



2008 Tax Preference Performance Reviews Proposed Final Reports

Joint Legislative Audit & Review Committee
January 7, 2009

Gary Benson and Lizbeth Martin-Mahar



Presentation Overview

- Summary of the 2008 reviews
 - Staff recommendations
 - Tax Preference Commission comments
 - Any agency comments (comments received on four tax preferences)

Tax Preference Reviews



- Legislation enacted in 2006 (EHB 1069) mandated performance reviews of Washington's tax preferences – over 10 years.
- Outlined specific questions to be answered in reviews
 - Public Policy Objectives
 - Beneficiaries
 - Revenue and Economic Impacts
 - Other States

JLARC and the Tax Preference Commission Have Reviewed the Reports



- July 23, 2008 – Preliminary reports presented to JLARC
- August 6 – Preliminary reports presented to the Tax Preference Commission
- September 7 – Tax Preference Commission conducted public hearing
- October 29 – Tax Preference Commission adopted comments
- January 7, 2009 – Proposed final reports to JLARC
- Next – Joint meeting of Senate Ways & Means and House Finance committees

The 2008 Reviews Are:



- Grouped into 27 chapters in two reports
 - 14 Full reviews
 - 13 Expedited reviews
- Reviewed preferences for the following types of taxes:
 - Property tax
 - Leasehold excise tax
 - Business & occupation tax
 - Public utility tax
 - Retail sales and/or use taxes
 - Motor vehicle fuel taxes

Staff Recommended “Continue” for:



- Property tax exemptions
 - Private K-12 schools
 - Private colleges
 - Intangibles
 - Commercial vessels
 - Other ships and vessels

Staff Recommended “Continue” for:



- B&O tax

- Real estate sales
- Public utilities
- Credit losses
- Insurance premiums
- Fraternal insurance
- Processing horticultural products

Staff Recommended “Continue” for:



- Public utility tax

- Credit losses
- Sales for resale by water and gas utilities
- Minimum gross income filing threshold

- Sales/use taxes

- Public utility operating property

- Fuel taxes

- Exported/imported fuel

With Regards to the Preceding Tax Preferences, the Commission



- Mostly endorsed the JLARC staff recommendations to continue the tax preferences
 - And no additional comments were adopted
- The Commission had additional comments for two of the tax preferences
 - Intangibles (did not endorse the JLARC staff recommendation)
 - Exported and Imported Fuel (endorsed the JLARC staff recommendation with a comment)

State Agencies had Comments on Two of These Reviews



- The Department of Revenue had concerns with the review on private K-12 schools
 - The preliminary report was revised to address these concerns (the revisions did not affect the recommendation)
- The Department of Licensing supports the recommendation regarding the motor vehicle fuel tax exemption for exported/imported fuel

Tax Preferences with Recommendations Other Than “Continue”:



- Terminate (2)
- Extend expiration dates and add accountability requirement (3)
- Re-examine and clarify intent (6)
- Additional Commission comments (2)

JLARC 2008 Tax Preference Review Proposed Final Reports January 7, 2009 11

Airports Owned by Cities in Other States



Brief Background



Airports owned by out-of-state municipalities

- Property tax exemption – real and personal
- Enacted in 1941
- Applies to all out-of-state municipalities owning airport property in Washington
 - The Dalles, Oregon airport property qualified
- In 1998 – restriction placed on airport size
 - The Dalles airport was disqualified
- Currently no airports qualify

Staff Recommends Termination and Commission Endorses



Airports owned by out-of-state municipalities

Staff Recommendation

Given that there are no out-of-state municipalities owning airport property in Washington, the Legislature should terminate this property tax exemption.

Commission Comments

Endorsed JLARC staff recommendations to terminate the tax preferences.
No additional comments were adopted.

Gas Handling Losses



Oil truck delivering fuel, 1948

Brief Background



Gas Handling Losses

- A deduction from the gas tax is allowed to account for handling losses between the point of removal and the point of delivery.
- The handling loss deduction was first enacted in 1939 and since then:
 - The point of taxation has been changed;
 - Environmental regulations attempt to limit the amount of handling losses.

Staff Recommends Termination and Commission Endorses



Gas Handling Losses

Staff Recommendation

The Legislature should terminate the motor vehicle fuel handling loss deduction.

Commission Comments

Endorsed the JLARC staff recommendation to terminate the tax preferences with no additional comments.

Agency Comments

The Department of Licensing has no position.

Expedited Report Page 92, 164, 169 JLARC 2008 Tax Preference Review Proposed Final Reports January 7, 2009 17

Electric Generating Equipment – Renewable Resources



Brief Background



Electric Generating Equip. – Renewable Resources

- **Retail Sales and Use Tax Exemption – 1996**
 - Applies to machinery and equipment used in generating electricity using renewable energy.
 - Machinery must produce 200 kilowatts electricity.
 - Purchaser had to provide DOR with a duplicate certificate of exempt sale.
- **1999 and 2001**
 - Eliminated the reporting requirement.
 - Decreased the required energy wattage of the machinery and equipment to 200 watts.
- **Current expiration dates in 2009**

Full Report Page 215-216 JLARC 2008 Tax Preference Review Proposed Final Reports January 7, 2009 19

Staff Recommends Extending Expiration Dates with Accountability



Electric Generating Equip. – Renewable Resources

Areas of Uncertainty

- Lack of data
- Legislative intent

Staff Recommendation

- 1) Continue the retail sales and use tax preferences and reexamine these alternative energy tax preferences at a later date to determine their effectiveness in encouraging growth in this industry in Washington.
- 2) The Legislature should implement reporting requirements and criteria on which to evaluate the tax exemptions and reevaluate the wattage threshold limit to ensure there are not unintended beneficiaries.

Full Report Page 232 JLARC 2008 Tax Preference Review Proposed Final Reports January 7, 2009 20

Commission Endorses Staff Recommendations



Electric Generating Equip. – Renewable Resources

Commission Comments

Endorsed the JLARC staff recommendation to extend expiration dates and add accountability reporting requirements.

Biofuels and Wood Biomass Fuel: Production Facilities / Sale/ Distribution



Brief Background



Biofuels and Wood Biomass Fuel

- Property, leasehold excise, B&O, and sales/use taxes
 - Wood biomass fuel: production facilities, sales, and distribution
 - Alcohol and biodiesel fuel production facilities
- These exemptions were enacted in 2003.
- They are scheduled to expire in 2009.

Expedited Report Pages 123 & 139 JLARC 2008 Tax Preference Review Proposed Final Reports January 7, 2009 23

Brief Background - Biofuels



Biofuels and Wood Biomass Fuel

- Tax preferences for producing & distributing biofuels (biodiesel and ethanol) from various feedstocks including wood biomass feedstock
- Biodiesel: 4 biodiesel producers; 4 oil crushing facilities
- Wood biomass fuel: no beneficiaries
 - Tax Preferences were enacted before the technology to convert biomass to ethanol had been developed in Washington State.
 - Cellulosic ethanol research is underway.
 - Pilot plants are beginning in other states.

Expedited Report Page 133 & 150 JLARC 2008 Tax Preference Review Proposed Final Reports January 7, 2009 24

Staff Recommends Extending Expiration Dates on Biofuels Tax Preferences



Biofuels and Wood Biomass Fuel

Staff Recommendations

- 1) The Legislature should continue the property tax exemption for machinery and equipment used in producing alcohol fuel, biodiesel and biodiesel feedstock, and this tax preference should be reviewed for effectiveness in the future once this industry is more developed.
- 2) The Legislature should continue the leasehold excise tax exemption for leasehold interests of machinery and equipment used in producing alcohol, biodiesel and biodiesel feedstock and review for effectiveness in the future once this industry is more developed.

Expedited Report Page 153 JLARC 2008 Tax Preference Review Proposed Final Reports January 7, 2009 25

Staff Recommends Extending Expiration Dates on Biofuels Tax Preferences and Commission Endorses



Biofuels and Wood Biomass Fuel

Staff Recommendations (cont.)

- 3) The Legislature should continue the preferred business and occupation tax rate for manufacturers of alcohol and biodiesel fuel and feedstock and review for effectiveness in the future once this industry is more developed.

Commission Comments

The Commission endorses the Biofuels tax preference recommendations with no additional comments.

Expedited Report Page 153 & 165 JLARC 2008 Tax Preference Review Proposed Final Reports January 7, 2009 26

Staff Recommends Extending the Expiration Dates on Wood Biomass Fuel Preferences and Commission Adds New Recommendation



Biofuels and Wood Biomass Fuel

Staff Recommendations

The Legislature should extend the expiration dates and review in the future five tax preferences for production, distribution and sales of wood biomass fuel.

Commission Comments

The Commission recommends that these tax preferences be allowed to expire in 2009 unless there is evidence that taxpayers plan to use them.

ILARC 2008 Tax Preference Review Proposed Final Reports January 7, 2009 27
Expedited Report Pages 137-138 & 161

Agricultural Producers



Property of Museum of History & Industry, Seattle

Brief Background



Agricultural Producers

- Business and Occupation Tax Exemption
- **1933:**
 - The Legislature passed a Business and Activities Tax of 0.1 of 1% on income of agricultural producers.
 - Governor vetoed the tax on the basis that the money collected on ag. producers would be minimal compared to burden of paying the tax.
- **1935:**
 - Agricultural producers were exempt from the B&O tax.

Staff Recommends Modification and Commission Endorses



Agricultural Producers

Area of Uncertainty

- Legislative intent is unclear on why farms, regardless of income, are all tax exempt.

Staff Recommendation

Given the fact that incomes have increased significantly for some farms since the period of financial hardships when this tax exemption was enacted, the Legislature should consider establishing an income threshold in order to qualify for the business and occupation tax exemption for agricultural producers.

Staff Recommends Modification and Commission Endorses



Commission Comments

Agricultural Producers

The Commission endorses this recommendation with no additional comments.

Radio/TV Broadcasting



Brief Background



Radio and TV Broadcasting

- Some radio/TV broadcasting advertising income is subject to the B&O tax.
- Advertising income coming from out-of-state may be deducted, by either:
 - Itemizing actual non-local income, or
 - Using a “standard deduction” derived from annual FCC data – **data which the FCC no longer provides.**
- This deduction is not required by the U.S. Constitution.

Expedited Report Page 57 JLARC 2008 Tax Preference Review Proposed Final Reports January 7, 2009 33

Staff Recommends Modification and Review



Radio and TV Broadcasting

(1) The Department of Revenue should conform its rule and practice on radio/TV broadcasting advertising income to comply with the statute that allows two means for broadcasters to deduct income earned from the sale of network, national, and regional advertising. Since one of these means is no longer operative, broadcasters should deduct only actual sales of network, national, and regional advertising.

(2) The Legislature should review the policy of exempting all network, national, and regional advertising from the B&O tax.

Expedited Report Page 60 JLARC 2008 Tax Preference Review Proposed Final Reports January 7, 2009 34

The Commission Endorses and the Department of Revenue Has a Comment



Commission Comments

Endorsed the JLARC staff recommendations with no additional comments.

Agency Comments

The Department of Revenue believes that the current rule is in the spirit of the legislation; nevertheless, it is planning to review its current rule and practice regarding the standard deduction.

Urban Transportation and Vessels < 65 Feet



Seattle traffic scene (date unknown)



Seattle-Tacoma interurban railway, near Kent, ca. 1909

Brief Background



Urban Transportation and Vessels < 65 Feet

- Under the public utility tax, transportation services for people and freight, such as motor transportation, railroads, tugboats, and water transportation conducted in vessels >65 are taxed at 1.926%.
- “Urban transportation” (conducted in or within 5 miles of cities) is taxed at 0.642%.
- Water transportation conducted in vessels <65 feet is taxed at 0.642%.
- These preferential tax rates were adopted during a time of transition in transportation modes in the 1930s.
 - The policy adopted in 1933 and 1935 recognizing the financial problems of streetcars, interurban railways, and the Mosquito Fleet may no longer be relevant.

Staff Recommends Review and Commission Endorses



Urban Transportation and Vessels < 65 Feet

Staff Recommendation

The Legislature should review the policy of taxing transportation-related business activity at different public utility tax rates based on where a transportation service takes place or the size of a vessel in which the service is conducted.

Commission Comments

Endorsed the JLARC staff recommendation with no additional comments.

Irrigation Water



Brief Background



Irrigation Water

- Public Utility Tax Deduction
 - Utilities can deduct the income derived from the distribution of water through an irrigation system.
- Established in 1935: no change in 73 years
- 1998: DOR changed its interpretation of statute and administration of deduction to allow irrigation water for non-ag. purposes.

Area of Uncertainty

- Change over time in utilization of irrigation water beyond agricultural purposes.

Staff Recommends Clarification and Commission Endorses



Irrigation Water

Staff Recommendation

Due to the lack of legislative intent and growth in beneficiaries of the public utility tax deduction for irrigation water, the Legislature should clarify if gross income derived from non-agricultural uses of irrigation water should be allowed for this tax deduction.

Commission Endorsement

Endorsed JLARC staff recommendations to clarify the tax preference. No additional comments were adopted.

Expedited Report Pages 38 & 164 JLARC 2008 Tax Preference Review Proposed Final Reports January 7, 2009 41

Items Used in Interstate Commerce



Current Law



Items Used in Interstate Commerce

- The sale of tangible personal property (such as fuel and food) to air, rail, and water carriers for use in interstate or foreign commerce is exempt from the retail sales tax.
- The use of such items within Washington is subject to the use tax.
- The original public policy objective or the legal rationale for the exemption is not clear.

Staff Recommends Clarification and Commission Endorses



Items Used in Interstate Commerce

Staff Recommendation

The Legislature should clarify the public policy purpose for the retail sales tax exemption for sales of tangible personal property to air, rail, and water private or common carriers to be used in interstate or foreign commerce.

Commission Comments

Endorsed the JLARC staff recommendation with no additional comments.

Farm Auction Sales



Property of Museum of History & Industry, Seattle

Brief Background



Farm Auction Sales

- Retail Sales and Use Tax exemption
- 1935: sales of used farm machinery by farmers were exempt – AG opinion
- Enacted in 1943 – both sales and use tax exemption
- Applies only to certain farm auction sales
 - Conducted on any farm by an auctioneer
 - Any items owned by a farmer and used in a farm activity can be sold
- Unequal tax treatment – farm machinery sales
- No reporting requirement

Staff Recommends Reporting and Review and Commission Endorses



Area of Uncertainty

Statute does not indicate legislative intent.

- Unequal sales and use tax treatment of purchases of used farm machinery

Staff Recommendation

Due to the fact that Washington currently does not have uniform tax treatment for all purchases of used farm machinery and equipment regardless of location and method by which the property is acquired, the Legislature should require reporting information of on-farm auction sales and review the policy of these retail sales and use tax exemptions.

Farm Auction Sales

Staff Recommends Reporting and Review and Commission Endorses



Commission Comments

Endorsed the JLARC staff recommendation with no additional comments.

Farm Auction Sales

Intangible Personal Property



Property of Museum of History & Industry, Seattle

Brief Background



Intangible Personal Property

- Personal Property Tax Exemption
 - Two types of intangible personal property
- 1901: Exemption for intangible personal property
- 1930: Constitutional amendment
- 1997: Legislature expanded the intangible personal property definition and clarified the property features which were not tax exempt
- New Economy: nationwide studies show growth in value of intangible personal property
- WA intangible prop. value: estimated \$1 trillion (CY07)

Staff Recommends Continuation and Commission Adopts Comments



Intangible Personal Property

Staff Recommendation

The Legislature should continue the property tax preference for intangible personal property.

Commission Comments

Given the magnitude of revenue impact of the exemption (\$11 billion in 2008), the dramatic growth of intangible property in the New Economy, and the impact of such a large exemption on the adequacy, efficiency and fairness of the tax system, the Commission recommends that the Legislature study the exemption and consider how to appropriately treat intangible property.

Exported and Imported Fuel



Brief Background



Exported Fuel

- Exported and imported fuel is exempt from the gas tax.
- This exemption fits with the public policy that only fuel used on Washington's public highways is subject to the gas tax.
- U.S. Supreme Court decisions open the possibility that the current exemption is broader than required by the U.S. Constitution and that exported fuel could be made subject to a portion of the gas tax.

Staff Recommends Continuation and Commission Endorses With Comments



Exported Fuel

Staff Recommendation

The Legislature should continue the motor vehicle fuel tax exemption for exported and imported fuel.

Commission Comments

Endorsed the JLARC staff recommendations subject to the following comment:

The Commission recommends the Legislature consider whether to modify this exemption in light of U.S. Supreme Court decisions subsequent to enactment of this exemption.

Staff Recommends Continuation and Commission Endorses With Comments



Agency Comments

The Department of Licensing supports the staff recommendation.

Exported Fuel

Contact Information



Gary Benson
360-786-5618
benson.gary@leg.wa.gov

Lizbeth Martin-Mahar
360-786-5123
martin-mahar.lizbeth@leg.wa.gov

www.jlarc.leg.wa.gov