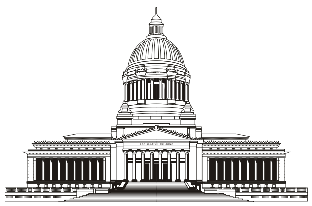
2012 Tax Preference Performance Reviews

Report 13-1

February 20, 2013



STATE OF WASHINGTON

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REPORT SUMMARY

What Is a Tax Preference?

Tax preferences are defined in statute as 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 total number of tax preferences changes as they are added or expire: currently there are 619.

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 (now found in Chapter 43.136, Revised Code of Washington). The legislation assigns specific roles in the process to two different entities.

- The Citizen Commission for Performance Measurement of Tax Preferences creates a schedule for reviews, holds public hearings, and comments on the reviews.
- The Joint Legislative Audit and Review Committee (JLARC) conducts the reviews.

Citizen Commission Sets the Schedule

The Legislature directed the Citizen Commission for Performance Measurement of Tax Preferences to develop a schedule to accomplish an orderly review of most tax preferences over ten years. The Commission is directed to omit certain tax preferences from the schedule, such as those required by constitutional law.

The Commission conducts its reviews based on analysis prepared by JLARC. In addition, the Commission may elect to rely on information supplied by the Department of Revenue. This volume includes 20 chapters covering 23 preferences (similar preferences may be combined in one chapter) completed by JLARC in 2012. Analysis of preferences completed in previous years is found on the Commission's website: http://www.citizentaxpref.wa.gov/

JLARC's Approach to the Tax Preference Reviews

The statute directs the type of questions to be addressed in JLARC's reviews. The 11 questions typically covered in the reviews, along with their statutory reference, are stated below:

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))
10. For those preferences enacted for economic development purposes, what are the economic impacts of the tax preference compared to the economic impacts of government activities funded by the tax? (RCW 43.136.055(j))

Other States:

11. 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(k))

Depending on the tax preference, certain questions may be excluded. For instance, question #4 relates to modifying a preference if the public policy is not being fulfilled. If the preference is fulfilling its public policy, this question is skipped.

Questions related to economic impacts may be skipped for preferences whose purpose is not economic development.

JLARC's Analysis Process

JLARC staff carefully analyze a variety of evidence in conducting these reviews: 1) the legal and public policy history of the tax preferences; 2) the beneficiaries of the tax preferences; 3) government data pertaining to the utilization of these tax preferences and other relevant data; 4) available information on the economic and revenue impact of the tax preferences; and 5) other states' laws to identify similar tax preferences.

When a preference's public policy objective is identified in statute, staff are able to affirmatively state the public policy objective. This is sometimes found in intent statements or in other parts of statute.

However, for many of the preferences, the Legislature did not state the public policy objective. In such instances, staff may be able to infer what the public policy objective might be.

To arrive at this inferred policy objective we go through the following step-by-step process:

- Review final bills and bill reports for any statements on the intent or public policy objectives.
- Review bills prior to the final version and legislative action on bills related to the same topic.
- Review bill reports and testimony from various versions of the bill.
- Review records of floor debate, when available.
- Review whether there were court cases that provide information on the objective.
- Review any information available through the Department of Revenue's files on the history of tax preferences, including rules, determinations, appeals, audits, and taxpayer communication.
- Review any press reports during the time of the passage of the bill which may indicate the intention of the preference.
- Review any other historic documents that may address the issue addressed by the tax preference.

If there is sufficient information in this evidence to identify an inferred policy objective, we state that in our reviews. In these instances, though, the purpose may be a more generalized statement than can be made compared to instances that have explicit statutory language. And in many cases, there simply is not sufficient evidence to identify any policy purpose.

JLARC staff also interview the agencies that administer the tax preferences or are knowledgeable of the industries affected by the tax such as the Department of Revenue, the Department of Licensing, the Department of Transportation, and the Department of Financial Institutions. These parties provide data on the value and usage of the tax preference and the beneficiaries. If the beneficiaries of the tax are required to report to other state or federal agencies, JLARC staff will also obtain data from those agencies.

In addition, for the preference related to a business and occupation tax credit for high technology businesses, JLARC contracted with expert econometricians to evaluate the preference's impact on job creation. The econometricians' report is incorporated into the review, and can be found in Appendix 4.

Summary of the Results from JLARC's Reviews

The table beginning on page 5 provides a summary of auditor recommendations. These are:

- Terminate one preference.
- Review and clarify the intent of twelve preferences.
- Continue ten preferences.

Organization of This Report

This report summary is followed by two report addenda, added by the Joint Legislative Audit and Review Committee. These addenda are followed by a letter from the chair of the Citizen Commission, noting the adoption of the Commission's comments on the reviews. The letter is followed by a summary of the preferences, including the full text of Commission's comments, presented in alphabetical order. More detailed information is then presented for each preference. The appendices provide the Scope and Objectives and the text of current law for each preference.

In addition to the preferences reviewed in this report, information on 33 other preferences considered by the Commission in 2012 can be found in the 2012 Expedited Tax Preferences. Information on these preferences was provided by the Department of Revenue.

COMMITTEE ADDENDA

At the February 20, 2013 JLARC meeting the Committee approved this report for distribution and adopted two addenda to the report.

NOTE: Addendum #2 reflects the views of the individual sponsors listed below. It does not reflect the views of all members of the Committee.

Committee Addendum #1

The Committee notes that its action to distribute the **2012 Tax Preference Performance Reviews: Proposed Final Report** does not imply the Committee agrees or disagrees with auditor recommendations or the recommendations of the Citizen Commission for Performance Measurement of Tax Preferences.

Statute directs the auditors and the Citizen Commission to make recommendations on tax preferences. Action to pursue or not pursue the auditor and Citizen Commission recommendations takes place in the policy-making forum outside of JLARC. The role of performance audit reviews and recommendations is to help inform the Legislature's decisions.

Committee Addendum #2

Sponsors:

Rep. Cathy Dahlquist
Rep. Gary Alexander
Rep. Kathy Haigh
Sen. Mike Hewitt
Sen. Janéa Holmquist Newbry
Rep. Ed Orcutt
Rep. Hans Zeiger

While we respect the work performed by the Auditor and the Tax Preference Commission, we reach different conclusions and would make different recommendations as to certain policies. Specifically:

1. With respect to the B&O Tax Rate for Stevedoring and International Charter and Freight Brokers we recommend that the rate **CONTINUE WITHOUT MODIFICATION**. These preferences lower costs and are one tool for increasing the competitiveness of our ports, which are major sources of jobs and economic growth.
2. With respect to the B&O Tax Rate for Insurance Producers, Title Insurance Agents, and Surplus Line Brokers we recommend that the rate **CONTINUE WITHOUT MODIFICATION**. This preference a) offsets the impact of pyramiding taxation on insurance producer commissions paid by locally owned and operated insurance businesses and b) minimizes the competitive disadvantages faced by Washington insurance producers who compete with out-of-state, non-commissioned direct selling insurance companies.

SUMMARY OF AUDIT RESULTS AND CITIZEN COMMISSION COMMENTS

State of Washington

E-mail: JLARC@leg.wa.gov
www.citizentaxpref.wa.gov

Citizen Commission for Performance Measurement of Tax Preferences

William A. Longbrake, Chair
Governor's Council of Economic Advisors

Stephen B. Miller, Vice Chair
Washington Education Association

James Bobst
Pacific Fibre Products, Inc.

Ruta Fanning
Retired Legislative Auditor

Paul Guppy
Washington Policy Center

NON-VOTING MEMBERS:

Senator **Craig Pridemore**
Chair, Joint Legislative Audit & Review Committee

Brian Sonntag
State Auditor

October 31, 2012

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

2012 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 your action on these recommendations during the upcoming legislative session.

This is the sixth 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.

Tax preference reviews provide a valuable evaluation tool at a time when the Legislature is grappling with difficult fiscal issues. Terminating tax preferences that do not appear to be meeting their intended purposes provides the Legislature with the option of using resources for alternative revenue or program purposes. Similarly, continuing effective preferences provides an assurance that the state is getting the value it expects.

After reviewing JLARC's report and taking public testimony, the Commission has unanimously recommended the expiration of eight of the twenty-three preferences reviewed this year. The Commission recommends the Legislature should continue nine other preferences, and clarify the purpose for the remaining six preferences. Summaries of the analysis, JLARC recommendations, and Commission comments are attached to this letter.

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Washington's legislatively-mandated process for reviewing tax preferences over a ten-year period was cited in a recent report by the Pew Center for the States as one of thirteen states "leading the way" in efforts to evaluate tax incentives for jobs and growth, including *informing policy choices*, *reviewing all tax incentives* and *drawing clear conclusions*. The report indicated that only one state (Oregon) met a fourth criterion of *measuring economic impact*. I am pleased to report that this year Washington joined Oregon in measuring economic impact of certain tax preferences.

With respect to the Pew Center report, I asked the Legislative Auditor the following questions: *"Do JLARC staff feel the Pew Center's characterization of Washington State's efforts to evaluate tax preferences is accurate?" and "What are the Legislative Auditor's office's views on the six key questions the Pew Center posed for measuring economic impact?"* By unanimous agreement the Commission requested that the Legislative Auditor include his responses in the 2012 report to the Legislature.

Some tax preferences are established with the goal of stimulating economic development. As the recent report by the Pew Center for the States found, these types of preferences are typically difficult to evaluate, and very few states across the nation have done so in a credible fashion.

Our state is an exception and is among a few that are making progress in evaluating such economic impacts. This year's report by JLARC includes a rigorous economic analysis of the B&O tax credit for high technology research and development. The JLARC analysis provided credible and unbiased information about the performance of this preference. Based on this analysis from JLARC, the Commission unanimously concluded the Legislature should allow this preference to expire because the cost of this preference greatly exceeds the estimated benefits. The Commission concluded that the Legislature's objective of creating "quality" employment opportunities in the state might be achieved more cost effectively in other ways.

This type of analysis by JLARC is critical to helping the Legislature determine whether an economic development tax preference should continue, be modified or be terminated. However, making informed recommendations requires rigorous analysis that depends upon the availability of financial resources for contracting with economic experts. The Legislature's support of JLARC's efforts will help ensure JLARC can sustain and apply these analytical techniques to other tax preferences in the upcoming biennia. This year the Commission has specifically recommended the Legislature provide funds for JLARC to study the economic impact of three preferences related to freight and shipping industries. While the Commission is cognizant of the state's limited financial resources, it believes that only a very small amount will be required to conduct rigorous economic analysis. The benefits of better structured tax preferences, which promote more effective economic development and employment, will repay the small amount invested many times over.

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

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evaluating tax preferences. I encourage you to consider the recommendations of JLARC staff and Citizen Commission comments covering the entire six 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 six years of tax preference reviews can be found at: www.citizentaxpref.wa.gov/reports.htm.

Sincerely,

William A. Longbrake

William A. Longbrake, Chair
Citizen Commission for Performance Measurement of Tax Preferences

cc: All Legislators
Keenan Konopaski, Legislative Auditor
Stan Marshburn, Director, Office of Financial Management
Brad Flaherty, Director, Department of Revenue

attachment

Summary of 2012 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	Auditor Recommendation
Annuities (Insurance Premiums Tax)/ RCW 48.14.020(1)			Detail on page 21
Exempts life insurance companies from insurance premiums tax on payments received on "qualifying" and "non-qualifying" annuity contracts. "Qualifying" annuities qualify for federal tax deferrals on contributions.	The Legislature did not state the public policy objectives of the preference. JLARC infers that the public policy objective is to encourage individuals to save toward retirement, and to treat "qualifying" and "non-qualifying" annuities the same.	$188.7 million in 2013-15 Biennium	**Continue**: Because payments to "qualifying" and "non-qualifying" annuities are receiving the same tax treatment, and to the extent tax savings are passed on, the exemptions are encouraging individuals to save for retirement.
Commission Comment: Commission endorses the auditor recommendation.			
Biotechnology Manufacturing Deferral/Waiver (Sales and Use Tax) / RCWs 82.75.010; 82.75.030			Detail on page 27
Provides a deferral and eventual waiver of state and local sales and use taxes on construction of facilities and purchases of machinery and equipment by firms engaged in manufacturing of biotechnology related products. Expires January 1, 2017.	The Legislature stated the public policy objectives of this deferral: 1) To encourage expenditures in commercial biotechnology operations; and 2) To develop employment opportunities in biotechnology manufacturing.	$1.4 million in 2013-15 Biennium	**Review and clarify**: To determine if progress toward its biotechnology manufacturing objectives is sufficient and to consider identifying targets for investment and employment.
Commission Comment: The Commission does not endorse the recommendation that the Legislature should review and clarify this tax preference and recommends that the Legislature take no action and allow this preference to expire in 2017, as scheduled. **Rationale:** The JLARC audit staff was unable to determine the impact, if any, this preference has had on encouraging investment and creating jobs. Additionally, there is no evidence that this industry needs this preference for unique competitive conditions. No testimony was provided by beneficiaries in support of continuing this tax preference.			
Business Inventories (Property Tax) / RCWs 84.36.477; 84.36.510			Detail on page 39
Exempts business inventories from property tax.	The Legislature stated that the public policy objective for exempting business inventories from the property tax is to stimulate the economy and, thereby, increase revenues to the state and local governments.	$1.4 billion in 2013-15 Biennium	**Continue**: Because it has removed a competitive disadvantage relative to states where inventories are exempt.
Commission Comment: Commission endorses the auditor recommendation.			

<table>
<tr><th colspan="4">Summary of 2012 Tax Preference Performance Reviews</th></tr>
<tr><th>What the Preference Does</th><th>Public Policy Objective</th><th>Estimated Beneficiary Savings</th><th>Auditor Recommendation</th></tr>
<tr><td colspan="3">Commuting Programs (B&O Tax, PUT) / RCW 82.70.020</td><td>Detail on page 49</td></tr>
<tr><td>Provides a credit against either B&O tax or public utility tax to employers and property managers for amounts they pay to or on behalf of employees that use commuting programs.

Expires June 30, 2013.</td><td>The Legislature did not state the public policy objective of the preference.

JLARC infers the public policy objective is to encourage businesses to provide financial incentives to their employees who participate in commute trip reduction programs that reduce single occupancy vehicle travel in Washington.</td><td>$0 in 2013-15 Biennium

(The preference is scheduled to expire at the end of the 2013-15 Biennium.)</td><td>Review and clarify: Because while it is providing a credit to businesses that provide financial incentives to their employees who participate in commute trip reduction activities, it is unclear whether the preference is meeting the broader public policy objective of increasing participation in commute reduction programs.</td></tr>
<tr><td colspan="4">Commission Comment: The Commission does not endorse the recommendation that the Legislature should review and clarify the public policy objective of the preference and determine whether it is necessary any longer to encourage trip reduction activities. The Commission recommends that the Legislature allow the preference to expire as scheduled on June 30, 2013.

Rationale: The Legislature did not specify a public policy purpose for this preference. JLARC staff inferred from the record that the implied public policy purpose is to encourage businesses to provide financial incentives to their employees who participate in commute trip reduction programs. This preference may no longer be essential to achieve the implied public policy objective because many businesses offer trip reduction financial incentives to employees as a standard component of their employee benefit programs. In 1994, the Department of Revenue stated that many firms already had commute trip reduction programs in place and tax credits were not expected to generate significantly higher participation in such programs. The Commission believes that expiration of this preference would be unlikely to result in a material reduction in businesses' provision of trip reduction financial incentives to employees.</td></tr>
<tr><td colspan="3">Condominium and Homeowner Maintenance Fees (B&O Tax) / RCW 82.04.4298</td><td>Detail on page 61</td></tr>
<tr><td>Provides condominium, apartment, and homeowners' associations with a deduction for fees paid by owners to cover costs of repair, maintenance, replacement, management, or improvement of residential structures and "commonly held property."</td><td>The Legislature did not state a public policy objective for the preference.

JLARC infers that the public policy objective is to provide equal tax treatment between homeowners who pay directly for their home maintenance and homeowners who pay maintenance fees to an association.</td><td>$20 million in 2013-15 Biennium</td><td>Continue: Because it is providing equal tax treatment between homeowners who pay directly for their home maintenance and homeowners who pay maintenance fees to an association.</td></tr>
<tr><td colspan="4">Commission Comment: Commission endorses the auditor recommendation.</td></tr>
</table>

<table>
<tr><th colspan="4">Summary of 2012 Tax Preference Performance Reviews</th></tr>
<tr><th>What the Preference Does</th><th>Public Policy Objective</th><th>Estimated Beneficiary Savings</th><th>Auditor Recommendation</th></tr>
<tr><td colspan="4">Ferry Boats (Sales and Use Tax) / RCWs 82.08.0285; 82.12.0279 — Detail on page 67</td></tr>
<tr><td>Exempts from sales/use tax purchases by state and local governments of ferry boats and component parts, as well as labor and services to build, repair, or maintain such vessels.</td><td>The Legislature did not state the public policy objective of the preference.
JLARC infers the public policy objective is to support state and local governments by reducing the cost of building and repairing ferry vessels owned and operated by state and local government entities.</td><td>$26.1 million in 2013-15 Biennium</td><td>Continue: Because it is meeting the inferred public policy objective of reducing the cost to state and local government entities of building, maintaining, and repairing ferry vessels they own and operate.</td></tr>
<tr><td colspan="4">Commission Comment: The Commission does not endorse the recommendation to continue the preference and encourages the Legislature to review and clarify the public policy intent of the preference.
Rationale: The JLARC staff study infers the public policy objective is to support state and local governments by reducing the cost of building and repairing ferry vessels owned and operated by state or local government entities. The principal beneficiary of this preference is Washington State Ferries. If the preference were terminated, state and local government entities that operate ferries in Washington would have to pay sales and use tax, which presumably would be a burden on state and local entities' finances. However, because state and local entities that operate ferries charge fees to users of ferries, it would be possible for those entities to raise user fees to recover the amount of sales and use tax. Thus, in effect, this preference is a subsidy that reduces the fees paid by users of ferries. The Commission recommends that the Legislature review and clarify the public policy objective of this preference and determine whether the intent of the preference is to subsidize public use of ferries. If that is not the public policy intent, the Legislature should consider terminating this preference.</td></tr>
<tr><td colspan="4">Fish Tax Differential Rates (Enhanced Food Fish Tax) / RCW 82.27.020(4) — Detail on page 75</td></tr>
<tr><td>Provides five differential fish tax rates for different species of enhanced food fish. The tax applies to the first commercial possession by an owner of the fish in Washington.</td><td>The Legislature did not state the public policy objective of the preference.
JLARC infers the public policy objective is to set fish tax rates so that those that most benefited from state expenditures for hatcheries and fisheries management paid at a higher rate to fund them.
It is unclear why the Legislature set the differential tax rates at the level at which they were established.</td><td>$7.5 million in 2013-15 Biennium</td><td>Review and clarify: Because it is unclear:
1) Why the differential rates were set at the levels they were; and
2) Whether the Legislature seeks a rate structure that reflects the relative levels of state expenditures for maintaining and enhancing the different fish and shellfish species.</td></tr>
<tr><td colspan="4">Commission Comment: Commission endorses the auditor recommendation.</td></tr>
</table>

Summary of 2012 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	Auditor Recommendation
Health Insurance by State Pool (Insurance Premiums Tax) / RCW 48.14.022			Detail on page 85
Allows health insurance carriers to deduct from their insurance premium income the fees they are required to pay to the Washington State Health Insurance Pool (WSHIP) before calculating their insurance premiums tax.	The Legislature did not state the public policy objective of the tax preference. JLARC infers that the public policy objective is to define the insurance premiums tax base.	$2.9 million in 2013-15 Biennium	**Continue**: Because the tax deduction for fees paid to WSHIP is defining the base for the insurance premiums tax.
Commission Comment: Commission endorses the auditor recommendation.			
High Technology R&D Deferral/Waiver (Sales and Use Tax) and Credit (B&O Tax) / RCWs 82.04.4452; 82.63.010; 82.63.030			Detail on page 91
Provides: 1) a deferral/waiver of state and local sales and use taxes on investment in facilities, and machinery and equipment by firms engaged in high technology R&D and pilot scale manufacturing; and 2) a B&O tax credit for qualified research and development spending. Expires January 1, 2015.	The Legislature stated the public policy objectives of the high technology R&D tax preferences are to: 1) Create “quality” employment opportunities in this state; and 2) Encourage expenditures in research and development, supporting, and sustaining the high technology sector as it develops new technologies and products.	$114 million in 2013-15 Biennium	**Review and clarify**: To determine if progress toward its high technology R&D objectives is sufficient and to consider identifying targets for investment and employment.

Summary of 2012 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	Auditor Recommendation
High Technology R&D Deferral/Waiver *(continued from previous page)*			
Commission Comment: The Commission does not endorse the recommendation that the Legislature review and clarify this tax preference and recommends that the Legislature allow the B&O tax credit and sales and use tax deferral/waiver to expire in 2015, as scheduled. **Rationale**: The JLARC audit staff study provided substantive evidence that these tax preferences created approximately 454 new jobs between 2004 and 2009 at an overall cost in terms of foregone tax revenue of approximately \$20.5 million per year or \$45,000 per job. However, new earnings per job were estimated to amount to \$25,000. Even allowing for measurement errors, it is clear that the cost of these preferences greatly exceeds the estimated benefits. Industry representatives provided general information in support of these tax preferences. However, they did not provide tangible evidence to refute the findings of the JLARC staff study nor did they provide alternative evidence of a direct link between these tax preferences and significant job creation. Industry representatives testified that competition from other states to attract high technology R&D companies is intense, but provided no evidence that investment in high technology R&D would decline meaningfully if this tax preference were terminated. An industry representative testified that these preferences are important for industry profitability. However, since most participants in this industry are neither fledgling nor facing unique short-term competitive pressures, financially supporting the industry through these tax preferences appears to be of little or no value. The Legislature's objective to create "quality" employment opportunities in the state might be achieved more cost effectively in other ways such as partnering with the high technology R&D industry to provide educational and training programs that develop human resources skills needed by the industry.			
Insurance Guaranty Funds (Insurance Premiums Tax) / RCWs 48.32.145; 48.32A.125			Detail on page 107
Allows insurance companies to credit guaranty fund assessments against their insurance premiums taxes in 20 percent increments annually, fully recouping the assessment after five years.	The Legislature did not state the public policy objective of the tax preference. JLARC infers that the public policy objective is to allow insurers to re coup assessments paid to the guaranty funds.	\$480,000 in 2013-15 Biennium	**Continue**: Because insurers are being allowed to recoup assessments to the guaranty funds.
Commission Comment: Commission endorses the auditor recommendation.			

Summary of 2012 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	Auditor Recommendation
Insurance Producers, Title Insurance Agents, and Surplus Line Brokers (B&O Tax) / RCW 82.04.260(9)			Detail on page 113
Provides a lower B&O tax rate of 0.484 percent to insurance producers, title insurance agents, and surplus line brokers. The current general service rate is 1.8 percent.	The Legislature did not state the public policy objective of the tax preference. JLARC infers that the public policy objectives are: 1) To reduce the impact of B&O surtaxes on insurance contractors because they are unable to raise commissions to cover tax increases in the short term (1983); 2) To provide some equity for insurance businesses following the removal of pyramiding for real estate businesses (1983 and 1995); and 3) To simplify the tax code by consolidating B&O tax rates (1998).	$35.6 million in 2013-15 Biennium	**Review and clarify:** Because it is unclear why the Legislature is providing different tax treatment to businesses with similar agent/sub agent relationships; and because the inferred objectives related to the inability of passing on rate increases and of consolidating rates may no longer apply.

Commission Comment: The Commission endorses the recommendation that the Legislature should review and clarify the public policy purpose of the preference and unless there is a compelling reason for a differential rate, the Legislature should increase the tax rate to provide equivalent tax treatment with businesses with similar agent/sub-agent relationships.

Rationale: The JLARC staff study documents numerous changes in this tax preference between its initiation in 1935 and the most recent change in 2009. Beginning in 1995 the Legislature has reduced the tax rate on insurance commissions from 1.172% of insurance commissions to 0.484%. The Legislature provided no economic or competitive rationale for the reductions in the tax rate. Over the same time period, the Legislature has reduced the tax rate on real estate commissions from 2.13% to 1.80%. It should be noted that pyramiding of B&O taxes applies to insurance agents but not to real estate agents, pursuant to a 1992 state Supreme Court case that ruled that insurance agents are not entitled to the same exemption that removed tax pyramiding for real estate agents. Adjusting the current insurance commissions tax rate for pyramiding results in a combined B&O tax rate of 0.726% compared to 1.80% for real estate services. In public testimony, representatives of insurance agents pointed out that commission rates are established by insurance companies. Thus, there are limitations on how agents can recover costs directly from policyholders if there is an increase in the insurance commissions B&O tax rate. However, no evidence was provided for why a lower tax rate relative to similar agent/sub-agent relationships in other industries is appropriate.

Summary of 2012 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	Auditor Recommendation
Leases Under $250 Per Year and Short Term Leases (Leasehold Excise Tax) / RCW 82.29A.130(8)-(9)			Detail on page 123
Exempts private leases of publicly owned property from leasehold excise tax where: • The taxable rent is less than $250 per year, or • The possession or use is less than 30 days.	The Legislature did not state the public policy objective of the preferences. JLARC infers the public policy objective is to define the leasehold excise tax base by avoiding double taxation and by easing administration of the tax.	$5.6 million in 2013-15 Biennium	**Continue**: Because the preference is meeting the inferred public policy objectives of avoiding double taxation and easing administration of the leasehold excise tax.
Commission Comment: Commission endorses the auditor recommendation.			
Minor Final Assembly Completed in Washington (B&O Tax) / RCW 82.04.4295			Detail on page 131
Provides a B&O tax deduction to manufacturers that perform minor final assembly in Washington on components that have been imported from outside the United States.	The Legislature did not state the public policy objective of the tax preference. JLARC infers that the public policy objective is to address the specific circumstance of the assembly of Chevrolet LUV trucks at the Port of Seattle in order to retain that operation.	None	**Terminate**: Because of changes in federal import regulations, imported truck components are no longer being assembled at Washington ports, and there are no known beneficiaries of this deduction for minor final assembly.
Commission Comment: Commission endorses the auditor recommendation.			

Summary of 2012 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	Auditor Recommendation
Natural and Manufactured Gas (Sales and Use Tax) / RCWs 82.08.026; 82.12.023; 82.14.030(1)			Detail on page 139
Provides a sales/use tax exemption for natural and manufactured gas purchased by consumers when the consumer pays Washington's brokered natural gas use tax.	The Legislature did not state a public policy objective for the preference. JLARC infers the public policy objectives of the preference, working in conjunction with the brokered natural gas use tax, are to: 1) Ensure equitable taxation by avoiding double taxation of natural or manufactured gas purchased from outside the state; 2) Provide local governments with a continued source of local tax revenue; and 3) Comply with the federal Constitution.	$193.7 million in 2013-15 Biennium	**Continue:** Because it is meeting the inferred public policy objectives of: 1) Ensuring equitable taxation by avoiding double taxation; 2) Providing local governments with a continued source of local tax revenue; and 3) Complying with the federal Constitution.
Commission Comment: Commission endorses the auditor recommendation.			
Precious Metals and Bullion (Sales and Use Tax, B&O Tax) / RCW 82.04.062			Detail on page 149
The two preferences: • Exempt sales or use of precious metal and bullion from sales/use tax; and • Subject sellers of precious metal and bullion to B&O tax on commissions on transactions for third parties, not on gross receipts.	The Legislature did not state the public policy objective of the tax preferences. JLARC infers the public policy objective is to make Washington coin and bullion dealers more competitive with out-of-state competitors by treating precious metal and bullion sales like sales of investments rather than sales of tangible personal property.	$42.2 million in 2013-15 Biennium	**Review and clarify**: Because implementation of the statute may not be achieving the inferred public policy objective of treating precious metal and bullion sales like sales of investments.
Commission Comment: Commission endorses the auditor recommendation.			

Summary of 2012 Tax Preference Performance Reviews

<table>
<tr><th>What the Preference Does</th><th>Public Policy Objective</th><th>Estimated Beneficiary Savings</th><th>Auditor Recommendation</th></tr>
<tr><td colspan="3">Solar Energy and Silicon Product Manufacturers (B&O Tax) / RCW 82.04.294</td><td>Detail on page 161</td></tr>
<tr><td>Provides a preferential B&O tax rate of 0.275 to:
• Manufacturers of certain solar energy systems;
• Manufacturers of solar grade silicon and other products used as components of solar energy systems; and
• Wholesalers of solar energy systems or component products they manufactured
Expires June 30, 2014.</td><td>The Legislature stated the public policy objectives of the solar energy and silicon product manufacturers B&O tax preferences are to:
1) Retain and expand existing solar industry manufacturing businesses in Washington;
2) Attract new solar energy manufacturers/wholesalers to the state; and
3) Create jobs in Washington.</td><td>$1.6 million in 2013-15 Biennium</td><td>Review and clarify: To determine if progress toward solar industry objectives is sufficient and to consider identifying targets for solar business retention, attraction, and job creation.</td></tr>
<tr><td colspan="4">Commission Comment: Commission endorses the auditor recommendation.</td></tr>
<tr><td colspan="3">Special Fuel Use Exemptions (Fuel Tax) / RCW 82.38.080</td><td>Detail on page 171</td></tr>
<tr><td>Provides a number of exemptions from the special fuel tax for specific uses of fuel.</td><td>The Legislature did not state the public policy objective of the tax preference.
JLARC infers the public policy objectives are:
1) To establish the tax base for special fuel tax; and
2) To exempt fuel used for public purposes.</td><td>$36.4 million in 2013-15 Biennium</td><td>Continue: Because they are achieving the inferred public policy objective of:
1) Establishing the tax base for special fuel tax; and
2) Exempting fuel used for public purposes from the special fuel tax.</td></tr>
<tr><td colspan="4">Commission Comment: Commission endorses the auditor recommendation.</td></tr>
</table>

Summary of 2012 Tax Preference Performance Reviews

<table>
<tr><th>What the Preference Does</th><th>Public Policy Objective</th><th>Estimated Beneficiary Savings</th><th>Auditor Recommendation</th></tr>
<tr><td colspan="3">Stevedoring and International Charter and Freight Brokers (B&O Tax) / RCWs 82.04.260(6); 82.04.260(7)</td><td>Detail on page 181</td></tr>
<tr><td>These two preferences provide a preferential B&O tax rate of 0.275 percent to stevedoring and associated activities and to international charter and freight brokers.</td><td>The Legislature did not state the initial public policy objective of the tax preferences.
JLARC infers the public policy objective for the preferential tax rate for stevedoring activities is to keep Washington's ports and port-related businesses competitive.
JLARC could not determine the public policy objective for the preferential tax rate for international charter and freight brokers.
The stated public policy objective in 1998 for reducing the tax rates for both stevedoring and international charter and freight brokers was to simplify the tax code by consolidating B&O tax rates.</td><td>Stevedoring:
$17.9 million in 2013-15 Biennium
International Charter and Freight Brokers:
$8.5 million in 2013-15 Biennium</td><td>Review and clarify: Because:
1) The public policy objective for why the Legislature chose the particular current preferential tax rate for stevedoring activities is unclear;
2) The objective for providing the preferential tax rate for international charter and freight brokers is unclear; and
3) The objective to consolidate B&O tax rates and classifications may no longer apply.</td></tr>
<tr><td colspan="4">Commission Comment: The Commission does not endorse the auditor recommendation to review and clarify these two preferences and recommends that the Legislature should terminate both of these preferential tax rates.

Rationale: The apparent original intent of providing a preferential tax rate in 1979 was to maintain an equivalent tax burden after a U.S. Supreme Court decision eliminated the tax exemption of certain stevedoring activities. While the industry has argued that the preferential rate is justified for competitive reasons, the industry has never provided substantiation for this claim. In testimony provided to the Commission by a representative of these industries, no substantive evidence was provided that elimination of this preference would harm the competitiveness of Washington's ports materially. In response to a question during public testimony, an industry representative acknowledged no competing west coast ports in the U.S. receive a similar tax break. The JLARC staff study indicated that it is unclear that the preferential B&O tax rate has had any role in making Washington's ports more competitive. Therefore, the Commission recommends that the Legislature stop supporting these industries financially by terminating the preferential tax rates.</td></tr>
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Summary of 2012 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	Auditor Recommendation
Travel Agents and Tour Operators (B&O Tax) / RCW 82.04.260(5)			Detail on page 193
Provides a preferential B&O tax rate of 0.275 percent to travel agents and tour operators.	The Legislature did not state the initial public policy objective of the tax preferences. JLARC infers the public policy objectives for this preference are to: 1) Reduce the financial impact of DOR's 1975 rule change on travel agents by reducing their tax rate in proportion to the commissions earned from arranging interstate air travel; 2) Provide equitable tax treatment between travel agents and air carriers; and 3) Achieve administrative simplicity by taxing tour operators at the same rate as travel agents.	$10.2 million in 2013-15 Biennium	**Review and clarify**: Because it is unclear whether the inferred public policy objectives of reducing the financial impact of DOR's 1975 rule change, providing equitable tax treatment with air carriers, and achieving administrative simplicity still apply in light of the changes to the industry since the time of enactment.
Commission Comment: The Commission does not endorse the auditor recommendation and recommends that the Legislature terminate the preferential tax rate for travel agents and tour operators. **Rationale**: JLARC audit staff documented that circumstances in the travel industry have changed since this preference was established. Based on the JLARC staff analysis, it appears there are no longer competitive reasons to continue the preference and thus retention of the preference simply increases commissions for travel agents. Moreover, administrative considerations, which prompted the Department of Revenue to request the Legislature extend the preference to tour operators, no longer exist. Because there is no apparent compelling reason any longer for preferential tax treatment, the Legislature should terminate this preference.			

Summary of 2012 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	Auditor Recommendation
Urban Passenger Transit Fuel (Sales and Use Tax) / RCWs 82.08.0255(1)(a), (c); 82.12.0256(2)(a)			Detail on page 201
Provides a sales/use tax exemption for fuel purchased for: • Urban passenger public transportation by an urban passenger transportation system; or • Use in passenger-only ferries by public transportation benefit areas, counties, or county ferry districts.	The Legislature did not state the public policy objective of the tax preference. JLARC infers that the public policy objective is to reduce operating costs for public transportation providers and thus improve public transportation and reduce transportation costs for urban transit users.	$22 million in 2013-15 Biennium	**Continue**: Because it is meeting the inferred public policy objective of reducing the costs for providers of urban passenger transportation services.
Commission Comment: Commission endorses the auditor recommendation.			

The Citizen Commission also updated comments on three preferences reviewed in 2010.

Updated Comments on Select 2010 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	Auditor Recommendation
Interstate Transportation, Instate Portion (PUT) / 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.	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. 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.	$59.7 million in 2011-13 Biennium	**Terminate:** Because the U.S. Constitution no longer prohibits the instate portion of interstate transportation from being taxed. 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.

Commission Comment (2010): 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.

Legislative Action: No action taken.

Additional Commission Comment (2012): The Commission notes that the Legislature took no action on the Commission's recommendation, and notes that the fiscal impact of these preferences exceeds $100 million per biennium. The Commission therefore recommends that the Legislature mandate JLARC to conduct an economic impact study of the preferences and appropriate sufficient resources to conduct this study. After the 2013 session, if the Legislature has taken no action the Commission will consider whether to schedule these preferences for further review.

Updated Comments on Select 2010 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	Auditor Recommendation
Transportation, Through Freight (PUT) / RCW 82.16.050(8)			
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.	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.	$32.2 million in 2011-13 Biennium	**Terminate:** Because this preference is no longer constitutionally necessary.

Commission Comment (2010): 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.

Legislative Action: No action taken.

Additional Commission Comment (2012): The Commission notes that the Legislature took no action on the Commission's recommendation, and notes that the fiscal impact of these preferences exceeds $100 million per biennium. The Commission therefore recommends that the Legislature mandate JLARC to conduct an economic impact study of the preferences and appropriate sufficient resources to conduct this study. After the 2013 session, if the Legislature has taken no action the Commission will consider whether to schedule these preferences for further review.

Updated Comments on Select 2010 Tax Preference Performance Reviews

What the Preference Does	Public Policy Objective	Estimated Beneficiary Savings	Auditor Recommendation
Shipments to Ports (PUT) / RCW 82.16.050(9)			
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.	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.	$15.2 million in 2009-11 Biennium	**Review and clarify:** 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 still exist.
Commission Comment (2010): 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. **Legislative Action:** No action taken.			
Additional Commission Comment (2012): The Commission notes that the Legislature took no action on the Commission's recommendation, and notes that the fiscal impact of these preferences exceeds $100 million per biennium. The Commission therefore recommends that the Legislature mandate JLARC to conduct an economic impact study of the preferences and appropriate sufficient resources to conduct this study. After the 2013 session, if the Legislature has taken no action the Commission will consider whether to schedule these preferences for further review.			

Commission Comments on Auditor Recommendations to DOR and OFM

In a supplement to the 2012 preference reviews, JLARC staff noted difficulties with two tools related to evaluating preferences: 1) the annual survey that the Department of Revenue uses to collect and report beneficiary information; and 2) the current version of the Office of Financial Management's Washington Input-Output Model.

The auditor made two recommendations:

1. The Department of Revenue should convene a work group to address how to improve the reliability and the accuracy of the information collected in the annual survey and reported to the Legislature and the public. The Department of Revenue concurred with the recommendation.
2. The Office of Financial Management should estimate the cost of including state government and local government as separate sectors within the Washington Input-Output model. The Office of Financial Management concurred with the recommendation.

The Commission endorsed the auditor recommendations.