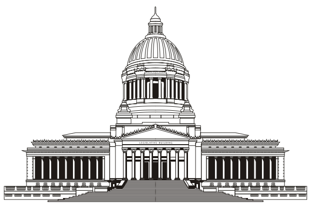
**2013 Tax Preference Performance Reviews**

**Report 13-5**

**December 11, 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 624.

## Why a 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). Statute 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.
- Staff to the Joint Legislative Audit and Review Committee (JLARC) conduct 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 staff. In addition, the Commission may elect to rely on information supplied by the Department of Revenue. This volume includes 22 preference reviews (similar preferences may be combined in one chapter) completed by JLARC staff in 2013. One additional preference, a sales and use tax exemption for local residential and coin-operated telephone services, was scheduled for review in 2013. However, the Legislature repealed the preference in June 2013 prior to publication of this report and this preference was not reviewed. Analysis of preferences completed in previous years is found on the Commission's website: http://www.citizentaxpref.wa.gov/

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

Statute guides the 11 questions typically covered in the reviews.

### 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.

## JLARC Staff'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) 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 implied public policy objective might be.

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

- Review final 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.
- 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, such as stakeholder statements, that may address the issue addressed by the tax preference.

If there is sufficient information in this evidence to infer a 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 Health, and the Office of the Insurance Commissioner. 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.

## Summary of the Results from JLARC Staff's Reviews

The table beginning on page 9 provides a summary of the recommendations from JLARC staff's analysis and includes the Citizen Commission's comments on those recommendations. Of the preferences, JLARC staff recommends the Legislature:

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

## Organization of this Report

This report summary is 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. Since the Commission selected several preferences related to health care for JLARC staff to review in 2013, both the summary and detail begin with health care related preferences. 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 48 other preferences considered by the Commission in 2013 can be found in the 2013 Expedited Tax Preferences. Information on these preferences was provided by the Department of Revenue.

# COMMITTEE ADDENDUM

At the December 11, 2013 JLARC meeting the Committee approved this report for distribution and adopted one addendum to the report.

While we respect the work performed by the Auditor, we reach different conclusions and would maintain the dentistry service prepayment tax exemption. The primary basis for the Auditor's recommendation to terminate this exemption would seem to be an inability to determine the public policy objective for the exemption and the Auditor's inference that the exemption was meant to be temporary. Based on information which was provided to the Citizen Commission for Performance Measurement of Tax Preferences, we recommend maintaining this exemption. Specifically, we base this on:

1. New input from the sponsor of the original legislation which enacted the exemption (Engrossed Second Substitute Senate Bill 5304 of 1993, the "Health Care Reform Act of 1993"), former Senator Phil Talmadge, indicates that legislators at that time considered compelling evidence that the exemption served an important public health interest by promoting oral health programs for children and seniors, retaining dentistry service providers and insurers that might otherwise abandon the market, and helping to make dental coverage more affordable for employers who provide dental insurance to their employees.
2. Review of the Health Care Reform Act of 1993 (E2SSB 5304) demonstrates that the law contains sunset and expiration dates for numerous tax preferences, but includes no expiration for the dentistry service prepayment tax exemption (Section 301(6)(B)). The application and placement of the exemption within the context of the bill also clearly contemplates that this tax exemption was intended to continue for dental benefits even as the market for medical benefits transition to Certified Health Plans. Thus, by both its own specific terms and the context of the enacting legislation, it is clear that the exemption was not intended to expire but is meant to continue.
3. Evidence presented to the Citizen Commission for Performance Measurement of Tax Preferences highlights numerous direct and indirect health, economic, and local investment benefits and opportunities for residents of our state, including increased water fluoridation programs, founding of the Center for Pediatric Dentistry, savings associated with Medicaid-insured adults, the decline in tooth decay among children, and increased dental service insurance coverage of children.

As a result, we recommend that the exemption **CONTINUE WITHOUT MODIFICATION**. The tax exemption for dentistry prepayments is achieving its intended purpose of promoting dental health and dental insurance coverage for Washington residents and should be continued.

# 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



November 6, 2013

The Honorable Representative Ross Hunter
The Honorable Representative Gary Alexander
The Honorable Representative Bruce Chandler
The Honorable Representative Reuven Carlyle
The Honorable Senator Andy Hill
The Honorable Senator James Hargrove
The Honorable Representative Terry Nealey

**Re: 2013 Tax Preference Reviews**

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

The attached comments are the consensus of all five voting 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 staff (JLARC), 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 seventh year that tax preferences have been reviewed at the direction of the Legislature. Legislation enacted in 2006 and amended in 2010 established the 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 to assist the Legislature in 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 the Legislature expects. And reviewing preferences with an unclear policy purpose and those whose costs or benefits may not be meeting the Legislature's intent provides information and analysis to the Legislature which enables the Legislature to review and clarify those preferences.

After reviewing JLARC staff's report and receiving public testimony, the Commission has unanimously recommended the Legislature should review and clarify the purpose of 10 preferences, and continue 12

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preferences. Summaries of JLARC staff's analysis of and recommendations for these 22 preferences, and Commission comments are attached to this letter.

To better inform our deliberations this year, the Commission undertook some changes to our public testimony process. These changes were developed with the intent of improving the focus of the testimony, and expanding the group of testifying parties. In addition to transmitting our comments, I wanted to explain the additional efforts we took when soliciting public testimony.

Commissioners requested that stakeholders respond to a set of questions when testifying either in support or in opposition to a tax preference. These questions were developed at the Commission's August meeting, posted to our web site, and published along with the agenda for our public hearing. We posed four questions:

1. Is there evidence that the tax preference is achieving its intended purpose, as noted in the 2013 tax preferences reports? If so, please explain and provide documented evidence.
2. Does the tax preference provide other benefits which are not stated in its purpose? If so, please explain.
3. Does the tax preference stimulate economic activity that either results in additional tax revenues or reduces state budget expenditures by an amount that exceeds the direct loss of revenue from the preference?
4. Does the tax preference have any negative consequences? For example, were other industries, workers, or the environment harmed by the economic activities stimulated by this tax preference?

In addition to soliciting testimony from the beneficiaries of tax preferences, the Commission also invited and received testimony from other parties. As a result, we received testimony from individuals who spoke to broader issues concerning tax preferences, including their views on impacts on individuals and the state budget.

Finally, as you know, the availability of JLARC staff resources limits how many tax preferences JLARC staff can evaluate each year. As a result, every year the Commission considers information on a list of "expedited" preferences, which do not receive a JLARC staff evaluation. Many of these expedited preferences have limited revenue impacts, and consideration of some others, in the Commission's judgment, would not benefit from a JLARC staff evaluation. In 2013, the Commission scheduled 48 preferences for "expedited" review. In our call for public testimony, the Commission explicitly solicited public testimony on these expedited preferences as well those that received a JLARC staff evaluation. We received testimony from parties on a number of the expedited preferences.

The Commission chose not to comment on any of the 2013 expedited preferences. However, Commissioners agreed to explore the possibility of adopting procedures in 2014 that might lead to the Commission providing comments to the Legislature on some 2014 expedited preferences.

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I believe the work of JLARC staff and the 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 Commission comments covering the entire seven 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 staff'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 seven years of tax preference reviews can be found at:
www.citizentaxpref.wa.gov/reports.htm.

Recordings of this year's public testimony can be found under the link for the September 20, 2013, meeting at: www.citizentaxpref.wa.gov/meeting.htm.

Sincerely,

William A. Longbrake

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

cc: All Legislators
Keenan Konopaski, Legislative Auditor
David Schumacher, Director, Office of Financial Management
Carol Nelson, Director, Department of Revenue

Attachment

<table>
<tr><th colspan="4">Summary of 2013 Tax Preference Performance Reviews</th></tr>
<tr><th>What the Preference Does</th><th>Public Policy Objective</th><th>Est. Beneficiary Savings</th><th>Legislative Auditor Recommendation</th></tr>
<tr><td colspan="4">Preferences Related to Medical Items and Services</td></tr>
<tr><td colspan="4">Government Payments to Public and Nonprofit Hospitals (B&O Tax) / RCW 82.04.4311 — Detail on page 21</td></tr>
<tr><td>Provides a B&O tax deduction to public or nonprofit hospitals, or nonprofit community health centers for amounts received under a health service program paid for by the federal or state government.</td><td>The Legislature stated the public policy objective for the preference was to not tax amounts paid to public or nonprofit hospitals under a government-subsidized health care program for the care of elderly, low income, or disabled people, as providing health care for such persons is a recognized, necessary, and vital governmental function.</td><td>$162.7 million in the 2015-17 Biennium</td><td>Review and clarify: Because it is unclear why for-profit hospitals that provide government-subsidized health care are excluded from the preference.</td></tr>
<tr><td colspan="4">Comment: The Commission endorses the Legislative Auditor’s recommendation but notes that the Legislature has consistently excluded for-profit hospitals from this preference since 1937 and explicitly omitted for-profit hospitals in its statement of purpose when it amended the preference in 2005.<br><br>Rationale for comment: The Legislative Auditor observes that although exclusion of for-profit hospitals from this preference has been long-standing, no rationale for their exclusion is included in the legislative record. Only 5 percent of government subsidized payments in 2011 went to for-profit hospitals. Thus, if the preference were extended to for-profit hospitals, the reduction in B&O tax receipts would be small. If the Legislature decides to review this preference, it will need to determine whether extending this preference to for-profit hospitals would result in a public benefit. The Commission received no testimony in support of the Legislative Auditor’s recommendation.</td></tr>
<tr><td colspan="4">Health Maintenance Organizations (B&O Tax) / RCW 82.04.322 — Detail on page 33</td></tr>
<tr><td>Exempts health maintenance organizations and health care service contractors from B&O tax on income from premiums and prepayments that are taxed under the insurance premium tax.</td><td>The Legislature did not state the public policy objective of the tax preference. JLARC staff infer the public policy objective was to avoid double taxation of health maintenance organization and health care service contractor premium and prepayment income.</td><td>$53.1 million in the 2015-17 Biennium</td><td>Continue: Because it is fulfilling the inferred public policy objective of avoiding double taxation of this income.</td></tr>
<tr><td colspan="4">Endorse without comment.</td></tr>
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<tr><td colspan="4">Medicare and Basic Health Plan Receipts (Insurance Premium Tax) / RCWs 48.14.0201(6)(a), 48.14.0201(6)(b) Detail on page 41</td></tr>
<tr><td>Exempts health maintenance organizations and health care service contractors from insurance premium tax for:<br>1) Certain federal payments for Medicare; and<br>2) Subsidized enrollees in the state Basic Health Plan and medical care services for certain persons.</td><td>The Legislature did not state the public policy objectives of the tax preferences. JLARC staff infer the public policy objectives were to:<br>1) Comply with federal law prohibiting states from taxing federal Medicare prepayments; and<br>2) Reduce costs to the state by exempting state-funded Basic Health Plan and certain medical care services.</td><td>$89.4 million in the 2011-13 Biennium</td><td>Continue: Because the preferences are meeting the inferred public policy objectives of: 1) keeping Washington in compliance with federal law that prohibits states from taxing Medicare receipts; and 2) reducing state medical care costs.</td></tr>
<tr><td colspan="4">Endorse without comment.</td></tr>
<tr><td colspan="4">Dentistry Prepayments (Insurance Premium Tax) / RCW 48.14.0201(6)(c) Detail on page 49</td></tr>
<tr><td>Exempts health care service contractors from insurance premium tax on prepayments received for dentistry services. Effective July 28, 2013, the exemption becomes available to health maintenance organizations and life and disability insurers.</td><td>The Legislature did not state the public policy objective for the tax preference. JLARC staff infer the tax preference was intended to be temporary while health care service contractors offering dentistry services transitioned into certified health plans.</td><td>$22.4 million in the 2015-17 Biennium</td><td>Terminate: Because the inferred public policy objective of providing a temporary exemption during the transition of health care service contractors to certified health plans is no longer applicable.</td></tr>
<tr><td colspan="4">Comment: The Commission does not endorse the recommendation of the Legislative Auditor to terminate the exemption from the insurance premium tax for health care service contractors on prepayments received for dentistry services. The Commission recommends that the Legislature review and clarify whether this exemption is serving a broad-based public policy objective.<br><br>Rationale for comment: Based upon its review the Legislature could determine to terminate the dentistry insurance premium tax exemption, continue it, or establish a preferential insurance premium tax rate. While the 1993 law established a temporary exemption, the exemption became permanent when the part of the 1993 law pertaining to Certified Health Plans was repealed in 1995. There is no public record that the Legislature explicitly intended the temporary exemption to become permanent or whether this was simply the outcome of repealing parts of the 1993 law. The Commission received public testimony that argued that this was an intentional, not an accidental, outcome at the time the Legislature revised the law in 1995.<br><br>While the Legislature did not expressly provide a permanent exemption for all health care service contractors providing prepaid dental services in the Health Care Reform Act originally adopted in 1993, the Legislature clearly intended that the tax preference apply for Limited Certified Health Plans for Dental Services. These original intended beneficiaries of the preference continue to enjoy the benefits of this preference along with health care service contractors that would not have had the benefit of this preference for dentistry services under the original 1993 legislation. The 1995 legislation adopted changes to the statute in its current</td></tr>
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<tr><td colspan="4">form that extended the tax preference to all health care service contractors. The Legislative Auditor inferred that the absence of any specific reference in the 1995 legislation or in the legislative history of an intent to extend the preference to all health care service contractors was, in effect, an oversight and that the Legislature did not intend to provide the tax preference to all health care service contractors. However, the Commission believes the record is inconclusive as to whether the Legislature simply overlooked the fact that the 1995 legislation converted a temporary exemption into a permanent one or whether the Legislature intended to make the exemption permanent.<br><br>The Affordable Care Act (ACA) and its impact may raise a new issue specific to this tax preference. According to public testimony, the industry is facing a 2% tax (instead of 1.5%) on insurance obtained in the new ACA-mandated insurance exchange. For pediatric dentistry, the higher tax rate is intended to help pay the costs of running the exchange. The industry argued that increasing the tax from 1.5% to 2% (by terminating the tax preference) would lower the amount of dental services provided to vulnerable populations. If this assertion is true, it raises the question of whether the 2% tax on exchange-obtained insurance would result in a similar outcome. The industry did not comment on this possibility.<br><br>Furthermore, if the Legislature intended this tax preference to be temporary when enacted in 1993, it is possible the tax preference may have had the unintended consequence of increasing the supply of dental services to vulnerable populations. If so, this may have some social-welfare benefits. The Legislature should request the industry to clarify the specific programs that are at risk if the tax preference is terminated. In response to a commission question during public testimony, the industry was either unable or unwilling to comment on specifics about programs at risk. Finally, there is a question of whether program cuts, if they occur, would be mitigated by increased health insurance coverage generated by the ACA exchanges.<br><br>The Legislature may also wish to consider the disparity of tax treatment between the different types of insurance carriers for dental services.<br><br>The Commission also received public testimony which indicated that most providers of dentistry services are not-for-profit organizations which engage in substantial public service initiatives. Thus, it is possible that some of the benefits of the tax preference, perhaps a significant portion, are passed on to the public through various educational programs to reduce oral disease and improve overall health.</td></tr>
<tr><td colspan="3">Prescription Drug Administration (B&O Tax) / RCW 82.04.620</td><td>Detail on page 59</td></tr>
<tr><td>Provides a B&O tax deduction to physicians and medical clinics for sales to patients of certain prescription drugs covered under Medicare Part B that are infused or injected.</td><td>The Legislature did not state the public policy objective for the tax preference. JLARC staff infer the public policy objectives were:<br>1) To lower costs for physicians and medical clinics that infuse or inject drugs covered under Medicare Part B; and<br>2) To help keep these physicians' offices and medical clinics open to provide better patient access to these drugs.</td><td>$6.1 million in the 2015-17 Biennium</td><td>Review and clarify: Because while the preference is meeting the inferred public policy objective of lowering costs, the Legislature may want to consider adding reporting or other accountability requirements to provide better information on the effectiveness of the preference.</td></tr>
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<tr><td colspan="4">Comment: The Commission endorses the Legislative Auditor’s recommendation that the Legislature may want to consider adding reporting or other accountability requirements and suggests the Legislature consider how the Affordable Care Act (ACA) impacts incentives to provide services covered by this preference.<br><br>Rationale for comment: In light of the Affordable Care Act (ACA), the Legislature may want to track how the ACA impacts incentives to provide the services covered by this preference. Depending on the results of this tracking, alterations in the preference may be appropriate.</td></tr>
<tr><td colspan="4">Medical Items, Dietary Supplements, Insulin, and Kidney Dialysis Devices (Sales and Use Tax) / RCWs 82.08.0283, 82.12.0277, 82.08.925, 82.12.925, 82.08.985, 82.12.985, 82.08.945, 82.12.945 — Detail on page 67</td></tr>
<tr><td>These four preferences provide sales and use tax exemptions for the following medical and health care related items for human use:<br>• Medical items, including prescribed prosthetic devices, naturopath-prescribed medicines, prescribed medical oxygen systems, and repair labor and services for any of these items;<br>• Prescribed dietary supplements;<br>• Insulin; and<br>• Kidney dialysis devices.</td><td>The Legislature did not state the public policy objective for any of the tax preferences. JLARC staff infer the public policy objective was to selectively address the regressive nature of sales tax by exempting certain "medically necessary" items for basic human needs.</td><td>Medical Devices: $122.9 million in the 2015-17 Biennium<br>Dietary Supplements: $12.2 million in the 2015-17 Biennium<br>Insulin: $52.4 million in the 2015-17 Biennium<br>Kidney Dialysis Devices: $8.8 million in the 2015-17 Biennium</td><td>Continue: Because the preferences are meeting the inferred public policy objective of reducing the regressive nature of Washington's sales and use tax by exempting certain medical items and services that meet basic human needs.</td></tr>
<tr><td colspan="4">Endorse without Comment.</td></tr>
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<tr><td colspan="4">Nonprofit Blood and Tissue Banks (B&O Tax, Sales and Use Tax) / RCWs 82.04.324, 82.08.02805, 82.12.02747 Detail on page 83</td></tr>
<tr><td>Exempts nonprofit blood and tissue banks from:<br>1) B&O tax on revenue from collection, storage, and distribution of blood and tissue if the income is also exempt from federal income tax, and<br>2) Sales and use taxes on purchases of qualified medical supplies, chemicals, and materials.</td><td>The Legislature did not state the public policy objective for the tax preferences in 2004. JLARC staff infer the public policy objective was to provide the same tax treatment to nonprofit blood and tissue banks as the federal law required states to provide to the American Red Cross.</td><td>B&O Tax:<br>$4.7 million in the 2015-17 Biennium<br>Sales and Use Tax:<br>$17.9 million in the 2015-17 Biennium</td><td>Continue: Because the 2004 preferences are achieving the inferred public policy objective of providing the same tax treatment to nonprofit blood and tissue banks as to the American Red Cross.</td></tr>
<tr><td colspan="4">Endorse without comment.</td></tr>
<tr><td colspan="4">Prescription Drug Resellers (B&O Tax) / RCW 82.04.272 Detail on page 91</td></tr>
<tr><td>Provides a reduced B&O tax rate for businesses that warehouse and resell prescription drugs.</td><td>The Legislature did not state the public policy objective for the tax preference. JLARC staff infer the Legislature intended to reduce a competitive disadvantage for drug resellers operating warehouses in Washington relative to businesses that distribute drugs in the state without nexus and that owe no B&O tax.</td><td>$29.9 million in the 2015-17 Biennium</td><td>Continue: Because the preference is meeting the inferred public policy objective of reducing a competitive disadvantage for wholesalers operating Washington warehouses relative to out-of-state drug distributors that have no nexus to Washington and pay no B&O tax.</td></tr>
<tr><td colspan="4">Comment: The Commission endorses the Legislative Auditor’s recommendation to continue the prescription drug resellers preference, but in light of public testimony, the Legislature could consider whether to review this preference.<br>Rationale for comment: The Legislative Auditor believes the Legislature’s inferred public policy objective for the prescription drug resellers B&O preferential tax rate is intended to reduce a competitive disadvantage for drug resellers operating warehouses in Washington relative to businesses that distribute drugs in the state without nexus and that owe no B&O tax. But, the preference is also available to drug resellers operating out-of-state warehouses that have nexus. The Commission received testimony questioning the necessity of this preference, but also received testimony indicating that drug reseller employment in the state has grown 182% since the preference was enacted in 1998.</td></tr>
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<tr><td colspan="4">Artistic and Cultural Organizations (B&O Tax, Sales and Use Tax) / RCWs 82.04.4322, 82.04.4324, 82.04.4326, 82.04.4327, 82.08.031, 82.12.031 Detail on page 101</td></tr>
<tr>
<td>These preferences provide nonprofit artistic and cultural organizations with:<br>B&O tax deductions for income from:<ul><li>Government funding and support;</li><li>The value of items manufactured for their own use;</li><li>Tuition program charges; and</li><li>Income earned from business activities.</li></ul>Sales and use tax exemptions for purchases or acquisitions of:<ul><li>Objects of art;</li><li>Objects of cultural value;</li><li>Objects used to create art; and</li><li>Objects used to display art objects or present artistic or cultural performances.</li></ul></td>
<td>The Legislature did not state public policy objectives for any of the tax preferences. JLARC staff infer the public policy objectives were:<br>1) To offset funding reductions experienced by artistic and cultural organizations during a time when their government support had been reduced;<br>2) To make taxation of artistic and cultural organization income in Washington consistent with the federal government and other states; and<br>3) To support Washington's nonprofit artistic and cultural organizations.</td>
<td>B&O Tax:<br>$7.6 million in the 2015-17 Biennium<br>Sales and Use Tax:<br>$6 million in the 2013-15 Biennium</td>
<td>Review and clarify: Because although the preferences appear to have achieved or partially achieved the inferred public policy objectives: 1) the Legislature has not yet identified if it intends any long-term offsetting relationship between beneficiary savings for artistic and cultural organizations and government funding levels for such organizations; and 2) the B&O tax exemption is broader than that provided by the federal government and other states that follow the federal exemption.</td>
</tr>
<tr><td colspan="4">Endorse without comment.</td></tr>
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<table>
<tr><th colspan="4">Summary of 2013 Tax Preference Performance Reviews</th></tr>
<tr><th>What the Preference Does</th><th>Public Policy Objective</th><th>Est. Beneficiary Savings</th><th>Legislative Auditor Recommendation</th></tr>
<tr><td colspan="3">Fishing Boat Fuel (Sales and Use Tax) / RCWs 82.08.0298, 82.12.0298</td><td>Detail on page 113</td></tr>
<tr><td>Exempts commercial deep sea fishing and commercial passenger charter fishing businesses from sales and use tax on purchases of diesel fuel for use in their watercraft.</td><td>The Legislature did not state the public policy objective for the tax preference. JLARC staff infer the public policy objectives may have been:<br>1) To support Washington's commercial fishing industry, coastal communities, and businesses by removing a disincentive for fishing boats to buy fuel in Washington; and<br>2) To provide tax treatment of fuel for commercial and charter fishing vessels that is equitable with the tax treatment of fuel for vessels conducting interstate and foreign commerce.</td><td>$12.2 million in the 2015-17 Biennium</td><td>Review and clarify: Because the preference is not meeting the inferred public policy objective of providing equitable tax treatment on fuel for Washington commercial deep sea fishing and charter fishing boats when compared to tax treatment on fuel for vessels engaged in interstate and foreign commerce. In addition, the $5,000 minimum gross receipts level has not been reviewed since 1987.</td></tr>
<tr><td colspan="4">Comment: The Commission endorses the Legislative Auditor’s recommendation and encourages the Legislature to state an explicit public policy objective for this preference and to structure this preference to be consistent with the stated public policy objective.<br><br>Rationale for comment: The Legislative Auditor determined that although the preference removes a possible disincentive for fishing boats to purchase fuel in Washington, the preference is not meeting the inferred public policy objective of providing equitable tax treatment on fuel for Washington commercial deep sea fishing and charter boats when compared to tax treatment on fuel for commercial vessels engaged in interstate and foreign commerce. The Legislature should determine whether this preference serves a public policy objective and, if so, structure the preference to align with an explicitly stated objective.</td></tr>
<tr><td colspan="3">Fuel Used in Commercial Vessels (B&O Tax) / RCW 82.04.433</td><td>Detail on page 121</td></tr>
<tr><td>Provides a B&O tax deduction to businesses selling fuel for consumption outside of U.S. territorial waters by commercial vessels used primarily in foreign commerce.</td><td>The Legislature did not state the public policy objective for the tax preference. JLARC staff infer the public policy objectives may have been:<br>1) To treat income from marine fuel sales delivered in Washington for use in vessels conducting foreign commerce the same as income from sales of goods delivered out-of-state, and<br>2) To keep marine fuel sellers from moving out of Washington.</td><td>$8.1 million in the 2015-17 Biennium</td><td>Review and clarify: To consider if the Legislature wants to add reporting or other accountability requirements that would provide better information on the effectiveness of this preference in keeping marine fuel sellers from moving out of Washington.</td></tr>
<tr><td colspan="4">Endorse without comment.</td></tr>
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| Summary of 2013 Tax Preference Performance Reviews | | | |
|---|---|---|---|
| **What the Preference Does** | **Public Policy Objective** | **Est. Beneficiary Savings** | **Legislative Auditor Recommendation** |
| Nonprofit Youth Recreation Services and Local Government Physical Fitness Classes (Sales and Use Tax) / RCWs 82.08.0291, 82.12.02917 | | | Detail on page 131 |
| Exempts the following from sales tax:<br>• Amusement and recreation services provided by nonprofit youth organizations to their members (also exempt from use tax);<br>• Physical fitness services provided by nonprofit youth organizations to their members; and<br>• Physical fitness classes provided by local governments. | The Legislature did not state a public policy objective for the tax preference. JLARC staff infer the public policy objective of the exemption for amusement and recreation services and personal services classified as retail services by nonprofit youth organizations is to support and recognize that such organizations provide for the public good.<br>JLARC staff infer the public policy objective for the local government physical fitness class exemption is to reduce costs for patrons of such classes. | $29.6 million in the 2015-17 Biennium | **Review and clarify:** Because while the preference appears to be achieving the inferred public policy objective of recognizing the general public good provided by character-building nonprofit youth organizations, the preference benefits adults as well as youth. In addition, the exemption for personal services classified as retail sales technically includes services not generally provided by nonprofit youth organizations. |
| Endorse without comment. | | | |

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<tr><th>What the Preference Does</th><th>Public Policy Objective</th><th>Est. Beneficiary Savings</th><th>Legislative Auditor Recommendation</th></tr>
<tr><td colspan="4">Retailing (B&O Tax) / RCW 82.04.250(1) Detail on page 141</td></tr>
<tr><td>Provides a lower B&O tax rate for retailers than the rate paid by manufacturers and wholesalers.</td><td>The Legislature did not state the public policy objective for the tax preference. JLARC staff infer that, at the time of enactment, the Legislature wanted to lessen the financial impact of a sales tax increase on retailers by not imposing a B&O tax increase on them at the same time.</td><td>$47.1 million in the 2015-17 Biennium</td><td>Review and clarify: Because sales tax-related changes since 1983 may impact the rationale for the level of preferential rate provided to the retail industry compared to other businesses.</td></tr>
<tr><td colspan="4">Comment: The Commission endorses the recommendation of the Legislative Auditor for the Legislature to review and clarify the retailing preferential B&O tax rate and encourages the Legislature to examine whether the preferential B&O tax rate should be eliminated or be changed to some other amount.<br><br>Rationale for comment: The Legislative Auditor believes that the inferred public policy objective of establishing a preferential retailing B&O tax rate was to lessen the impact of a sales tax increase in 1983. Currently, this preferential rate is 0.471%, which is not significantly different from the 0.484% B&O tax rate that applies to manufacturing and wholesaling. Thus, elimination of the preferential rate would likely have minimal effect. However, public testimony received by the Commission suggested that the B&O tax rate places a competitive disadvantage on retailers who compete with on-line providers who are not subject to comparable sales tax rates. In its review the Legislature could examine whether there would be broad-based public benefits by revising, rather than eliminating, the preferential B&O tax rate.</td></tr>
<tr><td colspan="4">Rural County and CEZ New Jobs (B&O Tax) / RCWs 82.62.030, 82.62.045 Detail on page 151</td></tr>
<tr><td>Provides a B&O tax credit to manufacturing, research and development, and commercial testing businesses that hire workers in rural counties or in Community Empowerment Zones (CEZs).</td><td>The Legislature did not state the public policy objective when it enacted this preference in 1986, but included intent language in 1997 when it amended the tax preference. The Legislature stated the public policy objective is to assist rural distressed areas in their efforts to address above average unemployment rates and below average employment growth.</td><td>$4.3 million in the 2015-17 Biennium</td><td>Review and clarify: To determine if the new jobs are located where the Legislature intended and if the number of new jobs is what the Legislature intended.</td></tr>
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| Summary of 2013 Tax Preference Performance Reviews | | | |
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| **What the Preference Does** | **Public Policy Objective** | **Est. Beneficiary Savings** | **Legislative Auditor Recommendation** |
| **Comment:** The Commission endorses the Legislative Auditor's recommendation to determine if new jobs are located where the Legislature intended and if the number of new jobs is what the Legislature intended. In its review the Commission recommends that the Legislature consider whether "rural" rather than "distressed" is the appropriate determinant of eligibility and whether the 15% increase in employment requirement is the most appropriate standard for retaining preference benefits.<br>**Rationale for comment:** Shifting this preference's emphasis from "distressed" to "rural" has opened the preference to rural counties with relatively healthy economies. As a result, this may be creating an unnecessary loss of tax revenue. Population density is not a direct measure of economic distress. The Legislature should consider returning to economic measures (as opposed to demographic measures) for defining eligibility. Additionally, under current law, existing firms need to show a 15% increase in employment to retain the tax benefits. It is unclear why a 15% rate is more appropriate than some other rate, such as 10%. | | | |
| Tree Trimming Under Power Lines (Sales and Use Tax) / RCW 82.04.050(3)(e) | | | Detail on page 165 |
| Exempts line clearing activities performed by or for an electric utility from sales tax. These activities are instead subject to B&O tax under the service classification. | The Legislature never intended to extend sales tax to utility line clearing when it defined landscaping services as a retail sale. Its public policy objective in enacting the 1995 legislation was to clarify this fact by specifically excluding line clearing from the list of taxable activities. | $0 | **Continue:** The language clarifies that landscaping services subject to sales tax do not include line clearing services performed by or for electric utilities. |
| Endorse without comment. | | | |
| Use Tax on Rental Value (Use Tax) / RCW 82.12.010(7)(c) | | | Detail on page 171 |
| Provides that out-of-state businesses that bring property temporarily into Washington for business purposes owe use tax on a reduced, "reasonable rental value" instead of on the full purchase price of the property. | The Legislature did not state the public policy objective for this preference. JLARC staff infer the Legislature enacted the tax preference in order to end a tax dispute with Oregon by reducing the costs to businesses doing work temporarily in Washington. | $3.3 million in the 2015-17 Biennium | **Continue:** Because the inferred public policy objective of resolving a 1980s tax dispute with Oregon by reducing costs to businesses temporarily working in Washington has been achieved. |
| Endorse without comment. | | | |