log trucking, was $43,167. (See Exhibit 12.) Although 2008 wage information was not available, the 2007 average Washington railroad wage was over $73,000.

Exhibit 12 – Washington Trucking Transportation Industry Employment and Wage Data - 2008

Industry	Employment	Total Wages ($ in Millions)	Average Wages
General Freight Trucking, Local	4,579	$187	$40,794
General Freight Trucking, Long Distance	13,115	$597	$46,760
Specialized Trucking,* Local	4,046	$152	$37,566
Specialized Trucking,* Long Distance	1,728	$78	$44,852
Totals	**23,467**	**$1,013**	**$43,167**

Source: Employment Security QCEW Annual Data, 2008. * Includes log trucking.

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

There would be no change in the distribution of liability for payment of state taxes for the beneficiaries of this tax preference. If the tax preference were terminated, transportation providers would be subject to public utility tax on the instate legs of interstate trips under a through freight bill similar to other wholly instate transportation services. This would result in increased public utility tax revenues for the state.

Other States

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

Unlike Washington, 45 states and the District of Columbia apportion revenue from interstate transportation and tax the in-state portion. Most states apportion interstate transportation by using a ratio of the number of miles traveled in state compared with miles traveled everywhere. Except for Washington, no specific exemptions for through freight stopping for storage or processing were found.

All 44 states and the District of Columbia that impose a corporate net income tax require multistate businesses to apportion the income among the states. Most states use a three-factor apportionment formula based on the business's property, personnel, and sales, although an increasing number of states now rely on the sales factor alone. The sales factor is based on gross revenue, which is analogous to the tax base of Washington's public utility tax.

Special apportionment rules are often required for interstate transportation services, since the location of performance spans multiple states. The Multistate Tax Commission, an organization of state governments that works with taxpayers to administer tax laws that apply to multistate enterprises, issues model apportionment regulations, as well as special rules for various transportation services. These special rules apportion transportation services based on the ratio of miles traveled within the state against the miles traveled everywhere.

Of the 44 states with a corporate net income tax, at least 37 states and the District of Columbia use a variation of the model rules to apportion transportation revenue by miles traveled within the state. The remaining states use a variety of methods to apportion the revenue derived from transportation activities in the state. Regardless of the exact method of apportionment, however, all of these states tax the instate portion of interstate transportation activities to some extent.

A few other states impose gross receipt taxes. Texas imposes a franchise tax on value-added (gross receipts minus the costs of wages paid and goods sold). Like Washington, Texas restricts taxation to transportation that is conducted entirely intrastate, meaning that transportation from interstate commerce (even the Texas portion) is not apportioned to Texas. JLARC was unable to determine if Texas provides a deduction for through freight stopping for storage or processing. Ohio imposes a commercial activity tax on gross receipts. Unlike Washington, Ohio apportions transportation revenue by the ratio of mileage traveled in the state to the mileage traveled everywhere.

Recommendation

Because this preference is no longer necessary constitutionally, the Legislature should terminate the preference providing a public utility tax deduction tax for intrastate portions of interstate shipments of goods under a through freight billing.

Legislation Required: Yes.

Fiscal Impact: Yes, but the amount is unknown.

SHIPMENTS TO PORTS FOR INTERSTATE OR FOREIGN TRANSPORTATION PUBLIC UTILITY TAX DEDUCTION – SUMMARY

Current Law

The public utility tax applies to the gross operating income of public service businesses, including businesses engaging in transportation. The public utility tax is in lieu of the business and occupation (B&O) tax and, similar to the B&O tax, applies to the gross receipts of a business without deduction for loss or costs of doing business.

Generally, wholly intrastate trips (from one point in Washington to another) are fully subject to public utility tax. This preference provides a deduction from public utility tax for transportation of commodities from a point in Washington directly to an instate port, dock, wharf, export elevator, or shipside for direct shipment by vessel outside the state. The preference is not available when the origin and point of delivery are within the same city. The preference applies to transportation of commodities by truck, rail, and certain water transportation.

JLARC's 2010 tax preference reports also address two related tax preferences: one that is interpreted to provide a public utility tax deduction for income from the instate portion of interstate transportation; and one providing a public utility tax deduction for income from transportation under a "through freight billing" with an instate stop.

See page A3-4 in Appendix 3 for the current statute, RCW 82.16.050(9).

Legal History and Public Policy Objectives

1933 The Legislature passed a temporary business activities tax for the period August 1, 1933, through July 31, 1935. The Legislature anticipated that new taxes adopted by July 1935 would replace the temporary tax. The tax applied to the gross sales, gross income, or value of products for a wide range of activities, including transportation and utility companies.

1935 The Legislature passed the Revenue Act of 1935, which replaced the temporary business taxes imposed in 1933. Transportation and utility activities were taxed under the newly created "public utility tax." Seven deductions from the public utility tax were provided in the Revenue Act of 1935, including one for income from activities the state is constitutionally prohibited from taxing. At the time, the U.S. Supreme Court's interpretation of the Commerce Clause was that a state tax on any portion of interstate transportation activities, even instate portions, was a burden on interstate commerce and unconstitutional.

1936 The Tax Commission filed suit against two railroad companies to collect public utility tax for certain transportation activities. The suit involved the transportation of goods into or out of the state that temporarily stopped in Washington at transit stations for storage or

processing. The Tax Commission sought to tax the income derived from the entirely instate transportation between the transit station and the point of either origin or destination in Washington. The suits were withdrawn before going to trial.

1937 The Legislature added a new public utility tax deduction for income from transporting "commodities from points of origin in the State of Washington to export elevators, docks, or shipside on tidewater and the Columbia River" that were then forwarded in their original or converted form outside the state to interstate or foreign destinations.

1949 The Legislature clarified the preference for shipments to ports to:

- Add "wharf" as a qualifying waterside point of delivery.
- Replace the specific reference to the Columbia River with "navigable tributaries," thereby expanding the deduction.
- Limit that commodities must be in their "original" (but not converted) form when shipped outside the state.
- Clarify that the deduction was not allowed when the point of origin and point of delivery to the waterside location were located in the same city or town.

1967 The Legislature again clarified the preference for shipments to ports to note it applied only to transportation from the point of origin directly to the waterside destination, with no intervening transportation.

1977 In *Complete Auto Transit, Inc. v. Brady*,[12] the U.S. Supreme Court clearly stated that a gross income tax on interstate transportation, such as Washington's public utility tax, was constitutional if it was apportioned to the instate portion of the transportation activity. The Court crafted a four-prong test to determine if a state tax on interstate commerce was constitutionally prohibited. All subsequent interstate transportation cases have upheld this doctrine.

1978 In *Department of Revenue v. Assn. of WA Stevedoring Companies,*[13] the U.S. Supreme Court reversed a long line of precedent (and the Washington State Supreme Court) to find that a gross receipts tax on instate stevedoring, which includes activities such as loading and unloading vessels and moving, storing, and handling cargo, did not violate the Constitution. The tax on instate services was upheld because it satisfied the four-prong *Complete Auto* test and was simply a proxy for taxing the underlying exports. This did not change the nature of this preference per se, but indicated a change in the U.S. Supreme Court's interpretation of Commerce Clause restrictions on state taxation.

1979 In *Japan Line, Ltd. v. County of Los Angeles,*[14] the U.S. Supreme Court provided two extra test prongs for taxation of international commerce. In addition to meeting the four-prong *Complete Auto* test, a state tax on international commerce cannot create a substantial risk of

---

[12] *Complete Auto Transit, Inc., v. Brady*, 430 U.S. 274 (1977).

[13] *Department of Revenue v. Assn. of WA Stevedoring Companies,* 435 U.S. 734 (1978).

[14] *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979).

international multiple taxation or prevent the federal government from speaking with one voice on international trade.

2007 The Legislature moved the deduction for shipments to ports to a separate subsection in Title 82.16 RCW. While the language of the deduction was updated, no substantive changes were made.

The Legislature did not state its intent when the preference was enacted in 1937. However, the implied intent appears to be based on the 1930s-era U.S. Supreme Court's analysis and interpretation of federal Commerce Clause prohibitions. This interpretation held that taxing any portion of interstate transportation activities, even instate portions, was a burden on interstate commerce and unconstitutional.

However, this interpretation is outdated and no longer compatible with current Commerce Clause interstate taxation doctrine. Since 1977, the U.S. Supreme Court has consistently upheld state taxation of activities in interstate commerce so long as the tax is: 1) applied to an activity with a substantial nexus in the state, 2) fairly apportioned, 3) not discriminatory to interstate commerce, and 4) fairly related to the services provided in the state. Changes to the preference in 1949 and 1967 suggest the Legislature may have had additional policy objectives in mind but the nature of the objectives is unclear.

Maintaining consistency across multiple preferences may be important because the 1977 *Complete Auto* case requires that a state tax cannot be discriminatory against interstate commerce. If the tax preference covered in this review was continued, but other interstate commerce-related tax preferences were discontinued, an issue of discrimination could be raised.

Beneficiaries

The beneficiaries of this preference are trucking and motor freight, railroad, and certain waterway transportation businesses that transport commodities from within the state to Washington ports, docks, etc., for shipment outside the state.

Revenue and Economic Impacts

The Department of Revenue estimated the taxpayer savings at $7.6 million for Fiscal Year 2009. JLARC did not identify a method to estimate the taxpayer savings for this preference.

If the tax preference were terminated, businesses transporting commodities from points in Washington to instate waterside destinations would have a greater public utility tax burden. Transportation providers to ports, docks, etc., would be subject to public utility tax similar to other businesses providing transportation services wholly instate.

Transportation providers may choose to raise their rates or charge additional fees to cover their increased costs due to the public utility tax. If competition in the transportation market will not allow an increase in rates or fees, transportation providers would have to absorb the additional costs, which may result in lower profits for the businesses or lower wages for employees.

Other States

Unlike Washington, 45 states and the District of Columbia apportion revenue from interstate transportation and tax the instate portion of transportation activities in some manner. Most states generally apportion interstate transportation by using a ratio of the number of miles traveled in state compared with miles traveled everywhere. No specific exemptions for shipments to ports were found in other states.

Recommendation

Since this tax preference providing a public utility tax deduction for shipments to ports is no longer required by the Constitution, the original public policy objective is no longer applicable. Statutory changes in 1949 and 1967, however, imply that the Legislature may have had additional policy objectives. Because the Legislature did not identify its objectives at those times, the Legislature should reexamine and clarify this preference to identify what, if any, public policy objectives still exist.

Legislation Required: Possibly, if the Legislature wants to clarify the preference.

Fiscal Impact: Possibly, if changes are made.

SHIPMENTS TO PORTS FOR INTERSTATE OR FOREIGN TRANSPORTATION PUBLIC UTILITY TAX DEDUCTION – REPORT DETAIL

Current Law

The public utility tax applies to the gross operating income of public service businesses, including businesses engaging in transportation. The public utility tax is in lieu of the business and occupation (B&O) tax and, similar to the B&O tax, applies to the gross receipts of a business without deduction for loss or costs of doing business. There are currently eight public utility tax classifications and six statutorily prescribed rates under the public utility tax. The classifications impacted by this preference include:

- Motor transportation and railroad activities - 1.926 percent
- Urban transportation and watercraft under 65 feet - 0.642 percent
- Log hauling over public roads - 1.3696 percent (temporary rate effective 7-1-2009; reverts to 1.926 percent rate 7-01-2013)

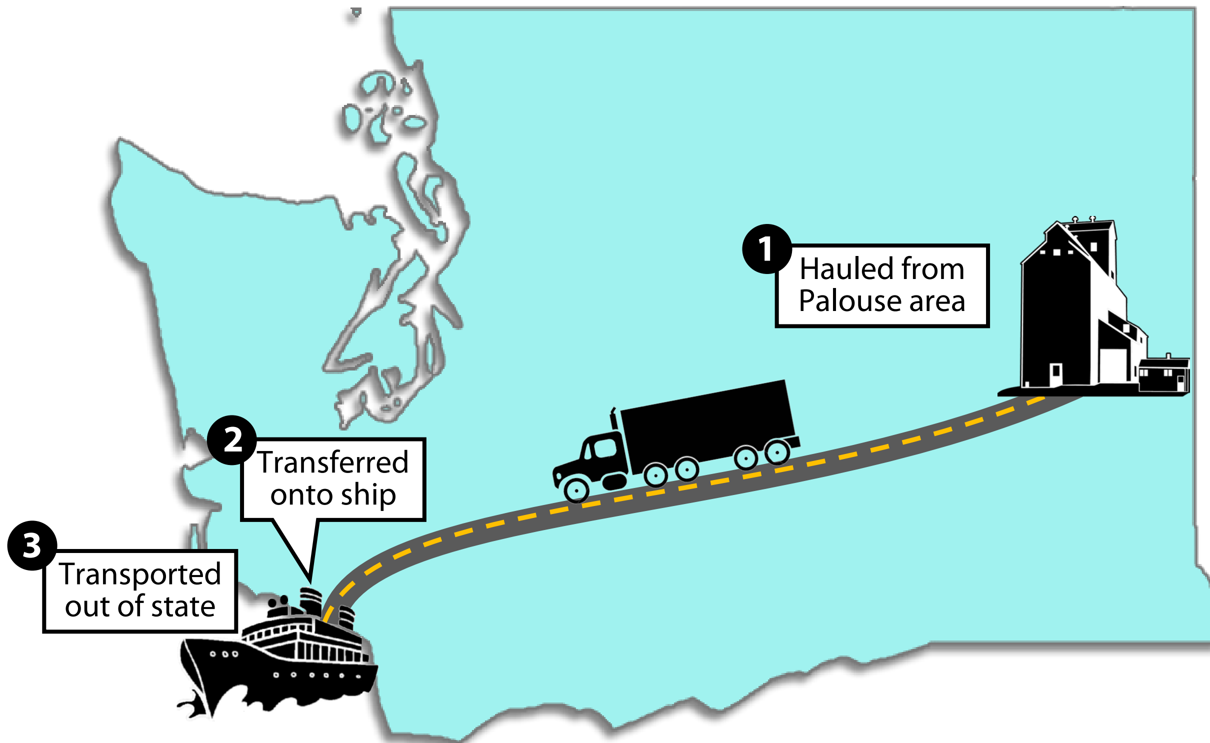
Generally, wholly intrastate trips (from one point in Washington to another) are fully subject to public utility tax. This preference provides a deduction from the public utility tax for transportation of commodities from a point in Washington directly to an instate port, dock, wharf, export elevator, or shipside for direct shipment by vessel outside the state. The preference is not available when the origin and point of delivery are within the same city. The preference applies to transportation of commodities by truck, rail, and certain water transportation.

JLARC's 2010 tax preference reports also address two related tax preferences: one that is interpreted to provide a public utility tax deduction for income from the instate portion of interstate transportation; and one providing a public utility tax deduction for income from transportation under a "through freight billing" with an instate stop.

See page A3-4 in Appendix 3 for the current statute, RCW 82.16.050(9).

Exhibit 13 illustrates the type of transportation trips not taxed under this tax preference.

Exhibit 13 – Hypothetical Shipment to a Port for Delivery Out of State



Source: JLARC illustration of RCW 82.16.050(9).

Legal History

1933 The Legislature passed a temporary business activities tax for the period August 1, 1933, through July 31, 1935. The Legislature anticipated that new taxes adopted by July 1935 would replace the temporary tax. The tax applied to the gross sales, gross income, or value of products for a wide range of activities, including transportation and utility companies.

1935 The Legislature passed the Revenue Act of 1935, which replaced the temporary business taxes imposed in 1933. Transportation and utility activities were taxed under the newly created "public utility tax." Seven deductions from the public utility tax were provided in the Revenue Act of 1935, including one for income from activities the state is constitutionally prohibited from taxing. At the time, the U.S. Supreme Court's interpretation of the Commerce Clause was that a state tax on any portion of interstate transportation activities, even instate portions, was a burden on interstate commerce and unconstitutional.

1936 The Tax Commission filed suit against two railroad companies to collect public utility tax for certain transportation activities. The suit involved the transportation of goods either into or out of the state that temporarily stopped in Washington at transit stations for storage or processing. The Tax Commission sought to tax the income derived from the entirely instate transportation between the transit station and the point of either origin or destination in Washington. The suits were withdrawn before going to trial.

1937 The Legislature added a new public utility tax deduction for income from transporting "commodities from points of origin in the State of Washington to export elevators, docks, or

shipside on tidewater and the Columbia River" that were then forwarded in their original or converted form, outside the state to interstate or foreign destinations.

1949 The Legislature clarified the preference for shipments to ports to:

- Add "wharf" as a qualifying waterside point of delivery.
- Replace the specific reference to the Columbia River with "navigable tributaries," thereby expanding the deduction.
- Limit that commodities must be in their "original" (but not converted) form when shipped outside the state.
- Clarify that the deduction was not allowed when the points of origin and delivery to the waterside locations were located in the same city or town.

1967 The Legislature again clarified the preference for shipments to ports to note it applied only to transportation from the point of origin directly to the waterside destination, with no intervening transportation.

1977 In *Complete Auto Transit, Inc. v. Brady*,[15] the U.S. Supreme Court clearly stated that a gross income tax on interstate transportation, such as Washington's public utility tax, was constitutional if it was apportioned to the instate portion of the transportation activity. The Court crafted a four-prong test to determine if a state tax on interstate commerce was constitutionally prohibited. All subsequent interstate transportation cases have upheld this doctrine.

1978 In *Department of Revenue v. Assn. of WA Stevedoring Companies,*[16] the U.S. Supreme Court reversed a long line of precedent (and the Washington State Supreme Court) to find that a gross receipts tax on instate stevedoring activities, which includes activities such as loading and unloading vessels and moving, storing, and handling cargo, did not violate the Constitution. The tax on instate services was upheld because it satisfied the four-prong *Complete Auto* test and was simply a proxy for taxing the underlying exports. This did not change the nature of this preference per se, but indicated a change in the U.S. Supreme Court's interpretation of Commerce Clause restrictions on state taxation.

1979 In *Japan Line, Ltd. v. County of Los Angeles,*[17] the U.S. Supreme Court provided two extra test prongs for taxation of international commerce. In addition to meeting the four-prong *Complete Auto* test, a state tax on international commerce cannot create a substantial risk of international multiple taxation or prevent the federal government from speaking with one voice on international trade.

2007 The Legislature moved the deduction for shipments to ports to a separate subsection in Title 82.16 RCW. Until then, the deduction had shared the same subsection as the deduction for through freight transportation in RCW 82.16.050(8). While the language of the deduction was updated, no substantive changes were made.

[15] *Complete Auto Transit, Inc., v. Brady*, 430 U.S. 274 (1977).

[16] *Department of Revenue v. Assn. of WA Stevedoring Companies,* 435 U.S. 734 (1978).

[17] *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979).

Other Relevant Background

The Commerce Clause and Import-Export Clause of the U.S. Constitution limit the taxes that states may levy on interstate and foreign commerce. The constitutionality of state taxes on interstate commerce has been debated and decided through a long history of U.S. Supreme Court decisions.

At the time this preference was enacted in 1937, the Court strictly prohibited any state tax that potentially burdened interstate commerce. The Court's constitutional analysis and decisions evolved through the years. In 1977, the Court unanimously rejected decades of varying decisions, providing a four-prong test that remains the framework for analyzing state taxation on interstate commerce. Under the court's test, a state tax on interstate commerce was constitutional if it was:

1) applied to an activity with a substantial nexus with the taxing state;
2) fairly apportioned;
3) nondiscriminatory against interstate commerce; and
4) fairly related to the services provided by the state.

The 1978 *Japan Line* decision added two additional test prongs for any state tax on international commerce. The state tax cannot create a substantial risk of international multiple taxation nor can it prevent the federal government from speaking with one voice on international trade.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference?

The Legislature did not state its intent when the preference was enacted in 1937. A likely public policy objective was to avoid potentially unconstitutional taxation, including taxation of a haul destined for an interstate or foreign location. The 1930s-era U.S. Supreme Court analysis and decisions held that instate transportation activities were part of the interstate or foreign export transportation of goods and that any tax on such instate activities was prohibited by the Commerce Clause and Import-Export Clause. Shipments to a port for subsequent export, even if the transportation was conducted entirely within Washington, almost certainly would have been held unconstitutional at the time this preference was enacted.

Changes to the preference in 1949 and 1967 suggest the Legislature may have had additional policy objectives in mind, but the nature of the objectives is unclear.

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

Evidence indicates the interpretation adopted by the Tax Commission in 1935, that taxing the instate portion of interstate and foreign transportation is constitutionally prohibited, is outdated and is no longer compatible with current Commerce Clause and Import-Export Clause taxation doctrine. The implied public policy objective in 1937 was to not tax any constitutionally prohibited

activity. U.S. Supreme Court decisions have subsequently established that states are not constitutionally prohibited from taxing the instate portion of interstate or foreign transportation or instate activities associated with interstate or foreign commerce. Thus, the tax preference is no longer necessary to achieve this public policy objective.

Since 1977, the U.S. Supreme Court has consistently upheld state taxation of activities in interstate commerce so long as the tax is: 1) applied to an activity with a substantial nexus in the state, 2) fairly apportioned, 3) not discriminatory to interstate commerce, and 4) fairly related to the services provided in the state. The Court established two additional test prongs for state taxes on international commerce: the state tax cannot create a substantial risk of international multiple taxation; and a state tax cannot prevent the federal government from speaking with one voice on international trade.

Since this preference only applies to transportation conducted entirely within the state, it is not constitutionally required. Any constitutional concerns over taxing instate transportation between points within Washington, even if they are ultimately part of an interstate trip or foreign export, are no longer valid.

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

Taxing the instate transportation of commodities originating in Washington and delivered directly to an instate port, dock, etc., for shipment outside the state is now recognized as constitutional. Since 1977, taxing a wholly intrastate transportation activity is not constitutionally prohibited.

Assuming the Legislature's intent was to comply with constitutional Commerce Clause and Import-Export Clause prohibitions, this preference is no longer necessary to comply with the federal Constitution.

Maintaining consistency across multiple preferences may be important because the 1977 *Complete Auto* case requires that a state tax cannot be discriminatory against interstate commerce. Any changes to one interstate commerce-related preference might affect the constitutionality of other preferences. (See JLARC's review of public utility tax exemptions for through freight and shipments to ports, included in separate chapters in this report.) If the tax preference covered in this review was continued, but others were discontinued, an issue of discrimination could be raised. For example, if a leg of a shipment from out-of-state to a Washington port were taxed, but a shipment from instate to a Washington port were not, the constitutionality of the tax treatment may be questioned.

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

If the Legislature's intent was to comply with constitutional Commerce Clause and Import-Export Clause prohibitions, then this statute is no longer necessary and the Legislature should terminate the preference. If the Legislature had additional policy objectives in mind, the Legislature should clarify those objectives, so that the effectiveness of meeting those objectives can be evaluated.

Beneficiaries

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

The beneficiaries of this preference are trucking and motor freight, railroad, and certain waterway transportation businesses that transport commodities from within the state to Washington waterside locations for shipment outside the state. Federal law specifically preempts states from taxing air transportation of commodities.[18]

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

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

Revenue and Economic Impacts

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

The Department of Revenue estimated the taxpayer savings for this preference at $7.6 million for Fiscal Year 2009. Although the accuracy of this estimate is unclear, JLARC did not identify a method to estimate the taxpayer savings.

If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy?

If the tax preference were terminated, transportation providers transporting commodities from points in Washington to instate waterside locations would have a greater public utility tax burden. They would be subject to public utility tax in the same manner as businesses providing transportation services wholly instate.

The transportation sector is highly competitive. Both freight railroads and motor transportation are largely deregulated at the federal level. Rates are established primarily through competition between companies within the motor freight or rail industries and among competing transportation modes. The current federal regulation formula for freight railroads in the U.S. was established by the

[18] 49 U.S.C. § 40116(b).

Railroad Revitalization and Regulatory Reform Act (4R Act) in 1976 and the Staggers Act, enacted in 1980. Federal motor carrier deregulation began with the Motor Carrier Act of 1980. In 1995, Congress preempted states from regulating entry and rates for intrastate common carriers with some exceptions for safety, insurance, and household goods. Thus, the rates charged by transportation providers are largely dictated by competition between carriers.

Businesses that hire companies to transport commodities from points in Washington to instate ports and docks for shipment outside the state could experience an increase in transportation costs. Transportation businesses may choose to raise their rates or add additional fees to cover their increased costs due to the public utility tax. If the competitive transportation market will not allow an increase in rates or fees, transportation providers would have to absorb the additional costs, which may result in decreased profits for the business or lower wages for employees.

Total employment in the freight and specialized trucking sectors and railroads accounted for less than one percent of Washington's employment figure in 2008. The average wage earned in the trucking industry, including log trucking, was $43,167. (See Exhibit 14.) Although 2008 wage information was not available, the 2007 average Washington railroad wage was over $73,000.

Exhibit 14 – Washington Trucking Transportation Industry Employment and Wage Data – 2008

Industry	Employment	Total Wages ($ Millions)	Average Wages
General Freight Trucking, Local	4,579	$187	$40,794
General Freight Trucking, Long Distance	13,115	$597	$46,760
Specialized Trucking,* Local	4,046	$152	$37,566
Specialized Trucking,* Long Distance	1,728	$78	$44,852
Totals	**23,467**	**$1,013**	**$43,167**

Source: Employment Security QCEW Annual Data, 2008. * Includes log trucking.

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

There would be no change in the distribution of liability for payment of state taxes for the beneficiaries of this tax preference. If the tax preference were terminated, transportation providers shipping from points in Washington to instate ports would be subject to public utility tax on the income from such transportation activities similar to other instate transportation providers. This would result in increased public utility tax revenues for the state.

Other States

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

Unlike Washington, 45 states apportion revenue from interstate transportation and tax the instate portion of transportation activities in some manner. Most states generally apportion interstate transportation by using a ratio of the number of miles traveled in state compared with miles traveled everywhere. No specific exemptions for shipments to ports were found in other states.

Texas imposes a franchise tax on value-added (gross receipts minus the costs of wages paid and goods sold). Like Washington, Texas restricts taxation to transportation that is conducted entirely intrastate, meaning that transportation from interstate commerce (even the Texas portion) is not apportioned to Texas. JLARC was unable to determine if Texas provides a deduction for transportation from points within the state to an instate port for shipment outside the state.

Recommendation

Since this tax preference is no longer required by the Constitution, the original public policy objective is no longer applicable. Statutory changes in 1949 and 1967, however, imply that the Legislature may have had additional policy objectives. Because the Legislature did not identify its objectives at those times, the Legislature should reexamine and clarify this preference to identify what, if any, public policy objectives exist and how best to address them.

Legislation Required: Possibly, if the Legislature wants to clarify the preference.

Fiscal Impact: Possibly, if changes are made.

INTERSTATE TRANSPORTATION EQUIPMENT SALES & USE TAX EXEMPTIONS – SUMMARY

Current Law

In general, the Washington sales tax applies to the sale of goods delivered in state. The use tax applies when sales tax has not been paid. Current law provides sales and use tax exemptions for interstate transportation equipment. Sales of interstate transportation equipment are eligible for the sales tax exemption without limitations on the amount of interstate use. However, in order to qualify for the use tax exemption, vehicles must be used "in substantial part" and other transportation equipment such as airplanes and watercraft must be "used primarily" in interstate commerce.

Specifically, the statutes provide tax exemptions for the sale or use of:

- Airplanes, locomotives, railroad cars, or watercraft for use in conducting interstate commerce (requires an exemption certificate and registration with the Department of Revenue);
- Motor vehicles and trailers for use in conducting interstate commerce (requires a permit from the Interstate Commerce Commission or successor agency);
- Vessels for conducting commercial deep sea fishing outside the territorial waters of the state (requires an exemption certificate);
- Component parts for such equipment or vehicles; and
- Labor and services for constructing, repairing, cleaning, altering, and improving such equipment or vehicles.

The Department of Revenue (DOR) interprets "in substantial part" to mean at least 25 percent of the time in interstate commerce; DOR interprets "used primarily" to mean more than 50 percent of the time.

See page A3-4 and A3-5 in Appendix 3 for the current statutes, RCWs 82.08.0262, 82.08.0263, and 82.12.0254.

Legal History and Public Policy Objectives

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure, including the retail sales tax and the companion use tax. The sales tax applied if the purchaser took delivery in Washington. The use tax applied if the sales tax had not been paid, for instance when personal property is purchased out of state for use in Washington. Both sales and use taxes were imposed at the same rate.

1939 Locomotives, railcars, airplanes, and watercraft used in interstate commerce became exempt from Washington's use tax.

1949 The Legislature enacted sales tax exemptions for motor vehicles and transportation equipment used in interstate commerce and for related labor, services, and component parts. The use tax exemption was amended to require airplanes, locomotives, railcars, and watercraft, and deep sea fishing vessels to be "used primarily" in interstate commerce. In addition, the Legislature expanded the use tax exemption to deep sea fishing vessels "used primarily" outside territorial waters of the state and motor vehicles without limitation on the amount of use in interstate commerce.

1951 The Legislature imposed the same limitation on motor vehicles that applied to other transportation equipment. Now, in order to qualify for the use tax exemption, all forms of transportation equipment had to be "used primarily" in interstate commerce.

1965 The Legislature reduced the limitation on the amount of time motor vehicles must be used in interstate commerce. With this change, motor vehicles qualify for the use tax exemption if they are used "in substantial part" in interstate commerce. The stricter limitation continued to apply to other transportation equipment.

1984 The Washington State Supreme Court upheld a Department of Revenue rule that established a threshold vehicles must meet in order to qualify for the use tax exemption. Of the total number of trips a vehicle makes, at least 25 percent of the trips must cross a state border.

2003 The Legislature imposed an additional tax of 0.3 percent on sales and use of motor vehicles, but exempted the sales and use of vehicles used in interstate commerce.

2010 During the 2010 Legislative Session, the Legislature considered increasing the qualifying threshold for motor vehicles from used "in substantial part" to "primarily used" in interstate commerce. This legislation, which did not pass, would have provided the same 50 percent interstate use threshold for both motor vehicles and other transportation equipment.

The public policy objective is to give a competitive advantage to Washington-based transportation manufacturing industries in order to retain high-wage, skilled manufacturing jobs.

Beneficiaries

The beneficiaries are the purchasers of interstate transportation equipment and vehicles that take delivery in Washington. A total of $19 billion in these purchases were made in 2008. Aerospace products and parts make up the largest share (94 percent) of these purchases. Persons who use interstate transportation equipment and vehicles in Washington or have equipment and vehicles repaired in Washington are also beneficiaries.

Revenue and Economic Impacts

Purchasers of interstate transportation equipment saved $2.1 billion in state and local sales taxes in Fiscal Year 2008. Owners and leasers of interstate carriers used in Washington saved $488 million in state and local use taxes. These tax savings are comprised of state and local sales and use taxes, and additional vehicle sales and use taxes.

Other States

There are 45 states and the District of Columbia that impose sales and use taxes. Almost all states with a sales tax provide an exemption for certain types of transportation equipment (such as airplanes, watercraft, trains, motor vehicles, and trailers). Washington is one of 12 states that provide a specific exemption for sales of all types of equipment used in interstate commerce.

Recommendation

Because the public policy purpose of increasing the competitive advantage of Washington transportation equipment industries is being met, the Legislature should continue the exemptions.

Legislation Required: No.

Fiscal Impact: None.

INTERSTATE TRANSPORTATION EQUIPMENT SALES & USE TAX EXEMPTIONS – REPORT DETAIL

Current Law

In general, the Washington sales tax applies to the sale of goods delivered in state. The use tax applies when sales tax has not been paid. Current law provides sales and use tax exemptions for interstate transportation equipment. Sales of interstate transportation equipment are eligible for the sales tax exemption without limitations on the amount of interstate use. However, in order to qualify for the use tax exemption, vehicles must be used "in substantial part" and other transportation equipment such as airplanes and watercraft must be "used primarily" in interstate commerce.

Specifically, the statutes provide tax exemptions for the sale or use of:

- Airplanes, locomotives, railroad cars, or watercraft for use in conducting interstate commerce (requires an exemption certificate and registration with the Department of Revenue);
- Motor vehicles and trailers for use in conducting interstate commerce (requires a permit from the Interstate Commerce Commission or successor agency);
- Vessels for conducting commercial deep sea fishing outside the territorial waters of the state (requires an exemption certificate);
- Component parts for such equipment or vehicles; and
- Labor and services for constructing, repairing, cleaning, altering, and improving such equipment or vehicles.

The Department of Revenue (DOR) interprets "in substantial part" to mean at least 25 percent of the time in interstate commerce; DOR interprets "used primarily" to mean more than 50 percent of the time.

See page A3-4 and a3-5 in Appendix 3 for the current statutes, RCWs 82.08.0262, 82.08.0263, and 82.12.0254.

Legal History

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure, including the retail sales tax and the companion use tax. The sales tax applied if the purchaser took delivery in Washington. The use tax applied if the sales tax had not been paid, for instance when personal property is purchased out of state for use in Washington. Both sales and use taxes were imposed at the same rate.

1939 Locomotives, railcars, airplanes, and watercraft used in interstate commerce became exempt from Washington's use tax.

1949 The Legislature enacted sales tax exemptions for motor vehicles and transportation equipment used in interstate commerce and for related labor, services, and component parts. The use tax exemption was amended to require airplanes, locomotives, railcars, and watercraft, and deep sea fishing vessels to be "used primarily" in interstate commerce. In addition, the Legislature expanded the use tax exemption to deep sea fishing vessels "used primarily" outside territorial waters of the state and motor vehicles without limitation on the amount of use in interstate commerce.

1951 The Legislature imposed the same limitation on motor vehicles that applied to other transportation equipment. Now, in order to qualify for the use tax exemption, all forms of transportation equipment had to be "used primarily" in interstate commerce.

1965 The Legislature reduced the limitation on the amount of time motor vehicles must be used in interstate commerce. With this change, motor vehicles qualify for the use tax exemption if they are used "in substantial part" in interstate commerce. The stricter limitation continued to apply to other transportation equipment.

1984 The Washington State Supreme Court upheld a Department of Revenue rule that established a threshold vehicles must meet in order to qualify for the use tax exemption. Of the total number of trips a vehicle makes, at least 25 percent of the trips must cross a state border.

2003 The Legislature imposed an additional tax of 0.3 percent on sales and use of motor vehicles, but exempted the sales and use of vehicles used in interstate commerce.

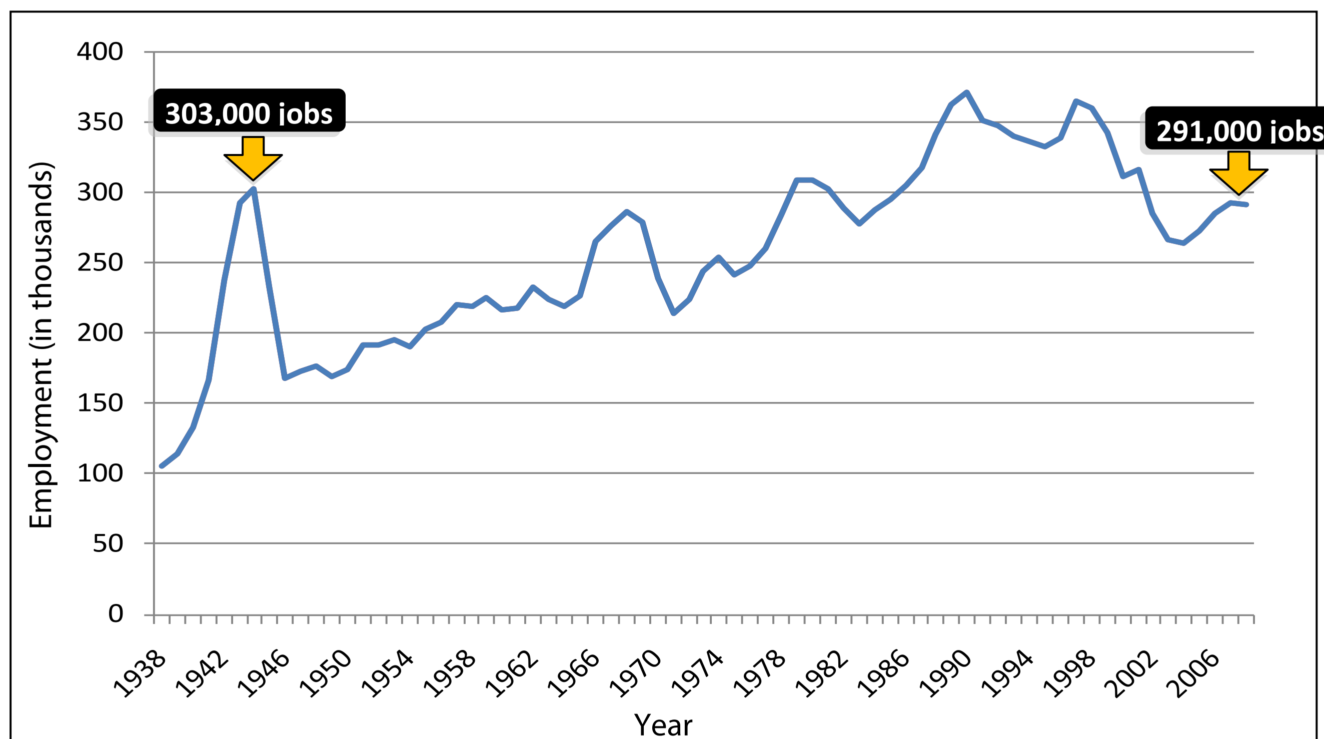
2010 During the 2010 Legislative Session, the Legislature considered increasing the qualifying threshold for motor vehicles from used "in substantial part" to "primarily used" in interstate commerce. This legislation, which did not pass, would have provided the same 50 percent interstate use threshold for both motor vehicles and other transportation equipment.

Other Relevant Background

WWII and the War Effort

The transportation equipment sector in Washington was heavily impacted by World War II, both before and after the entry of the United States into the war. Washington manufacturers mobilized for the war effort by tripling the size of their workforce from 100,000 workers in 1938 to over 300,000 by 1944. (See Exhibit 16 on the following page.)

Exhibit 16 – WA Manufacturers Mobilized for WWII by Tripling their Workforce



Source: Employment Security Department Wage and Salary Employment.

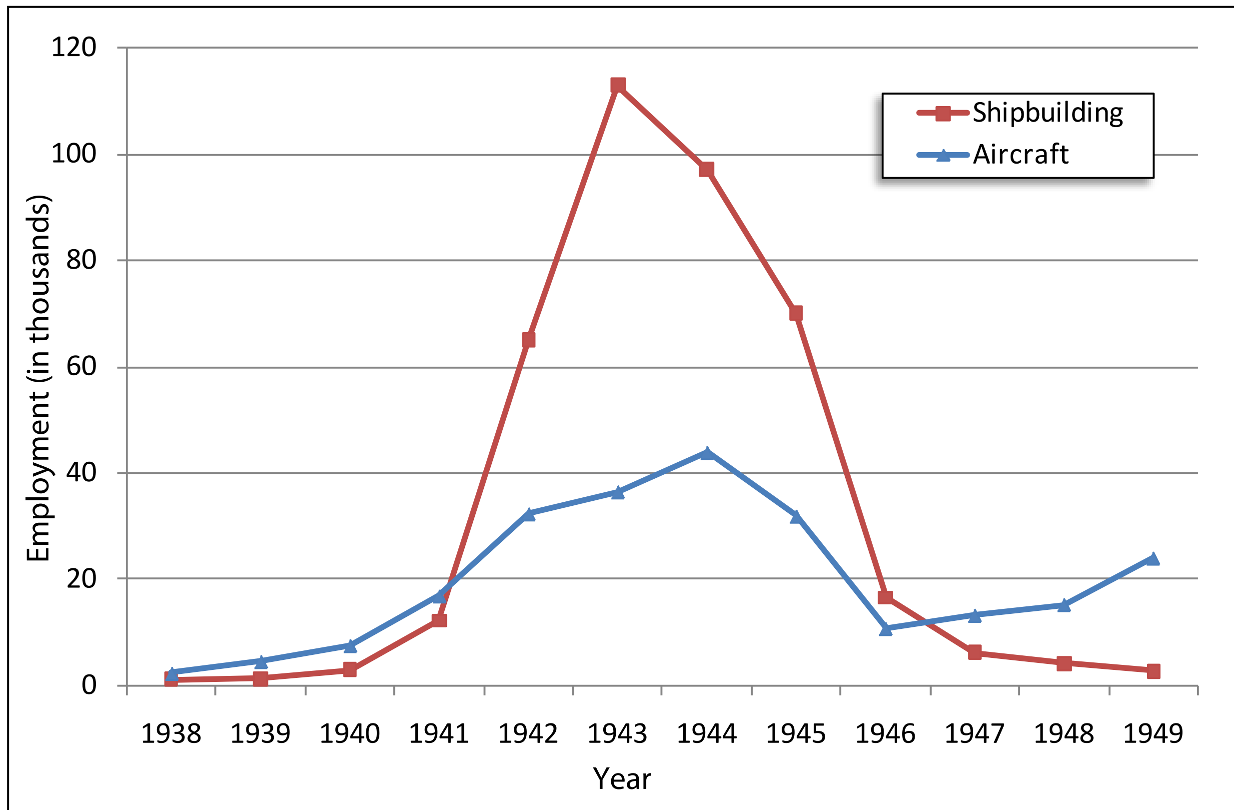
Washington-based businesses that converted to building war materiel included:

- Kenworth Trucks and Pacific Car and Foundry, later to become PACCAR, built tanks and heavy trucks at their Renton plants;
- Boeing built bombers and military transport airplanes;
- Kaiser Shipyard in Vancouver, and Puget Sound Bridge and Dredging Company in Seattle built vessels for use in the Pacific Theater; and
- Todd Shipbuilding Company built destroyers and repaired ships.

Post-War Reconversion

With the end of the war, the military abruptly cancelled its orders, and Washington's economy lost nearly half its manufacturing jobs from the peak employment during the war years. Airplane manufacturing jobs fell from a war-time high of 44,000 jobs to 11,000 jobs in 1946. Shipbuilding employment fell even more dramatically from 113,000 jobs to 2,750 jobs by 1949. (See Exhibit 17 on the following page.)

Exhibit 17 – Airplane and Ship Building Employment Peaked during WWII



Source: Employment Security Department Wage and Salary Employment.

Washington's heavy industry struggled to convert to peace-time production. A federal report on reconversion singled out transportation as the industry most severely impacted by the war's end.[19] A New York Herald Tribune reporter wrote that "nowhere in the nation is the problem of reconversion being worked out as painfully and from the ground up as in Seattle, home of the Flying Fortress and the Superfortress."

Boeing supporters argued that the company needed to move smoothly into peacetime production by gradually substituting commercial airliners for bombers. While California-based competitors Douglas Aircraft and Lockheed emerged from the war with ready orders for commercial airliners, Boeing could not escape its dependence on military contracts. In another blow to the Washington manufacturing industry, the newly-formed Air Force decided to build its bombers in Boeing's Wichita plant because Seattle was considered strategically vulnerable.

By the time the exemptions were enacted in 1949, Boeing faced tough competition in the commercial sector from Douglas Aircraft, was losing money on its new commercial airliner, the Stratocruiser, and had no work beyond year's end.

[19] Impact of Reconversion, War Profits Study #18, Office of Price Administration, 1946.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference?

The Legislature did not specifically state its intent. The original public policy objective was likely to maintain the competitiveness of Washington's transportation manufacturers, primarily in the aerospace and component parts industries. By providing these tax exemptions, the Legislature intended to preserve this industry's high-wage, skilled manufacturing jobs during the transition to a commercial peace-time economy after the end of WWII.

The continued importance of airplane manufacturing to the state's economy and the need to attract and retain aerospace businesses makes the original public policy purpose still relevant. In January 2010, the Washington Council on Aerospace reported to the Governor and the Legislature that its overarching objective is to "grow and improve jobs in the aerospace sector; retain and grow our existing aerospace cluster; make our existing aerospace companies, suppliers, and supporting firms more competitive, both nationally and internationally…" The report found that Washington is at a disadvantage compared with other states based on tax incentives, research and development expenditures, and labor costs. The Council recommended further state tax incentives for aerospace research and development. [20]

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

The exemption continues to provide a benefit to Washington industries that manufacture, sell, or repair interstate transportation equipment by allowing them to sell their products tax free. However, there is no direct evidence to show that the tax preferences contribute to maintaining competitiveness and preserving high-wage jobs.

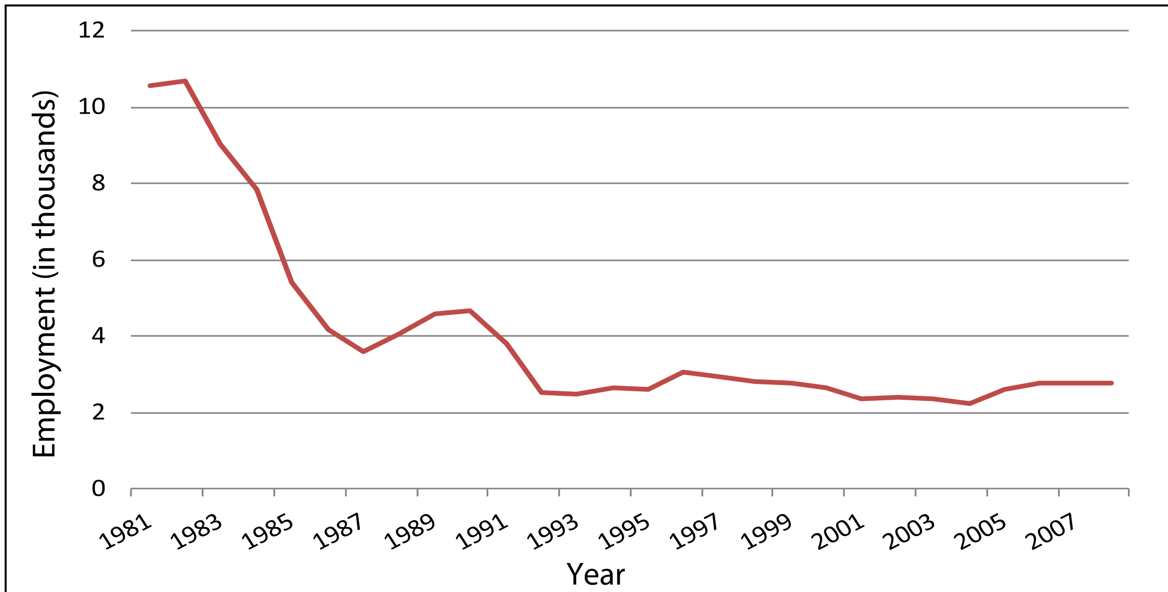
The exemptions provide a considerable tax benefit to purchasers of high-priced transportation equipment. For example, sales tax on a Boeing 777 passenger liner would add $25 million to the price of the airplane and could be a deterrent to purchasing and taking delivery in Washington.

Some manufacturers failed to make the transition to the commercial market following WWII and remain competitive in Washington. Heavy duty truck manufacturing is not a significant Washington employer. Shipbuilding has declined significantly in the last 30 years due to international competition, although building of commercial fishing vessels and ship repair still takes place in the state. Washington lost most of its ocean-going shipbuilding and repair when Lockheed closed its Puget Sound plant and Todd Shipyard reduced its employment by half in the early 1980s (see Exhibit 18 on the following page).

[20] Washington Council on Aerospace, Report to the Governor and Legislature, Washington Department of Commerce, 2010.

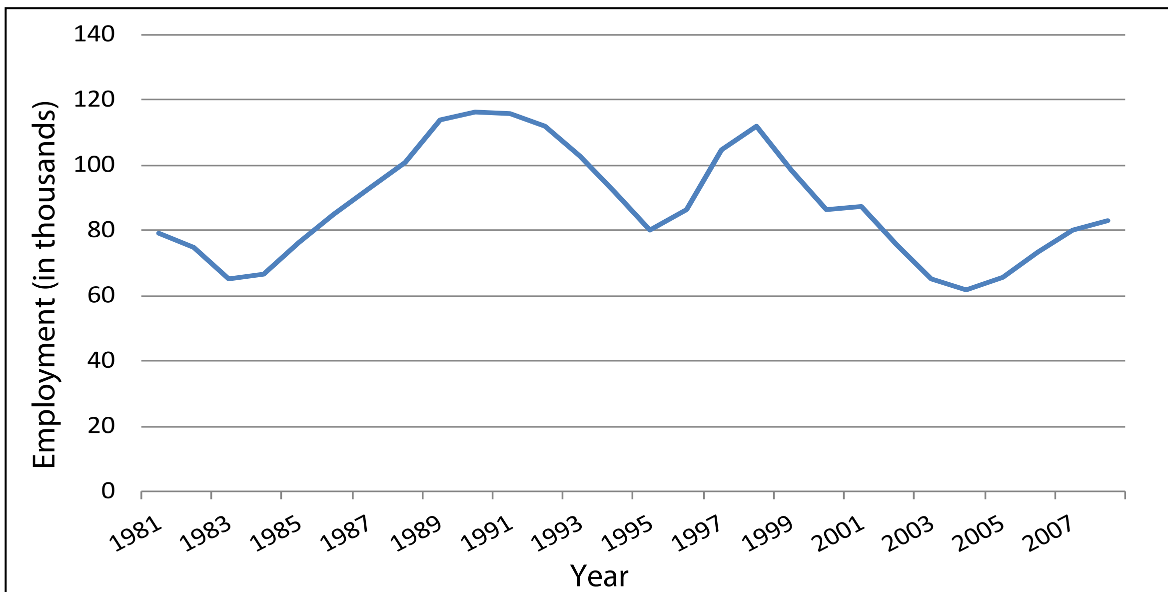
However, Boeing is now the dominant commercial airplane manufacturer in the country. Employment in Washington's airplane manufacturing industry is volatile, fluctuating around 80,000 jobs. (See Exhibit 19.)

Exhibit 18 – Commercial Shipbuilding Lost 80 percent of its Workforce Since 1981



Source: Employment Security Department, Wage and Salary Employment. Includes commercial deep sea fishing vessels.

Exhibit 19 – The Aircraft & Parts Industry is Volatile but a Significant Employer in WA



Source: Employment Security Department, Wage and Salary Employment.

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

The public policy objective of assisting the transportation manufacturing industry is being achieved. The tax preference cannot be directly linked to job preservation, but continuation of the tax preference results in a significant cost savings to purchasers and is an inducement to buy Washington-made equipment.

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

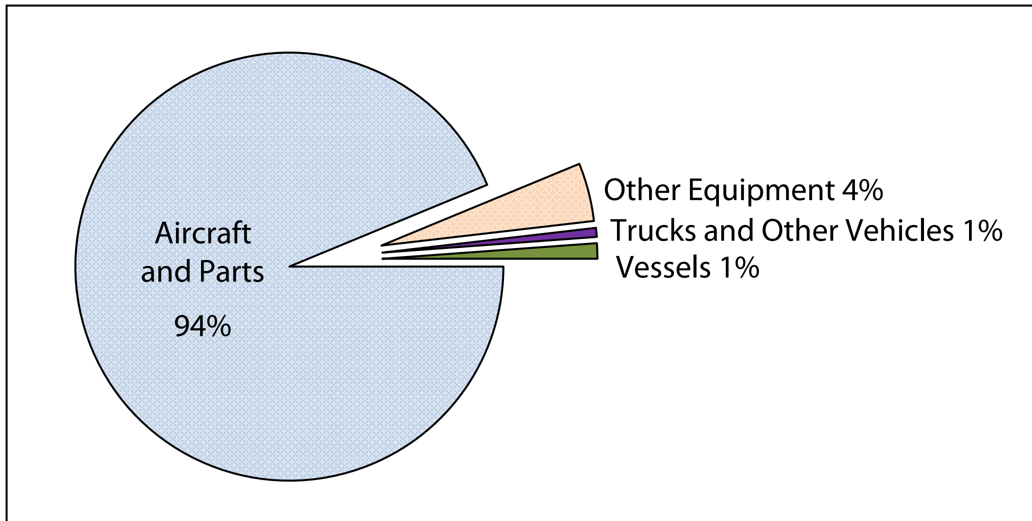
The public policy objective is being achieved.

Beneficiaries

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

The beneficiaries are purchasers of interstate transportation equipment that take delivery in Washington, and of component parts, labor, and services for cleaning, altering, improving, and repairing such equipment in Washington. Aerospace products and parts made up the largest share (94 percent) of the $19 billion in purchases in Fiscal Year 2008 (see Exhibit 20). Persons that use interstate transportation equipment in Washington benefit from the use tax exemption as well, but are not represented in the Exhibit below.

Exhibit 20 – Aircraft & Parts Sales are 94% of WA Interstate Equipment Sales



Source: Department of Revenue tax returns.

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

There is no evidence that the tax preference is providing unintended benefits to other entities than those intended by the Legislature.

Revenue and Economic Impacts

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

Purchasers of interstate transportation equipment saved $2.1 billion in state and local sales taxes in Fiscal Year 2008 (see Exhibit 21). Owners and leasers of interstate carriers used in Washington saved $488 million in state and local use taxes (see Exhibit 22). Sales and use tax savings are made up of three parts:

1) State sales and use taxes at 6.5 percent of the value of property;
2) Local sales and use taxes which vary by jurisdiction, but average 2.4 percent of the value of the property; and
3) Special motor vehicle sales and use taxes of 0.3 percent of the value of the vehicle.

Exhibit 21 – Interstate Transportation Equipment – Sales Tax Savings ($ in Millions)

Fiscal Year	State Sales Tax	Local Sales Tax	Vehicle Sales Tax	Total Taxpayer Savings
	Tax Rate = 6.5%	Tax Rate = 2.4% (avg.)	Tax Rate = 0.3%	
2008	$1,525.6	$559.3	$0.3	$2,084.9
2009	$1,400.7	$513.6	$0.3	$1,914.3
2010	$1,373.3	$503.5	$0.3	$1,876.8
2011	$1,531.1	$561.4	$0.3	$2,092.4
2012	$1,670.3	$612.4	$0.4	$2,282.8
2013	$1,752.4	$642.5	$0.4	$2,394.9

Source: Department of Revenue tax returns and Economic & Revenue Forecast Council February 2010 forecast.

Exhibit 22 – Interstate Transportation Equipment Exemption – Use Tax Savings ($ in Millions)

Fiscal Year	State Use Tax	Local Use Tax	Vehicle Use Tax	Total Taxpayer Savings
	Tax Rate = 6.5%	Tax Rate = 2.4% (avg.)	Tax Rate = 0.3%	
2008	$357.1	$130.9	$0.1	$488.0
2009	$327.8	$120.2	$0.1	$448.0
2010	$321.4	$117.8	$0.1	$439.2
2011	$358.3	$131.4	$0.1	$489.7
2012	$390.9	$143.3	$0.1	$534.3
2013	$410.1	$150.4	$0.1	$560.5

Source: Department of Revenue tax returns, IMPLAN, and Economic & Revenue Forecast council February 2010 forecast.

The tax preference may indirectly contribute to the state economy by making it more convenient to purchase transportation equipment made in Washington. Transportation equipment manufacturing is a significant portion of economic activity, providing 30 percent of the manufacturing jobs in the state. Transportation equipment jobs pay higher wages on average ($82,000 a year) compared to other manufacturing jobs ($61,000 a year).

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?

Termination of the tax preferences would have different effects on the beneficiaries and the economy depending on the type of purchase or use:

1) Purchases from the Washington manufacturer,
2) Purchasers from dealerships and repair service businesses, and
3) Use of interstate transportation equipment in Washington.

Purchases from Washington Manufacturers

If the tax preferences were terminated, a purchaser of interstate transportation equipment from a Washington manufacturer would pay state and local retail sales taxes if the purchaser took delivery in Washington. However, repeal of the sales tax exemptions would probably not have a significant impact on the sales or employment of transportation equipment manufacturers. The mobility of transportation equipment such as airplanes makes out-of-state deliveries easier than for other products. Purchasers could avoid the sales tax by taking delivery of the equipment in a state with either an exemption or no sales tax at all, such as Oregon. Additionally, most sales of equipment to foreign individuals or companies would be exempt under the Import-Export clause of the Constitution, even if delivered within the state.

Transportation Equipment Dealerships and Repair Services

Termination of the tax preferences could have a significant impact on the competitiveness of Washington dealerships and repair services. Local dealerships may see a loss of customers to dealerships located in other states. Repair service businesses would need to collect the sales tax for both parts and labor, and could consequently see a reduction in customers. Repeal would have no effect on military contracts, which are exempt from taxation under the U.S. Constitution.

Use of Equipment in Washington

Interstate carriers would be subject to Washington's use tax on entry into Washington. Under a multi-state agreement, however, Washington's law allows a credit for sales tax paid in other states, so this would largely impact interstate transportation, parts, and services purchased in Oregon and other states with no sales tax or lower sales tax rates.

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

There would be no effect on the distribution of state tax liability. However, purchasers of interstate transportation equipment, component parts, labor, and services, and users of transportation equipment in Washington would be liable for payment of tax if the preferences were terminated.

Other States

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

There are 45 states and the District of Columbia that impose sales and use taxes. Almost all states with a sales tax provide an exemption for certain types of transportation equipment (airplanes, watercraft, trains, motor vehicles, and trailers). Washington is one of 12 states that provide a specific exemption for sales of all types of equipment used in interstate commerce.

Recommendation

Because the public policy purpose of increasing the competitive advantage of Washington transportation equipment industries is being met, the Legislature should continue the exemptions.

Legislation Required: No.

Fiscal Impact: None.

Fertilizer, Spray Materials, and Chemical Sprays and Washes Retail Sales Tax Exemption – Summary

Current Law

Washington imposes a retail sales tax based on the selling price of tangible personal property and certain retail services. Fertilizer and spray materials, as well as chemical sprays or washes used on postharvest fruit to prevent decay, are exempt from retail sales tax. The exemption applies to:

- Farmers producing agricultural products for sale;
- Farmers acting under cooperative habitat development or access contracts with a 501(c)(3) tax exempt organization or the Washington State Department of Fish and Wildlife; and
- Persons participating in the federal Conservation Reserve Program, the Environmental Quality Incentives Program, the Wetlands Reserve Program, the Wildlife Habitat Incentives Program, or successive programs administered by the U.S. Department of Agriculture.

See page A3-6 in Appendix 3 for the current statute, RCW 82.04.050(11).

Legal History and Public Policy Objectives

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. The definition of "retail sale" specifically excluded "sales of feed to persons producing for sale milk, eggs, wool, fur, meat or other substances obtained from livestock, animals or poultry."

1936 The Tax Commission published rules implementing the Revenue Act of 1935. The rules provided that spray materials used to produce fruit, berries, vegetables, and nursery stock, and fertilizer used in commercial production were wholesale sales and not subject to retail sales tax. The rules also specified that fertilizer did not include any substance that did not become an ingredient or part of the product being grown.

1943 The Legislature expanded the 1935 exemption to specifically exclude seed, fertilizer, and spray materials from the definition of retail sale. The bill also expanded the exemption to persons that used such items to produce for sale any agricultural product, not just those specifically listed in 1935.

1967 The Legislature restricted the exemption to apply only to agricultural products produced and sold at wholesale. The Legislature also expanded the exemption to apply to sales of chemical sprays or washes used postharvest on fruit to prevent scald, fungus, mold, or decay.

1987 Legislation extended the exemption to include seedling sales and clarified the exemption applied to sales of fertilizer, sprays, etc., to plantation Christmas tree growers.

1988 The Legislature further extended the exemption to persons participating in the Federal Conservation Reserve Program.

1993 The Legislature removed the restriction added in 1967 that the items produced must be sold at wholesale.

1997 The Legislature expanded the exemption by adding other conservation and habitat protection programs to the list of programs for which exempt products could be used.

Although the Legislature provided no clear public policy statement, the implied public policy objective is to recognize these items as ingredients and component parts used by farmers and agricultural producers to produce agricultural products for sale. This is consistent with sales tax exemptions provided for ingredients and component parts in other industries.

A second implied public policy objective is to encourage participation in conservation and habitat protection programs.

Beneficiaries

The beneficiaries of the tax preference are farmers and also landowners enrolled in conservation and habitat protection programs. Over 17,000 Washington farms purchased fertilizer and over 16,000 purchased chemicals in 2007. Additionally, over 12,000 Washington landowners and farmers are enrolled in federal or state conservation and habitat protection programs. JLARC cannot determine to what extent they benefit from this preference.

Revenue and Economic Impacts

Washington farmers purchased over $698 million in fertilizer and chemical sprays in 2007 and were estimated to make more than $799 million in such purchases in 2009. The estimated taxpayer savings in 2009 from this preference is over $65 million. Of this amount, nearly $52 million is in state sales tax and over $13 million is in local sales tax.

The economic impact of the tax preference is likely increased income for farmers and their employees. Farmers are generally "price-takers," meaning they are relatively small producers in a national commodities market and cannot dictate the price at which they sell their products. If this preference were terminated, the retail sales tax would be an added cost of production for farmers that they may not be able to pass along to their customers. The sales tax would fall on the farmers to pay, resulting in less income to farmers and their employees.

Other States

Of the states and the District of Columbia that impose sales and use taxes, 41 states provide sales tax exemptions for both fertilizer and spray materials. Four others (Arizona, California, Nevada, and Wyoming) exempt one or the other, but not both. The District of Columbia is the only jurisdiction that does not provide an exemption for either fertilizer or spray materials.

Recommendation

Because the tax preference is achieving the public policy objectives of: 1) recognizing fertilizer and spray materials as ingredients and component parts used by farmers/agricultural producers to produce agricultural products for sale, and 2) encouraging farmers and landowners to participate in conservation and habitat protection programs, the Legislature should continue the retail sales tax exemption for sales of fertilizer, spray materials, and chemical sprays and washes for preventing decay in postharvest fruit.

Legislation Required: No.

Fiscal Impact: None.

Fertilizer, Spray Materials, and Chemical Sprays and Washes Retail Sales Tax Exemption – Report Detail

Current Law

Washington imposes a retail sales tax based on the selling price of tangible personal property and certain retail services. Fertilizer and spray materials, as well as chemical sprays or washes used on postharvest fruit to prevent decay, are exempt from retail sales tax. The exemption applies to:

- Farmers producing agricultural products for sale;
- Farmers acting under cooperative habitat development or access contracts with a 501(c)(3) tax exempt organization or the Washington State Department of Fish and Wildlife; and
- Persons participating in the federal Conservation Reserve Program, the Environmental Quality Incentives Program, the Wetlands Reserve Program, the Wildlife Habitat Incentives Program, or successive programs administered by the U.S. Department of Agriculture.

See page A3-6 in Appendix 3 for the current statute, RCW 82.04.050(11).

Legal History

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. The definition of "retail sale" specifically excluded "sales of feed to persons producing for sale milk, eggs, wool, fur, meat or other substances obtained from livestock, animals or poultry."

1936 The Tax Commission published rules implementing the Revenue Act of 1935. The rules provided that spray materials used to produce fruit, berries, vegetables, and nursery stock, and fertilizer used in commercial production were wholesale sales and not subject to retail sales tax. The rule specified that fertilizer did not include any substance that did not become an ingredient or part of the product being grown.

1943 The Legislature expanded the 1935 sales tax exemption to specifically exclude seed, fertilizer, and spray materials from the definition of retail sale. The bill also expanded the exemption to persons that used such items to produce for sale any agricultural product, not just those specifically listed in 1935.

1967 The Legislature restricted the exemption to apply only to agricultural products produced and sold at wholesale. The Legislature also expanded the exemption to apply to sales of chemical sprays or washes used postharvest to treat fruit for preventing scald, fungus, mold, or decay.

1987 Legislation extended the exemption to include seedling sales and clarified the exemption applied to sales of fertilizer, sprays, etc., to plantation Christmas tree growers.

1988 The Legislature further extended the exemption to persons participating in the Federal Conservation Reserve Program.

1993 The Legislature removed the restriction passed in 1967 that the items produced must be sold at wholesale.

1997 The Legislature expanded the exemption by adding other conservation and habitat protection programs to the list of programs for which exempt products could be used, including the Environmental Quality Incentives Program, the Wetlands Reserve Program, the Wildlife Habitat Incentives Program, and successive programs administered by the U.S. Department of Agriculture.

Other Relevant Background

Tax Exemptions for Ingredients and Component Parts used in Agricultural Production

State statutes provide several sales and use tax exemptions to farmers/agricultural producers for their purchases or use of goods that are used as ingredients or component parts in the production of agricultural products. For example, exemptions are provided for feed and seed (reviewed in the 2009 Tax Preference Report); poultry used to produce poultry and poultry products (reviewed in the 2010 Tax Preference Report); and breeding livestock, cattle and milk cows (also reviewed in the 2010 Tax Preference Report). Sales tax is generally defined as a tax on the final consumer of goods. In the case of ingredients or component parts used in agricultural production, the farmer/agricultural producer uses the goods to produce a new product for sale, rather than being the final consumer of the goods.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference?

Sales to farmers: Although no intent was specified in the law, the implied public policy objective for exempting fertilizer, spray materials, and chemical sprays or washes used on postharvest fruit was to recognize these items as ingredients and component parts used by farmers/agricultural producers to produce agricultural products for sale. This is consistent with sales tax exemptions provided for ingredients and component parts in other industries.

Sales tax is defined as a tax on the final consumer of goods. However, fertilizer, spray materials, and chemical sprays or washes sold to farmers for the purpose of producing agricultural products for sale are analogous to sales of ingredients or component parts, rather than sales for final consumption. Fertilizer, sprays, and chemical sprays/washes become an ingredient or component part of the agricultural product that will be sold. In other words, the farmer uses the products to produce a new product, rather than being the final consumer of these goods.

In 1935, the Legislature specified that sales of tangible personal property consumed as an ingredient or component, as well as sales of feed used to produce products from livestock, animals, or poultry,

were not within the definition of a "retail sale." In 1936, the Tax Commission adopted rules that defined as wholesale sales fertilizer used in a commercial production, and spray materials used to produce fruit, berries, vegetables, or nursery stock. Wholesale sales are specifically not retail sales. The Legislature confirmed the Tax Commission rules in 1943 when it specified that sales of seed, fertilizer, and spray materials for the purpose of producing for sale any agricultural product were not retail sales.

Sales to persons participating in state or federal conservation and habitat protection programs: The public policy objective for providing a sales tax exemption for fertilizer and spray materials sold to farmers and landowners participating in various state and federal conservation and habitat protection programs was to encourage farmers and other landowners to participate in state and federal programs that protect and preserve natural habitat and wetlands and mitigate impacts on wildlife habitat.

The federal Conservation Reserve Program (CRP) started in the 1980s. For administrative reasons, the Department of Revenue developed a policy exempting from sales tax purchases of vegetative cover, including fertilizer and spray materials, for use on land enrolled in the CRP. The 1988 amendment to the definition of "retail sale" put this policy in statute.

The 1997 amendment that expanded the exemption to other conservation and habitat protection programs had two aims. First, the prime sponsor wanted to encourage private participation in programs that would mitigate impacts on wildlife habitat. Second, it eased sales tax administration for sales of fertilizer and spray materials on lands enrolled in such programs. Without the exemption, farmers would have to apportion their purchases of fertilizer and sprays into nontaxable (used on crops for sale) and taxable (used on conservation property) portions, depending on how the land was ultimately used.

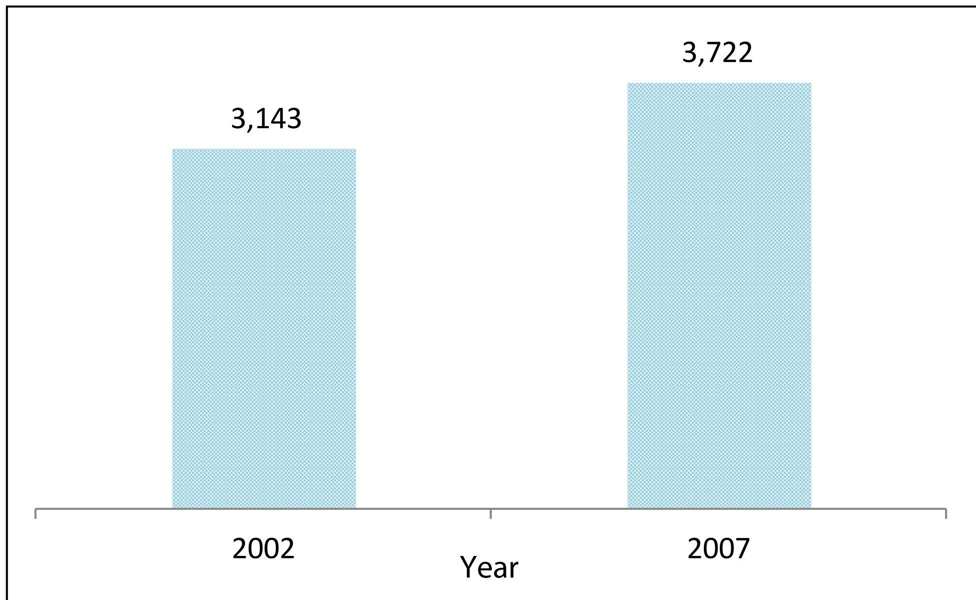
The Department of Revenue testified it would be administratively difficult to force farmers to allocate their purchases of fertilizer and sprays between those used to produce products for sale and those used on land enrolled in conservation or habitat control programs. The Department generally monitors payment of sales and use taxes through audits of businesses. Because farmers are not generally required to register with the Department of Revenue, most farmers are not audited by the state. The Department's position was that trying to apply sales tax on fertilizer and spray materials used by farmers on land enrolled in conservation and habitat protection programs was unenforceable and, even if such sales were not exempt from sales tax, the sales tax would largely go uncollected.

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

Production exemption for ingredients and component parts: Farmers purchase fertilizer and spray materials, and also chemical sprays and washes used on postharvest fruit to create a new product for sale. This fits within the concept of an ingredient or component part. Other people that purchase fertilizer or spray materials are subject to sales tax or use tax because they do not produce a new or different product for sale.

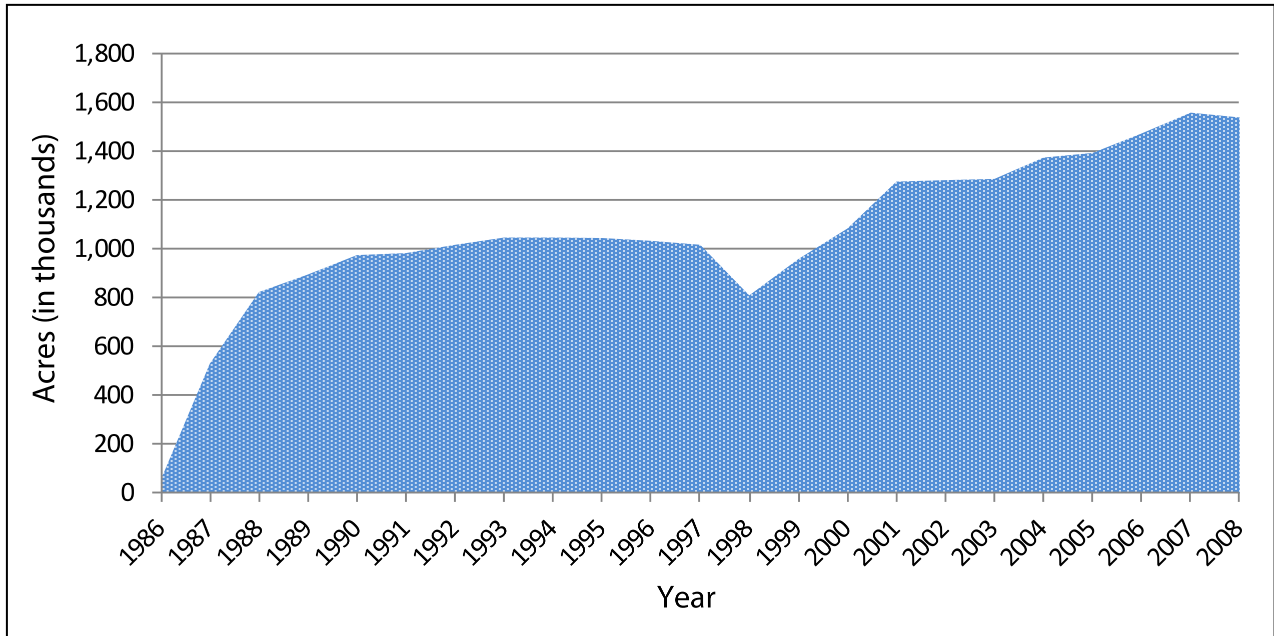
Encouraging participation in conservation and habitat protection programs: Enrollment in these programs has steadily grown in Washington. The number of farms enrolled in various conservation programs increased from 3,143 farms in 2002 to 3,722 farms in 2007. (See Exhibit 23.) In 1986, the CRP program had 54,618 acres enrolled in Washington. 2008 USDA reports reflect cumulative enrollment at over 1.5 million acres instate and over 36.5 million nationwide. (See Exhibits 24 and 25.) However, it is difficult to directly tie the growth in program participation to the sales tax exemption for fertilizer and spray materials.

Exhibit 23 – Number of Washington Farms Enrolled in Conservation Programs Increases



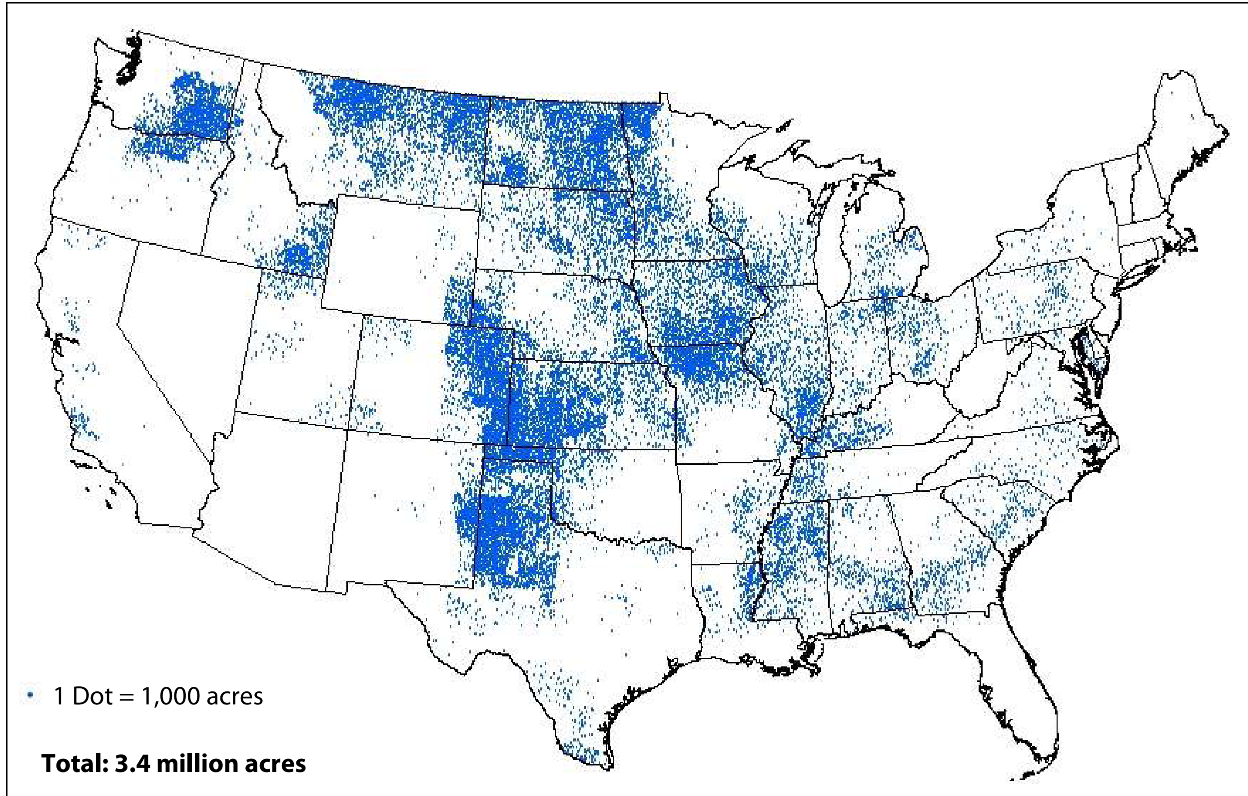
Source: USDA 2007 Census of Agriculture, Land in Conservation Reserve, Wetlands Reserve, Farmable Wetland, or Conservation Reserve Enhancement Programs.

Exhibit 24 – Washington Cumulative Conservation Reserve Program Enrollment 1986 - 2008 (in Acres)



Source: USDA Conservation Reserve Program Summary and Enrollment Statistics – 2008. http://www.fsa.usda.gov/Internet/FSA_File/annualsummary2008.pdf.

Exhibit 25 – FY 2008 Conservation Reserve Program Enrollment



Source: USDA Conservation Reserve Program Summary and Enrollment Statistics – 2008. http://www.fsa.usda.gov/Internet/FSA_File/annualsummary2008.pdf

Easing tax administration: As a result of the exemption, farmers participating in conservation and habitat protection programs do not have to apportion their purchases of fertilizer and sprays into nontaxable (used on crops for sale) and taxable (used on land enrolled in conservation programs) portions.

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

Continuing the retail sales tax exemption for purchases of fertilizers, spray materials, and chemical sprays/washes applied to fruit post harvest to farmers producing agricultural products will maintain the treatment of these purchases as ingredient and component parts. As of 2008, there was approximately 14.8 million acres of land in farms in Washington.

Continuing the sales tax exemption for purchases of fertilizer and spray materials for farmers and landowners enrolled in conservation and habitat protection programs encourages habitat conservation and preservation programs and relieves the Department of Revenue of the duty to collect retail sales tax from taxpayers who are not otherwise required to register with the Department.

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

The public policy objectives are being fulfilled.

Beneficiaries

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

Beneficiaries of the tax preference are farmers that produce agricultural products for sale. The 2007 USDA Census of Agriculture reflected that 17,083 Washington farms purchased fertilizer or other soil amendments, and 16,386 (likely many of the same farms) purchased chemicals for use on the farm. Family or individually owned farms purchased 35 percent of all fertilizer and chemicals, closely followed by family-held corporations, which purchased 34 percent of the fertilizer and chemicals. (See Exhibit 26.)

Exhibit 26 – Purchases of Fertilizer and Chemicals by Type of Farm Ownership in Washington ($ in Thousands)

	Purchases of Fertilizer, Lime, & Soil Conditioners		Purchases of Chemicals		Total Purchases	Share of Total
Farm Ownership	**# Farms**	**$ 000**	**# Farms**	**$ 000**	**$ 000**	**%**
Family or individual	12,921	$142,681	12,317	$102,435	$245,116	35%
Family Held Corporation	2,112	$128,009	2,033	$109,290	$237,299	34%
Partnership	1,725	$83,042	1,620	$74,822	$157,864	23%
Other Corporation	184	$22,663	177	$29,001	$51,664	7%
Other Ownership	141	$3,963	239	$2,236	$6,199	1%
Total	**17,083**	**$380,358**	**16,386**	**$317,784**	**$698,142**	**100%**

Source: 2007 Census of Agriculture, U.S. Department of Agriculture, Table 61.

Additionally, manufacturers of fruit products benefit from the tax exemption for chemical sprays and washes used on postharvest fruit to prevent decay. The preference does not extend to manufacturers of vegetable products. There are 150 fruit and vegetable manufacturers registered to do business in Washington, but only those that manufacture fruit products benefit from the preference.

Finally, landowners enrolled in a federal or state habitat conservation and preservation program benefit from this preference. These landowners include many farmers. Because of the administrative issues mentioned earlier, it would be difficult to collect tax on fertilizers and sprays used by farmers on conservation lands. The most recent USDA report (February 2010) on the largest of these programs, the Conservation Reserve Program, shows 12,112 contracts in Washington with 1.4 million acres enrolled.

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

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

Revenue & Economic Impacts

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

Washington farmers purchased over $698 million in fertilizer and chemicals in 2007. As noted in Exhibit 27, the estimated taxpayer savings realized by exempting these purchases from sales tax is over $65 million in 2009. JLARC could not identify the amount of fertilizer and chemicals purchased by landowners participating in habitat conservation and protection programs or the amount of postharvest chemical sprays/washes purchased by manufacturers, therefore the estimated taxpayer savings do not account for these sales.

Exhibit 27 – Estimated Taxpayer Savings - Retail Sales Tax Exemption for Sales of Fertilizer, Sprays, and Chemical Sprays or Washes to Farmers ($ in Millions)

Calendar Year	Fertilizer and Chemical Expenses	State Tax (6.5%)	Local Tax (1.72%)	Total Sales Tax
2007	$698.1	$45.4	$12.0	$57.4
2008	$747.0	$48.6	$12.8	$61.4
2009	$799.3	$52.0	$13.7	$65.7
2010	$855.3	$55.6	$14.7	$70.3
2011	$915.1	$59.5	$15.7	$75.2
2012	$979.2	$63.6	$16.9	$80.5
2013	$1,047.7	$68.1	$18.0	$86.1

Source: JLARC estimate based on 2007 U.S. Census of Agriculture data.

The economic impact of the tax preference is likely increased income to farmers and their employees.

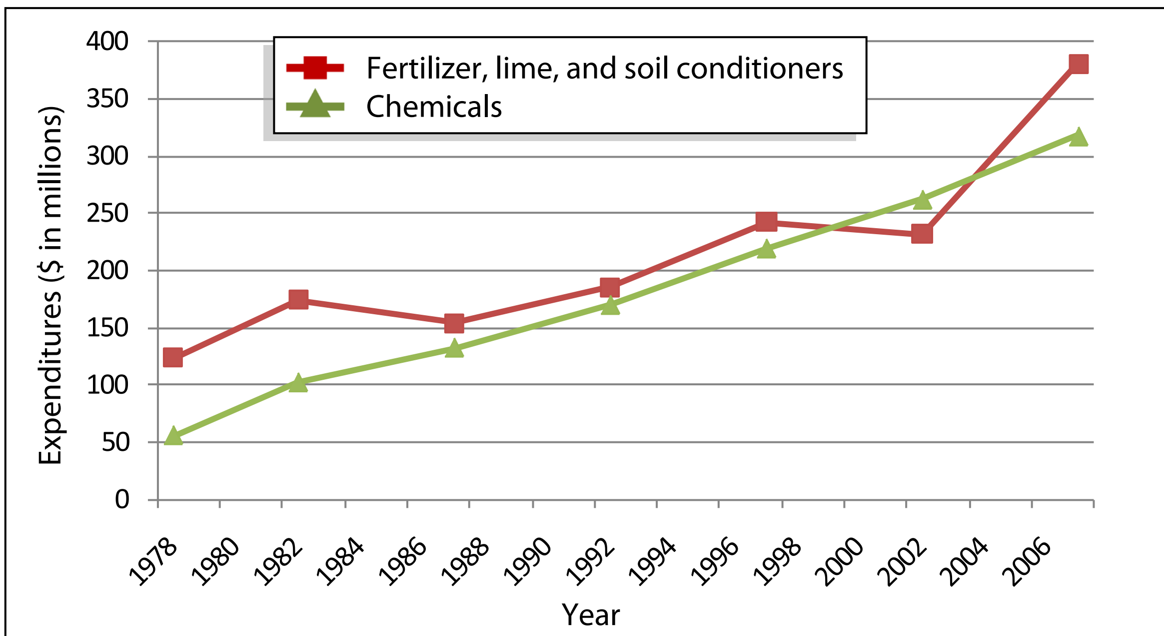
If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy?

If the sales tax exemption was terminated, farmers and landowners participating in conservation and habitat protection programs would pay sales tax on their purchases of fertilizer and spray materials.

As Exhibit 26 reflects, 69 percent of the farms that purchase fertilizer or chemicals are owned by individuals, families, or family owned corporations. Farmers are generally "price-takers," meaning they are relatively small producers in a national commodities market and cannot dictate the price at which they sell their products. The retail sales tax would be an added cost of production for farmers that they may not be able to pass along to their customers and would fall on the farmers to pay.

Expenditures for fertilizer and chemicals used in farm production increased from 1978 through 2006. (See Exhibit 28.) Amounts paid by farmers on purchases of such inputs would increase by an estimated $70.3 million in 2010 if the preference were terminated. The likely result would be less income for the farmers and their employees.

Exhibit 28 – Farm Production Expenditures in Washington 1978 - 2006



Source: 2007 Census of Agriculture, U.S. Department of Agriculture, Table 3.

Participants in habitat and conservation programs would experience increased costs for their purchases of fertilizers and chemicals as well. As they do not produce products to resell and cannot pass increased costs on, they would have to absorb the added sales tax if the tax preference was terminated.

Fruit farmers and manufacturers also would be subject to sales tax on purchases of chemical sprays and washes that prevent postharvest decay. It is unclear to what extent manufacturers could adjust their prices to pass on increased costs.

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

There would be no change in the distribution of liability for payment of state taxes for the beneficiaries of this tax preference. If the tax preference were terminated, farmers, farmers and landowners enrolled in certain habitat and conservation programs, and fruit product manufacturers would pay sales tax or use tax on their purchases or acquisitions of fertilizer, sprays, and chemical sprays/washes to prevent postharvest decay. Currently, they are exempt from sales or use tax on such purchases. The result is that beneficiaries would pay over $70 million more in state sales and use taxes in 2010 than they currently pay. (See Exhibit 27.)

Other States

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

Of the states and the District of Columbia that impose sales and use taxes, 41 states provide sales tax exemptions for both fertilizer and spray materials. Four others (Arizona, California, Nevada, and Wyoming) exempt one or the other, but not both. The District of Columbia is the only jurisdiction that does not provide an exemption for either fertilizer or spray materials.

Recommendation

Because the tax preference is achieving the public policy objectives of: 1) recognizing fertilizer and spray materials as ingredients and component parts used by farmers/agricultural producers to produce agricultural products for sale, and 2) encouraging farmers and landowners to participate in conservation and habitat protection programs, the Legislature should continue the retail sales tax exemption for sales of fertilizer, spray materials, and chemical sprays and washes for preventing decay in postharvest fruit.

Legislation Required: No.

Fiscal Impact: None.

LABOR AND SERVICES USED IN CONSTRUCTION AND REPAIR OF PUBLIC ROADS EXCLUSION FROM RETAIL SALE – SUMMARY

Current Law

Under this tax preference, local governments that hire a contractor to construct or repair their roads are exempt from paying sales or use tax on the contractor charges for labor and services. Local governments receiving the preference include municipal corporations (cities and towns) and other political subdivisions of the state (counties, port districts, etc.). The federal government also qualifies for the exemption. The exemption applies to contractor charges for labor and services performed as part of building, repairing, or improving any street, place, road, highway, right-of-way, mass transit terminal or parking facility, bridge, etc., owned by a local government or the federal government and used for foot, vehicle, or mass transportation traffic.

In general, the final consumer is responsible for paying sales tax on taxable retail goods or services. If a private landowner or the state of Washington hires a contractor to build a road, the private landowner or the state, as the case may be, is the consumer and is responsible for paying sales tax on the full contract price, including materials, labor, and services. With this preference, if a local government hires a contractor to build or repair its road, the local government is not subject to sales tax on labor and services, because road construction labor and services for local governments are specifically excluded from the definition of a retail sale. On materials for such road construction, the contactor is defined in statute as the consumer. The contractor, therefore, pays sales or use tax on the materials incorporated into the road being built or repaired. The contractor's charges to the local government are not subject to sales tax.

See pages A3-6 and A3-7 in Appendix 3 for the current statute, RCW 82.04.050(10) as well as RCW 82.04.190(3), defining "consumer."

Legal History and Public Policy Objectives

Much of the legal history for this preference revolves around what activities are defined as being a retail sale and who is identified as the "consumer" and thus responsible for paying sales or use tax.

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. The taxability of construction activities was not addressed in the Revenue Act of 1935. At that time, labor and services performed to tangible personal or real property were not considered retail activities and therefore not taxed.

1939 The Legislature defined "consumer" to include persons engaged in certain activities, including constructing buildings or improving real property for others and persons performing public improvement contacts. The law clarified that contractors were the

consumers of materials they used in performing their services and owed sales or use tax on their materials purchases and acquisitions. The Legislature did not yet define construction labor and services as a retail activity.

1941 The Legislature imposed retail sales tax on construction activities. Road construction charges, like other construction work, became subject to retail sales tax on the full contract price. Because construction work was now defined as a retail sale, the incidence of tax changed. The landowner became the consumer of the materials, labor, and services performed as part of the retail construction work, so the landowner became responsible for paying the sales tax.

1943 The Legislature modified the taxability of road construction for "publicly owned" roads. Charges for labor and services provided for building, repairing, or improving any publicly owned road, street, etc., were specifically excluded from the definition of "retail sale" and no longer subject to sales or use tax. The term "publicly owned" included roads owned by any governmental entity, including cities, counties, the federal government, and the state of Washington.

1969 Legislation expanded the exclusion to include labor and services used to build publicly owned mass public transit terminals and parking facilities.

1971 The Legislature made road construction and repair work for the state of Washington a retail sale, but kept the sales and use tax exemptions for other government entities. The Legislature removed the term "publicly owned" roads from the labor and services sales tax exclusion and instead specifically stated the exclusion applied to roads owned by municipal corporations, political subdivisions of the state, or the federal government.

Although no public policy objective was stated, the implied public policy objective of the preference when adopted in 1943 was to reduce the cost of road construction for "publicly owned" (at the time, city, county, state, and federal) roads and make funds for road construction and repairs stretch further. It appears that the Legislature decided to subject labor and services for state roads to sales tax beginning in 1971 to maximize federal funds, which primarily financed state road construction at the time.

Beneficiaries

The beneficiaries of this preference are Washington cities, counties, and other political subdivisions of the state, such as port districts and public transportation benefit districts. They are relieved from paying sales tax or use tax on the contractor labor and services performed as part of local government road, bridge, sidewalk, etc., new construction, maintenance, or repair work.

Revenue and Economic Impacts

Qualifying road construction and maintenance work is mainly performed for local city and county governments. Washington city and county expenditures for construction and maintenance of roads, sidewalks, bridges, etc., exceeded $1 billion annually in each year since 2005.

Local government savings realized by exempting the labor and services activities of public road construction from sales tax is estimated at over $60 million in 2009 – over $44.5 million in state sales tax and over $16.3 million in local sales tax.

Other States

Of the 45 states and the District of Columbia that impose sales and use taxes, 38 states and the District of Columbia provide sales tax exemptions to local governments, which include local government road construction work. In the remaining seven states, road construction activities are not subject to sales or use tax. Hawaii taxes the labor for local road construction, but by imposing a general excise rather than a sales tax.

Recommendations

Recommendation 1

Because it is meeting the implied public policy objective of reducing road construction and maintenance costs for cities, counties, and other local government entities, the Legislature should continue the preference providing a sales and use tax exemption for labor and services performed as part of city, county, and federal road construction, maintenance, and repair work.

Recommendation 2

Because circumstances have changed and state road construction and maintenance work is no longer predominately paid by the federal government, the Legislature should review and clarify whether it wants to continue subjecting labor and services performed as part of state road construction and maintenance work to retail sales tax.

Legislation Required: No legislation is required to continue the preference as it is. Legislation would be required if the Legislature decided to change the taxation of labor and services for road construction for the state.

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

LABOR AND SERVICES USED IN CONSTRUCTION AND REPAIR OF PUBLIC ROADS EXCLUSION FROM RETAIL SALE – REPORT DETAIL

Current Law

Under this tax preference, local governments that hire a contractor to construct or repair their roads are exempt from paying sales or use tax on the contractor charges for labor and services. Local governments receiving the preference include municipal corporations (cities and towns) and other political subdivisions of the state (counties, port districts, etc.). The federal government also qualifies for the exemption. The exemption applies to contractor charges for labor and services performed as part of building, repairing, or improving any street, place, road, highway, right-of-way, mass transit terminal or parking facility, bridge, etc., owned by a local government or the federal government and used for foot, vehicle, or mass transportation traffic.

In general, the final consumer is responsible for paying sales tax on taxable retail goods or services. If a private landowner or the state of Washington hires a contractor to build a road, the private landowner or the state, as the case may be, is the consumer and is responsible for paying sales tax on the full contract price, including materials, labor, and services. With this preference, if a local government hires a contractor to build or repair its road, the local government is not subject to sales tax on labor and services, because road construction labor and services for local governments are specifically excluded from the definition of a retail sale. On materials for such road construction, the contactor is defined in statute as the consumer. The contractor, therefore, pays sales or use tax on the materials incorporated into the road being built or repaired. The contractor's charges to the local government are not subject to sales tax.

See page A3-6 and A3-7 in s 3 for the current statute, RCW 82.04.050(10) as well as RCW 82.04.190(3), defining "consumer."

Legal History

Much of the legal history for this preference revolves around what activities are defined as being a retail sale and who is identified as the "consumer" and thus responsible for paying sales or use tax.

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. Retail sale was defined to include all sales of tangible personal property to persons who used the property in building, improving, altering or repairing real property for others. The taxability of construction activities was not addressed in the Revenue Act of 1935. At that time, labor and services performed to real property were not considered retail activities and therefore not taxed.

1939 The Legislature defined "consumer" to include persons engaged in constructing buildings or improving real property for others, persons performing public improvement contacts, and persons engaged in rendering personal and professional services. The law clarified that contractors were the consumers of materials they used in performing their services and the incidence of tax was upon them. The Legislature did not yet define construction labor and services as a retail activity.

1941 The Legislature imposed retail sales tax on construction activities by adding "services performed to real property" to the definition of "retail sale." Road construction charges, like other construction work, were now subject to retail sales tax on the full contract price. Because construction work was now defined as a retail sale, the incidence of tax changed. The landowner became the consumer of the materials, labor, and services performed as part of the retail construction work.

1943 The Legislature modified the taxability of road construction for "publicly owned" roads. Charges for labor and services provided for building, repairing, or improving any publicly owned road, street, etc., were specifically excluded from the definition of "retail sale" and no longer subject to sales or use tax. The term "publicly owned" included roads owned by any governmental entity, including cities, counties, the federal government, and the state of Washington.

Also during the 1943 Legislative Session, the Legislature passed a proposed constitutional amendment dedicating gasoline tax and vehicle license revenues solely for funding state roads and highways. The Good Roads Association conducted a nationwide campaign to enact similar laws in other states and lobbied strongly for passage in Washington. The Association was concerned that gas tax revenues were being used to support general fund programs, such as education, welfare and mass transportation. State voters approved the measure in November 1944, which became the 18th Amendment to the State Constitution.

1969 Legislation expanded the sales tax exclusion to include labor and services used to build publicly owned mass public transit terminals and parking facilities.

1971 The Legislature made road construction for the state of Washington a retail sale. The Legislature removed the term "publicly owned" roads from the labor and services sales tax exclusion and instead specifically stated the exclusion applied to roads owned by municipal corporations, political subdivisions of the state, or the federal government. Construction and repair work on state-owned or maintained roads became a retail sale with the incidence of tax on the landowner (the state) to pay retail sales tax on the full contract price.

While specifically noting the exemption applies to labor and services on roads owned by the federal government, this preference does not change the constitutional prohibition on the state from taxing the federal government. Even without the specific sales tax exclusion for federal roads, Washington could not subject labor and services performed on roads owned by the federal government to sales or use taxes.

This review focuses on the preference as it relates to municipal corporations (cities) and political subdivisions of the state (counties and others).

Other Relevant Background:

Prior to the Legislative Session in 1971, the Department of Revenue presented a Tax Exemption Study previously commissioned by the Legislature. The report stated the justification for the labor and services sales tax exclusion enacted in 1943 as "The exclusion of public road contractors' fees from sales tax results in lower costs of public road construction and is therefore a policy decision to aid local governments and the state highway program." The study also stated:

> A sales tax on contractors of state highway projects would *redistribute state funds from the Highway Fund to the General Fund*. To the extent that the Federal Government *pays up to 90 percent* of the cost of certain highways, *the extra burden from such a tax would fall largely on federal taxes*. However, the exclusion applies only to charges for labor and services; retail sales tax is collected on all materials which are sold in connection with public road construction.[21] (Emphasis added.)

Later that year, the Legislature limited the sales tax exclusion to apply only to roads owned by cities, counties, other political subdivisions of the state, and the federal government. This change meant that the state now paid sales tax when contracting for work on state highways. The change in tax treatment for construction on state-owned roads resulted in more money in the state general fund. The understanding at the time was that the federal government provided funding (up to 90 percent on some projects) for a great deal of state road construction, including the sales tax portion of the work.

Sales tax paid by the state (in part with federal funds) for state highway construction and maintenance work is deposited into the state general fund. In Fiscal Year 2010, most state road projects (excluding ferries) received some portion of federal funding, although during the 2009-11 Biennium, the federal portion of total road project funding from all sources was just 13 percent. While certain projects may be funded up to 100 percent with federal funds, federal funding covers a smaller portion of the overall state road construction and maintenance costs than what was covered by federal funds when the Legislature initially made this change.

Using Washington State Department of Transportation (WSDOT) data on actual highway construction expenditures, JLARC estimates the state portion of retail sales tax collected from highway construction and maintenance on state-owned roads in Exhibit 29. These figures represent taxes paid by WSDOT on both labor and materials.

[21] "Tax Exemptions; A study of tax exemptions, exclusions, deductions, credits, and differential rates in the state of Washington." 1971, Department of Revenue.

Exhibit 29 – Estimated Washington Sales Tax Collected on State Highway Construction and Maintenance Work ($ in Thousands)

Fiscal Year	State Highway Construction and Maintenance Expenditures	State Sales Tax 6.5%
2005	$939,247	$61,051
2006	$1,087,391	$70,680
2007	$1,247,382	$81,080
2008	$1,483,965	$96,458
2009	$1,732,390	$112,605

Source: WSDOT estimate using construction and maintenance expenditure figures from FHWA Report 534 State Highway Capital Outlays, including totals for tolls and state ferries.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference?

Although no public policy objective was stated, the implied public policy objective of the preference when adopted in 1943 was to reduce construction costs for "publicly owned" (at the time, city, county, state, and federal) roads and make funds for government road construction and repairs stretch further.

In the early 1940s, cities and counties experienced decreased revenues. Reduced gas and liquor consumption during the war decreased distributions to cities and counties from state shared revenues. Additionally, local property taxes were growing slowly because most assessors were not actively revaluing property. At the same time, local governments were pressured for more services, as large influxes of people moved to Washington as part of the war effort to work in the aerospace and shipbuilding industries. During the war years, only maintenance work to keep roads passable was performed, as road construction was largely confined to that necessary for the war effort.[22]

By 1943, there was a great need by cities, counties, and the state for road construction and maintenance work. This preference allowed governments building or maintaining roads to use funds that would have gone toward paying sales tax on labor and services to instead pay for additional road work.

The Legislature's action in 1971 to remove state road construction labor and services from the preference appears to have been an effort to maximize federal funds, which primarily financed state road construction at the time.

[22] "40 years with the WA Department of Highways: A History of Highways and Transportation: Washington State Highway & Transportation Department 1905-1993."

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

City and county expenditures for road construction, maintenance, and repair work are lowered by excluding contracted labor and services on the work from sales tax. This allows cities and counties to complete more road construction and maintenance than they otherwise could.

Washington city and county annual expenditures for constructing and maintaining roads, sidewalks, bridges and other infrastructure have exceeded $1 billion each year since 2005. (See Exhibit 30.)

Exhibit 30 – City and Country Road Construction and Maintenance Expenditures ($ in Thousands)

State FY	Construction	Maintenance & Preservation	Total Construction & Maintenance
2005	$739,663	$416,869	$1,156,532
2006	$785,227	$386,267	$1,171,494
2007	$891,821	$491,140	$1,382,961
2008	$937,378	$509,793	$1,447,171
2009	$934,739	$508,358	$1,272,320

Source: WSDOT estimate using construction and maintenance expenditure figures from FHWA Report 534 State Highway Capital Outlays, including totals for tolls and state ferries.

During the 2009-11 Biennium, while most state road projects received some portion of federal funding, federal funds represented just 13 percent of the total road project funding from all sources. While certain projects may be fully funded with federal money, federal funding covers a smaller portion of the overall state road construction and maintenance than it did when the Legislature made state road construction labor and services subject to sales tax.

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

Continuing the sales tax exemption for labor and services for building, repairing, etc., roads, bridges, etc., for cities and counties will contribute to the public policy objectives by reducing their contract costs and providing cities and counties an opportunity to receive more road construction or repair work for the same cost.

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

The public policy objective to reduce road construction and repair costs for local governments is being fulfilled. However, circumstances have changed and sales tax on charges for state road construction and maintenance work is no longer predominately paid for with federal government funds.

Beneficiaries

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

The beneficiaries of this preference are Washington cities and towns, counties, and other political subdivisions of the state (for example, port districts, public transportation benefit districts, etc.). They are relieved from paying sales tax or use tax on labor and services performed by contractors as part of road, bridge, sidewalk, etc., new construction and maintenance or repair work.

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

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

Revenue & Economic Impacts

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

According to data provided by WSDOT, qualifying city and county expenditures for contracted construction and maintenance work on roads, sidewalks, bridges, etc., exceeded $1 billion annually in each year since 2005. (See Exhibit 30.)

According to WSDOT and Global Insight (an international economic forecasting company), the labor portion of road work varies depending on the nature of the work. For new road construction, the labor component of the construction cost is generally 30 percent. Maintenance and preservation work is more labor intensive, with the labor portion comprising about 60 percent of the contract price.

Accounting for those labor cost variances, the taxpayer savings realized by excluding the labor and services portion of public road construction from sales tax is estimated at over $60 million in 2009 – over $44.5 million in state sales tax and over $16.3 million in local sales tax. (See Exhibit 31.)

Exhibit 31 – Estimated Taxpayer Savings ($ in Millions)

State Fiscal Year	State Sales Tax	Local Sales Tax	Total Savings
2009	$44.5	$16.3	$60.8
2010	$44.6	$16.4	$61.0
2011	$45.6	$16.7	$62.3
2012	$46.4	$17.0	$63.4
2013	$47.3	$17.3	$64.7

Source: WSDOT actual and forecast data for 2009 – 2013. Data reflects city and county expenditures only; does not include federal government road work, state highway construction, or maintenance work.

If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy?

If the preference were terminated, counties, cities, and other local governments would pay more for contracted new construction and road maintenance work, as sales tax would be charged on the full contract price, including the labor and services components that are now untaxed. Sales tax on labor and services charges for road, street, bridge, etc., construction and repair work, at rates varying by locality from 7 to 9.5 percent, would be owed by local government entities on all road, street, bridge, etc., work they contracted.

A study published in 2008 by the Association of Washington Cities found Washington cities' capital infrastructure to be "in a state of disrepair." The study noted local governments face increasing challenges, both structural and financial, in providing roads and other infrastructure. It also asserted increased demands were competing with decreased revenue streams.

If the preference were terminated, cities and counties might reduce or delay road construction and repair work. This could result in fewer jobs in the road construction industry and in city and county governments.

Road construction jobs have experienced steady growth. The number of jobs increased modestly each year from 2002 through 2008, when job numbers were reduced to pre-2006 levels, likely due to effects from the national recession. Exhibit 32 reflects general wages and average employment in the highway/street/bridge construction industry. Data could not be separated to reflect road construction workers employed by local governments.

Exhibit 32 – Washington Average Jobs and Wages – Highway, Street, and Bridge Construction

Year	Total Wages	Average Annual Employment	Average Annual Wage
2002	$299,491,565	6,197	$48,328
2003	$305,874,383	6,176	$49,526
2004	$341,300,428	6,497	$52,532
2005	$381,707,292	7,061	$54,059
2006	$424,806,024	7,427	$57,198
2007	$462,391,843	7,656	$60,393
2008	$439,233,012	7,256	$60,534

Source: Washington Employment Security data.

Average wages for highway, street, and bridge construction jobs are well above the average wages for jobs in the general construction industry. However, road construction wages rank slightly below the average wages by all jobs in the manufacturing industry. (See Exhibit 33.)

Exhibit 33 – Comparable Industry Averages - Washington Jobs and Wages - 2008

Industry	Average Annual Employment	Total Wages ($ in thousands)	Average Annual Wage
Manufacturing (all)	287,229	$17,595,631	$61,260
Construction (all)	185,773	$9,185,206	$49,443
Highway, Street, Bridge Construction	7,256	$439,233	$60,534

Source: 2008 US Department of Labor/Bureau of Labor Statistics data.

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

There would be no change in the distribution of liability for payment of state taxes for the beneficiaries of this tax preference. If the tax preference were terminated, cities, counties, and other local government entities would have to pay sales tax on contracted road construction labor and services for which they currently receive an exemption. The result is that beneficiaries would pay approximately $61 million more in state sales and use taxes in 2010 than they currently pay. (See Exhibit 31.)

Other States

Of the 45 states and the District of Columbia that impose sales and use taxes, 38 states and the District of Columbia exempt sales to local governments from sales tax, which includes local government road construction work. Road construction is not a taxable service in five of the remaining seven states. Only one state (Hawaii) taxes the labor for local road construction. However, Hawaii imposes a general excise tax on gross receipts in lieu of a genuine sales tax.

Recommendations

Recommendation 1

Because it is meeting the implied public policy objective of reducing road construction and maintenance costs for cities, counties, and other local government entities, the Legislature should continue the preference providing a sales and use tax exemption for labor and services performed as part of city, county, and federal road construction, maintenance, and repair work.

Recommendation 2

Because circumstances have changed and state road construction and maintenance work is no longer predominately paid by the federal government, the Legislature should review and clarify whether it wants to continue subjecting labor and services performed as part of state road construction and maintenance work to retail sales tax.

Legislation Required: No legislation is required to continue the preference as it is. Legislation would be required if the Legislature decided to change the taxation of labor and services for road construction for the state.

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

SALES OF BREEDING LIVESTOCK, CATTLE, AND MILK COWS RETAIL SALES AND USE TAX EXEMPTIONS – SUMMARY

Current Law

Current law provides both retail sales tax and use tax exemptions for sales of livestock to be used for breeding purposes and sales of cattle and milk cows for use on a farm. The livestock for breeding must be registered in a nationally recognized breed association.

See page A3-7 in Appendix 3 for the current statutes, RCW 82.08.0259 and RCW 82.12.0261.

Legal History and Public Policy Objectives

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. The act provided for certain exemptions, but did not provide a specific exemption for purchases or use of purebred livestock, cattle, or milk cows.

1945 The Legislature added retail sales tax and use tax exemptions for "purebred livestock for breeding purposes." To qualify for the exemption, the livestock had to be registered in a nationally recognized breed association.

1955 Legislation expanded the retail sales tax and use tax exemptions to include cattle and milk cows used on farms.

2001 The Legislature modified the retail sales and use tax exemptions, removing the requirement that qualifying livestock be "purebred" and instead requiring that qualifying animals meet the definition of "livestock" provided in RCW 16.36.005. The Legislature retained the requirement that livestock be registered in a nationally recognized breed association.

Although the Legislature provided no clear public policy statement, the implied public policy objective is to recognize breeding livestock, cattle, and milk cows as ingredients and component parts used by farmers/agricultural producers to produce agricultural products for sale. This is consistent with sales tax exemptions provided for ingredients and component parts in other industries.

Beneficiaries

Beneficiaries of the tax preference are livestock breeders, cattle operations, and dairies in Washington that purchase animals for use in producing other animals or products for sale.

Revenue and Economic Impacts

The estimated taxpayer savings from exempting breeding livestock, cattle, and milk cows used on farms from sales and use tax was nearly $9.3 million in 2009 – over $7.3 million in state sales tax and over $1.9 million in local sales tax.

The economic impact of the tax preference is likely increased income for agricultural producers and their employees. Agricultural producers are generally "price-takers," meaning they are relatively small producers in a national commodities market and cannot dictate the price at which they sell their products. If this preference were terminated, the retail sales and use taxes would be added costs of production for agricultural producers that they may not be able to pass along to their customers. The tax burden would fall on the producers to pay, resulting in less income for the agricultural producers and their employees.

Other States

Of the 45 states and the District of Columbia that impose sales and use taxes, only two states and the District of Columbia do not provide an exemption for livestock sales. Washington is one of six states that target an exemption for sales of breeding livestock, but it is the only state that requires registration in a national recognized breed association. In all other states, exemptions for cattle and milk cows fall under the general livestock exemption. Washington is the only state to provide a separate exemption specifically for cattle and milk cows used on farms.

JLARC Recommendation

Because the preference is meeting its public policy objective of recognizing breeding livestock, cattle, and milk cows used on farms as ingredients and component parts used by farmers/ agricultural producers to produce agricultural products for sale, the Legislature should continue the tax preference.

Legislation Required: No.

Fiscal Impact: None.

Sales of Breeding Livestock, Cattle, and Milk Cows Retail Sales and Use Tax Exemptions – Report Detail

Current Law

Current law provides both retail sales tax and use tax exemptions for sales of livestock to be used for breeding purposes and sales of cattle and milk cows for use on a farm. The livestock for breeding must be registered in a nationally recognized breed association.

See page A3-7 in Appendix 3 for the current statutes, RCW 82.08.0259 and RCW 82.12.0261.

Legal History

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and companion use tax. The act provided for certain exemptions, but did not provide a specific exemption for purchases or use of purebred livestock, cattle, or milk cows.

1945 The Legislature added retail sales tax and use tax exemptions for "purebred livestock for breeding purposes." To qualify for the exemption, the livestock had to be registered in a nationally recognized breed association.

1955 Legislation expanded the retail sales tax and use tax exemptions to include sales of cattle and milk cows used on farms.

2001 The Legislature modified the retail sales and use tax exemptions, removing the requirement that qualifying livestock be "purebred" and instead requiring that qualifying animals meet the definition of "livestock" provided in RCW 16.36.005. The Legislature retained the requirement that livestock be registered in a nationally recognized breed association.

Other Relevant Background

Tax Exemptions for Ingredients and Component Parts used in Agricultural Production

State statute provides several sales and use tax exemptions to farmers/agricultural producers for their purchases or use of goods that are used as ingredients or component parts in producing agricultural products for sale. For example, exemptions are provided for feed and seed (covered in the 2009 Tax Preference Reports); fertilizer, sprays, and chemical sprays (covered in the 2010 Tax Preference Reports); and poultry used to produce poultry or poultry products (also covered in the 2010 Tax Preference Reports). Sales tax is generally defined as a tax on the final consumer of goods. In the case of ingredients or component parts used in agricultural production, the farmer/agricultural producer uses the goods to produce a new product for sale, rather than being the final consumer of the goods.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference?

Although no intent was specified in the law, the implied public policy objective is to recognize breeding livestock, cattle, and milk cows as ingredients and component parts used by farmers/agricultural producers to produce agricultural products for sale. This is consistent with sales tax exemptions provided for ingredients and component parts in other industries.

Sales of livestock and cattle that will be used for breeding and sales of cows for use in producing dairy products to be resold are analogous to sales of ingredients or component parts, rather than sales for final consumption. Livestock, cattle, and milk cows are used by the farmer to produce a new product for sale. These livestock are used to produce more purebred livestock; cattle are used to breed other, regular cattle; milk cows are used to produce a variety of dairy products to be resold. In this manner, they are like an ingredient or component part producing an agricultural product that will be sold.

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

Farmers and ranchers purchase or acquire livestock for breeding, and cattle and milk cows for use on farms to create a final, new product for sale. This fits within the production concept of an ingredient or component part.

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

Continuing the sales and use tax exemption will allow agricultural producers to purchase certain livestock for breeding purposes, as well as other cattle and milk cows used in their operations, without paying sales or use tax on these purchases.

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

The public policy objective is being achieved.

Beneficiaries

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

Beneficiaries of the tax preference are livestock breeders, cattle operations, and dairies in Washington that purchase animals for use in producing other animals or products for sale.

The majority of sales exempted by the preference are not reported in any manner. Although the excise tax return provides a specific sales tax deduction line for such transactions, the bulk of qualifying sales of breeding livestock, other cattle, and milk cows are made by farmers or other

agricultural producers to other farmers or agricultural producers. Since most farmers and agricultural producers are not required to register or report to the Department of Revenue, these transactions are not reported. JLARC examined 2007 and 2008 Department of Revenue tax return data and found the deduction was reported by about 85 businesses in each year, mostly by specialty livestock operations, such as alpaca, llama, or horse breeders, and some pet stores.

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

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

Revenue & Economic Impacts

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

Washington agricultural producers spent over $37.8 million for breeding livestock in 2007. In addition, the value of milk cattle and calf sales in 2007 was $73.7 million.

As shown in Exhibit 34, the estimated taxpayer savings from exempting agricultural sales of breeding livestock and cattle and milk cows used on farms from sales and use tax was nearly $9.3 million in 2009 – over $7.3 million in state sales tax and over $1.9 million in local sales tax. This estimate may not include some specialty breeder sales, but these sales are likely to represent a small portion of this preference.

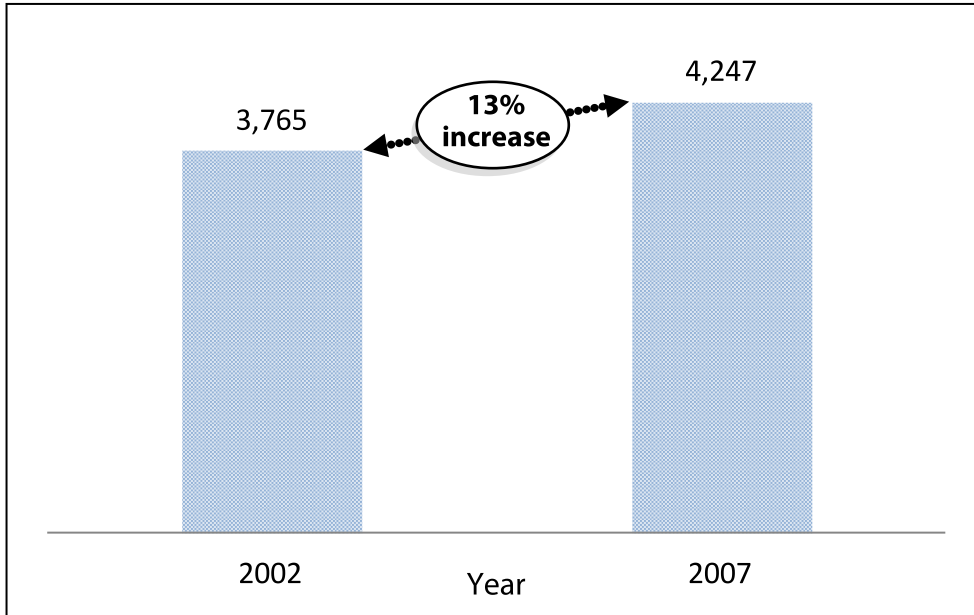
Exhibit 34 – Estimated Taxpayer Savings – Sales of Breeding Livestock, Cattle, and Milk Cows ($ in Thousands)

Calendar Year	State	Local	Total
2007	$7,249	$1,918	$9,167
2008	$7,503	$1,985	$9,488
2009	$7,353	$1,946	$9,299
2010	$7,352	$1,945	$9,297
2011	$7,565	$2,002	$9,567
2012	$7,731	$2,046	$9,777
2013	$7,914	$2,101	$10,015

Source: U.S. Department of Agriculture, 2007 Census of Agriculture. 2008 – 2013 estimated by JLARC.

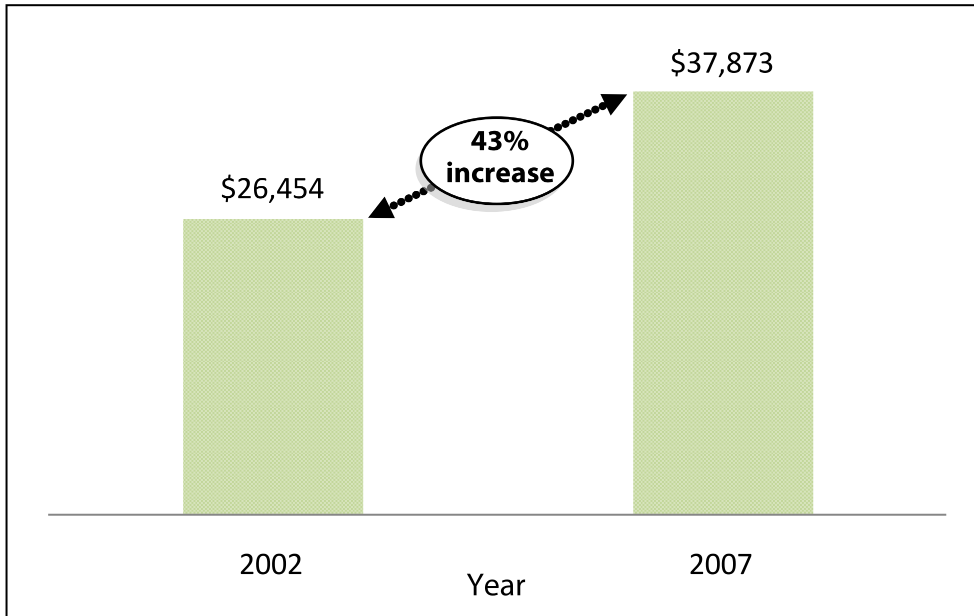
Washington farms that purchased or leased breeding livestock increased from 3,765 farms in 2002 to 4,247 farms in 2007. (See Exhibit 35.) Expenditures for breeding livestock purchases and leases increased 43 percent during the same timeframe, from nearly $26.5 million in 2002 to $37.9 million in 2007. (See Exhibit 36.)

Exhibit 35 – Washington Farms Purchasing Breeding Livestock 2002 and 2007



Source: USDA 2007 Census of Agriculture, Table 4.

Exhibit 36 – Washington Breeding Livestock Purchases 2002 and 2007 ($ in Thousands)



Source: USDA 2007 Census of Agriculture, Table 4.

If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy?

If the sales and use tax exemptions were terminated, agricultural producers would have to pay sales tax or use tax on their purchases or acquisitions of breeding livestock, cattle, and milk cows used on the farm.

Based on the estimated taxpayer savings, the additional costs to agricultural producers for their purchases of breeding livestock, cattle, and milk cows used on farms would amount to over $9.2 million in 2010 if the preference were terminated. The likely result would be less income for the agricultural producers and their employees.

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

There would be no change in the distribution of liability for payment of state taxes for the beneficiaries of this tax preference. If the sales and use tax exemptions were terminated, agricultural producers would pay sales tax or use tax on their purchases or acquisition of breeding livestock, cattle, and milk cows used on farms. The result is that beneficiaries would pay over $9.2 million more in state sales and use taxes in 2010 than they currently pay. (See Exhibit 34.)

Other States

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

Of the 45 states and the District of Columbia that impose sales and use taxes, almost every state provides an exemption for livestock sales. Only Hawaii, North Dakota, and the District of Columbia do not provide an exemption. The remaining 43 states offer exemptions for sales of livestock with various qualifications and conditions.

Eight states provide broad livestock sales tax exemptions without any limiting provisions. Eight other states provide broad exemptions for sales of livestock used for agricultural purposes. Six states allow an exemption if the livestock is sold *by* a farmer or producer, while four other states allow the exemption when the livestock is sold *to* a qualified farmer. Seven states limit the exemption to animals that are normally used to produce food for human consumption.

Washington is one of six states that allows an exemption for sales of breeding livestock. Eight other states also provide exemptions for some types of breeding stock. Washington is the only state that requires registration in a national recognized breed association.

In all other states, exemptions for cattle and milk cows fall under the general livestock exemption. Washington is the only state to provide a separate exemption specifically for cattle and milk cows used on farms.

Recommendation

Because the preference is meeting its public policy objective of recognizing breeding livestock, cattle, and milk cows used on farms as ingredients and component parts used by farmers/agricultural producers to produce agricultural products for sale, the Legislature should continue the tax preference.

Legislation Required: No.

Fiscal Impact: None.

TITLE INSURANCE PREMIUMS TAX EXEMPTION – SUMMARY

Current Law

Current law exempts title insurance premiums from the insurance premiums tax. Instead, title insurers pay business and occupation (B&O) tax under the retailing classification. Purchasers of title insurance pay the retail sales tax.

See page A3-7 in Appendix 3 for the current statutes, RCW48.14.020(1) and (4).

Legal History and Public Policy Objective

1891 The Legislature imposed a tax on all insurance companies at a rate of 2.0 percent of gross premiums collected less insurance company losses. Title insurers were not specifically mentioned.

1911 The Legislature adopted its first insurance code, including a chapter on title insurance. The new code taxed title insurers based on the physical property owned "in accordance with the general laws related to taxation in this state, and not otherwise." At the time, the "general law" of taxation was the property tax.

1935 Facing a significant revenue shortfall, the Legislature passed the Revenue Act of 1935. As part of the act, the Legislature created the B&O tax that applied to "persons" engaged in taxable business activities. The new B&O tax included title insurers under the service tax classification. The service tax rate was set at 0.5 percent.

1947 As part of an entirely new insurance code, the Legislature specifically excluded title insurance from the insurance premiums tax. Title insurance continued to be taxed under the B&O tax.

1961 Due to the effects of a national recession, Washington's tax revenue collections declined below expectations. Needing to fill the budget gap, the Legislature reclassified title insurance companies as retailers and required them to collect sales tax from their customers.

Legal history suggests the Legislature's original public policy objective was to tax title insurance like a service activity under the business and occupation (B&O) tax, and not like other forms of insurance subject to the insurance premiums tax. The bulk of title insurers' costs are related to research services rather than payments to claimants (only 14 percent of premiums). Other insurers' primary costs are payments to claimants (83 percent for accident and health insurance and 55 percent for property and casualty insurance).

Beneficiaries

The entities benefiting from the tax preference are the five title insurance companies doing business in Washington: Fidelity National Title Insurance, First American Title Insurance, Pacific Northwest Title Insurance, Stewart Title Insurance, and Old Republic National Title Insurance. Fidelity is the leader in the Washington market for title insurance, with 56 percent of the sales in this state. Fidelity owns a number of subsidiaries that operate in Washington, including Chicago Title Insurance. Pacific Northwest Title Insurance Company is the only Washington domiciled firm.

Revenue and Economic Impacts

In Calendar Year 2008, title insurance companies paid $1.1 million in retailing B&O tax. Without the exemption from the insurance premiums tax, these firms would have paid insurance premiums tax of $4.6 million. The taxpayer savings equal the difference between the two amounts—$3.5 million.

If the tax preference were to be terminated, title insurers would pay insurance premiums tax. Businesses that pay insurance premiums tax are exempt from the B&O tax. Purchasers of title insurance would no longer owe the retail sales tax. The difference in taxation would have resulted in a net loss to state revenues of $16.8 million in 2008. In addition, overall closing costs of purchasing real estate would be reduced.

Recommendation

Because the exemption is achieving the original objective of taxing title insurance like a service activity, the Legislature should continue the insurance premiums tax exemption for title insurance.

Legislation Required: No.

Fiscal Impact: None.

TITLE INSURANCE PREMIUMS TAX EXEMPTION – REPORT DETAIL

Current Law

Current law exempts title insurance premiums from the insurance premiums tax. Instead, title insurers pay business and occupation (B&O) tax under the retailing classification. Purchasers of title insurance pay the retail sales tax.

See page A3-7 in Appendix 3 for the current statutes, RCW48.14.020(1) and (4).

Legal History

1891 The Legislature imposed a tax on all insurance companies at a rate of 2.0 percent of gross premiums collected less insurance company losses. Title insurers were not specifically mentioned.

1911 The Legislature adopted its first insurance code, including a chapter on title insurance. The new code taxed title insurers based on the physical property owned "in accordance with the general laws related to taxation in this state, and not otherwise." At the time, the "general law" of taxation was the property tax.

1935 Facing a significant revenue shortfall, the Legislature passed the Revenue Act of 1935. As part of the act, the Legislature created the B&O tax that applied to "persons" engaged in taxable business activities. The new B&O tax included title insurers under the service tax classification. The service tax rate was set at 0.5 percent.

1947 As part of an entirely new insurance code, the Legislature specifically excluded title insurance from the insurance premiums tax. Title insurance continued to be taxed under the B&O tax.

1961 Due to the effects of a national recession, Washington's tax revenue collections declined below expectations. Needing to fill the budget gap, the Legislature reclassified title insurance companies as retailers and required them to collect sales tax from their customers.

Other Relevant Background

What are title insurers?

The purpose of title insurance is to protect home buyers, sellers of real estate, and mortgage lenders against the loss of the real estate if someone else can claim legal ownership. Before businesses began offering title insurance in the late 1800s, lawyers performed a similar service by searching for documents and providing a legal opinion on the status of the title. Transactions to exchange real property did not include any guarantee against loss of property. Courts generally ruled that lawyers were only liable if they were negligent in giving their legal opinion, and only liable for the amount of their fees.

Title insurers search past deeds, wills, and other documents to ensure that title has passed correctly to the new owner. Title examiners look for easements, mineral rights, pending legal action, liens, and unpaid mortgages and tax assessments. Title insurers maintain "title plants" to store information based on property records filed with the county.

Along with other closing costs, title insurance can add considerably to the price of a house. These costs can be highly variable both within and among states. Title insurance can range from 0.6 percent to 2.3 percent of the loan amount. Based on a national sample of 2001 home purchases that took into account the variation in loan amount, the cost of title insurance averaged $1,639 in Washington compared to a national average of $1,194.[23]

Studies have shown that title insurance premiums in most states are based on the loan amount rather than the cost of providing the title service. Studies also show that the industry is dominated by a few firms, and that consumers tend to buy insurance from title companies referred by their real estate agents and are unaware of the price of title insurance.[24]

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference?

Legal history suggests the Legislature's original public policy objective was to tax title insurance like a service activity under the business and occupation (B&O) tax, and not like other forms of insurance subject to the insurance premiums tax.

Insurers in other lines cannot control risk beyond being selective of those they insure. However, title companies are able to minimize risk by the work they do in determining the status of a title. The bulk of title insurers' costs are related to research services rather than payments to claimants (only 14 percent of premiums). Other insurers' primary costs are payments to claimants (83 percent for accident and health insurance and 55 percent for property and casualty insurance). (See Exhibit 37.)

[23] A Study of Closing Costs for FHA Mortgages, U.S. Department of Housing and Urban Development, 2008.

[24] For example, see Title Insurance—Actions Needed to Improve Oversight of the Title Industry and Better Protect Consumers, U.S. Government Accountability Office, 2007; and Title Insurance in Washington—Improving Competition and Consumer Choice, Report of the Title Insurance Review Task Force, 2007.

Exhibit 37 – Title Insurers Losses are a Smaller Percent of Premiums than Other Insurers

Type of Insurance	2005	2006	2007	2008
Accident and Health	84.3%	83.9%	85.2%	83.0%
Property and Casualty	48.8%	57.3%	54.7%	55.2%
Title	5.2%	4.7%	8.1%	13.6%
Total Authorized Companies	68.1%	71.9%	72.2%	71.5%

Source: Office of the Insurance Commissioner, Annual Reports.

Accordingly, the Legislature established a tax framework that recognizes title insurance is more like a service activity than insurance.

Legislators made it clear from 1911 on that title insurers are to be taxed under "the general laws related to taxation in this state," and not the insurance premiums tax. At first, the "general laws of taxation" referred to the property tax as the primary form of general taxation at the time. The Legislature reaffirmed its policy in 1935 when it classified title insurance as a service under the new business and occupation (B&O) tax. The B&O tax applies generally to the gross proceeds or value of product of all business activities.

The Legislature restated its policy again in 1947 when it specifically excluded title insurance from the insurance premiums tax.

By 1961, the Legislature had classified service to real property and many services purchased by end consumers under the retailing B&O tax and made them subject to the sales tax. Including title insurers in this classification was consistent with taxation of these types of service businesses.

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

Evidence indicates that title insurers continue to perform services and can control risk to a greater extent than other insurance companies. Title insurers are paid for the services they provide similar to other firms in the service industry.

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

The continuation of the tax preference is consistent with long-standing legislative policy to treat title insurers differently than other types of insurers.

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

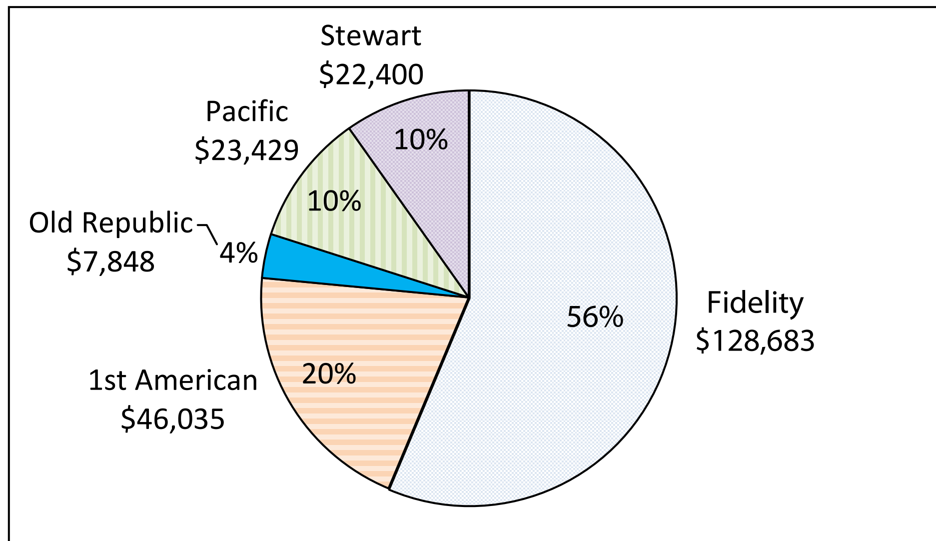
The public policy objective is being achieved.

Beneficiaries

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

The entities benefiting from the tax preference are the five title insurance companies doing business in Washington: Fidelity National Title Insurance, First American Title Insurance, Pacific Northwest Title Insurance, Stewart Title Insurance, and Old Republic National Title Insurance. Fidelity is the leader in the Washington market for title insurance, with 56 percent of the sales in this state (See Exhibit 38). Fidelity owns a number of subsidiaries that operate in Washington, including Chicago Title Insurance. Pacific Northwest Title Insurance Company is the only Washington domiciled firm.

Exhibit 38 – Fidelity Insurance Company Holds 56 percent of Washington's Market Share



Source: Office of the Insurance Commissioner, Annual Report, 2008.

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

There do not appear to be any unintended beneficiaries.

Revenue and Economic Impacts

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

In Calendar Year 2008, title insurance companies paid $1.1 million in retailing B&O tax. Without the exemption from the insurance premiums tax, these firms would have paid insurance premiums tax of $4.6 million. The taxpayer savings equal the difference between the two amounts—$3.5 million. Taxpayer savings declined in 2009 due to the slowing real estate market. (See Exhibit 39.)

Exhibit 39 – Taxpayer Savings from Premiums Tax Exemption for Title Insurers ($ in Thousands)

Calendar Year	Premiums Tax at 2.0%	Retailing B&O at 0.471%	Difference=Taxpayer Savings
2008	$4,570	$1,080	$3,490
2009	$2,680	$630	$2,050
2010	$2,900	$680	$2,220
2011	$3,760	$890	$2,870
2012	$3,900	$920	$2,980
2013	$4,030	$950	$3,080

Source: OIC Annual Reports, Appendix A and the Economic & Revenue Forecast Council growth rates for the real estate excise tax.

If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy?

If the tax preference were terminated, title insurers would pay the insurance premiums tax. Businesses that pay insurance premiums tax are exempt from the B&O tax. Purchasers of title insurance would no longer owe the retail sales tax. The difference in taxation would have resulted in a net loss to state revenues of $16.8 million in 2008. In addition, overall closing costs of purchasing real estate would be reduced.

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

There would be no change in the distribution of liability for payment of state taxes for the beneficiaries of this tax preference. If the tax preference were terminated, title insurers would pay the insurance premiums tax instead of the B&O tax. All insurers pay insurance premiums tax unless they are specifically exempted. The insurance premiums tax rate of 2 percent is higher than the B&O tax rate of 0.471 percent for title insurers. The result is that title insurers would pay $3.5 million more in state taxes than they pay currently.

Other States

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

All states except for Arizona, Pennsylvania, and Washington impose insurance premiums taxes on title insurers. In Arizona, title insurers are subject to the state income tax. In Pennsylvania, title insurers headquartered out of state are charged an insurance premiums tax, but domestic title insurers are charged a 1.25 percent tax on their reserves.

Recommendation

Because the exemption is achieving the original objective of taxing title insurance like a service activity, the Legislature should continue the insurance premiums tax exemption for title insurance.

Legislation Required:	No.
Fiscal Impact:	None.

APPENDIX 1 – SCOPE AND OBJECTIVES

2010
FULL
TAX PREFERENCE
PERFORMANCE
REVIEWS

SCOPE AND OBJECTIVES

OCTOBER 2009

STATE OF WASHINGTON
JOINT LEGISLATIVE AUDIT
AND REVIEW COMMITTEE

STUDY TEAM
Mary Welsh
Dana Lynn
Stacia Hollar
Peter Heineccius

PROJECT SUPERVISOR
Keenan Konopaski

LEGISLATIVE AUDITOR
Ruta Fanning

Joint Legislative Audit &
Review Committee
1300 Quince St. SE
Olympia, WA 98504-0910
(360) 786-5171
(360) 786-5180 Fax

Website:
www.jlarc.leg.wa.gov
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 (less than $2 million)

This document identifies the scope and objectives for the first category: full 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 the full tax preferences JLARC is to provide recommendations to (1) continue, (2) modify, (3) add an expiration date and conduct another review prior to the expiration date, or (4) terminate the preference. JLARC may also recommend accountability standards for future reviews of tax preferences.

Full Study Scope

This tax preference performance review will include the tax preferences identified by the Citizen Commission to be reviewed prior to July 30, 2010. These tax preferences were recommended by the Citizen Commission as being subject to full review:

Brief Description	RCW Citation	Year Enacted
1. Interstate transportation, instate portion	82.16.050(6)	1935
2. Nonresidents' personal property	82.12.0251	1935
3. Vehicles sold to nonresidents	82.08.0264	1935
4. Interstate transportation, through freight	82.16.050(8)	1937
5. Shipments to ports	82.16.050(9)	1937
6. Vehicles used in commerce	82.12.0254	1937
7. Fertilizer and chemical spray	82.04.050(11)	1943
8. Labor for local road construction	82.04.050(10)	1943
9. Breeding livestock; cattle & milk cows	82.08.0259; 82.12.0261	1945
10. Title insurance	48.14.020	1947
11. Interstate transportation equipment	82.08.0262	1949
12. Vehicles in interstate commerce	82.08.0263	1949
13. Fruit/vegetable, dairy & seafood facilities	82.74.030	2005

Full 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 tax preference review should be conducted as an expedited review):

Public Policy Objectives:

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

Beneficiaries:

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

Revenue and Economic Impacts:

7. What are the past and future tax revenue and economic impacts of the tax preference to the taxpayer and to the government if it is continued? (This includes an analysis of the general effects of the tax preference on the overall state economy, including the effects on consumption and expenditures of persons and businesses within the state.) (RCW 43.136.055(h))
8. If the tax preference were to be terminated, what would be the negative effects on the taxpayers who currently benefit from the tax preference and the extent to which the resulting higher taxes would have an effect on employment and the economy? (RCW 43.136.055(f))
9. If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes? (RCW 43.136.055(i))

Other States:

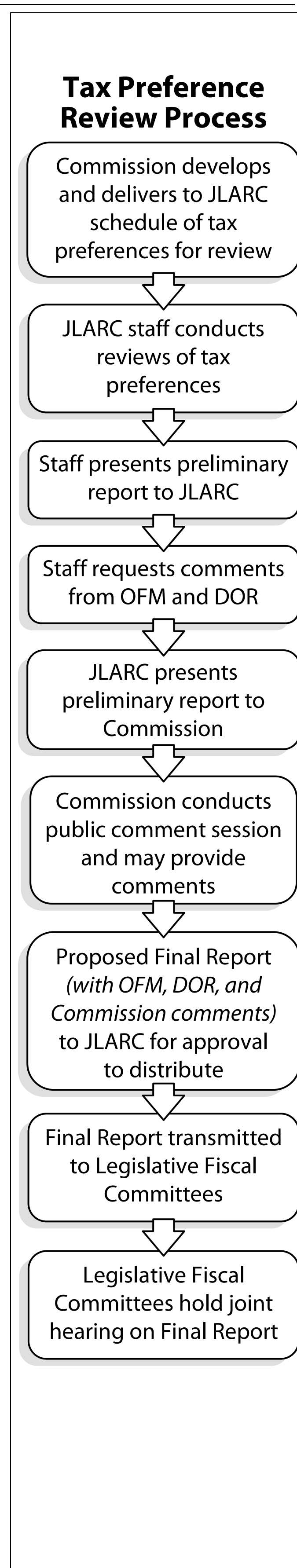
10. Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington? (RCW 43.136.055(j))

Timeframe for the Study

A preliminary audit report will be presented at the July 2010 JLARC meeting and at the August 2010 meeting of the Commission. A final report will be presented to JLARC in November 2010.

JLARC Staff Contact for the Study

Mary Welsh	(360) 786-5193	welsh.mary@leg.wa.gov
Dana Lynn	(360) 786-5177	lynn.dana@leg.wa.gov
Stacia Hollar	(360) 786-5191	hollar.stacia@leg.wa.gov
Peter Heineccius	(360) 786-5123	heineccius.peter@leg.wa.gov



APPENDIX 2 – AGENCY RESPONSES

- Office of Financial Management and Department of Revenue

RECEIVED
AUG 27 2010
JLARC

STATE OF WASHINGTON

August 25, 2010

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

FROM: Marty Brown, Director
Office of Financial Management

Cindi Holmstrom, Director
Department of Revenue

SUBJECT: JLARC PRELIMINARY REPORTS ON 2010 TAX PREFERENCE PERFORMANCE REVIEWS (FULL/EXPEDITED/EXPEDITEDLIGHT)

Thank you for the opportunity to review and comment on the Joint Legislative Audit and Review Committee's (JLARC's) 2010 Tax Preference Performance Reviews.

We appreciate JLARC's efforts and those of the Citizen Commission for Performance Measurement of Tax Preferences (Commission) to continuously review and analyze the state's numerous tax preferences. We believe it is important to systematically 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 also appreciate the opportunity to review the reports and JLARC's recommendations. We have no additional comments on the 2010 reports.

APPENDIX 3 – CURRENT LAW

Instate Portion of Interstate Transportation

82.16.050(6)

(6) Amounts derived from business which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States

Nonresidents' Personal Property

82.12.0251

The provisions of this chapter do not apply in respect to the use:

(1) Of any article of tangible personal property or any digital good or digital code, and any services that were rendered in respect to such property, brought into the state of Washington by a nonresident thereof for his or her use or enjoyment while temporarily within the state of Washington unless such property is used in conducting a nontransitory business activity within the state of Washington;

(2) By a nonresident of Washington of a motor vehicle or trailer which is registered or licensed under the laws of the state of his or her residence, and which is not required to be registered or licensed under the laws of Washington, including motor vehicles or trailers exempt pursuant to a declaration issued by the department of licensing under RCW 46.85.060, and services rendered outside the state of Washington in respect to such property;

(3) Of household goods, including digital goods, and digital codes, personal effects, private motor vehicles, and services rendered in respect to such property, by a bona fide resident of Washington, or nonresident members of the armed forces who are stationed in Washington pursuant to military orders, if such articles and services were acquired and used by such person in another state while a bona fide resident thereof and such acquisition and use occurred more than ninety days prior to the time he or she entered Washington. For purposes of this subsection, private motor vehicles do not include motor homes;

(4) Of an extended warranty, to the extent that the property covered by the extended warranty is exempt under this section from the tax imposed under this chapter.

For purposes of this section, "state" means a state of the United States, any political subdivision thereof, the District of Columbia, and any foreign country or political subdivision thereof, and "services" means services defined as retail sales in RCW 82.04.050(2) (a) or (g).

[2009 c 535 § 608; 2005 c 514 § 106; 2003 c 5 § 18; 1997 c 301 § 1; 1987 c 27 § 1; 1985 c 353 § 4; 1983 c 26 § 2; 1980 c 37 § 51. Formerly RCW 82.12.030(1).]

Notes:

Intent -- Construction -- 2009 c 535: See notes following RCW 82.04.192.
Effective date -- 2005 c 514: See note following RCW 83.100.230.
Part headings not law -- Severability -- 2005 c 514: See notes following RCW 82.12.808.
Finding -- Intent -- Retroactive application -- Effective date -- 2003 c 5: See notes following RCW 82.12.010.
Intent -- 1980 c 37: See note following RCW 82.04.4281.

Vehicles Sold to Nonresidents

82.08.0264

(1) The tax levied by RCW 82.08.020 does not apply to sales of motor vehicles, trailers, or campers to nonresidents of this state for use outside of this state, even when delivery is made within this state, but only if:

(a) The motor vehicles, trailers, or campers will be taken from the point of delivery in this state directly to a point outside this state under the authority of a vehicle trip permit issued by the department of licensing pursuant to the provisions of RCW 46.16.160, or any agency of another state that has authority to issue similar permits; or

(b) The motor vehicles, trailers, or campers will be registered and licensed immediately under the laws of the state of the buyer's residence, will not be used in this state more than three months, and will not be required to be registered and licensed under the laws of this state.

(2) For the purposes of this section, the seller of a motor vehicle, trailer, or camper is not required to collect and shall not be found liable for the tax levied by RCW 82.08.020 on the sale if the tax is not collected and the seller retains the following documents, which must be made available upon request of the department:

(a) A copy of the buyer's currently valid out-of-state driver's license or other official picture identification issued by a jurisdiction other than Washington state;

(b) A copy of any one of the following documents, on which there is an out-of-state address for the buyer:

(i) A current residential rental agreement;

(ii) A property tax statement from the current or previous year;

(iii) A utility bill, dated within the previous two months;

(iv) A state income tax return from the previous year;

(v) A voter registration card;

(vi) A current credit report; or

(vii) Any other document determined by the department to be acceptable;

(c) A witnessed declaration in the form designated by the department, signed by the buyer, and stating that the buyer's purchase meets the requirements of this section; and

(d) A seller's certification, in the form designated by the department, that either a vehicle trip permit was issued or the vehicle was immediately registered and licensed in another state as required under subsection (1) of this section.

(3) If the department has information indicating the buyer is a Washington resident, or if the addresses for the buyer shown on the documentation provided under subsection (2) of this section are not the same, the department may contact the buyer to verify the buyer's eligibility for the

exemption provided under this section. This subsection does not prevent the department from contacting a buyer as a result of information obtained from a source other than the seller's records.

(4)(a) Any person making fraudulent statements, which includes the offer of fraudulent identification or fraudulently procured identification to a seller, in order to purchase a motor vehicle, trailer, or camper without paying retail sales tax is guilty of perjury under chapter 9A.72 RCW.

(b) Any person making tax exempt purchases under this section by displaying proof of identification not his or her own, or counterfeit identification, with intent to violate the provisions of this section, is guilty of a misdemeanor and, in addition, is liable for the tax and subject to a penalty equal to the greater of one hundred dollars or the tax due on such purchases.

(5)(a) Any seller that makes sales without collecting the tax to a person who does not provide the documents required under subsection (2) of this section, and any seller who fails to retain the documents required under subsection (2) of this section for the period prescribed by RCW 82.32.070, is personally liable for the amount of tax due.

(b) Any seller that makes sales without collecting the retail sales tax under this section and who has actual knowledge that the buyer's documentation required by subsection (2) of this section is fraudulent is guilty of a misdemeanor and, in addition, is liable for the tax and subject to a penalty equal to the greater of one thousand dollars or the tax due on such sales. In addition, both the buyer and the seller are liable for any penalties and interest assessable under chapter 82.32 RCW.

(6) For purposes of this section, the term "buyer" does not include cosigners or financial guarantors, unless those parties are listed as a registered owner on the vehicle title.

[2007 c 135 § 1; 1980 c 37 § 31. Formerly RCW 82.08.030(13).]

Notes:

Intent -- 1980 c 37: See note following RCW 82.04.4281.

Through Freight in Interstate Transportation

82.16.050(8)

(8) Amounts derived from the transportation of commodities from points of origin in this state to final destination outside this state, or from points of origin outside this state to final destination in this state, with respect to which the carrier grants to the shipper the privilege of stopping the shipment in transit at some point in this state for the purpose of storing, manufacturing, milling, or other processing, and thereafter forwards the same commodity, or its equivalent, in the same or converted form, under a through freight rate from point of origin to final destination

Shipments to Ports for Interstate or Foreign Transportation

82.16.050(9)

(9) Amounts derived from the transportation of commodities from points of origin in the state to an export elevator, wharf, dock or ship side on tidewater or its navigable tributaries to be forwarded, without intervening transportation, by vessel, in their original form, to interstate or foreign destinations. No deduction is allowed under this subsection when the point of origin and the point

of delivery to the export elevator, wharf, dock, or ship side are located within the corporate limits of the same city or town

Interstate Transportation Equipment

82.08.0262

(1) The tax levied by RCW 82.08.020 does not apply to:

(a) Sales of airplanes (i) to the United States government; (ii) for use in conducting interstate or foreign commerce; or (iii) for use in providing intrastate air transportation by a commuter air carrier;

(b) Sales of locomotives, railroad cars, or watercraft for use in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire or for use in conducting commercial deep sea fishing operations outside the territorial waters of the state;

(c) Sales of tangible personal property that becomes a component part of such airplanes, locomotives, railroad cars, or watercraft, and of motor vehicles or trailers whether owned by or leased with or without drivers and used by the holder of a carrier permit issued by the interstate commerce commission or its successor agency authorizing transportation by motor vehicle across the boundaries of this state, in the course of constructing, repairing, cleaning, altering, or improving the same; and

(d) Sales of or charges made for labor and services rendered in respect to such constructing, repairing, cleaning, altering, or improving.

(2) The term "commuter air carrier" means an air carrier holding authority under Title 14, Part 298 of the code of federal regulations that carries passengers on at least five round trips per week on at least one route between two or more points according to its published flight schedules that specify the times, days of the week, and places between which those flights are performed.

[2009 c 503 § 1; 1998 c 311 § 5; 1994 c 43 § 1; 1980 c 37 § 29. Formerly RCW 82.08.030(11).]

Notes:

Intent -- 1980 c 37: See note following RCW 82.04.4281.

82.08.0263

The tax levied by RCW 82.08.020 shall not apply to sales of motor vehicles and trailers to be used for the purpose of transporting therein persons or property for hire in interstate or foreign commerce whether such use is by the owner or whether such motor vehicles and trailers are leased to the user with or without drivers: PROVIDED, That the purchaser or user must be the holder of a carrier permit issued by the Interstate Commerce Commission or its successor agency.

[1998 c 311 § 6; 1995 c 63 § 1; 1980 c 37 § 30. Formerly RCW 82.08.030(12).]

Notes:

Effective date -- 1995 c 63: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and shall take effect July 1, 1995." [1995 c 63 § 3.]

Intent -- 1980 c 37: See note following RCW 82.04.4281.

82.12.0254

(1) The provisions of this chapter do not apply in respect to the use of:

(a) Any airplane used primarily in (i) conducting interstate or foreign commerce or (ii) providing intrastate air transportation by a commuter air carrier as defined in RCW 82.08.0262;

(b) Any locomotive, railroad car, or watercraft used primarily in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire or used primarily in commercial deep sea fishing operations outside the territorial waters of the state;

(c) Tangible personal property that becomes a component part of any such airplane, locomotive, railroad car, or watercraft in the course of repairing, cleaning, altering, or improving the same; and

(d) Labor and services rendered in respect to such repairing, cleaning, altering, or improving.

(2) The provisions of this chapter do not apply in respect to the use by a nonresident of this state of any motor vehicle or trailer used exclusively in transporting persons or property across the boundaries of this state and in intrastate operations incidental thereto when such motor vehicle or trailer is registered and licensed in a foreign state and in respect to the use by a nonresident of this state of any motor vehicle or trailer so registered and licensed and used within this state for a period not exceeding fifteen consecutive days under such rules as the department must adopt. However, under circumstances determined to be justifiable by the department a second fifteen day period may be authorized consecutive with the first fifteen day period; and for the purposes of this exemption the term "nonresident" as used herein includes a user who has one or more places of business in this state as well as in one or more other states, but the exemption for nonresidents applies only to those vehicles which are most frequently dispatched, garaged, serviced, maintained, and operated from the user's place of business in another state.

(3) The provisions of this chapter do not apply in respect to the use by the holder of a carrier permit issued by the interstate commerce commission or its successor agency of any motor vehicle or trailer whether owned by or leased with or without driver to the permit holder and used in substantial part in the normal and ordinary course of the user's business for transporting therein persons or property for hire across the boundaries of this state; and in respect to the use of any motor vehicle or trailer while being operated under the authority of a one-transit permit issued by the director of licensing pursuant to RCW 46.16.160 and moving upon the highways from the point of delivery in this state to a point outside this state; and in respect to the use of tangible personal property which becomes a component part of any motor vehicle or trailer used by the holder of a carrier permit issued by the interstate commerce commission or its successor agency authorizing transportation by motor vehicle across the boundaries of this state whether such motor vehicle or trailer is owned by or leased with or without driver to the permit holder, in the course of repairing, cleaning, altering, or improving the same; also the use of labor and services rendered in respect to such repairing, cleaning, altering, or improving.

[2009 c 503 § 2; 2003 c 5 § 3; 1998 c 311 § 7; 1995 c 63 § 2; 1980 c 37 § 54. Formerly RCW 82.12.030(4).]

Notes:

Finding -- Intent -- Retroactive application -- Effective date -- 2003 c 5: See notes following RCW 82.12.010.

Effective date -- 1995 c 63: See note following RCW 82.08.0263.
Intent -- 1980 c 37: See note following RCW 82.04.4281.

Fertilizer, Spray Materials, and Chemical Sprays and Washes

82.04.050(11)

(11) The term also does not include sales of chemical sprays or washes to persons for the purpose of postharvest treatment of fruit for the prevention of scald, fungus, mold, or decay, nor does it include sales of feed, seed, seedlings, fertilizer, agents for enhanced pollination including insects such as bees, and spray materials to: (a) Persons who participate in the federal conservation reserve program, the environmental quality incentives program, the wetlands reserve program, and the wildlife habitat incentives program, or their successors administered by the United States department of agriculture; (b) farmers for the purpose of producing for sale any agricultural product; and (c) farmers acting under cooperative habitat development or access contracts with an organization exempt from federal income tax under Title 26 U.S.C. Sec. 501(c)(3) or the Washington state department of fish and wildlife to produce or improve wildlife habitat on land that the farmer owns or leases.

[2010 c 112 § 14; 2010 c 111 § 201; 2010 c 106 § 202. Prior: 2009 c 563 § 301; 2009 c 535 § 301; prior: 2007 c 54 § 4; 2007 c 6 § 1004; prior: 2005 c 515 § 2; 2005 c 514 § 101; prior: 2004 c 174 § 3; 2004 c 153 § 407; 2003 c 168 § 104; 2002 c 178 § 1; 2000 2nd sp.s. c 4 § 23; prior: 1998 c 332 § 2; 1998 c 315 § 1; 1998 c 308 § 1; 1998 c 275 § 1; 1997 c 127 § 1; prior: 1996 c 148 § 1; 1996 c 112 § 1; 1995 1st sp.s. c 12 § 2; 1995 c 39 § 2; 1993 sp.s. c 25 § 301; 1988 c 253 § 1; prior: 1987 c 285 § 1; 1987 c 23 § 2; 1986 c 231 § 1; 1983 2nd ex.s. c 3 § 25; 1981 c 144 § 3; 1975 1st ex.s. c 291 § 5; 1975 1st ex.s. c 90 § 1; 1973 1st ex.s. c 145 § 1; 1971 ex.s. c 299 § 3; 1971 ex.s. c 281 § 1; 1970 ex.s. c 8 § 1; prior: 1969 ex.s. c 262 § 30; 1969 ex.s. c 255 § 3; 1967 ex.s. c 149 § 4; 1965 ex.s. c 173 § 1; 1963 c 7 § 1; prior: 1961 ex.s. c 24 § 1; 1961 c 293 § 1; 1961 c 15 §82.04.050 ; prior: 1959 ex.s. c 5 § 2; 1957 c 279 § 1; 1955 c 389 § 6; 1953 c 91 § 3; 1951 2nd ex.s. c 28 § 3; 1949 c 228 § 2, part; 1945 c 249 § 1, part; 1943 c 156 § 2, part; 1941 c 178 § 2, part; 1939 c 225 § 2, part; 1937 c 227 § 2, part; 1935 c 180 § 5, part; Rem. Supp. 1949 § 8370-5, part.]

Notes:

Reviser's note: This section was amended by 2010 c 106 § 202, 2010 c 111 § 201, and by 2010 c 112 § 14, each without reference to the other. All amendments are incorporated in the publication of this section under RCW 1.12.025(2). For rule of construction, see RCW 1.12.025(1).

Retroactive application -- 2010 c 112: See note following RCW 82.32.780.

Purpose -- 2010 c 111: "The 2009 legislature enacted Engrossed Substitute House Bill No. 2075 (chapter 535, Laws of 2009), an act relating to the excise taxation of certain products and services provided or furnished electronically. The bill took effect July 26, 2009.

Engrossed Substitute House Bill No. 2075, at eighty-five pages, was a comprehensive piece of legislation that made major changes to state and local sales and use taxes, as well as the state business and occupation tax. Moreover, Engrossed Substitute House Bill No. 2075 was a complex piece of legislation because of the intricate interrelationship between the sales tax and the business and occupation tax and also because the bill affects the taxation of products and services that involve technologies that are changing rapidly.

Because of the complexity and length of Engrossed Substitute House Bill No. 2075, it was the legislature's expectation that, in the course of implementing the bill, ambiguities and unintended consequences would be discovered, which, if not corrected, will unsettle expectations. Thus, the legislature further anticipated that it would need to consider legislation in the 2010 Legislative Session to address these issues.

Therefore, the purpose of this act is to clarify ambiguities, correct unintended consequences, restore expectations, and conform the law to the original intent of the legislature." [2010 c 111 § 101.]

Retroactive application -- 2010 c 111: "(1) Except as provided in subsection (2) of this section, this act applies both prospectively and retroactively to July 26, 2009.

(2) Sections 202, 402, and 502 of this act, and those provisions of sections 401 and 501 of this act that eliminate the sales and use tax exemptions in RCW 82.08.02082 and 82.12.02082, apply prospectively only." [2010 c 111 § 902.]

Effective date -- 2010 c 111: "This act takes effect July 1, 2010." [2010 c 111 § 903.]

Effective date -- 2010 c 106: See note following RCW 35.102.145.

Finding -- Intent -- Construction -- Effective date -- Reports and recommendations -- 2009 c 563: See notes following RCW 82.32.780.

Intent -- Construction -- 2009 c 535: See notes following RCW 82.04.192.

Severability -- 2007 c 54: "If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected." [2007 c 54 § 32.]

Part headings not law -- Savings -- Effective date -- Severability -- 2007 c 6: See notes following RCW 82.32.020.

Findings -- Intent -- 2007 c 6: See note following RCW 82.14.495.

Findings -- 2005 c 515: "The legislature finds that:

(1) Public entities that receive tax dollars must continuously improve the way they operate and deliver service so citizens receive maximum value for their tax dollars; and

(2) An explicit statement clarifying that no sales or use tax shall apply to the entire charge paid by regional transit authorities for bus or rail combined operations and maintenance agreements that are provided to such authorities in support of their provision of urban transportation or transportation services is necessary to improve efficient service." [2005 c 515 § 1.]

Effective date -- 2005 c 514: See note following RCW 83.100.230.

Part headings not law -- Severability -- 2005 c 514: See notes following RCW 82.12.808.

Effective date -- 2004 c 174: See note following RCW 82.04.2908.

Retroactive effective date -- Effective date -- 2004 c 153: See note following RCW 82.08.0293.

Effective dates -- Part headings not law -- 2003 c 168: See notes following RCW 82.08.010.

Retroactive application -- Effective date -- 2002 c 178: See notes following RCW 67.28.180.

Findings -- Construction -- 2000 2nd sp.s. c 4 §§ 18-30: See notes following RCW 81.112.300.

Findings -- Intent -- Effective date -- 1998 c 332: See notes following RCW 82.04.29001.

Effective dates -- 1998 c 308: "(1) Sections 1 through 4 of this act take effect July 1, 1998.

(2) Section 5 of this act takes effect July 1, 2003." [1998 c 308 § 6.]

Effective date -- 1998 c 275: "This act takes effect July 1, 1998." [1998 c 275 § 2.]

Effective date -- 1997 c 127: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect July 1, 1997." [1997 c 127 § 2.]

Severability -- 1996 c 148: "If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected." [1996 c 148 § 7.]

Effective date -- 1996 c 148: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and shall take effect April 1, 1996." [1996 c 148 § 8.]

Effective date -- 1996 c 112: "This act shall take effect July 1, 1996." [1996 c 112 § 5.]

Intent -- 1995 1st sp.s. c 12: "It is the intent of the legislature that massage services be recognized as health care practitioners for the purposes of business and occupation tax application. To achieve this intent massage services are being removed from the definition of sale at retail and retail sale." [1995 1st sp.s. c 12 § 1.]

Effective date -- 1995 1st sp.s. c 12: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and shall take effect July 1, 1995." [1995 1st sp.s. c 12 § 5.]

Effective date -- 1995 c 39: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and shall take effect July 1, 1995." [1995 c 39 § 3.]

Severability -- Effective dates--Part headings, captions not law--1993 sp.s. c 25: See notes following RCW 82.04.230.

Construction -- Severability -- Effective dates -- 1983 2nd ex.s. c 3: See notes following RCW 82.04.255.

Intent -- Severability -- Effective date -- 1981 c 144: See notes following RCW 82.16.010.

Application to preexisting contracts -- 1975 1st ex.s. c 291; 1975 1st ex.s. c 90: See note following RCW 82.12.010.

Effective dates -- 1975 1st ex.s. c 291: "This 1975 amendatory act is necessary for the immediate preservation of the public peace, health, and safety, the support of the state government and its existing institutions, and shall take effect immediately: PROVIDED, That sections 8 and 26 through 43 of this amendatory act shall be effective on and after January 1, 1976: PROVIDED FURTHER,

That sections 2, 3, and 4, and subsections (1) and (2) of section 24 shall be effective on and after January 1, 1977: AND PROVIDED FURTHER, That subsections (3) through (15) of section 24 shall be effective on and after January 1, 1978." [1975 1st ex.s. c 291 § 46.]

Severability -- 1975 1st ex.s. c 291: "If any provision of this 1975 amendatory act, or its application to any person or circumstance is held invalid, the remainder of the act, or the application of the provision to other persons or circumstances is not affected." [1975 1st ex.s. c 291 § 45.]

Effective date -- 1975 1st ex.s. c 90: "This 1975 amendatory act is necessary for the immediate preservation of the public peace, health and safety, the support of the state government and its existing public institutions, and shall take effect July 1, 1975." [1975 1st ex.s. c 90 § 5.]

Effective date -- 1973 1st ex.s. c 145: "This act is necessary for the immediate preservation of the public peace, health and safety, the support of the state government and its existing public institutions, and shall take effect July 1, 1973." [1973 1st ex.s. c 145 § 2.]

Effective dates -- 1971 ex.s. c 299: "This 1971 amendatory act is necessary for the immediate preservation of the public peace, health and safety, the support of the state government and its existing public institutions, and shall take effect as follows:

(1) Sections 1 through 12, 15 through 34 and 53 shall take effect July 1, 1971;

(2) Sections 13, 14, and 77 and 78 shall take effect June 1, 1971; and

(3) Sections 35 through 52 and 54 through 76 shall take effect as provided in section 53." [1971 ex.s. c 299 § 79.]

Severability -- 1971 ex.s. c 299: "If any phrase, clause, subsection or section of this 1971 amendatory act shall be declared unconstitutional or invalid by any court of competent jurisdiction, it shall be conclusively presumed that the legislature would have enacted this 1971 amendatory act without the phrase, clause, subsection or section so held unconstitutional or invalid and the remainder of the act shall not be affected as a result of said part being held unconstitutional or invalid." [1971 ex.s. c 299 § 78.]

Construction -- Severability -- 1969 ex.s. c 255: See notes following RCW 35.58.272.

Effective date -- 1967 ex.s. c 149: "This act is necessary for the immediate preservation of the public peace, health and safety, the support of the state government and its existing public institutions, and shall take effect July 1, 1967." [1967 ex.s. c 149 § 65.]

Effective date -- 1965 ex.s. c 173: "This act is necessary for the immediate preservation of the public peace, health and safety, the support of the state government and its existing public institutions, and shall take effect June 1, 1965." [1965 ex.s. c 173 § 33.]

Credit for retail sales or use taxes paid to other jurisdictions with respect to property used: RCW 82.12.035.

"Services rendered in respect to" defined: RCW 82.04.051.

Labor and Services Used in Construction and Repair of Public Roads

82.04.050(10)

(10) The term does not include the sale of or charge made for labor and services rendered in respect to the constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for the United States, any instrumentality thereof, or a county or city housing authority created pursuant to chapter 35.82 RCW, including the installing, or attaching of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation. Nor does the term include the sale of services or charges made for the clearing of land and the moving of earth of or for the United States, any instrumentality thereof, or a county or city housing authority. Nor does the term include the sale of services or charges made for cleaning up for the United States, or its instrumentalities, radioactive waste and other by-products of weapons production and nuclear research and development.

[2010 c 112 § 14; 2010 c 111 § 201; 2010 c 106 § 202. Prior: 2009 c 563 § 301; 2009 c 535 § 301; prior: 2007 c 54 § 4; 2007 c 6 § 1004; prior: 2005 c 515 § 2; 2005 c 514 § 101; prior: 2004 c 174 § 3; 2004 c 153 § 407; 2003 c 168 § 104; 2002 c 178 § 1; 2000 2nd sp.s. c 4 § 23; prior: 1998 c 332 § 2; 1998 c 315 § 1; 1998 c 308 § 1; 1998 c 275 § 1; 1997 c 127 § 1; prior: 1996 c 148 § 1; 1996 c 112 § 1; 1995 1st sp.s. c 12 § 2; 1995 c 39 § 2; 1993 sp.s. c 25 § 301; 1988 c 253 § 1; prior: 1987 c 285 § 1; 1987 c 23 § 2; 1986 c 231 § 1; 1983 2nd ex.s. c 3 § 25; 1981 c 144 § 3; 1975 1st ex.s. c 291 § 5; 1975 1st ex.s. c 90 § 1; 1973 1st ex.s. c 145 § 1; 1971 ex.s. c 299 § 3; 1971 ex.s. c 281 § 1; 1970 ex.s. c 8 § 1; prior: 1969 ex.s. c 262 § 30; 1969 ex.s. c 255 § 3; 1967 ex.s. c 149 § 4; 1965 ex.s. c 173 § 1; 1963 c 7 § 1; prior: 1961 ex.s. c 24 § 1; 1961 c 293 § 1; 1961 c 15 §82.04.050 ; prior: 1959 ex.s. c 5 § 2; 1957 c 279 § 1; 1955 c 389 § 6; 1953 c 91 § 3; 1951 2nd ex.s. c 28 § 3; 1949 c 228 § 2, part; 1945 c 249 § 1, part; 1943 c 156 § 2, part; 1941 c 178 § 2, part; 1939 c 225 § 2, part; 1937 c 227 § 2, part; 1935 c 180 § 5, part; Rem. Supp. 1949 § 8370-5, part.]

Notes:

Reviser's note: This section was amended by 2010 c 106 § 202, 2010 c 111 § 201, and by 2010 c 112 § 14, each without reference to the other. All amendments are incorporated in the publication of this section under RCW 1.12.025(2). For rule of construction, see RCW 1.12.025(1).

Retroactive application -- 2010 c 112: See note following RCW 82.32.780.

Purpose -- 2010 c 111: "The 2009 legislature enacted Engrossed Substitute House Bill No. 2075 (chapter 535, Laws of 2009), an act relating to the excise taxation of certain products and services provided or furnished electronically. The bill took effect July 26, 2009.

Engrossed Substitute House Bill No. 2075, at eighty-five pages, was a comprehensive piece of legislation that made major changes to state and local sales and use taxes, as well as the state business and occupation tax. Moreover, Engrossed Substitute House Bill No. 2075 was a complex piece of legislation because of the intricate interrelationship between the sales tax and the business and occupation tax and also because the bill affects the taxation of products and services that involve technologies that are changing rapidly.

Because of the complexity and length of Engrossed Substitute House Bill No. 2075, it was the legislature's expectation that, in the course of implementing the bill, ambiguities and unintended consequences would be discovered, which, if not corrected, will unsettle expectations. Thus, the

legislature further anticipated that it would need to consider legislation in the 2010 Legislative Session to address these issues.

Therefore, the purpose of this act is to clarify ambiguities, correct unintended consequences, restore expectations, and conform the law to the original intent of the legislature." [2010 c 111 § 101.]

Retroactive application -- 2010 c 111: "(1) Except as provided in subsection (2) of this section, this act applies both prospectively and retroactively to July 26, 2009.

(2) Sections 202, 402, and 502 of this act, and those provisions of sections 401 and 501 of this act that eliminate the sales and use tax exemptions in RCW 82.08.02082 and 82.12.02082, apply prospectively only." [2010 c 111 § 902.]

Effective date -- 2010 c 111: "This act takes effect July 1, 2010." [2010 c 111 § 903.]

Effective date -- 2010 c 106: See note following RCW 35.102.145.

Finding -- Intent -- Construction -- Effective date -- Reports and recommendations -- 2009 c 563: See notes following RCW 82.32.780.

Intent -- Construction -- 2009 c 535: See notes following RCW 82.04.192.

Severability -- 2007 c 54: "If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected." [2007 c 54 § 32.]

Part headings not law -- Savings -- Effective date -- Severability -- 2007 c 6: See notes following RCW 82.32.020.

Findings -- Intent -- 2007 c 6: See note following RCW 82.14.495.

Findings -- 2005 c 515: "The legislature finds that:

(1) Public entities that receive tax dollars must continuously improve the way they operate and deliver service so citizens receive maximum value for their tax dollars; and

(2) An explicit statement clarifying that no sales or use tax shall apply to the entire charge paid by regional transit authorities for bus or rail combined operations and maintenance agreements that are provided to such authorities in support of their provision of urban transportation or transportation services is necessary to improve efficient service." [2005 c 515 § 1.]

Effective date -- 2005 c 514: See note following RCW 83.100.230.

Part headings not law -- Severability -- 2005 c 514: See notes following RCW 82.12.808.

Effective date -- 2004 c 174: See note following RCW 82.04.2908.

Retroactive effective date -- Effective date -- 2004 c 153: See note following RCW 82.08.0293.

Effective dates -- Part headings not law -- 2003 c 168: See notes following RCW 82.08.010.

Retroactive application -- Effective date -- 2002 c 178: See notes following RCW 67.28.180.

Findings -- Construction -- 2000 2nd sp.s. c 4 §§ 18-30: See notes following RCW 81.112.300.

Findings -- Intent -- Effective date -- 1998 c 332: See notes following RCW 82.04.29001.

Effective dates -- 1998 c 308: "(1) Sections 1 through 4 of this act take effect July 1, 1998.

(2) Section 5 of this act takes effect July 1, 2003." [1998 c 308 § 6.]

Effective date -- 1998 c 275: "This act takes effect July 1, 1998." [1998 c 275 § 2.]

Effective date -- 1997 c 127: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect July 1, 1997." [1997 c 127 § 2.]

Severability -- 1996 c 148: "If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected." [1996 c 148 § 7.]

Effective date -- 1996 c 148: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and shall take effect April 1, 1996." [1996 c 148 § 8.]

Effective date -- 1996 c 112: "This act shall take effect July 1, 1996." [1996 c 112 § 5.]

Intent -- 1995 1st sp.s. c 12: "It is the intent of the legislature that massage services be recognized as health care practitioners for the purposes of business and occupation tax application. To achieve this intent massage services are being removed from the definition of sale at retail and retail sale." [1995 1st sp.s. c 12 § 1.]

Effective date -- 1995 1st sp.s. c 12: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and shall take effect July 1, 1995." [1995 1st sp.s. c 12 § 5.]

Effective date -- 1995 c 39: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and shall take effect July 1, 1995." [1995 c 39 § 3.]

Severability -- Effective dates--Part headings, captions not law--1993 sp.s. c 25: See notes following RCW 82.04.230.

Construction -- Severability -- Effective dates -- 1983 2nd ex.s. c 3: See notes following RCW 82.04.255.

Intent -- Severability -- Effective date -- 1981 c 144: See notes following RCW 82.16.010.

Application to preexisting contracts -- 1975 1st ex.s. c 291; 1975 1st ex.s. c 90: See note following RCW 82.12.010.

Effective dates -- 1975 1st ex.s. c 291: "This 1975 amendatory act is necessary for the immediate preservation of the public peace, health, and safety, the support of the state government and its existing institutions, and shall take effect immediately: PROVIDED, That sections 8 and 26 through 43 of this amendatory act shall be effective on and after January 1, 1976: PROVIDED FURTHER, That sections 2, 3, and 4, and subsections (1) and (2) of section 24 shall be effective on and after January 1, 1977: AND PROVIDED FURTHER, That subsections (3) through (15) of section 24 shall be effective on and after January 1, 1978." [1975 1st ex.s. c 291 § 46.]

Severability -- 1975 1st ex.s. c 291: "If any provision of this 1975 amendatory act, or its application to any person or circumstance is held invalid, the remainder of the act, or the application of the provision to other persons or circumstances is not affected." [1975 1st ex.s. c 291 § 45.]

Effective date -- 1975 1st ex.s. c 90: "This 1975 amendatory act is necessary for the immediate preservation of the public peace, health and safety, the support of the state government and its existing public institutions, and shall take effect July 1, 1975." [1975 1st ex.s. c 90 § 5.]

Effective date -- 1973 1st ex.s. c 145: "This act is necessary for the immediate preservation of the public peace, health and safety, the support of the state government and its existing public institutions, and shall take effect July 1, 1973." [1973 1st ex.s. c 145 § 2.]

Effective dates -- 1971 ex.s. c 299: "This 1971 amendatory act is necessary for the immediate preservation of the public peace, health and safety, the support of the state government and its existing public institutions, and shall take effect as follows:

(1) Sections 1 through 12, 15 through 34 and 53 shall take effect July 1, 1971;

(2) Sections 13, 14, and 77 and 78 shall take effect June 1, 1971; and

(3) Sections 35 through 52 and 54 through 76 shall take effect as provided in section 53." [1971 ex.s. c 299 § 79.]

Severability -- 1971 ex.s. c 299: "If any phrase, clause, subsection or section of this 1971 amendatory act shall be declared unconstitutional or invalid by any court of competent jurisdiction, it shall be conclusively presumed that the legislature would have enacted this 1971 amendatory act without the phrase, clause, subsection or section so held unconstitutional or invalid and the remainder of the act shall not be affected as a result of said part being held unconstitutional or invalid." [1971 ex.s. c 299 § 78.]

Construction -- Severability -- 1969 ex.s. c 255: See notes following RCW 35.58.272.

Effective date -- 1967 ex.s. c 149: "This act is necessary for the immediate preservation of the public peace, health and safety, the support of the state government and its existing public institutions, and shall take effect July 1, 1967." [1967 ex.s. c 149 § 65.]

Effective date -- 1965 ex.s. c 173: "This act is necessary for the immediate preservation of the public peace, health and safety, the support of the state government and its existing public institutions, and shall take effect June 1, 1965." [1965 ex.s. c 173 § 33.]

Credit for retail sales or use taxes paid to other jurisdictions with respect to property used: RCW 82.12.035.

"Services rendered in respect to" defined: RCW 82.04.051.

82.04.190(3)

(3) Any person engaged in the business of contracting for the building, repairing or improving of any street, place, road, highway, easement, right-of-way, mass public transportation terminal or parking facility, bridge, tunnel, or trestle which is owned by a municipal corporation or political subdivision of the state of Washington or by the United States and which is used or to be used primarily for foot or vehicular traffic including mass transportation vehicles of any kind as defined

in RCW 82.04.280, in respect to tangible personal property when such person incorporates such property as an ingredient or component of such publicly owned street, place, road, highway, easement, right-of-way, mass public transportation terminal or parking facility, bridge, tunnel, or trestle by installing, placing or spreading the property in or upon the right-of-way of such street, place, road, highway, easement, bridge, tunnel, or trestle or in or upon the site of such mass public transportation terminal or parking facility.

[2010 c 111 § 202; 2010 c 106 § 204; 2009 c 535 § 302; 2007 c 6 § 1008; 2005 c 514 § 103. Prior: 2004 c 174 § 4; 2004 c 2 § 8; 2002 c 367 § 2; prior: 1998 c 332 § 6; 1998 c 308 § 2; prior: 1996 c 173 § 2; 1996 c 148 § 4; 1996 c 112 § 2; 1995 1st sp.s. c 3 § 4; 1986 c 231 § 2; 1985 c 134 § 1; 1983 2nd ex.s. c 3 § 27; 1975 1st ex.s. c 90 § 2; 1971 ex.s. c 299 § 4; 1969 ex.s. c 255 § 4; 1967 ex.s. c 149 § 6; 1965 ex.s. c 173 § 4; 1961 c 15 §82.04.190 ; prior: 1959 ex.s. c 3 § 3; 1957 c 279 § 2; 1955 c 389 § 20; prior: 1949 c 228 § 2, part; 1945 c 249 § 1, part; 1943 c 156 § 2, part; 1941 c 178 § 2, part; 1939 c 225 § 2, part; 1937 c 227 § 2, part; 1935 c 180 § 5, part; Rem. Supp. 1949 § 8370-5, part.]

Notes:

Reviser's note: This section was amended by 2010 c 106 § 204 and by 2010 c 111 § 202, each without reference to the other. Both amendments are incorporated in the publication of this section under RCW 1.12.025(2). For rule of construction, see RCW 1.12.025(1).

Purpose -- Retroactive application -- Effective date -- 2010 c 111: See notes following RCW 82.04.050.

Effective date -- 2010 c 106: See note following RCW 35.102.145.

Intent -- Construction -- 2009 c 535: See notes following RCW 82.04.192.

Part headings not law -- Savings -- Effective date -- Severability -- 2007 c 6: See notes following RCW 82.32.020.

Findings -- Intent -- 2007 c 6: See note following RCW 82.14.495.

Effective date -- 2005 c 514: See note following RCW 83.100.230.

Part headings not law -- Severability -- 2005 c 514: See notes following RCW 82.12.808.

Effective date -- 2004 c 174: See note following RCW 82.04.2908.

Severability -- Effective date -- 2002 c 367: See notes following RCW 82.04.060.

Findings -- Intent -- Effective date -- 1998 c 332: See notes following RCW 82.04.29001.

Effective dates -- 1998 c 308: See note following RCW 82.04.050.

Findings -- Intent -- 1996 c 173: See note following RCW 82.08.02565.

Severability -- Effective date -- 1996 c 148: See notes following RCW 82.04.050.

Effective date -- 1996 c 112: See note following RCW 82.04.050.

Findings -- Effective date -- 1995 1st sp.s. c 3: See notes following RCW 82.08.02565.

Construction -- Severability -- Effective dates -- 1983 2nd ex.s. c 3: See notes following RCW 82.04.255.

Application to preexisting contracts -- 1975 1st ex.s. c 90: See note following RCW 82.12.010.

Effective date -- 1975 1st ex.s. c 90: See note following RCW 82.04.050.

Effective dates -- Severability -- 1971 ex.s. c 299: See notes following RCW 82.04.050.

Construction -- Severability -- 1969 ex.s. c 255: See notes following RCW 35.58.272.

Sales of Breeding Livestock, Cattle, and Milk Cows

82.08.0259

The tax levied by RCW 82.08.020 shall not apply to sales of livestock, as defined in RCW 16.36.005, for breeding purposes where the animals are registered in a nationally recognized breed association; or to sales of cattle and milk cows used on the farm.

[2001 c 118 § 4; 1980 c 37 § 27. Formerly RCW 82.08.030(9).]

Notes:

Intent -- 1980 c 37: See note following RCW 82.04.4281.

82.12.0261

The provisions of this chapter shall not apply in respect to the use of livestock, as defined in RCW 16.36.005, for breeding purposes where said animals are registered in a nationally recognized breed association; or to sales of cattle and milk cows used on the farm.

[2001 c 118 § 5; 1980 c 37 § 60. Formerly RCW 82.12.030(10).]

Notes:

Intent -- 1980 c 37: See note following RCW 82.04.4281.

Title Insurance Premiums

48.14.020 (1)

(1) Subject to other provisions of this chapter, each authorized insurer except title insurers shall on or before the first day of March of each year pay to the state treasurer through the commissioner's office a tax on premiums. Except as provided in subsection (2) of this section, such tax shall be in the amount of two percent of all premiums, excluding amounts returned to or the amount of reductions in premiums allowed to holders of industrial life policies for payment of premiums directly to an office of the insurer, collected or received by the insurer under RCW 48.14.090 during the preceding calendar year other than ocean marine and foreign trade insurances, after deducting premiums paid to policyholders as returned premiums, upon risks or property resident, situated, or to be performed in this state. For tax purposes, the reporting of premiums shall be on a written basis or on a paid-for basis consistent with the basis required by the annual statement. For the purposes of this section the consideration received by an insurer for the granting of an annuity shall not be deemed to be a premium.

48.14.020 (4)

(4) The state does hereby preempt the field of imposing excise or privilege taxes upon insurers or their appointed insurance producers, other than title insurers, and no county, city, town or other municipal subdivision shall have the right to impose any such taxes upon such insurers or these insurance producers.