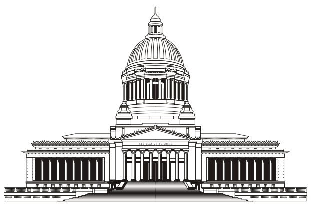
2011 Tax Preference Performance Reviews

Report 12-2

January 11, 2012



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REPORT SUMMARY

What Is a Tax Preference?

Tax preferences are exemptions, exclusions, or deductions from the base of a state tax; a credit against a state tax; a deferral of a state tax; or a preferential state tax rate. Washington has 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 Joint Legislative Audit and Review Committee (JLARC).

Citizen Commission Sets the Schedule

The Legislature directed 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 Commission is directed to omit certain tax preferences from the schedule, such as those required by constitutional law.

In October 2010, the Commission adopted its fifth ten-year schedule for the tax preference reviews. This volume includes reviews of a total of 25 tax preferences under the business and occupation tax, sales tax, use tax, property tax, aircraft fuel tax, and the real estate excise tax.

JLARC's Approach to the Tax Preference Reviews

JLARC's assignment from EHB 1069 is to conduct the reviews of tax preference according to the schedule developed by the Commission and consistent with the guidelines set forth in statute. The reviews are conducted independently by JLARC staff.

Preferences with a Fiscal Impact Greater than $10 Million

For tax preferences with an estimated biennial fiscal impact of greater than $10 million, JLARC staff evaluated the tax preferences using a set of ten questions:

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? (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))

Preferences with a Fiscal Impact Between $2 and $10 Million

For the tax preferences with estimated fiscal impacts between $2 and $10 million, JLARC evaluated the tax preferences using a set of four questions.

Public Policy Objectives:

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

Beneficiaries:

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

Revenue and Economic Impacts:

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

Forty-three preferences with an estimated impact of less than $2 million are presented in a separate document, based on information compiled by the Department of Revenue

Methodology

JLARC staff analyzed the following evidence in conducting these 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 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 or are knowledgeable of the industries affected by the tax (the Department of Revenue, the Department of Licensing, the Department of Transportation, and the Department of Financial Institutions). 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.

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 review in 2011. Of the 25 tax preferences included in this volume, this report recommends the Legislature:

- Terminate one tax preference;
- Allow two tax preferences to expire;
- Review and/or clarify the intent of eight tax preferences; and
- Continue 14 tax preferences.

Organization of This Report

The report begins with a letter from the chair of the Citizen Commission, noting the adoption of the Commission's comments for the 2011 tax preference reviews. The letter is followed by a summary of all 25 preferences, including the Citizen Commission's comments, presented in alphabetical order. For those accessing the information electronically, a link is provided with each summary to "jump" to the detailed analysis. The current appendices provide the Scope and Objectives and the text of current law for each preference.

State of Washington

Citizen Commission for Performance Measurement of Tax Preferences

E-mail: lisa.hennessy@leg.wa.gov
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October 27, 2011

The Honorable Senator Ed Murray
The Honorable Senator Joseph Zarelli
The Honorable Representative Ross Hunter
The Honorable Representative Gary Alexander

2011 Tax Preference Reviews

I am pleased to report that the Citizen Commission for Performance Measurement of Tax Preferences (Citizen Commission) has unanimously adopted its comments for this year's review of tax preferences.

The attached comments are the consensus of all Commissioners. Commissioners encouraged me, in my capacity as Chair, to emphasize to you the importance of the Legislature considering this year's and previous years' recommendations and comments on tax preference statutes, which have undergone rigorous review by the Joint Legislative Audit and Review Committee (JLARC) staff, pursuant to legislatively-mandated criteria and government auditing standards.

As the chairs and ranking minority members of the fiscal committees, I urge you to consider these recommendations and act upon them during the upcoming special session.

This is the fifth year that tax preferences have been reviewed at the direction of the Legislature. Legislation enacted in 2006 established the Citizen Commission and directed it to develop a schedule for an orderly review of tax preferences over ten years. The reviews are conducted independently by the non-partisan staff of JLARC, using government auditing standards. In 2011 the Legislature amended the statutory framework which will enable JLARC staff and the Citizens Commission beginning with the 2012 tax preference reviews to focus resources more effectively on those tax preferences where the provision of information and analysis might have the greatest beneficial impact.

Tax preference reviews provide a valuable resource at a time when the Legislature is grappling with difficult fiscal issues. Some tax preferences have unclear purposes and objectives which make it difficult to ascertain whether the preference is serving a larger public purpose or benefiting a narrower interest group. Some preferences are outdated; some have served legitimate temporary needs that have passed; some may convey unfair competitive advantage; and some may be administratively cumbersome. JLARC staff reviews and Citizen Commission comments provide the Legislature with information which creates opportunities to improve the effectiveness, simplicity, and fairness of our tax system.

Tax preference reviews underscore the importance of on-going evaluations of whether tax preferences are meeting their intended purposes and are serving the broader public interest. Commissioners asked me to convey their collective belief that tax preferences should not be established permanently. Preferences that are established, modified, or extended by the Legislature should include an expiration date so that they will be reviewed periodically to ensure they are performing as intended.

And, we encourage the Legislature to include clear statements of public policy purpose. Such clarity will improve our ability to evaluate a tax preference. Last year the Citizen Commission endorsed a list

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of best practices for drafting statements of the legislative intent of individual tax preferences. We believe that the Legislature's use of these best practices would assist JLARC staff and the Citizen Commission in determining whether the public policy purpose of a tax preference is being achieved.

In addition to comments on individual tax preference reviews, the Citizen Commission included a general comment this year pertaining to the use of the term "expiration" in legislation. We recommend that the Legislature either clarify directly in a tax preference statute the intent of an expiration date or provide commentary in the legislative record that clarifies the intent of an expiration date. We included this general recommendation because an expiration date can have different meanings – the Legislature might intend the date to require review of experience with the preference to determine whether to extend or modify it, or the Legislature might intend the preference to be a time-limited response to temporary short-term industry or economic circumstances with the expectation that the preference will not be extended.

I believe the work of JLARC staff and the Citizen Commission has provided a thoughtful and deliberative forum for highlighting many important performance and policy issues associated with evaluating tax preferences. I encourage you to consider the recommendations of JLARC staff and Citizen Commission comments covering the entire five years of tax preference reviews during the upcoming legislative session.

As Chair of the Citizen Commission for Performance Measurement of Tax Preferences, I would be pleased to discuss the Commission's position and comments with you and any interested legislators. I can be contacted via email at bill@tlff.org.

If you have questions about JLARC's performance audits, please feel free to contact the Legislative Auditor, Keenan Konopaski, at 360-786-5187 or keenan.konopaski@leg.wa.gov. Additional information on all five years of tax preference reviews can be found at www.citizentaxpref.wa.gov/reports.htm.

Sincerely,

William A. Longbrake

William A. Longbrake, Chair

cc: All Legislators
Keenan Konopaski, Legislative Auditor
Marty Brown, Director, Office of Financial Management
Suzan DelBene, Director, Department of Revenue

attachment

<table>
<tr><th colspan="4">Summary of 2011 Tax Preference Performance Reviews</th></tr>
<tr><th>What the Preference Does</th><th>Public Policy Objective</th><th>Estimated Beneficiary Savings</th><th>JLARC Staff Recommendation</th></tr>
<tr><td colspan="4">Aircraft Fuel Tax, Export and Commercial Use (Aircraft Fuel Tax) / 82.42.030; 82.42.070 Detail on page 25</td></tr>
<tr><td>Exempts certain purchases of aircraft fuel from aircraft fuel tax.</td><td>The Legislature did not specifically state the public policy objectives of the preferences.
JLARC infers two possible objectives:
1) To structure the preferences so the parties that benefited from the expenditure of aircraft fuel tax receipts were the ones that paid the tax.
2) To comply with U.S. Constitutional prohibitions on taxing goods in interstate or foreign commerce and taxing the federal government.</td><td>$299.9 million in 2011-13 Biennium</td><td>Review and clarify: Because parties that currently are exempt from paying the aircraft fuel tax benefit from the expenditures of fuel tax receipts.</td></tr>
<tr><td colspan="4">Commission Comment: The Commission endorses the recommendation and encourages the Legislature to state the public policy objectives of the preference and narrow the scope of the preference commensurate with the stated public policy objectives.
Rationale: The JLARC staff study indicates that there are two implied public policy objectives for this preference. The first is that parties benefiting from the expenditure of aircraft fuel tax receipts were the ones that paid the tax. This implied public policy objective is not being met. The second implied public policy objective was to comply with U.S. Constitutional prohibitions on taxing goods in interstate commerce. However, in many instances the tax could be levied and comply with the U.S. Constitution provided that credit was provided for taxes paid in other states.</td></tr>
<tr><td colspan="4">Boat Sales to Nonresidents/Foreign Residents (Sales Tax) / 82.08.0266; 82.08.02665 Detail on page 37</td></tr>
<tr><td>Provides sales tax exemptions to residents from other states and countries when they purchase and take possession of boats in Washington.</td><td>The Legislature did not specifically state the public policy objectives of the preferences.
The implied intent is to support sales of boats in Washington by removing a disincentive for nonresidents and foreign residents to purchase and take possession of boats in-state.</td><td>$13.7 million in 2011-13 Biennium</td><td>Continue: Because the preferences are meeting the implied public policy objective of removing a disincentive for nonresidents to purchase and take delivery of boats in Washington.</td></tr>
<tr><td colspan="4">Commission Comment: Commission endorses the JLARC staff recommendation.</td></tr>
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Summary of 2011 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	JLARC Staff Recommendation
Church Camps (Property Tax) / 84.36.030(2)			Detail on page 51
Exempts from property tax camps owned by nonprofit churches, denominations, or organizations whose membership is comprised of churches.	The Legislature did not specifically state the public policy objective of the preference. JLARC infers two public policy objectives: 1) To ensure that church camps conducted for sectarian purposes are treated consistently for tax purposes with nonprofit camps conducted for nonsectarian purposes. 2) The Legislature may have wanted to support church camps in the same manner it has supported other nonprofit organizations that provide social services to youth.	$6.9 million in 2011-13 Biennium	**Continue**: Because the preference is fulfilling the implied public policy objective of ensuring that church camps are being treated consistently for tax purposes with nonsectarian camps.
Commission Comment: Commission endorses the JLARC staff recommendation.			
Display Items for Trade Shows (Use Tax) / 82.12.0272			Detail on page 59
Provides a use tax exemption for personal property used by businesses (not in excess of 30 days) at a single trade show to promote sales of products or services.	The Legislature did not specifically state the public policy objective of the preference. Historic documents imply the preference was intended to remove a potential disincentive for vendor participation in trade shows held in Washington.	$5 million in 2009-11 Biennium per DOR (JLARC unable to determine)	**Continue**: Because the preference is meeting the implied public policy objective of removing a potential disincentive for vendor participation in trade shows held in Washington.
Commission Comment: Commission endorses the JLARC staff recommendation.			

Summary of 2011 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	JLARC Staff Recommendation
Extracted Fuel (Use Tax) / 82.12.0263			Detail on page 65
Provides a use tax exemption for fuel produced by an extractor/manufacturer during extracting or manufacturing activities, when the fuel is used by the producer directly in the same extracting or manufacturing activity.	The Legislature did not specifically state the public policy objective of the preference. JLARC infers two possible objectives: 1) The Legislature wanted to generally apply a use tax to byproducts but did not want to contradict a state Supreme Court decision, so it provided a limited use tax exemption. 2) The Legislature wanted to provide a tax preference to certain extractors/manufacturers to support those industries, so it structured the preference narrowly. A court decision made shortly before the Legislature created the preference in 1949 dealt with the taxability of a wood product manufacturer. However, the majority of the beneficiary savings now appear to be realized by oil refineries.	$69.2 million in 2011-13 Biennium	**Review and clarify**: Because the public policy objective and intended beneficiaries are unclear.
Commission Comment: Commission endorses the JLARC staff recommendation.			

Summary of 2011 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	JLARC Staff Recommendation
Hog Fuel to Produce Energy (Sales & Use Tax) / 82.08.956; 82.12.956			Detail on page 77
Provides sales and use tax exemptions for hog fuel used to produce electricity, steam, heat, or biofuel.	The Legislature did not specifically state a public policy objective for these preferences; however, it did make the preferences temporary. Because of the sharp declines in oil and natural gas prices occurring at the time that the preferences were enacted, JLARC infers that the Legislature may have intended to temporarily make the price of hog fuel more competitive.	$3.2 million in 2011-13 Biennium	**Allow to expire**: Because the Legislature intended the exemptions to be temporary and did not provide performance goals to guide any other assessment of performance.

Commission Comment: The Commission does not endorse the recommendation that the Legislature should allow the sales and use tax exemptions for hog fuel to expire because it is unclear that the Legislature intended the exemptions in this preference to be temporary. The Commission recommends that the Legislature review available evidence before determining whether to let the preference expire. Further, if the Legislature determines to extend the preference, the Commission recommends a two year extension and that performance goals (public policy objectives) be specified and reporting be required to enable subsequent assessment of the benefits and costs of the preference.

Rationale: Although the Legislature did not specify a public policy objective for this preference, public testimony provided to the Commission argued that the public purpose was summarized in testimony on SB 5442, which was a precursor to SB 6170, which included the hog fuel tax preference: "The forestry industry is facing an economic crisis, and this bill will help preserve jobs, promote healthy forest, and ensure CO2-neutral energy by encouraging the use of woody biomass. The forestry industry in eastern and western Washington is distressed, which is stressing rural local governments and social programs. This bill will help preserve the forestry industry and thereby rural economies."

As the JLARC study points out part of the rationale for the hog fuel tax preference may have been because hog fuel was less competitive during a time of declining oil prices. Because the price of oil since enactment has risen, presumably the economic disadvantage no longer exists. However, public testimony provided to the Commission asserted that the more relevant alternative fuel price is natural gas rather than oil and, further, because of significant structural changes in the market for natural gas the price of natural gas has declined significantly since the hog fuel preference was enacted. Public testimony also pointed out that since hog fuel must be transported, diesel fuel costs, which are subject to tax, have risen along with oil prices, and this has exacerbated hog fuel's price competitiveness relative to natural gas.

Hog fuel is a low-cost raw material (LCRM). Utilizing this LCRM produced at sawmills and chipping facilities creates a low cost energy source for those who burn it to produce green energy. Utilizing the LCRM prevents the need to stockpile mountains of this material on property which creates safety issues such as fire hazards. Burning LCRM for the production of energy is the primary way to deal with this material on a large-scale basis. Relying on the LCRM to produce energy would significantly reduce dependence on fossil fuels.

Public testimony suggested that the Legislature extend the hog fuel tax preference for two years subject to collection of sufficient data to evaluate the public policy merits of this preference.

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<tr><td colspan="3">Interest from State and Municipal Obligations (Business & Occupation Tax) / 82.04.4293</td><td>Detail on page 85</td></tr>
<tr><td>Provides a B&O tax deduction to financial businesses for gross income received as interest from state and municipal government obligations.</td><td>The Legislature did not specifically state the public policy objective of the preference.
JLARC infers that the public policy objective is to provide consistent tax treatment for interest income from all forms of government obligations.</td><td>$1.8 million in 2011-13 Biennium</td><td>Continue: Because the implied public policy objective of ensuring that tax treatment is consistent for interest from state, municipal, and U.S. government obligations is being achieved.</td></tr>
<tr><td colspan="4">Commission Comment: Commission endorses the JLARC staff recommendation.</td></tr>
<tr><td colspan="3">Interest on Real Estate Loans (Business & Occupation Tax) / 82.04.4292</td><td>Detail on page 91</td></tr>
<tr><td>Provides a B&O tax deduction to banks and other financial businesses for interest derived from investments or loans primarily secured by first mortgages or trust deeds on non-transient residential properties in Washington.</td><td>The Legislature did not specifically state the public policy objective of the preference.
Documents from the period of enactment suggest the original purpose was to encourage Washingtonians to buy homes by making loans more available and less expensive.</td><td>$172.6 million in 2011-13 Biennium</td><td>Review and clarify: Because it is unclear whether the original public policy objective applies, given changes in the lending industry and the rise in the secondary mortgage market.</td></tr>
<tr><td colspan="4">Commission Comment: The Commission endorses the recommendation that the Legislature should review and clarify the public policy objective of the preference and should consider whether the preference is essential to maintaining competitive residential lending capability for state-domiciled residential real estate lenders.
Rationale: The Legislature did not specify a public purpose for this preference. JLARC staff inferred from the record that the implied public policy purpose was to encourage Washingtonians to buy homes by making loans more available and less expensive. However, if the deduction were to be removed, the holder of the residential mortgage loan would bear the full burden rather than the borrower, unless the elimination of the deduction applied only to loans originated or purchased after the effective date of the repeal of the deduction. On a prospective basis the portfolio lender could attempt to recoup the cost of the B&O tax by charging a higher interest rate to the borrower; however, the mortgage market is national in scope, which virtually makes it impossible to charge interest-rate differentials on a geographic basis.
As is often the case when the B&O gross receipts tax is involved in a preference, another unstated public policy purpose may be to assure competitive balance with similarity situated business firms in other states subject to other types of tax regimes. The Commission received testimony that removal of the deduction would place a burden on state-domiciled residential mortgage lenders that retain the loans they originate in their portfolios.</td></tr>
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Summary of 2011 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	JLARC Staff Recommendation
Interstate Bridges (Property and Other Taxes) / 84.36.230			Detail on page 103
Provides an exemption from Washington property taxes and all other state taxes to other states for bridges and bridge approaches over rivers or bodies of water forming interstate boundaries.	The Legislature did not specifically state the public policy objective of the preference. The implied public policy objective is to avoid paying Oregon property taxes on Washington-owned interstate bridges by exempting Oregon-owned bridges.	$29 million in 2011-13 Biennium	**Continue**: Because Oregon is not currently taxing Washington on Washington-owned bridges.
Commission Comment: Commission endorses the JLARC staff recommendation.			
Investment of Businesses in Related Entities (Business & Occupation Tax) / 82.04.4281(1)(b),(c)			Detail on page 111
Provides a B&O tax deduction for two types of investments in related entities: 1) Dividends and distributions paid by subsidiaries to parent entities; and 2) Interest on loans between certain affiliated entities if the total investment and loan income is less than 5 percent of gross receipts of the parent business annually.	The Legislature did not specifically state the public policy objective of the preference. However, by adopting the preference, the Legislature indicated it wanted to exempt income earned by a business from investing in its own subsidiaries and in intercompany loans. These investments are not considered engaging in business for B&O tax purposes.	$14.4 million in 2011-13 Biennium	**Continue**: Because the preference is meeting the implied public policy objective of not treating income from intercompany investments in affiliates as a business activity.
Commission Comment: Commission endorses the JLARC staff recommendation.			

Summary of 2011 Tax Preference Performance Reviews			
What the Preference Does	**Public Policy Objective**	**Estimated Beneficiary Savings**	**JLARC Staff Recommendation**
Laundry Services for Nonprofit Health Care Facilities (Sales Tax) / 82.04.050(2)(a)			Detail on page 119
Provides a sales tax exemption to nonprofit health care facilities for purchases of laundry services.	The Legislature did not specifically state the public policy objective of the preference. When enacted, the preference provided a specific, targeted sales tax exemption for cooperative nonprofit associates formed by nonprofit hospitals to operate a central laundry facility for hospital members. Documents from this time note the purpose was to reduce member hospitals' laundry costs and assure a standard of laundry quality and cleanliness. JLARC infers the public policy purpose for the 1998 expansion of the preference was to reduce the cost of outsourced laundry services for all nonprofit health care facilities.	$8.8 million in 2011-13 Biennium	**Continue**: Because the implied public policy objective of reducing costs for outsourced laundry services for nonprofit health care facilities is being achieved.
Commission Comment: Commission endorses the JLARC staff recommendation.			

Summary of 2011 Tax Preference Performance Reviews			
What the Preference Does	**Public Policy Objective**	**Estimated Beneficiary Savings**	**JLARC Staff Recommendation**
Limited Income Property Tax Deferral (Property Tax) / 84.37.030			Detail on page 125
Allows taxpayers with less than $57,000 of disposable income to defer one half of the property taxes or special assessments due on their primary place of residence.	The Legislature stated in the enacting legislation that the intent of the preference is to: "(a) provide a property tax safe harbor for families in economic crisis; and (b) prevent existing homeowners from being driven from their homes because of overly burdensome property taxes."	$270,891 in 2009-11 Biennium (to be repaid with interest)	**Review and clarify**: Because the intended beneficiaries of this preference are not clear in light of the recent economic recession, the Legislature should clarify the preference to define "families in economic crisis" and identify measurable evaluation criteria.
Commission Comment: The Commission endorses the recommendation that the Legislature should clarify the preference to define "families in economic crisis" and, if the Legislature determines to continue the preference, identify measurable evaluation criteria; however, the Commission notes that costs to administer the program are considerable relative to the participation rate and, as such, it might be appropriate to terminate the preference unless the preference can be restructured in a way that assures cost-effective achievement of the public policy objectives. **Rationale**: To date only 181 out of an estimated 425,000 potential participants have taken advantage of the preference. Participant benefits in the 2009-11 Biennium were $270,891 while costs to administer the preference were $350,184 for fiscal years 2009, 2010, and 2011. JLARC staff recommends that the Legislature clarify the definition of "families in economic crisis". While this might result in increasing the participation rate, it is possible that the low participation rate also results from the eligibility criteria and the design of the program. Furthermore, it is not clear that the preference, as designed, is serving a critical public policy purpose of helping families in economic crisis. If the Legislature determines that is the case, the Commission believes it would be better to terminate the preference and save the state costs of administering the program.			

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<tr><td colspan="3">Meat Processors (Business & Occupation Tax) / 82.04.260(4)</td><td>Detail on page 139</td></tr>
<tr><td>Provides a preferential B&O tax rate to businesses that slaughter, break, or process perishable meat products, and wholesalers of perishable meat products.</td><td>The Legislature did not specifically state the public policy objective of the preference.
Historic documents and legislative action suggest two implied policy objectives:
1) To lower costs for meat packing businesses for the purpose of allowing Washington to compete favorably with competitor states and to retain these industries in the state.
2) To treat Washington food processors consistently under the tax law.
Initiative 1107 stated a public policy objective similar to the Legislature's purpose to allow meat processors to compete. The Initiative repealed legislation that would have provided more consistent tax treatment of Washington food processors.</td><td>$30.5 million in 2011-13 Biennium</td><td>Review and clarify: Because it is unclear what the public purpose is for providing differential tax treatment of meat processors compared to other food processors.</td></tr>
<tr><td colspan="4">Commission Comment: The Commission endorses the recommendation that the Legislature should review and clarify the public policy purpose of the preference and further recommends that the Legislature determine whether the tax differential provides approximate competitive parity with state tax rates and geography-based differences in other business costs for meat processors domiciled in other states.
Rationale: Meat processing is a highly competitive, low margin business. This means that small differentials in state tax rates and other costs of business, such as transportation expenses, can have significant impacts on profitability and impact locational decisions. Public testimony provided to the Commission argued that the preferential tax rate for meat processors is comparable to the maximum corporate tax rate in other western states.</td></tr>
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Summary of 2011 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	JLARC Staff Recommendation
Municipal Sewer Charges (Business & Occupation Tax) / 82.04.432			Detail on page 151
Provides municipalities/cities a B&O tax deduction for amounts paid to other cities or governmental entities for sewage transfer, treatment, or disposal services they provide.	The Legislature did not specifically state the public policy objective of the preference. A Department of Revenue report states the preference's purpose was to eliminate taxing both the collection and the transfer/treatment/disposal of sewage when multiple utilities are involved in providing sewer services.	$3 million in 2011-13 Biennium	**Review and clarify**: Because it is unclear whether the purpose of the preference is to only avoid the pyramiding effect of the B&O tax or to completely eliminate taxation of sewage transfer, treatment, and disposal activities.
Commission Comment: Commission endorses the JLARC staff recommendation.			
Nonprofit Blood and Tissue Banks (Property Tax) / 84.36.035			Detail on page 157
Exempts blood and tissue banks and their administrative offices from property tax.	The Legislature did not specifically state the public policy objective of the preference. Based on the legal history of how the taxation of hospital-like services has evolved, the implied public policy objective is to provide support for organizations that: are nonprofit benevolent and charitable entities, and provide services traditionally performed in hospitals, but that are now performed outside the hospital setting.	$6.1 million in 2011-13 Biennium	**Continue**: Because the exemption for blood and tissue banks is consistent with the public policy objective to reduce costs for nonprofit organizations performing hospital-like services.
Commission Comment: Commission endorses the JLARC staff recommendation.			

Summary of 2011 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	JLARC Staff Recommendation
Nonprofit Day Care Centers (Property Tax) / 84.36.040(1)(a)			Detail on page 165
Exempts licensed nonprofit child day care centers from property tax.	The Legislature did not specifically state the public policy objective of the preference. JLARC infers the public policy objective is to support nonprofit organizations that provide social services to children and youth, consistent with long-standing legislative policy.	$15.8 million in 2011-13 Biennium	**Continue**: Because the preference is meeting the implied public policy objective of supporting nonprofit organizations that provide social services for youth.
Commission Comment: Commission endorses the JLARC staff recommendation.			
Nonprofit Sheltered Workshops (Property Tax) / 84.36.350			Detail on page 173
Provides a property tax exemption for property owned and leased by nonprofit sheltered workshops for people with disabilities.	The Legislature did not specifically state the public policy objective of the preference. JLARC infers that the original public policy objective was to encourage employment of persons with disabilities in sheltered workshops. However, government social services laws are now intended to encourage employment of persons with disabilities in supported work environments, particularly in work settings along with persons without disabilities.	$ 4.4 million in 2011-13 Biennium	**Review and clarify**: Because public policy related to employment of people with disabilities has changed from the time the tax preference was enacted.
Commission Comment: The Commission endorses the recommendation that the Legislature should review and clarify the public policy objective of the preference and further recommends that the Legislature evaluate whether the preference is necessary any longer to encourage employment of persons with disabilities. **Rationale**: Although the statute does not state a public policy purpose, the implied purpose was to encourage employment of persons with disabilities in sheltered workshops. Since the enactment of this preference in 1970 the federal government enacted the Americans with Disabilities Act in 1990. In response, over time employers have made efforts to employ persons with disabilities, frequently with beneficial economic results. In addition, the state has taken initiatives, beginning in 1992, to encourage employment of persons with disabilities. Thus, the need for sheltered workshops to employ persons with disabilities has diminished since enactment of the preference. While the preference clearly benefits established sheltered workshops, it is no longer clear that this preference is necessary to assure employment of persons with disabilities.			

Summary of 2011 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	JLARC Staff Recommendation
Open Space Additional Tax (Property Tax) / 84.34.108(6)			Detail on page 181
Provides certain exemptions to the additional tax owed when an owner removes private property from an "open space" designation (referred to as the Current Use Program).	The Legislature did not specifically state the public policy objective of the preference. JLARC infers that the Legislature intended to avoid penalizing owners in certain circumstances: 1) For circumstances beyond the control of the owner; 2) Where the change in use is compatible with the purpose of the Current Use Program; and 3) Where the property becomes fully exempt from property taxation upon transfer to a church or upon qualifying under a new property exemption.	$3.9 million in 2011-13 Biennium	**Continue**: Because the preference is achieving the implied public policy objective of avoiding penalizing property owners that remove property from current use under certain circumstances.
Commission Comment: Commission endorses the JLARC staff recommendation.			
Real Estate Excise Tax Exemptions (Real Estate Excise Tax) / 82.45.010(3)(a)-(m)			Detail on page 189
The preferences specifically exclude 13 types of property transfers or sales from the definition of a taxable "sale" for real estate excise tax purposes.	The Legislature did not specifically state the public policy objective of the preference. JLARC assumes these exclusions from the definition of what is a taxable "sale" for real estate excise tax purposes may function to define the tax and its base.	$1.4 billion in 2011-13 Biennium	**Continue**: Because the preferences are meeting the implied public policy objective of defining the tax base for application of the real estate excise tax.
Commission Comment: Commission endorses the JLARC staff recommendation.			

Summary of 2011 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	JLARC Staff Recommendation
Renewable Energy Machinery (Sales & Use Tax) / 82.08.962; 82.12.962			Detail on page 203
Provides sales and use tax exemptions for renewable energy machinery and equipment used directly in generating electricity from wind, sun, fuel cells, biomass energy, tidal or wave energy, geothermal resources, anaerobic digestion, and technology that converts otherwise lost energy from exhaust, or landfill gas into electricity.	The Legislature did not specifically state the public policy objective of these preferences; however, it did make the preferences temporary. JLARC infers that the Legislature's public policy objective was to encourage and support generation of electricity using renewable energy sources on a temporary basis.	$40.8 million in 2011-13 Biennium	**Allow to expire**: Because the Legislature intended the exemptions to be temporary and did not provide performance goals to guide any other assessment of performance.
Commission Comment: Commission endorses the JLARC staff recommendation.			
Repaired Goods Delivered Out-of-State (Sales Tax) / 82.08.0265			Detail on page 217
Provides a sales tax exemption to nonresidents for: materials that become a component part of items repaired, installed, cleaned, altered, or improved; and labor charges for items repaired, installed, cleaned, or altered.	The Legislature did not specifically state the public policy objective of the preference. The implied public policy objective was to remove the disincentive created by the sales tax in order to make Washington merchants who repair, clean, install, etc., items for nonresidents more competitive with business in neighboring states.	$0 in 2011-13 Biennium	**Terminate**: Because Washington's adoption of destination-sourcing for sales tax has made this preference unnecessary.
Commission Comment: Commission endorses the JLARC staff recommendation.			

Summary of 2011 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	JLARC Staff Recommendation
Sales of Goods to Certain Nonresidents for Use Outside the State (Sales Tax) / 82.08.0273			Detail on page 225
Provides a sales tax exemption on purchases of certain goods for use outside the state to nonresidents from states, possessions, or territories of the U.S. or Canadian provinces or territories that do not impose a sales, use, value-added or similar tax at a rate of 3 percent or more.	The Legislature did not specifically state the public policy objective of the preference. JLARC infers that the preference was intended to support Washington retailers by removing a disincentive for residents of states with a sales tax of less than 3 percent to purchase goods in Washington.	$58 million in 2011-13 Biennium	**Continue**: Because the preference is meeting its implied public policy objective of removing a disincentive for residents from states with a sales tax of less than 3 percent to purchase goods in Washington.

Commission Comment: The Commission does not endorse the recommendation because there is ambiguity about the Legislature's public policy objective and the economic benefits and costs; the Legislature should review and clarify the public policy objective and evaluate the economic impacts of this preference.

Rationale: The Legislature has not stated an explicit public policy objective for this preference. However, based on various commentaries and patterns of practice, JLARC staff determined that the "implied" public policy objective is to remove a disincentive for nonresidents to purchase goods in Washington. The beneficiaries are businesses that have greater sales than otherwise might be the case, thus benefiting the state's economy. However, it is possible that many of the purchases of goods benefiting from this preference would have occurred in the absence of this preference. To the extent that this has occurred, the state is sacrificing revenue without realizing any offsetting economic benefits. For example, it is possible that purchase of high value items could decline in the absence of this preference while the impact on purchase of low value items might be limited. While it would be difficult and expensive to conduct a thorough analysis of costs and benefits of this preference, it would be useful for the Legislature to consider the benefits and consequences that might stem from limiting the items and geographies covered by this preference.

Summary of 2011 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	JLARC Staff Recommendation
Sales or Use Tax Paid in Another State (Use Tax) / 82.12.035			Detail on page 239
Provides a use tax credit against sales and use tax owed in Washington on tangible personal property or certain services for the amount of "legally imposed" sales or use tax paid to another state, possession, territory, or commonwealth of the U.S. or any political subdivision of such, or any foreign country.	The Legislature did not specifically state the public policy objective of the preference. However, the preference is linked to Washington's membership in the Multistate Tax Commission and the Legislature's passage of the Multistate Tax Compact in 1967. Both of these actions were undertaken to provide a structure for states to work cooperatively on multistate tax issues and to avoid duplicative taxation of multistate taxpayers.	$1million in 2009-11 Biennium	**Continue**: Because the tax preference is meeting its implied objective of avoiding duplicative taxation to multistate taxpayers.
Commission Comment: Commission endorses the JLARC staff recommendation.			
Shared Real Estate Commissions (Business & Occupation Tax) / 82.04.255			Detail on page 247
Removes B&O pyramiding by providing real estate brokers participating in the closing of a real estate sale to pay B&O tax on their share of commissions. Also exempts sales agents if the broker has paid tax.	The Legislature did not specifically state a public policy objective for this preference. The Legislature, through its actions, demonstrated that it did not want to impose the "pyramiding" effect of the B&O tax on the commission shared with real estate agents and with other real estate firms. It is not clear why the Legislature provided a tax preference to the real estate industry and not to other businesses with similar broker-agent and cooperating broker relationships.	$36 million in 2011-13 Biennium	**Review and clarify**: Because it is not clear why the Legislature granted a tax preference to real estate brokers and agents and not to other businesses with similar broker-agent and cooperating broker relationships.
Commission Comment: The Commission endorses the recommendation that the Legislature should clarify the B&O tax preference for shared real estate commissions and further recommends that the Legislature align B&O tax treatment of real estate brokers and agents to brokers and agents in other industries unless there is a compelling reason for differential treatment. **Rationale**: The standard approach to applying the B&O tax to commissions received by brokers and agents is that the broker is taxed on the full amount of the commission and the agent, if any, who receives a portion of the broker's commission, must pay an additional B&O tax on the amount he/she receives. This approach is the standard for all but real estate brokers and agents in which case real estate agents are exempted from paying B&O tax. The Legislature did not specify a public policy objective for differential treatment between real estate agents and agents in other industries, such as insurance and investment services. The Washington Realtors, in a letter to the Commission, presented information which may be pertinent to the Legislature's consideration of this preference; however, this information also appears to be pertinent to brokers and agents in other industries and, as such, does not address the issue of differential treatment.			

Summary of 2011 Tax Preference Performance Reviews

<table>
<tr><th>What the Preference Does</th><th>Public Policy Objective</th><th>Estimated Beneficiary Savings</th><th>JLARC Staff Recommendation</th></tr>
<tr><td colspan="3">State-Chartered Credit Unions (Business & Occupation Tax) / 82.04.405</td><td>Detail on page 257</td></tr>
<tr><td>Provides a B&O tax exemption for state-chartered credit unions.</td><td>The Legislature did not explicitly state the public policy objective for this preference.
JLARC infers the Legislature may have originally had two objectives:
1) To remove an incentive for state-chartered credit unions to become federal credit unions, so that they would remain under state regulation; and
2) To support credit unions because they were originally formed to serve low-income groups underserved by commercial banks.</td><td>$60.9 million in 2011-13 Biennium</td><td>Continue: Because the B&O exemption removes an incentive for state credit unions to become federal credit unions and thus leave the state system of regulation.</td></tr>
<tr><td colspan="4">Commission Comment: Commission endorses the JLARC staff recommendation.</td></tr>
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