PRELIMINARY REPORT
2019 TAX PREFERENCE PERFORMANCE REVIEWS

Overview

July 2019

2019 Reviews

JLARC staff reviewed eleven tax preferences in 2019, which are organized into nine reports below.

View a more detailed summary of all the preferences here.

The Citizen Commission for Performance Measurement of Tax Preferences also considers preferences based on information provided by the Department of Revenue. View the 2019 expedited preference report here (PDF). Table below lists estimated beneficiary savings and legislative auditor's conclusion for each preference reviewed.

Aerospace Tax Preferences

$569 million in the 2021 - 23 biennium

The aerospace industry remains in Washington, offering wages and benefits above the state average. The preferences improved competitiveness by reducing the industry's effective tax rate by 50%. Employment has declined from its 2013 level, but it is unclear to what extent the preferences prevented greater job loss.

Legislative Auditor's Recommendation
Clarify

Commissioners' Recommendation
Available October 2019

Full Report

Video Summary

Summary

Aircraft Part Prototypes

$0

The preference has not been claimed and does not contribute to the public policy objectives, so the Legislative Auditor continues to recommend termination.

Legislative Auditor's Recommendation
Terminate

Commissioners' Recommendation
Available October 2019

Full Report

One Page Overview

Commercial Airplane Parts: Place of Sale $620,000

While the preference clarifies place of sale of certain airplane parts, it appears to conflict with policy objectives by providing more advantageous tax treatment to out-of-state manufacturers of airplane parts than to in-state manufacturers.

Legislative Auditor's Recommendation
Review and clarify

Commissioners' Recommendation
Available October 2019

Full Report

One Page Overview

Commuter Air Carrier Airplanes (Property Tax) $186,000 to $254,000

The preference streamlines tax reporting for one of three commuter air carriers in Washington. However, the qualifying carrier is paying an estimated 50%to 63% less in excise tax than it would have paid in property tax.

Legislative Auditor's Recommendation
Modify

Commissioners' Recommendation
Available October 2019

Full Report

Video Summary

One Page Overview

Commuter Air Carrier Airplanes (Sales and Use Tax) $447,000

Since 2009, the number of commuter air carriers has increased by one. There has been no change in the total number of small or rural airports served, but service has increased in some locations and ended in others.

Legislative Auditor's Recommendation
Clarify expectations for levels of service and locations served

Commissioners' Recommendation
Available October 2019

Full Report

Video Summary

One Page Overview

Financial Institutions' Income from Certain Airplane Loans

$2.1 million - $3.4 million

The preference provides targeted financial relief to two airlines headquartered in Washington. The Legislature should add a performance statement to clearly state the public policy objective.

Legislative Auditor's Recommendation Clarify the intent and duration **Commissioners' Recommendation** Available October 2019	Full Report Video Summary One Page Overview

Hog Fuel to Produce Energy

$5.6 million

The Legislature should continue this preference because beneficiaries are exceeding the goal of retaining 75% of the jobs at participating facilities.

Legislative Auditor's Recommendation Continue if facilities keep achieving the75% job retention goal **Commissioners' Recommendation** Available October 2019	Full Report Video Summary One Page Overview

Large Private Airplanes Owned by Nonresidents

$11.6 million

The preference has likely resulted in new jobs and increased state tax revenues by $1.8 million to $3.3 million annually. It has had a negligible impact on Washington's aerospace manufacturing industry.

Legislative Auditor's Recommendation Continue and clarify the objective **Commissioners' Recommendation** Available October 2019	Full Report Video Summary One Page Overview

Property Tax Exemption for Multifamily Housing in Urban Areas

$262 million in CY 2022-23

Developers have created housing using the Multifamily Housing Tax Exemption. It is inconclusive whether this use represents a net increase in development. Cities have opportunities to maximize the impact of the exemption and improve reporting on results.

Legislative Auditor's Recommendation Modify **Commissioners' Recommendation** Available October 2019	Full Report Video Summary One Page Overview

More about 2019 reviews

Study questions

The Citizen Commission selected the following tax preferences for a performance review by JLARC staff in 2019:

- Aerospace Tax Preferences (B&O Tax) | 82.04.625 | 2006
- Aircraft Part Prototypes (Public Utility Tax) | 82.16.300 | 2007
- Commercial Airplane Part Place of Sale (Sales and Use Tax) | 82.82.020 | 2008
- Commuter Air Carrier Airplanes (Property Tax) | Ch. 84.14 RCW; 84.14.040(1) | 2014
- Commuter Air Carriers Paying Aircraft Excise Tax (B&O Tax) | 82.04.4277 | 2011
- Financial Inst Commercial Air Loan Interest/Fees (Sales and Use Tax) | 82.60.040; 82.60.049 | 1985
- Hog Fuel to Produce Energy (Aircraft Excise Tax) | 82.48.100(8) | 2010
- Modifying Large Private Airplanes Owned by Nonresidents (Property Tax) | 84.36.575 | 2010
- Property Tax Exemption for Multifamily Housing in Urban Areas (Use Tax) | 82.12.225 | 2013

In addition, the Commission will consider the following tax preferences, using an expedited process. The expedited process is primarily based on information published by the Department of Revenue in its most recent statutorily required tax exemption study. View the 2019 Expedited Preference Review.

1. Academic Transcripts (B&O Tax) | 82.04.399 | 1996
2. Academic Transcripts (Sales and Use Tax) | 82.08.02537; 82.12.0347 | 1996
3. Aircraft Testing or Crew Training (Aircraft Fuel Tax) | 82.42.030(9)-(10); 82.42.230(2)-(3) | 1967
4. Cargo Containers (Property Tax) | 84.36.105 | 1975
5. Child Care (B&O Tax) | 82.04.2905 | 1998
6. Child Care Resource and Referral (B&O Tax) | 82.04.3395 | 1995
7. Church Child Care (B&O Tax) | 82.04.339 | 1992
8. Commercial Air Operations (Aircraft Fuel Tax) | 82.42.030(4)-(5) | 1967
9. Computers Donated to Schools (Use Tax) | 82.12.0284 | 1983
10. Driver Training Vehicles (Use Tax) | 82.12.0264 | 1955
11. International Charter and Freight Brokers (B&O Tax) | 82.04.260(6) | 1979
12. Interstate Transportation Equipment (Sales Tax) | 82.08.0262 | 1949
13. Interstate Transportation - In-State Portion (Public Utility Tax) | 82.16.050(6) | 1935
14. Interstate Transportation - Shipments to Ports (Public Utility Tax) | 82.16.050(9) | 1937
15. Interstate Transportation - Through Freight (Public Utility Tax) | 82.16.050(8) | 1937
16. Items Used in Interstate Commerce (Sales Tax) | 82.08.0261 | 1949
17. Log Transportation Businesses (Public Utility Tax) | 82.16.020(1)(h) | 2015
18. Motorcycles Used for Rider Training (Sales and Use Tax) | 82.08.870; 82.12.845 | 2001
19. Nonprofit Educational Foundations (Property Tax) | 84.36.050(2) | 2001
20. Nonresident Keeping Aircraft In-State (Aircraft Excise Tax) | 82.48.100(7) | 1999
21. Nonresidents' Rental Cars (Sales Tax) | 82.08.0279 | 1980
22. Private Kindergartens (B&O Tax) | 82.04.4282(7) | 1965
23. Returned Motor Vehicles (Sales Tax) | 82.32.065 | 1987
24. Student Loan Organizations (B&O Tax) | 82.04.367 | 1987
25. Student Loan Organizations (Property Tax) | 84.36.030(6) | 1987
26. Tuition and Fees (B&O Tax) | 82.04.4282(5) | 1935
27. Tuition Fees - Foreign Degree-Granting Institutions (B&O Tax) | 82.04.4332 | 1993

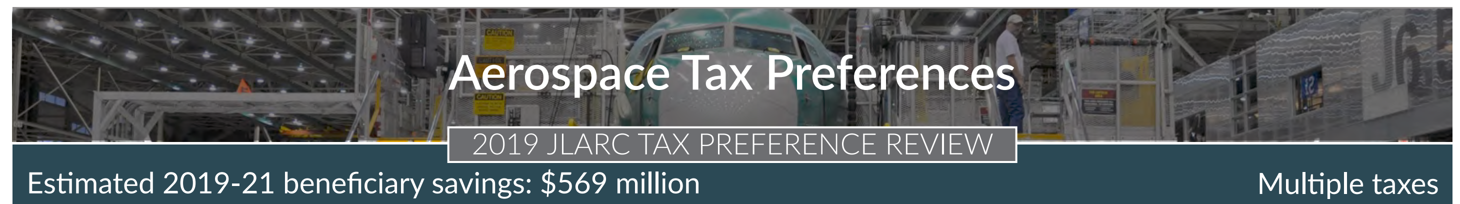
28. Urban Transportation (Public Utility Tax) | 82.16.020(1)(d) | 1935

29. Vehicles Used in Interstate Commerce (Use Tax) | 82.12.0254 | 1937

30. Vehicles in Interstate Commerce (Sales Tax) | 82.08.0263 | 1949

31. Vehicles Sold to Nonresidents (Sales Tax) | 82.08.0264 | 1935

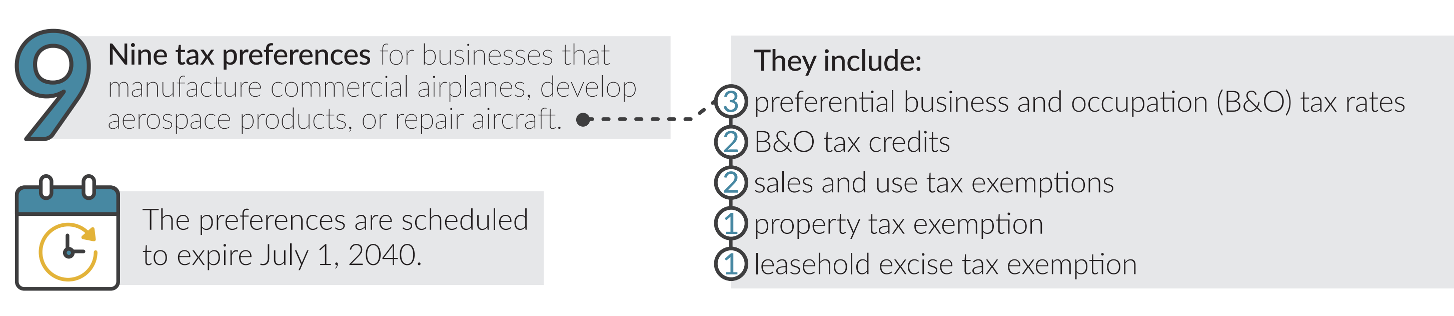
32. Wholesale Auto Auctions (B&O Tax) | 82.04.317; 82.04.422(1) | 1997



Aerospace Tax Preferences

2019 JLARC TAX PREFERENCE REVIEW

Estimated 2019-21 beneficiary savings: $569 million | Multiple taxes



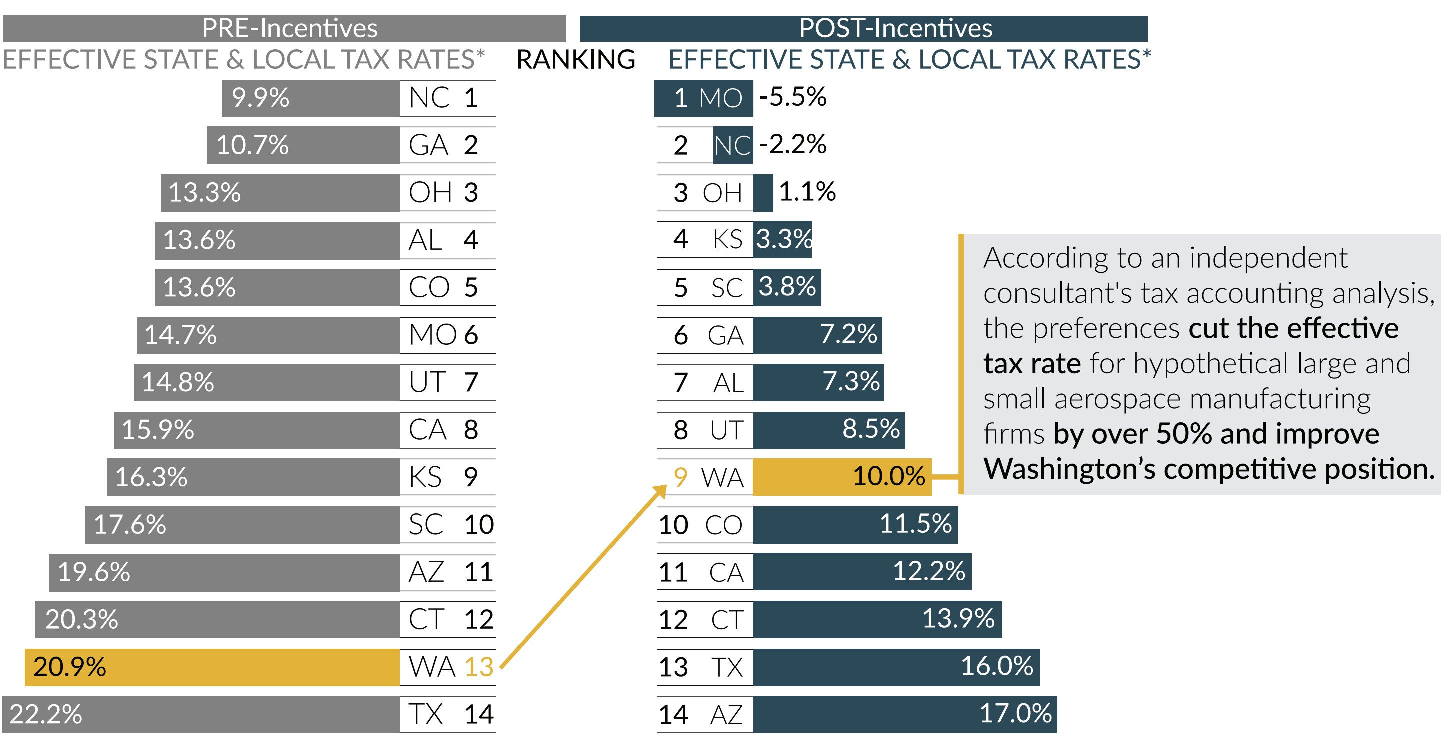
9 **Nine tax preferences** for businesses that manufacture commercial airplanes, develop aerospace products, or repair aircraft.

The preferences are scheduled to expire July 1, 2040.

They include:

- 3 preferential business and occupation (B&O) tax rates
- 2 B&O tax credits
- 2 sales and use tax exemptions
- 1 property tax exemption
- 1 leasehold excise tax exemption

The preferences reduce the cost of doing business and improve competitiveness with other states



According to an independent consultant's tax accounting analysis, the preferences **cut the effective tax rate** for hypothetical large and small aerospace manufacturing firms **by over 50% and improve Washington's competitive position.**

Note: Graph shows results for a hypothetical large aerospace firm.

**Effective tax rate is the estimated reduction in rate of return due to state and local taxes.*

Washington's aerospace industry leads the nation in output and employment

In addition, employees of tax preference beneficiaries earn wages above the state average and are provided benefits.

WA MANUFACTURING INDUSTRY	$76,000 average annual wage
BENEFICIARIES	$108,000 average annual wage

The complete report is on the JLARC web site: www.leg.wa.gov/jlarc

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
keenan.konopaski@leg.wa.gov • (360) 786-5187

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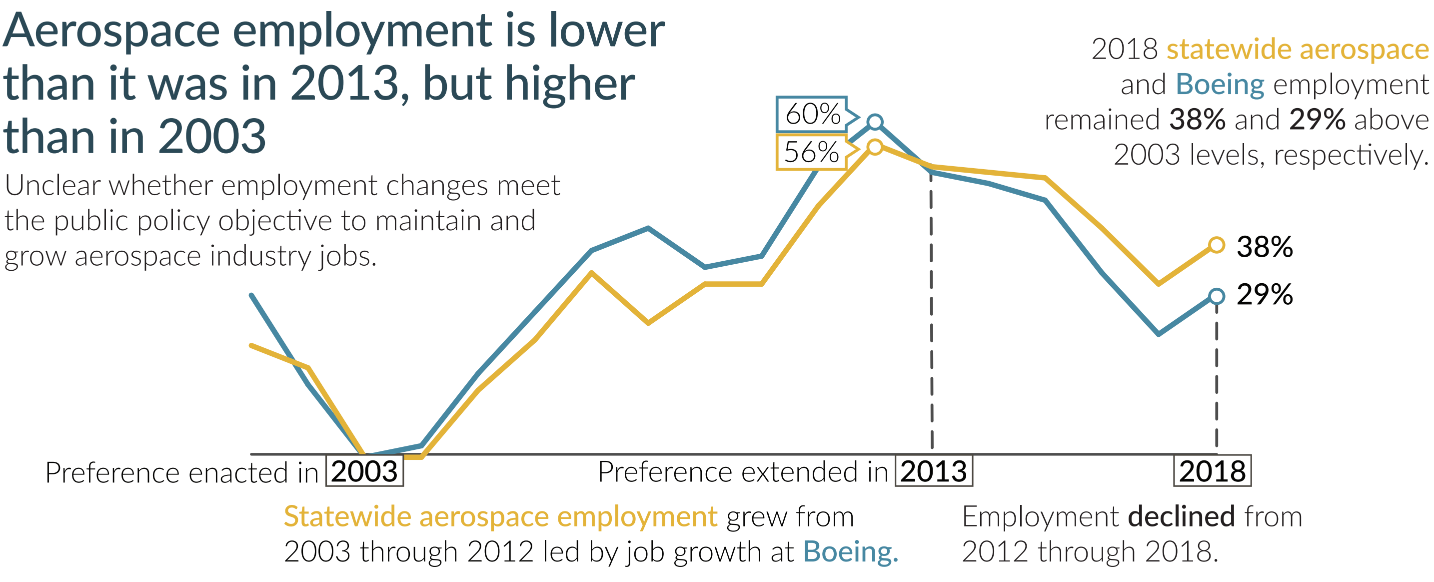
July 2019

Aerospace employment is lower than it was in 2013, but higher than in 2003

Unclear whether employment changes meet the public policy objective to maintain and grow aerospace industry jobs.



It is unclear whether the preferences prevented greater job losses

If the preferences led Boeing to remain in Washington, they may have kept the state from losing more jobs. If not, they reduced government spending and may have contributed to job losses.

THREE HYPOTHETICAL SCENARIOS
modeled what could have happened if the preferences were not extended.

SCENARIO 1	SCENARIO 2	SCENARIO 3
Boeing locates 777X production outside WA	Boeing locates all future production outside WA	Boeing locates 777X production in WA without preferences
Washington aerospace employment declines by over 13,000, with statewide job losses of over 71,000.	**Washington aerospace employment declines** by over 68,000, with statewide job losses of over 360,000.	**Increase in employment** from government spending offsets minor aerospace job losses resulting in an economy-wide increase of 4,700 jobs.

The effect of the preferences on aerospace employment depends on whether they influenced Boeing's decision to keep production in Washington.

LEGISLATIVE AUDITOR'S RECOMMENDATION

Clarify

The Legislature should clarify its expectations for the level of aerospace industry employment. Providing additional detail in the tax preference performance statement such as a baseline level of employment would facilitate future reviews of these preferences.

The complete report is on the JLARC web site: www.leg.wa.gov/jlarc

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
keenan.konopaski@leg.wa.gov ● (360) 786-5187

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July 2019

PRELIMINARY REPORT:

2019 TAX PREFERENCE PERFORMANCE REVIEWS

Aerospace Tax Preferences

LEGISLATIVE AUDITOR'S CONCLUSION:

The aerospace industry remains in Washington, offering wages and benefits above the state average. The preferences improved competitiveness by reducing the industry's effective tax rate by 50%. Employment has declined from its 2013 level, but it is unclear to what extent the preferences prevented greater job loss.

Updated August 21, 2019

Review focuses on nine tax preferences intended to benefit the aerospace industry

In 2013, the Legislature expanded a package of aerospace tax preferences that was initially enacted in 2003. The preferences include three preferential business and occupation (B&O) tax rates, two B&O tax credits, two sales and use tax exemptions, a property tax exemption, and a leasehold excise tax exemption. Detail is provided in Appendix A.

Estimated Biennial Beneficiary Savings $569 million in the 2021-23 Biennium
Tax Types Business and Occupation Tax, Sales and Use Tax, Leasehold Excise Tax, Property Tax Multiple RCWs Applicable Statutes

To claim a preference, a business must perform at least one of these activities:

1. Manufacture commercial airplanes.
2. Develop aerospace products (e.g., airplanes, components, repair equipment, and tooling).
3. Repair aircraft.

The preferences are scheduled to expire July 1, 2040.

The preferences lower the cost of doing business. The aerospace industry remains in Washington, and its employees earn wages above the state average and are provided benefits.

The Legislature stated three public policy objectives when the preferences were initially enacted in 2003, and added a fourth policy objective when extending the preferences in 2013.

Objectives (Stated)	Results
Reduce the cost of doing business in Washington for the aerospace industry compared to other states.	**Met**. The preferences save beneficiaries more than $500 million per biennium. They improve the state's competitive position by cutting the industry's effective tax rate by at least 50%, making the rate lower than 5 out of 13 competitor states. (Tab 1)
Encourage the continued presence of the aerospace industry in Washington.	**Met.** Aerospace continues to be a major industry in Washington. However, it is unclear to what extent the preferences influenced location decisions. (Tab 2)
Provide jobs with good wages and benefits.	**Met**. Aerospace industry employees earn wages and benefits well above the state average. (Tab 3)

However, aerospace employment is lower than it was in 2013. It is unclear whether the preferences prevented greater job losses.

Objectives (Stated)	Results
Maintain and grow Washington's aerospace industry workforce.	**Unclear**. Washington aerospace employment is lower than it was in 2013, but higher than when the preferences were first enacted in 2003. (Tab 3) If the preferences led Boeing to remain in Washington, they may have kept the state from losing more jobs. If not, they reduced government spending and may have contributed to job losses. (Tab 4)

Recommendations

Legislative Auditor's Recommendation: Clarify

The Legislature should clarify its expectations for the level of aerospace industry employment. Providing additional detail in the tax preference performance statement such as a baseline level of employment would facilitate future reviews of these preferences.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2019.

This report was updated on August 21, 2019 to clarify Boeing and total US aerospace employment.

REVIEW DETAILS

1. Preferences reduce costs and improve competitiveness

The preferences improved Washington's competitive position by cutting the industry's effective tax rate by at least 50%

Over 600 beneficiaries have claimed seven of nine preferences

In 2003, the Legislature approved a package of aerospace tax preferences. In 2013, it extended the preferences' expiration date from 2024 to 2040. The preferences include:

- Three preferential business and occupation (B&O) tax rates.
- Two B&O tax credits.
- Two sales and use tax exemptions (expanded in 2013).
- One property tax exemption (unclaimed).
- One leasehold excise tax exemption (unclaimed).

See Appendix A for details.

The tax preferences reduce the cost of doing business for the aerospace industry and other beneficiaries

A business may claim one or more of these preferences if it manufactures commercial airplanes, develops aerospace products[1], or repairs aircraft. Businesses in the aerospace industry were the primary beneficiaries, although firms in related industries also claim the preferences.

- The aerospace industry includes businesses that file taxes under North American Industry Classification System (NAICS) code 3364--Aerospace Product and Parts Manufacturing. Boeing is the largest aerospace business in Washington, and the state's largest private employer.
- Related industries include architectural and engineering services, durable goods wholesaling, and fabricated metal product manufacturing.

From fiscal year 2014 through fiscal year 2017, 664 businesses saved $1.1 billion by claiming the preferences. Beneficiaries in the aerospace industry claimed 93% of the savings. Detailed savings estimates for each preference are in Appendix A.

[1] Airplanes, airplane components, airplane repair equipment, and tooling used in manufacturing commercial airplanes

Exhibit 1.1: Beneficiaries save more than $500 million per biennium

Biennium	Fiscal Year	Estimated Fiscal Year Beneficiary Savings	Estimated Biennial Beneficiary Savings
2013-2015 *7/1/13-6/30/15*	2014	$223 million	$528 million
	2015	$305 million	
2015-2017 *7/1/15-6/30/17*	2016	$304 million	$543 million
	2017	$239 million	
2017-2019 *7/1/17-6/30/19*	2018	$246 million	$501 million
	2019	$255 million	
2019-2021 *7/1/19-6/30/21*	2020	$267 million	$545 million
	2021	$278 million	
2021-2023 *7/1/21-6/30/23*	2022	$282 million	$569 million
	2023	$287 million	

Source: JLARC staff analysis of tax return data - total savings may not equal sum of detailed estimates due to rounding.

Independent consultant's tax accounting analysis concludes that the preferences improved Washington's competitiveness relative to other states

JLARC staff hired Ernst & Young to evaluate the business tax climate for the aerospace industry across Washington and 13 other benchmark states. Benchmark states include those with the highest concentration of aerospace employment and those identified as leading states by recent studies of aerospace competitiveness. The analysis considers statutory incentives (including Washington's aerospace tax preferences), negotiated incentives, and cash grants provided to the aerospace industry. Appendix B has additional detail about the analysis and a link to the full report.

Four steps in Ernst & Young analysis to evaluate business tax climate

1. Estimate the rates of return and all taxes[2] paid by hypothetical small and large aerospace firms that invest in new manufacturing facilities.
2. Estimate the reduction in rate of return due to taxes. As shown in the hypothetical example below, the reduction due to taxes is the difference between the pre-tax and after-tax rates of return.

Pre-tax rate of return	5%
After-tax rate of return	− 4%
Reduction due to taxes	1%

3. Express the reduction as an effective tax rate.

$$\frac{\text{Reduction due to taxes} \quad 1\%}{\text{Pre-tax rate of return} \quad 5\%} = 20\% \text{ ETR}$$

4. Estimate the reduction in ETR due to statutory incentives[3] and negotiated incentives[4]. If incentives reduce taxes in the above example by half, the effective tax rate would be reduced to 10%.

$$\frac{\text{Reduction due to taxes after incentives} \quad 0.5\%}{\text{Pre-tax rate of return} \quad 5\%} = 10\% \text{ ETR}$$

According to the analysis:

- For the hypothetical large firm[5], the incentives reduce the effective tax rate from 20.9% to 10.0%. This improves the state's competitive ranking from thirteenth to ninth out of 14 states with a large aerospace presence (see Exhibit 1.2).
- For the small firm[6], the incentives reduce the effective tax rate from 15.8% to 6.1%. This improves the state's competitive ranking from eleventh to eighth place (see Appendix B).

2Including all state and local taxes a business may pay, including sales, property, and B&O or income tax as applicable
3Examples: preferential B&O rates, sales and use tax exemptions
4Examples: tax abatements, cash grants
5A firm with 10,000 employees

6A firm with 50 employees

In Washington, statutory incentives reduce the effective tax rate more than negotiated incentives. Other states use more negotiated incentives.

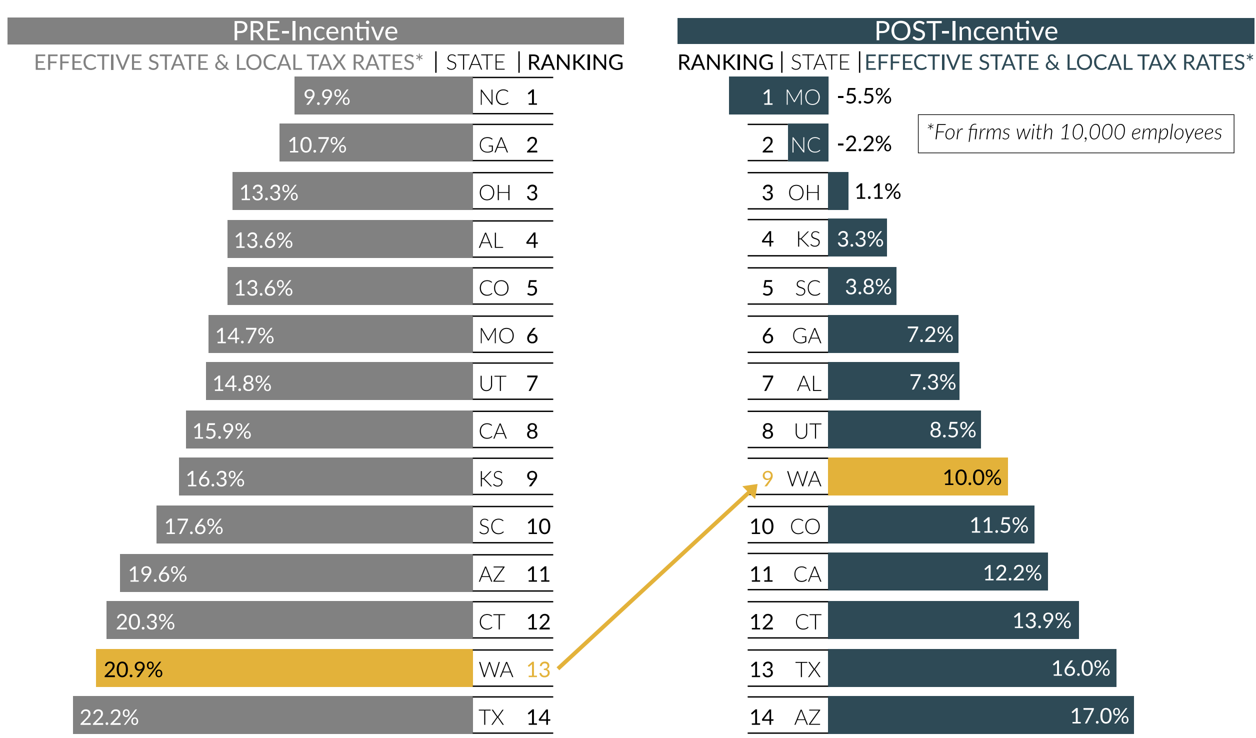
For this study, the effective tax rate (ETR) includes all state and local taxes a business may pay, including sales, property, and B&O or income tax as applicable.

Washington's statutory incentives lower the ETR for large firms by 9.4 percentage points (from 20.9% to 11.5%). Negotiated incentives reduce the ETR another 1.5 percentage points – from 11.5% to 10.0%. Cash grants are prohibited by the state constitution.

Several of the benchmark states offer significant negotiated incentives and cash grants that enhance their competitiveness compared to Washington.

- When only statutory incentives are applied, Washington ranks fourth out of the 14 states for large firms.
- When all types of incentives are considered, Washington places ninth for large firms.

Exhibit 1.2: Washington's tax preferences improve its tax competitiveness



Note: Post-incentive ETR includes statutory incentives, negotiated incentives, and cash grants.
Source: Ernst & Young analysis.

2. Aerospace remains a major Washington industry

Aerospace continues to be a major industry in Washington. However, it is unclear to what extent the preferences influenced location decisions.

Economic and employment data show that the aerospace industry has continued its presence in Washington

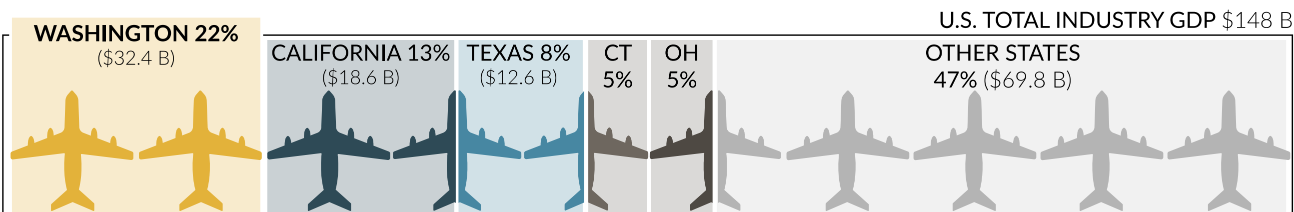
Data from the Bureau of Economic Analysis (BEA) indicates that:

- Nationally, the *Other Transportation Equipment Manufacturing* industry, which includes aerospace, contributed $148 billion to the gross domestic product in 2017. Washington's contribution – $32.4 billion – was 22% of the national total and more than any other state.
- In the 4th quarter of 2018, 198 businesses in the *Aerospace Products and Parts Manufacturing* industry (NAICS 3364) employed 85,900 workers in Washington. Although employment has declined in recent years (see Tab 3), it continues to be larger than in any other state, representing 17% of national industry employment.
- The concentration of aerospace value and jobs in Washington (location quotient)[7] is greater than the national average. In 2017, the value of goods and services made by Washington's *Other Transportation Equipment Manufacturing* industry, as a portion of the state's economy, was 8.2 times greater than the national average. In 2018, the relative concentration of aerospace industry jobs in the state was 7.3 times the national average.

BEA aggregates industries when measuring gross domestic product

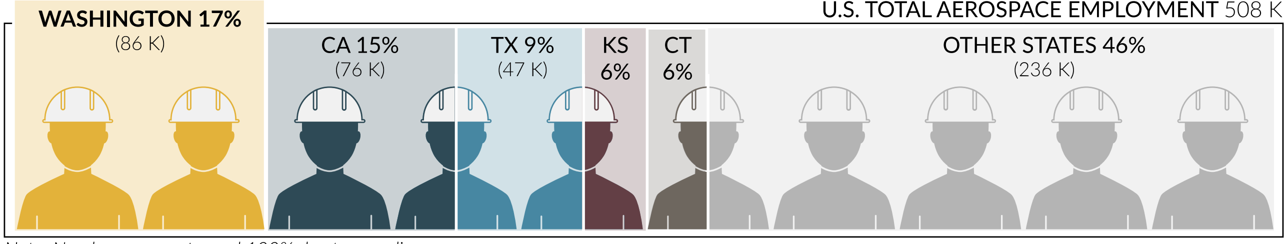
The aerospace industry includes businesses that file taxes under North American Industry Classification System (NAICS) code 3364--**Aerospace Product and Parts Manufacturing.** **Other Transportation Equipment Manufacturing** includes the aerospace NAICS group and three other industry groups related to the manufacture of railroad rolling stock, ships and boats, and other transportation equipment.

Exhibit 2.1: Washington's aerospace industry leads nation in contribution to GDP and industry employment



Note: "Other transportation equipment manufacturing" includes transportation equipment manufacturing excluding motor vehicles.

[7] A location quotient measures the concentration of a given industry in a given place relative to a larger region such as the nation



Note: Numbers may not equal 100% due to rounding.

Source: Bureau of Economic Analysis, Bureau of Labor Statistics.

On average, beneficiaries provide wages and benefits that meet or exceed state averages

The preferences aim to provide "good wages and benefits." Since these terms are not defined, JLARC staff compared wage and benefit data for preference beneficiaries to data from Washington's manufacturing industry in general.

- Washington's average annual wage for manufacturing is just over $76,000. It is $62,000 for all industries.
- Beneficiaries of the aerospace tax preferences reported to the Department of Revenue (DOR) that 72% of their employees earned more than $30 per hour (about $62,000 annually) in 2017, and that more than 90% of employees are enrolled in medical, dental, and retirement plans.
- Employment Security Department (ESD) data shows that between 2016 and 2017, beneficiaries paid employees an average annual wage greater than $100,000.

This data is consistent with information from the Bureau of Labor Statistics (BLS). According to BLS, aerospace industry businesses in Washington paid a total of $9.5 billion in wages in 2017, averaging $114,000 per employee. The average annual wage is the fourth highest of any state in the country for the industry and is above the U.S. average aerospace wage of $101,000.

Exhibit 2.2: Beneficiaries paid employees more than $108,000 per year in 2017

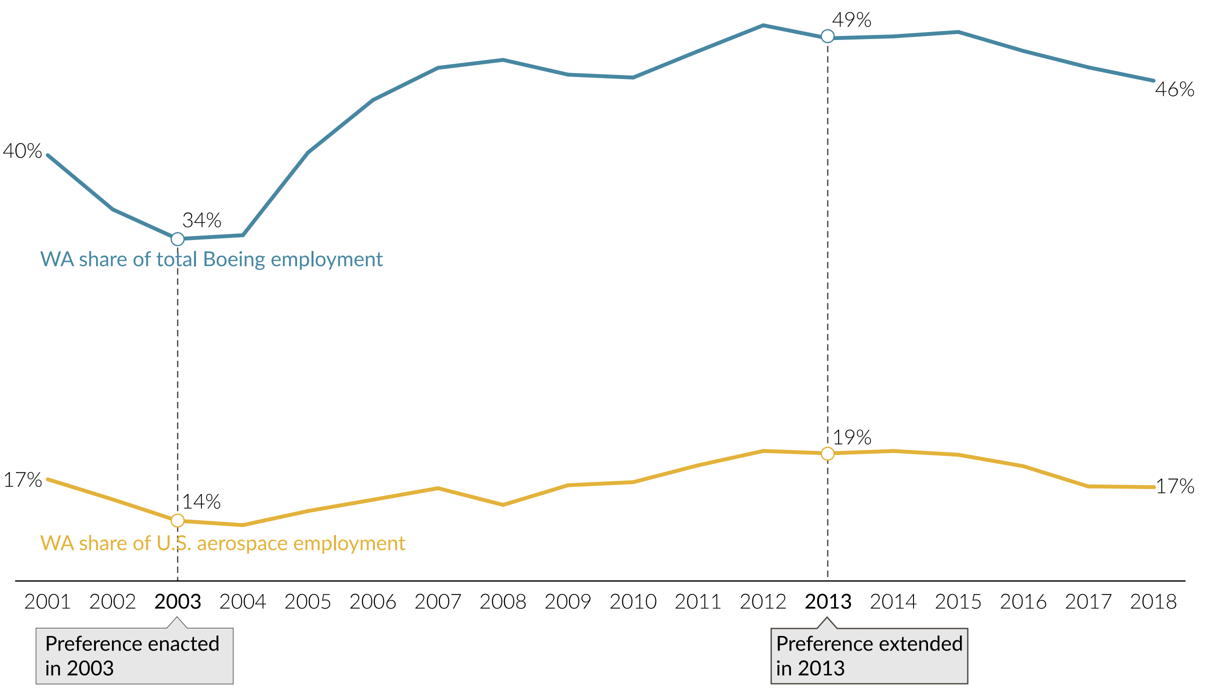
Source: JLARC analysis of ESD Data, DOR Tax Return Data, BLS Quarterly Census of Employment and Wages (QCEW) Data.

Boeing is the largest business in Washington's aerospace industry

Boeing is the largest aerospace business in Washington, and the state's largest private employer. Boeing reported Washington employment at the end of 2018 was 69,800, representing 46% of total company employment, more than in any other state. Boeing estimates its supply chain

network includes 1,500 supplier and vendor businesses in Washington, on which the company reported spending more than $5 billion in 2017.

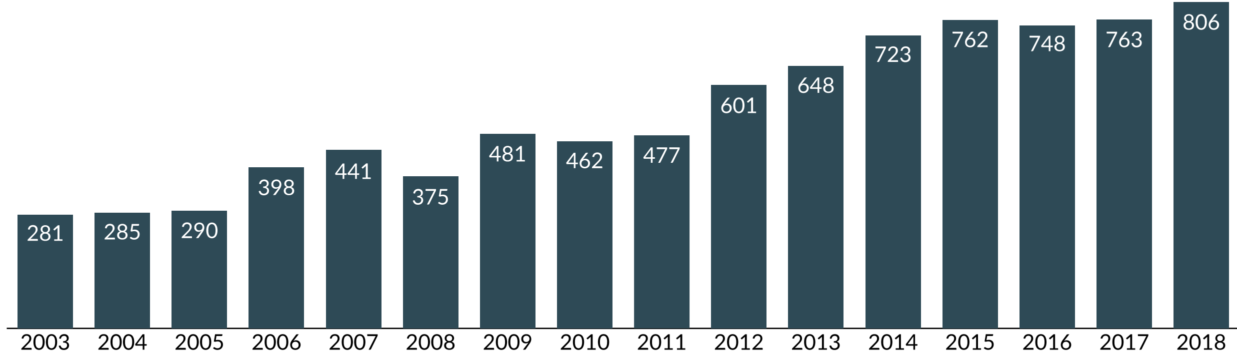
Exhibit 2.3: Washington has the nation's largest share of aerospace and Boeing jobs



Source: Bureau of Labor Statistics and Boeing.

The company's aircraft deliveries have increased since 2013, and Boeing reported delivering a record number of aircraft in 2018. Most of the aircraft were assembled in Washington[8]. Still, airplane orders outpaced deliveries, and Boeing states that its order backlog is more than 5,800 aircraft. The company estimates that this backlog represents seven years of airplane production.

Exhibit 2.4: Boeing airplane deliveries have increased



Source: JLARC representation of Boeing data.

[8]Boeing assembles all 737, 747, 767, 777, and Boeing Business Jets in Washington. It uses two assembly lines for the 787 – one in Everett, Washington, and one in North Charleston, South Carolina.

Industry has met statutory contingencies to locate a manufacturing program in Washington

The 2013 Legislature put two contingencies in the law:

Contingency	Outcome
The preference would not take effect until a significant commercial airplane manufacturing program was located in Washington.	The Department of Revenue (DOR) determined that the contingency was satisfied in 2014 after Boeing located the final assembly of the 777X and its composite wing facility in Everett.
The preferential B&O tax rate ends for the products made at the manufacturing site if DOR determines that any portion of that program has moved outside Washington.	This contingency has not occurred.

Influence of preferences on continued presence of industry unclear

JLARC staff are unable to determine the degree to which the aerospace tax preferences, particularly their 2013 extension and expansion, contributed to the continued presence of the aerospace industry in Washington.

To assess the impact of the preferences on employment and presence in the state, it is necessary to know the extent to which businesses make decisions as a result of the incentive. Boeing's decision to locate final assembly of the 777X and its composite wing facility in Washington ensured that the 2013 extension of tax preferences took effect. However, it is unknown whether the company would have made this location decision even if the preferences had not been extended.

- Research literature and staff interviews with subject matter experts indicate that taxes – and the availability of tax incentives – are just one of many factors that influence business location decisions. Other factors include the quality of transportation infrastructure, labor costs, workforce quality, and the regulatory environment.
- While some literature indicates that tax preferences influence a minority of business location decisions, using such a general assumption is not possible when evaluating an incentive's impact on a single location decision.
- An advisory panel of economic and labor experts convened by JLARC staff agreed with the staff conclusion that it is not feasible to analytically determine whether one factor (e.g., tax incentives) led a single business to make a location decision.

For additional analysis of Boeing's potential location decisions, refer to Tab 4.

3. Jobs above 2003 level, but decline since 2013 highest in the nation

Washington's aerospace employment is higher than when the preferences were first enacted in 2003. However, since 2013, Washington has lost more aerospace jobs than any other state.

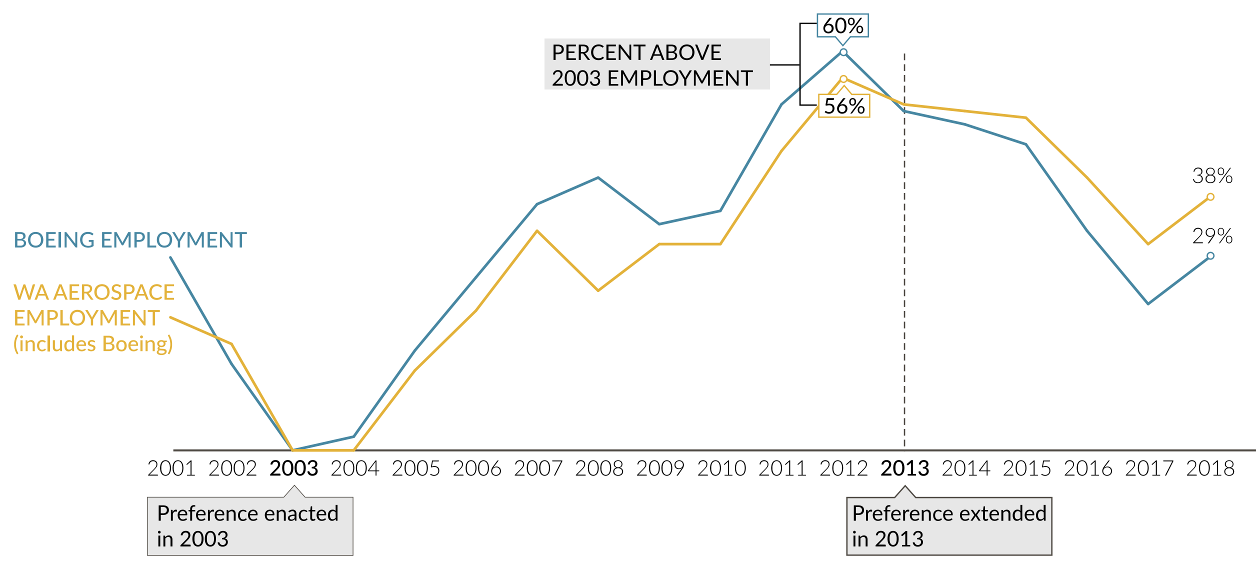
Aerospace industry employment trending down, but still above 2003

Since 2003, when the preferences were first enacted, aerospace industry employment followed two major trends:

1. **Statewide aerospace employment (yellow line) grew from 2003 through 2012.** From 2003 through 2012, Washington aerospace employment increased by 56%, as the state added 34,500 jobs. Of these new jobs, 32,400 were at Boeing, which increased its employment by 60% (blue line).
2. **Employment declined from 2012 through 2018.** From 2012 through 2018, Boeing employment in Washington fell by 16,700. This was partially offset by gains by other aerospace businesses, so Washington's total aerospace employment fell by 10,800.

Despite the decline, statewide aerospace and Boeing employment remained 38% and 29% above 2003 levels, respectively. JLARC staff do not assert a causal relationship between these trends and legislative action to create the preferences in 2003 and extend them in 2013.

Exhibit 3.1: Both Boeing and statewide aerospace employment trending down since 2013, but still above 2003 levels



Source: Bureau of Labor Statistics and Boeing.

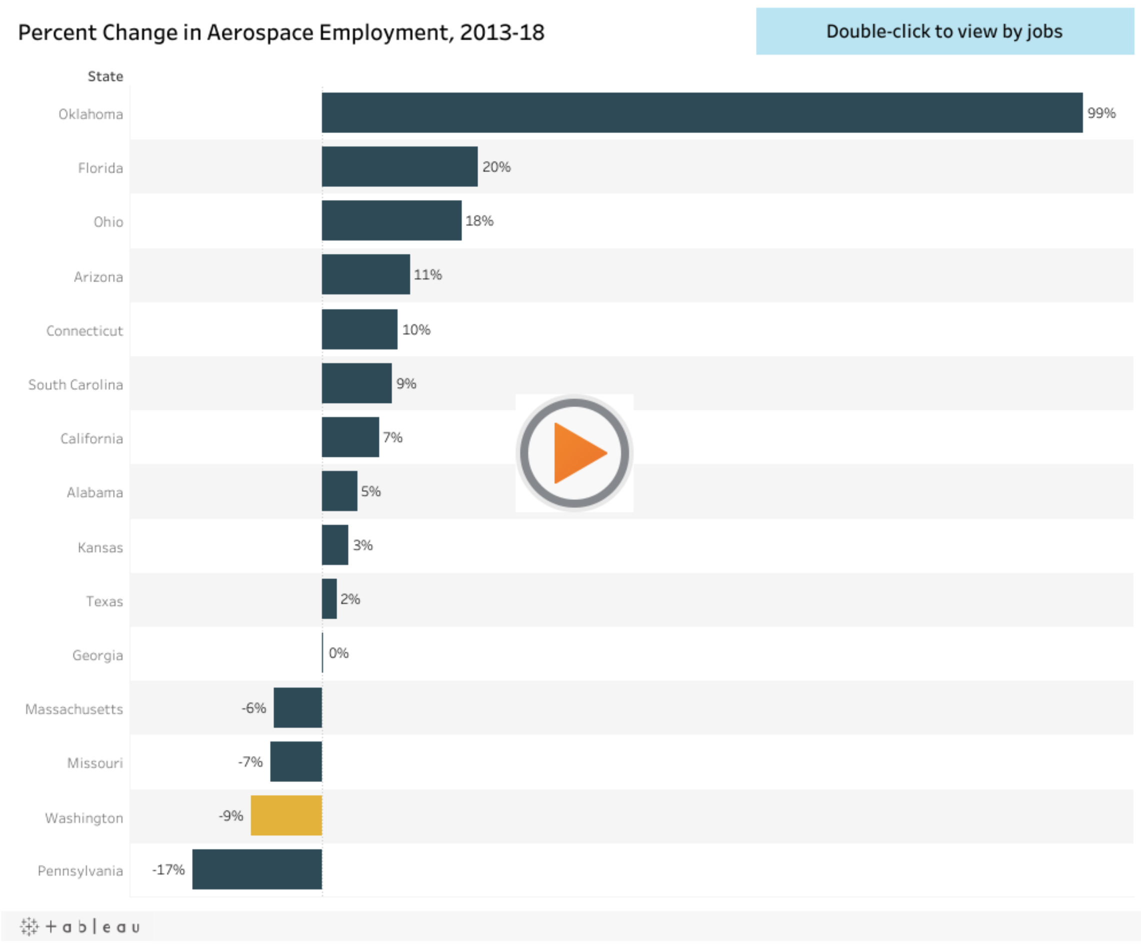
Washington aerospace employment losses since 2013 lead the nation

In 2013 the Legislature extended the aerospace tax preferences with the stated public policy objective to maintain and grow industry employment.

Washington's loss of 8,800 aerospace jobs from 2013 through 2018 was the largest in the U.S. and nearly four times more than in any other state. This represented a 9% decline, the second largest percentage decline among states with at least 10,000 aerospace employees in any year between 2013 and 2018.

- Over the same period, U.S. aerospace employment (excluding Washington) increased 7% or 27,000 jobs. This cut the state's share of total industry employment from 19% to 17%.
- International aerospace employment increased 6% from 2013-17, according to data from Deloitte.

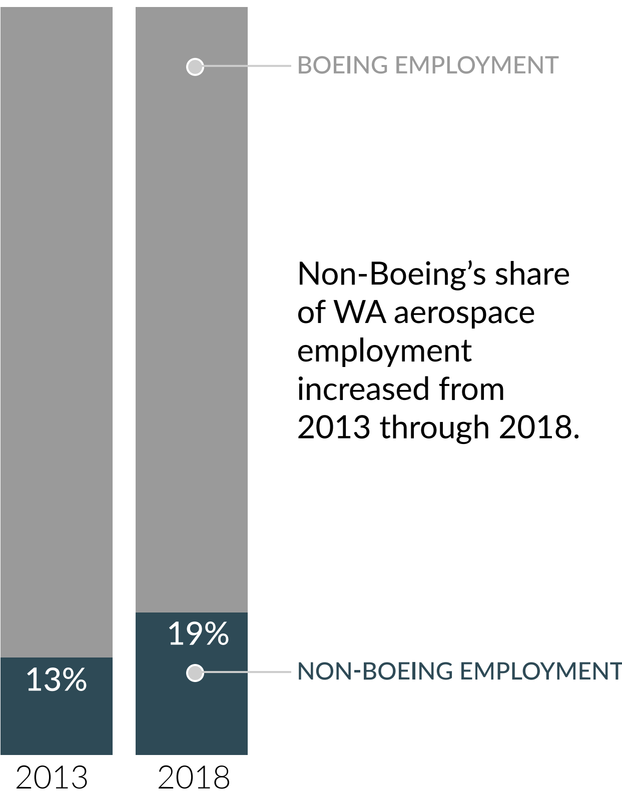
Exhibit 3.2: Washington's aerospace employment decline was the largest among states with a significant aerospace presence



The composition of Washington's aerospace employment has shifted, as non-Boeing employment grew

From 2013 through 2018, Boeing employment fell by 12,100 jobs. During this period, non-Boeing aerospace employment increased by 3,300 jobs. Boeing's share of Washington aerospace employment fell from 87% in 2013 to 81% in 2018.

Exhibit 3.3: Non-Boeing aerospace employment grew, capturing a larger share of thestate's workforce



Source: Bureau of Labor Statistics and Boeing.

Boeing job losses were greater in Washington than in other states.

Boeing's global employment fell by 15,400 from 2013 through 2018, a 9% decline. This decline disproportionately affected Washington, which accounted for 79% of job losses. As a result, the state's share of Boeing employment declined from 49% to 46%.

Boeing's Washington employment rebounded from 2017 to 2018, rising 6% to 69,800. Total company employment also grew in this period, resulting in a 1-percentage-point reduction in Washington's share of company employment.

Non-tax factors contribute to employment changes, but the extent of their effect is unclear

Media coverage of Boeing's wing facility has drawn increased attention to the role of technology and automation in aerospace manufacturing. From 2003 through 2018, Washington's aerospace industry saw increases in both output per employee (i.e., labor productivity) and total employment. Output[9] per employee increased 83% from $565,000 in 2003 to $1,032,000 in 2018, while employment was up 38%.

However, the effect of labor productivity growth on employment is unclear. Some literature points to outsourcing, rather than automation, as a driver of manufacturing employment changes. JLARC staff are unable to quantify the extent to which productivity changes influenced aerospace employment independent of other factors.

[9] Measured as gross business income

It is unclear whether industry employment meets legislative expectations

Without further information about the Legislature's expectations for aerospace industry employment, JLARC staff are unable to determine whether recent changes meet the public policy objective to maintain and grow aerospace industry jobs.

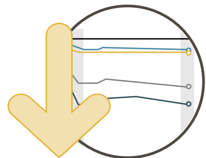
4. Effect of preferences on jobs unclear

If the preferences led Boeing to remain in Washington, they may have kept the state from losing more jobs. If not, they reduced government spending and may have contributed to job losses.

How did extending the preferences affect employment? It depends on whether they influenced Boeing's decision to remain in Washington.

In extending the aerospace tax preferences, the Legislature sought to secure final assembly of the new 777X and the composite wing facility in Washington. As required, Boeing located its new facility in Washington. It is unclear whether Boeing would have made the same decision if the preferences had not been extended. Whether Boeing was influenced by the preferences has direct implications on the effect of the extension on employment.

JLARC staff modeled three hypothetical scenarios of what could have happened if the preferences were not extended. They illustrate a range of potential employment outcomes.



SCENARIO 1

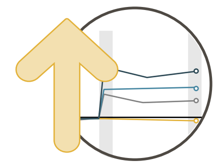
SIMULATED ACTION:
Legislature did not extend preferences in 2013.

POSSIBLE RESPONSE:
Boeing locates 777X production and composite wing facility outside Washington.

SCENARIO 2

SIMULATED ACTION:
Legislature did not extend preferences in 2013.

POSSIBLE RESPONSE:
Boeing locates 777X production and subsequent generations of airplanes outside Washington.



SCENARIO 3

SIMULATED ACTION:
Legislature did not extend preferences in 2013.

POSSIBLE RESPONSE:
Boeing sites 777X production in Washington despite the preferences not being expanded and extended.

JLARC staff used REMI[10] to model three hypothetical scenarios that illustrate the range of what could have happened if the Legislature had not extended the preferences in 2013. JLARC staff developed assumptions based on discussions with an advisory group, testimony in support of the 2013 legislation extending the preferences, and estimates of Boeing's direct 777 workforce. Because REMI is calibrated to Washington's economy in 2016, the first year of the analysis is 2017.

JLARC staff are not able to determine the likelihood that any of these scenarios would have occurred absent the extension of the tax preferences, or whether one is more likely to have occurred than another. They serve to illustrate the range of potential outcomes and the large employment multiplier of aerospace jobs in Washington's economy.

Appendix D provides additional detail about the REMI analysis.

Reading the results of the economic analysis

Model results are presented as jobs potentially lost or gained as a result of Boeing's decisions in the event the preferences had not been extended.

- Total jobs includes jobs in three categories: "State and Local Government," "Aerospace Products and Parts Manufacturing," and "Private Nonfarm (Excluding Aerospace)."

The job numbers include direct, indirect, and induced jobs. See Appendix C for explanations of these terms.

If the preferences led to Boeing's location decision, they may have prevented greater job losses

Aerospace employment has decreased since 2013 when the preferences were extended (Tab 3). However, scenarios 1 and 2 model the removal of additional aerospace jobs to simulate Boeing's decision to move airplane production out of state. The decline in aerospace jobs leads to a much larger drop in private sector employment, due to the high multiplier effect of aerospace jobs.

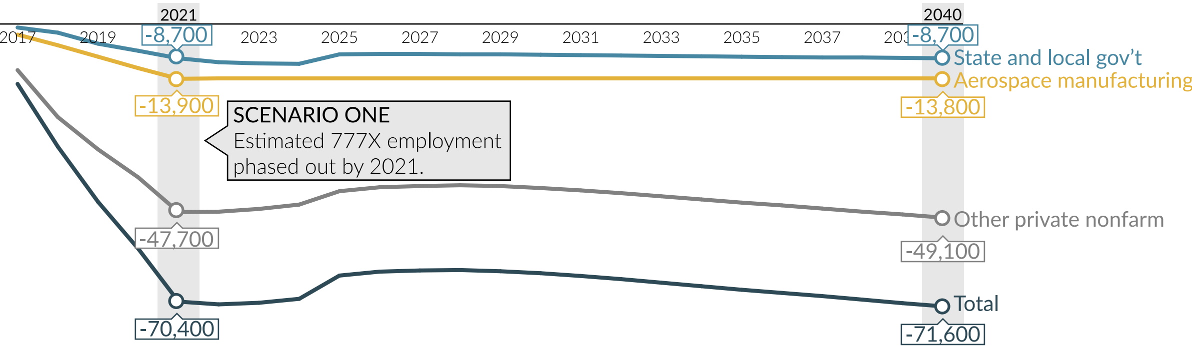
- In the REMI model, aerospace jobs have a multiplier of over 4, meaning that for every aerospace job lost, an additional four jobs are lost economy-wide.
- The high multiplier stems from the industry's high wages (e.g., supporting jobs in retail or construction) and from the number of industries in Washington that supply goods and services to the aerospace industry (e.g., engineering services and machine shops).

[10] The Regional Economic Models, Inc. (REMI) model can be used to estimate the effects of a policy change

Scenario 1: Boeing locates 777X production and the composite wing facility outside Washington. Boeing's decision to move the 777X out of state has no bearing on location decisions for future aircraft lines.

Assumptions	The preferences were not extended, and as a result: • Boeing moves 12,100 employees[11] out of state over five years as 777X production ramps up and production of the old model is phased out. • Boeing builds the composite wing facility outside Washington, and the state forgoes the benefits of $1 billion in construction and 500 jobs at the wing facility. • State government spending increases beginning in 2025 due to higher tax revenue as the preferences expire. Beneficiary production costs are increased by the same amount.
Results	The hypothetical loss of the 777X production line results in the loss of 70,400 jobs statewide by 2021 (estimated). Employment rebounds slightly when the original preferences expire in 2025, resulting in an increase in revenue collection and government spending. By 2040, REMI estimates total job losses of 71,600.

Exhibit 4.1: Scenario 1 shows a hypothetical loss of 12,100 Boeing jobs linked to 777X production could have resulted in loss of an estimated 71,600 jobs statewide



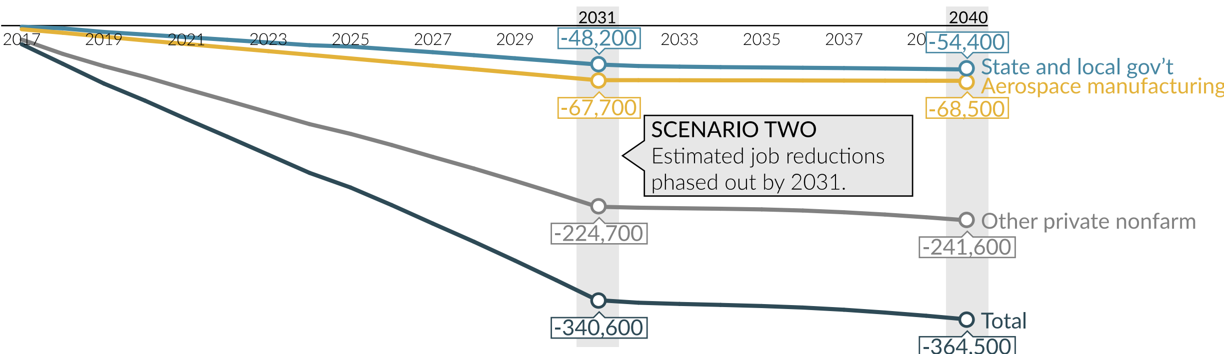
Source: JLARC staff analysis using REMI.

[11] Estimated 777X workforce

Scenario 2: Boeing locates 777X production and subsequent generations of airplanes outside Washington.

Assumptions	The preferences were not extended, and as a result: • Boeing moves 80%[12] of its workforce (estimated at 60,500 employees) out of state over fifteen years, as all new production lines are sited out of Washington. • Boeing builds the composite wing facility outside Washington, and the state forgoes the benefits of $1 billion in construction and 500 jobs at the wing facility. • State government spending is increased beginning in 2025 due to higher tax revenue as the preferences expire. Beneficiary production costs are increased by the same amount.
Results	The hypothetical loss of Boeing jobs results in the loss of 340,600 jobs statewide by 2031 (estimated). Total job losses reach an estimated 364,500 by 2040.

Exhibit 4.2: Scenario 2 shows a hypothetical loss of 80% of Boeing jobs for new production lines could have resulted in loss of an estimated 364,500 jobs statewide



Source: JLARC staff analysis using REMI.

If the location decision happened regardless of the preferences, then they reduced overall statewide employment after 2025

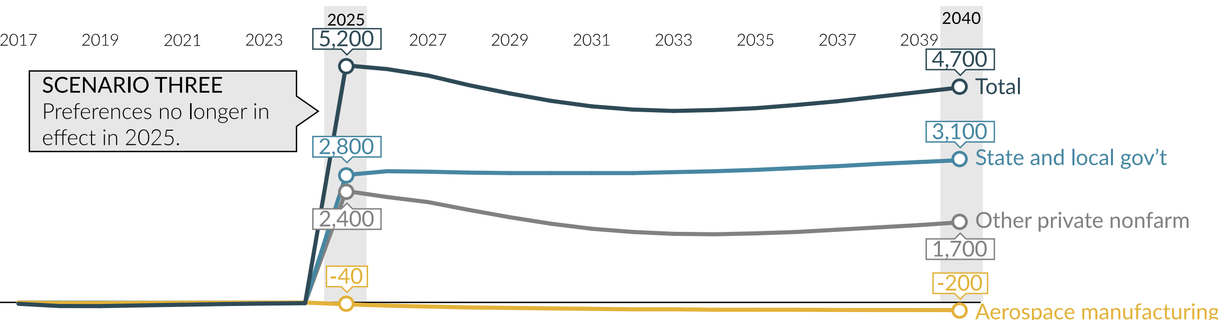
Scenario 3, models the effect if Boeing built the 777X and composite wing facility in Washington without the tax preferences. The implicit assumption is that the preferences – if passed – would have had no effect on the company's decision.

[12]This scenario was considered by the Office of Financial Management (OFM) in its analysis for the 2003 aerospace tax preferences and was included in JLARC's 2014 report on the preferences.

Scenario 3: Boeing sites 777X production in Washington despite the preferences not being expanded and extended.

Assumptions	The preferences were not extended. Boeing builds the 777X in Everett without them, and as a result: • Government spending is increased beginning in 2025, as the expiration of the preferences leads to higher tax receipts. • Beneficiary production costs are increased by the same amount as the additional tax revenue. • Employment and capital expenditures are unchanged from the baseline. However, the capital expenditure is subject to sales and use tax, as this expenditure would not have qualified for the exemption absent the 2013 expansion.
Results	The impacts to employment result from the non-expansion and subsequent expiration of the preferences: • Absent the expansion of the sales and use tax exemption for airplane manufacturing facilities, the tax due on the composite wing facility's construction is estimated to contribute to a small employment decline in the early years of the forecast. • Higher production costs due to the expiration of tax savings result in a drop in aerospace employment beginning in 2025, with the decrease reaching 200 by 2040. • Statewide employment is largely unchanged from the baseline until 2025, when the preferences' expiration increases government spending by an amount equal to estimated beneficiary savings. All of these effects net to an estimated 4,700 job increase by 2040.

Exhibit 4.3: Scenario 3 indicates if 777X siting would have happened without tax preferences, increase in government spending could have offset minor aerospace job losses



Source: JLARC staff analysis using REMI.

The Legislative Auditor cannot determine if the preferences maintained or grew aerospace employment

Since there is uncertainty as to how the preferences influenced Boeing's facility location decision, it is not possible to draw a definitive conclusion about whether the preferences resulted in maintaining or growing employment.

Section 5: Applicable Statutes

The aerospace tax preferences are codified in several sections of statute

If only selected language in a section of law is relevant, that relevant language is highlighted.

Certified Aircraft Repair Firms - Preferential Rate (B&O Tax)

RCW 82.04.250

Tax on Retailers

(1) Upon every person engaging within this state in the business of making sales at retail, except persons taxable as retailers under other provisions of this chapter, as to such persons, the amount of tax with respect to such business is equal to the gross proceeds of sales of the business, multiplied by the rate of 0.471 percent.

(2) Upon every person engaging within this state in the business of making sales at retail that are exempt from the tax imposed under chapter 82.08 RCW by reason of RCW 82.08.0261, 82.08.0262, or 82.08.0263, except persons taxable under RCW 82.04.260(11) or subsection (3) of this section, as to such persons, the amount of tax with respect to such business is equal to the gross proceeds of sales of the business, multiplied by the rate of 0.484 percent.

(3)(a) Until July 1, 2040, upon every person classified by the federal aviation administration as a federal aviation regulation part 145 certificated repair station and that is engaging within this state in the business of making sales at retail that are exempt from the tax imposed under chapter 82.08 RCW by reason of RCW 82.08.0261, 82.08.0262, or 82.08.0263, as to such persons, the amount of tax with respect to such business is equal to the gross proceeds of sales of the business, multiplied by the rate of .2904 percent.

(b) A person reporting under the tax rate provided in this subsection (3) must file a complete annual report with the department under RCW 82.32.534.

[2014 c 97 § 402; (2014 c 97 § 401 expired July 9, 2014); 2013 3rd sp.s. c 2 § 7; 2010 1st sp.s. c 23 § 509; (2010 1st sp.s. c 23 § 508 expired July 1, 2011); (2010 1st sp.s. c 23 § 507 expired July 13, 2010); 2010 1st sp.s. c 11 § 1; (2010 c 114 § 106 expired July 1, 2011); 2008 c 81 § 5; (2007 c 54 § 5 repealed by 2010 1st sp.s. c 11 § 7); 2006 c 177 § 5; 2003 2nd sp.s. c 1 § 2; (2003 1st sp.s. c 2 § 1 expired July 1, 2006). Prior: 1998 c 343 § 5; 1998 c 312 § 4; 1993 sp.s. c 25 § 103; 1981 c 172 § 2; 1971 ex.s. c 281 § 4; 1971 ex.s. c 186 § 2; 1969 ex.s. c 262 § 35; 1967 ex.s. c 149 § 9; 1961 c 15 § 82.04.250; prior: 1955 c 389 § 45; prior: 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

SELECTED NOTES:

Contingent effective date—2013 3rd sp.s. c 2: See RCW 82.32.850.

Findings—Intent—2013 3rd sp.s. c 2: See note following RCW 82.32.850.

Findings—Savings—Effective date—2008 c 81: See notes following RCW 82.08.975.

Finding—2003 2nd sp.s. c 1: See note following RCW 82.04.4461.

Commercial Airplane Manufacturing - Preferential Rate (B&O Tax)

RCW 82.04.260

Tax on manufacturers and processors of various foods and by-products—Research and development organizations—Travel agents—Certain international activities—Stevedoring and associated activities—Low-level waste disposers—Insurance producers, surplus line brokers, and title insurance agents—Hospitals—Commercial airplane activities—Timber product activities—Canned salmon processors. (*Effective January 1, 2018.*)

*** CHANGE IN 2018 *** (SEE 2580-S.SL) ***

(1) Upon every person engaging within this state in the business of manufacturing:

(a) Wheat into flour, barley into pearl barley, soybeans into soybean oil, canola into canola oil, canola meal, or canola by-products, or sunflower seeds into sunflower oil; as to such persons the amount of tax with respect to such business is equal to the value of the flour, pearl barley, oil, canola meal, or canola by-product manufactured, multiplied by the rate of 0.138 percent;

(b) Beginning July 1, 2025, seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing by that person; or selling manufactured seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing, to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales, multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(c)(i) Except as provided otherwise in (c)(iii) of this subsection, from July 1, 2025, until January 1, 2036, dairy products; or selling dairy products that the person has manufactured to purchasers who either transport in the ordinary course of business the goods out of state or purchasers who use such dairy products as an ingredient or component in the manufacturing of a dairy product; as to such persons the tax imposed is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state or sold to a manufacturer for use as an ingredient or component in the manufacturing of a dairy product. (ii) For the purposes of this subsection (1)(c), "dairy products" means: (A) Products, not including any marijuana-infused product, that as of September 20, 2001, are identified in 21

C.F.R., chapter 1, parts 131, 133, and 135, including by-products from the manufacturing of the dairy products, such as whey and casein; and (B) Products comprised of not less than seventy percent dairy products that qualify under (c)(ii)(A) of this subsection, measured by weight or volume. (iii) The preferential tax rate provided to taxpayers under this subsection (1)(c) does not apply to sales of dairy products on or after July 1, 2023, where a dairy product is used by the purchaser as an ingredient or component in the manufacturing in Washington of a dairy product;

(d)(i) Beginning July 1, 2025, fruits or vegetables by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables, or selling at wholesale fruits or vegetables manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state. (ii) For purposes of this subsection (1)(d), "fruits" and "vegetables" do not include marijuana, useable marijuana, or marijuana-infused products;

(e) Until July 1, 2009, alcohol fuel, biodiesel fuel, or biodiesel feedstock, as those terms are defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of alcohol fuel, biodiesel fuel, or biodiesel feedstock manufactured, multiplied by the rate of 0.138 percent; and

(f) Wood biomass fuel as defined in RCW 82.29A.135; as to such persons the amount of tax with respect to the business is equal to the value of wood biomass fuel manufactured, multiplied by the rate of 0.138 percent.

(2) Upon every person engaging within this state in the business of splitting or processing dried peas; as to such persons the amount of tax with respect to such business is equal to the value of the peas split or processed, multiplied by the rate of 0.138 percent.

(3) Upon every nonprofit corporation and nonprofit association engaging within this state in research and development, as to such corporations and associations, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(4) Upon every person engaging within this state in the business of slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale only and not at retail; as to such persons the tax imposed is equal to the gross proceeds derived from such sales multiplied by the rate of 0.138 percent.

(5) Upon every person engaging within this state in the business of acting as a travel agent or tour operator; as to such persons the amount of the tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(6) Upon every person engaging within this state in business as an international steamship agent, international customs house broker, international freight forwarder, vessel and/or cargo charter broker in foreign commerce, and/or international air cargo agent; as to such persons the amount of the tax with respect to only international activities is equal to the gross income derived from such activities multiplied by the rate of 0.275 percent.

(7) Upon every person engaging within this state in the business of stevedoring and associated activities pertinent to the movement of goods and commodities in waterborne interstate or foreign commerce; as to such persons the amount of tax with respect to such business is equal to the gross proceeds derived from such activities multiplied by the rate of 0.275 percent. Persons subject to taxation under this subsection are exempt from payment of taxes imposed by chapter 82.16 RCW for that portion of their business subject to taxation under this subsection. Stevedoring and associated activities pertinent to the conduct of goods and commodities in waterborne interstate or foreign commerce are defined as all activities of a labor, service or transportation nature whereby cargo may be loaded or unloaded to or from vessels or barges, passing over, onto or under a wharf, pier, or similar structure; cargo may be moved to a warehouse or similar holding or storage yard or area to await further movement in import or export or may move to a consolidation freight station and be stuffed, unstuffed, containerized, separated or otherwise segregated or aggregated for delivery or loaded on any mode of transportation for delivery to its consignee. Specific activities included in this definition are: Wharfage, handling, loading, unloading, moving of cargo to a convenient place of delivery to the consignee or a convenient place for further movement to export mode; documentation services in connection with the receipt, delivery, checking, care, custody and control of cargo required in the transfer of cargo; imported automobile handling prior to delivery to consignee; terminal stevedoring and incidental vessel services, including but not limited to plugging and unplugging refrigerator service to containers, trailers, and other refrigerated cargo receptacles, and securing ship hatch covers.

(8)(a) Upon every person engaging within this state in the business of disposing of low-level waste, as defined in RCW 43.145.010; as to such persons the amount of the tax with respect to such business is equal to the gross income of the business, excluding any fees imposed under chapter 43.200 RCW, multiplied by the rate of 3.3 percent.

(b) If the gross income of the taxpayer is attributable to activities both within and without this state, the gross income attributable to this state must be determined in accordance with the methods of apportionment required under RCW 82.04.460.

(9) Upon every person engaging within this state as an insurance producer or title insurance agent licensed under chapter 48.17 RCW or a surplus line broker licensed under chapter 48.15 RCW; as to such persons, the amount of the tax with respect to such licensed activities is equal to the gross income of such business multiplied by the rate of 0.484 percent.

(10) Upon every person engaging within this state in business as a hospital, as defined in chapter 70.41 RCW, that is operated as a nonprofit corporation or by the state or any of its political subdivisions, as to such persons, the amount of tax with respect to such activities is equal to the gross income of the business multiplied by the rate of 0.75 percent through June 30, 1995, and 1.5 percent thereafter.

(11)(a) Beginning October 1, 2005, upon every person engaging within this state in the business of manufacturing commercial airplanes, or components of such airplanes, or making sales, at retail or wholesale, of commercial airplanes or components of such airplanes, manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of: (i) 0.4235 percent from October 1, 2005, through June 30, 2007; and (ii) 0.2904 percent beginning July 1, 2007.

(b) Beginning July 1, 2008, upon every person who is not eligible to report under the provisions of (a) of this subsection (11) and is engaging within this state in the business of manufacturing tooling specifically designed for use in manufacturing commercial airplanes or components of such airplanes, or making sales, at retail or wholesale, of such tooling manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, be equal to the gross income of the business, multiplied by the rate of 0.2904 percent.

(c) For the purposes of this subsection (11), "commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(d) In addition to all other requirements under this title, a person reporting under the tax rate provided in this subsection (11) must file a complete annual tax performance report with the department under RCW 82.32.534.

(e)(i) Except as provided in (e)(ii) of this subsection (11), this subsection (11) does not apply on and after July 1, 2040. (ii) With respect to the manufacturing of commercial airplanes or making sales, at retail or wholesale, of commercial airplanes, this subsection (11) does not apply on and after July 1st of the year in which the department makes a determination that any final assembly or wing assembly of any version or variant of a commercial airplane that is the basis of a siting of a significant commercial airplane manufacturing program in the state under RCW 82.32.850 has been sited outside the state of Washington. This subsection (11)(e)(ii) only applies to the manufacturing or sale of commercial airplanes that are the basis of a siting of a significant commercial airplane manufacturing program in the state under RCW 82.32.850.

(12)(a) Until July 1, 2024, upon every person engaging within this state in the business of extracting timber or extracting for hire timber; as to such persons the amount of tax with respect to the business is, in the case of extractors, equal to the value of products, including by-products, extracted, or in the case of extractors for hire, equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(b) Until July 1, 2024, upon every person engaging within this state in the business of manufacturing or processing for hire: (i) Timber into timber products or wood products; or (ii) timber products into other timber products or wood products; as to such persons the amount of the tax with respect to the business is, in the case of manufacturers, equal to the value of products, including by-products, manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(c) Until July 1, 2024, upon every person engaging within this state in the business of selling at wholesale: (i) Timber extracted by that person; (ii) timber products manufactured by that person from timber or other timber products; or (iii) wood products manufactured by that person from timber or timber products; as to such persons the amount of the tax with respect to the business is equal to the gross proceeds of sales of the timber, timber products, or wood products multiplied by the rate of 0.4235 percent from July 1, 2006, through June 30, 2007, and 0.2904 percent from July 1, 2007, through June 30, 2024.

(d) Until July 1, 2024, upon every person engaging within this state in the business of selling standing timber; as to such persons the amount of the tax with respect to the business is equal to the gross income of the business multiplied by the rate of 0.2904 percent. For purposes of

this subsection (12)(d), "selling standing timber" means the sale of timber apart from the land, where the buyer is required to sever the timber within thirty months from the date of the original contract, regardless of the method of payment for the timber and whether title to the timber transfers before, upon, or after severance.

(e) For purposes of this subsection, the following definitions apply: (i) "Biocomposite surface products" means surface material products containing, by weight or volume, more than fifty percent recycled paper and that also use nonpetroleum-based phenolic resin as a bonding agent. (ii) "Paper and paper products" means products made of interwoven cellulosic fibers held together largely by hydrogen bonding. "Paper and paper products" includes newsprint; office, printing, fine, and pressure-sensitive papers; paper napkins, towels, and toilet tissue; kraft bag, construction, and other kraft industrial papers; paperboard, liquid packaging containers, containerboard, corrugated, and solid-fiber containers including linerboard and corrugated medium; and related types of cellulosic products containing primarily, by weight or volume, cellulosic materials. "Paper and paper products" does not include books, newspapers, magazines, periodicals, and other printed publications, advertising materials, calendars, and similar types of printed materials. (iii) "Recycled paper" means paper and paper products having fifty percent or more of their fiber content that comes from postconsumer waste. For purposes of this subsection (12)(e)(iii), "postconsumer waste" means a finished material that would normally be disposed of as solid waste, having completed its life cycle as a consumer item. (iv) "Timber" means forest trees, standing or down, on privately or publicly owned land. "Timber" does not include Christmas trees that are cultivated by agricultural methods or short-rotation hardwoods as defined in RCW 84.33.035. (v) "Timber products" means: (A) Logs, wood chips, sawdust, wood waste, and similar products obtained wholly from the processing of timber, short-rotation hardwoods as defined in RCW 84.33.035, or both; (B) Pulp, including market pulp and pulp derived from recovered paper or paper products; and (C) Recycled paper, but only when used in the manufacture of biocomposite surface products. (vi) "Wood products" means paper and paper products; dimensional lumber; engineered wood products such as particleboard, oriented strand board, medium density fiberboard, and plywood; wood doors; wood windows; and biocomposite surface products.

(f) Except for small harvesters as defined in RCW 84.33.035, a person reporting under the tax rate provided in this subsection (12) must file a complete annual tax performance report with the department under RCW 82.32.534.

(13) Upon every person engaging within this state in inspecting, testing, labeling, and storing canned salmon owned by another person, as to such persons, the amount of tax with respect to such activities is equal to the gross income derived from such activities multiplied by the rate of 0.484 percent.

(14)(a) Upon every person engaging within this state in the business of printing a newspaper, publishing a newspaper, or both, the amount of tax on such business is equal to the gross income of the business multiplied by the rate of 0.35 percent until July 1, 2024, and 0.484 percent thereafter.

(b) A person reporting under the tax rate provided in this subsection (14) must file a complete annual tax performance report with the department under RCW 82.32.534.

[2018 c 164 § 3; 2017 c 135 § 11. Prior: 2015 3rd sp.s. c 6 § 602; 2015 3rd sp.s. c 6 § 205; prior: 2014 c 140 § 6; (2014 c 140 § 5 expired July 1, 2015); 2014 c 140 § 4; (2014 c 140 § 3 expired July 1, 2015); 2013 3rd sp.s. c 2 § 6; (2013 3rd sp.s. c 2 § 5 expired July 1, 2015); 2013

2nd sp.s. c 13 § 203; (2013 2nd sp.s. c 13 § 202 expired July 1, 2015); prior: (2012 2nd sp.s. c 6 § 602 expired July 1, 2015); 2012 2nd sp.s. c 6 § 204; 2011 c 2 § 203 (Initiative Measure No. 1107, approved November 2, 2010); 2010 1st sp.s. c 23 § 506; (2010 1st sp.s. c 23 § 505 expired June 10, 2010); 2010 c 114 § 107; prior: 2009 c 479 § 64; 2009 c 461 § 1; 2009 c 162 § 34; prior: 2008 c 296 § 1; 2008 c 217 § 100; 2008 c 81 § 4; prior: 2007 c 54 § 6; 2007 c 48 § 2; prior: 2006 c 354 § 4; 2006 c 300 § 1; prior: 2005 c 513 § 2; 2005 c 443 § 4; prior: 2003 2nd sp.s. c 1 § 4; 2003 2nd sp.s. c 1 § 3; 2003 c 339 § 11; 2003 c 261 § 11; 2001 2nd sp.s. c 25 § 2; prior: 1998 c 312 § 5; 1998 c 311 § 2; prior: 1998 c 170 § 4; 1996 c 148 § 2; 1996 c 115 § 1; prior: 1995 2nd sp.s. c 12 § 1; 1995 2nd sp.s. c 6 § 1; 1993 sp.s. c 25 § 104; 1993 c 492 § 304; 1991 c 272 § 15; 1990 c 21 § 2; 1987 c 139 § 1; prior: 1985 c 471 § 1; 1985 c 135 § 2; 1983 2nd ex.s. c 3 § 5; prior: 1983 1st ex.s. c 66 § 4; 1983 1st ex.s. c 55 § 4; 1982 2nd ex.s. c 13 § 1; 1982 c 10 § 16; prior: 1981 c 178 § 1; 1981 c 172 § 3; 1979 ex.s. c 196 § 2; 1975 1st ex.s. c 291 § 7; 1971 ex.s. c 281 § 5; 1971 ex.s. c 186 § 3; 1969 ex.s. c 262 § 36; 1967 ex.s. c 149 § 10; 1965 ex.s. c 173 § 6; 1961 c 15 § 82.04.260; prior: 1959 c 211 § 2; 1955 c 389 § 46; prior: 1953 c 91 § 4; 1951 2nd ex.s. c 28 § 4; 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

SELECTED NOTES:

Contingent effective date—2013 3rd sp.s. c 2: See RCW 82.32.850.

Findings—Intent—2013 3rd sp.s. c 2: See note following RCW 82.32.850.

Findings—Savings—Effective date—2008 c 81: See notes following RCW 82.08.975.

Finding—2003 2nd sp.s. c 1: See note following RCW 82.04.4461.

Aerospace Product Development - Preferential Rate (B&O Tax)

RCW 82.04.290

Tax on international investment management services or other business or service activities.

(1) Upon every person engaging within this state in the business of providing international investment management services, as to such persons, the amount of tax with respect to such business is equal to the gross income or gross proceeds of sales of the business multiplied by a rate of 0.275 percent.

(2)(a) Upon every person engaging within this state in any business activity other than or in addition to an activity taxed explicitly under another section in this chapter or subsection (1) or (3) of this section; as to such persons the amount of tax on account of such activities is equal to the gross income of the business multiplied by the rate of 1.5 percent.

(b) This subsection (2) includes, among others, and without limiting the scope hereof (whether or not title to materials used in the performance of such business passes to another by accession, confusion or other than by outright sale), persons engaged in the business of rendering any type of service which does not constitute a "sale at retail" or a "sale at wholesale." The value of advertising, demonstration, and promotional supplies and materials furnished to an agent by his or her principal or supplier to be used for informational, educational, and promotional purposes is

not considered a part of the agent's remuneration or commission and is not subject to taxation under this section.

(3)(a) Until July 1, 2040, upon every person engaging within this state in the business of performing aerospace product development for others, as to such persons, the amount of tax with respect to such business is equal to the gross income of the business multiplied by a rate of 0.9 percent.

(b) A person reporting under the tax rate provided in this subsection (3) must file a complete annual report with the department under RCW 82.32.534.

(c) "Aerospace product development" has the meaning as provided in RCW 82.04.4461.

[2014 c 97 § 404; (2014 c 97 § 403 expired July 9, 2014); 2013 3rd sp.s. c 2 § 8; 2013 c 23 § 314; 2011 c 174 § 101; 2008 c 81 § 6; 2005 c 369 § 8; 2004 c 174 § 2; 2003 c 343 § 2; 2001 1st sp.s. c 9 § 6; (2001 1st sp.s. c 9 § 4 expired July 1, 2001). Prior: 1998 c 343 § 4; 1998 c 331 § 2; 1998 c 312 § 8; 1998 c 308 § 5; 1998 c 308 § 4; 1997 c 7 § 2; 1996 c 1 § 2; 1995 c 229 § 3; 1993 sp.s. c 25 § 203; 1985 c 32 § 3; 1983 2nd ex.s. c 3 § 2; 1983 c 9 § 2; 1983 c 3 § 212; 1971 ex.s. c 281 § 8; 1970 ex.s. c 65 § 4; 1969 ex.s. c 262 § 39; 1967 ex.s. c 149 § 14; 1963 ex.s. c 28 § 2; 1961 c 15 § 82.04.290; prior: 1959 ex.s. c 5 § 5; 1955 c 389 § 49; prior: 1953 c 195 § 2; 1950 ex.s. c 5 § 1, part; 1949 c 228 § 1, part; 1943 c 156 § 1, part; 1941 c 178 § 1, part; 1939 c 225 § 1, part; 1937 c 227 § 1, part; 1935 c 180 § 4, part; Rem. Supp. 1949 § 8370-4, part.]

SELECTED NOTES:

Contingent expiration date—2014 c 97 §§ 401 and 403: See note following RCW 82.04.250.

Contingent effective date—2013 3rd sp.s. c 2: See RCW 82.32.850.

Findings—Intent—2013 3rd sp.s. c 2: See note following RCW 82.32.850.

Findings—Savings—Effective date—2008 c 81: See notes following RCW 82.08.975.

Aerospace Product Development Expenditures - Credit (B&O Tax)

RCW 82.04.4461

Credit—Preproduction development expenditures. (*Effective January 1, 2018, until July 1, 2040.*)

(1)(a)(i) In computing the tax imposed under this chapter, a credit is allowed for each person for qualified aerospace product development. For a person who is a manufacturer or processor for hire of commercial airplanes or components of such airplanes, credit may be earned for expenditures occurring after December 1, 2003. For all other persons, credit may be earned only for expenditures occurring after June 30, 2008.(ii) For purposes of this subsection, "commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(b) Before July 1, 2005, any credits earned under this section must be accrued and carried forward and may not be used until July 1, 2005. These carryover credits may be used at any time thereafter, and may be carried over until used. Refunds may not be granted in the place of a credit.

(2) The credit is equal to the amount of qualified aerospace product development expenditures of a person, multiplied by the rate of 1.5 percent.

(3) Except as provided in subsection (1)(b) of this section the credit must be claimed against taxes due for the same calendar year in which the qualified aerospace product development expenditures are incurred. Credit earned on or after July 1, 2005, may not be carried over. The credit for each calendar year may not exceed the amount of tax otherwise due under this chapter for the calendar year. Refunds may not be granted in the place of a credit.

(4) Any person claiming the credit must file a form prescribed by the department that must include the amount of the credit claimed, an estimate of the anticipated aerospace product development expenditures during the calendar year for which the credit is claimed, an estimate of the taxable amount during the calendar year for which the credit is claimed, and such additional information as the department may prescribe.

(5) The definitions in this subsection apply throughout this section.(a) "Aerospace product" has the meaning given in RCW 82.08.975.(b) "Aerospace product development" means research, design, and engineering activities performed in relation to the development of an aerospace product or of a product line, model, or model derivative of an aerospace product, including prototype development, testing, and certification. The term includes the discovery of technological information, the translating of technological information into new or improved products, processes, techniques, formulas, or inventions, and the adaptation of existing products and models into new products or new models, or derivatives of products or models. The term does not include manufacturing activities or other production-oriented activities, however the term does include tool design and engineering design for the manufacturing process. The term does not include surveys and studies, social science and humanities research, market research or testing, quality control, sale promotion and service, computer software developed for internal use, and research in areas such as improved style, taste, and seasonal design.(c) "Qualified aerospace product development" means aerospace product development performed within this state.(d) "Qualified aerospace product development expenditures" means operating expenses, including wages, compensation of a proprietor or a partner in a partnership as determined by the department, benefits, supplies, and computer expenses, directly incurred in qualified aerospace product development by a person claiming the credit provided in this section. The term does not include amounts paid to a person or to the state and any of its departments and institutions, other than a public educational or research institution to conduct qualified aerospace product development. The term does not include capital costs and overhead, such as expenses for land, structures, or depreciable property.(e) "Taxable amount" means the taxable amount subject to the tax imposed in this chapter required to be reported on the person's tax returns during the year in which the credit is claimed, less any taxable amount for which a credit is allowed under RCW 82.04.440.

(6) In addition to all other requirements under this title, a person claiming the credit under this section must file a complete annual tax performance report with the department under RCW 82.32.534.

(7) Credit may not be claimed for expenditures for which a credit is claimed under *RCW 82.04.4452.

(8) This section expires July 1, 2040.

[2017 c 135 § 15; 2013 3rd sp.s. c 2 § 9; 2010 c 114 § 115; 2008 c 81 § 7; 2007 c 54 § 11; 2003 2nd sp.s. c 1 § 7.]

SELECTED NOTES:

Contingent effective date—2013 3rd sp.s. c 2: See RCW 82.32.850.

Findings—Intent—2013 3rd sp.s. c 2: See note following RCW 82.32.850.

Findings—Savings—Effective date—2008 c 81: See notes following RCW 82.08.975.

Finding—2003 2nd sp.s. c 1: "The legislature finds that the people of the state have benefited from the presence of the aerospace industry in Washington state. The aerospace industry provides good wages and benefits for the thousands of engineers, mechanics, and support staff working directly in the industry throughout the state. The suppliers and vendors that support the aerospace industry in turn provide a range of jobs. The legislature declares that it is in the public interest to encourage the continued presence of this industry through the provision of tax incentives. The comprehensive tax incentives in this act address the cost of doing business in Washington state compared to locations in other states." [2003 2nd sp.s. c 1 § 1.]

Commercial Airplane Manufacturing - Credit for Taxes Paid (B&O Tax)

RCW 82.04.4463

Credit—Property and leasehold taxes paid on property used for manufacture of commercial airplanes. (*Effective January 1, 2018, until July 1, 2040.*)

(1) In computing the tax imposed under this chapter, a credit is allowed for property taxes and leasehold excise taxes paid during the calendar year.

(2) The credit is equal to:

(a)(i)(A) Property taxes paid on buildings, and land upon which the buildings are located, constructed after December 1, 2003, and used exclusively in manufacturing commercial airplanes or components of such airplanes; and (B) Leasehold excise taxes paid with respect to buildings constructed after January 1, 2006, the land upon which the buildings are located, or both, if the buildings are used exclusively in manufacturing commercial airplanes or components of such airplanes; and(C) Property taxes or leasehold excise taxes paid on, or with respect to, buildings constructed after June 30, 2008, the land upon which the buildings are located, or both, and used exclusively for aerospace product development, manufacturing tooling specifically designed for use in manufacturing commercial airplanes or their components, or in providing aerospace services, by persons not within the scope of (a)(i)(A) and (B) of this subsection (2) and are taxable under RCW 82.04.290(3), 82.04.260(11)(b), or 82.04.250(3); or

(ii) Property taxes attributable to an increase in assessed value due to the renovation or expansion, after: (A) December 1, 2003, of a building used exclusively in manufacturing commercial airplanes or components of such airplanes; and (B) June 30, 2008, of buildings used exclusively for aerospace product development, manufacturing tooling specifically designed for use in manufacturing commercial airplanes or their components, or in providing aerospace services, by persons not within the scope of (a)(ii)(A) of this subsection (2) and are taxable under RCW 82.04.290(3), 82.04.260(11)(b), or 82.04.250(3); and

(b) An amount equal to:

(i)(A) Property taxes paid, by persons taxable under RCW 82.04.260(11)(a), on machinery and equipment exempt under RCW 82.08.02565 or 82.12.02565 and acquired after December 1, 2003; (B) Property taxes paid, by persons taxable under RCW 82.04.260(11)(b), on machinery and equipment exempt under RCW 82.08.02565 or 82.12.02565 and acquired after June 30, 2008; or (C) Property taxes paid, by persons taxable under RCW 82.04.250(3) or 82.04.290(3), on computer hardware, computer peripherals, and software exempt under RCW 82.08.975 or 82.12.975 and acquired after June 30, 2008.

(ii) For purposes of determining the amount eligible for credit under (i)(A) and (B) of this subsection (2)(b), the amount of property taxes paid is multiplied by a fraction. (A) The numerator of the fraction is the total taxable amount subject to the tax imposed under RCW 82.04.260(11)(a) or (b) on the applicable business activities of manufacturing commercial airplanes, components of such airplanes, or tooling specifically designed for use in the manufacturing of commercial airplanes or components of such airplanes. (B) The denominator of the fraction is the total taxable amount subject to the tax imposed under all manufacturing classifications in chapter 82.04 RCW. (C) For purposes of both the numerator and denominator of the fraction, the total taxable amount refers to the total taxable amount required to be reported on the person's returns for the calendar year before the calendar year in which the credit under this section is earned. The department may provide for an alternative method for calculating the numerator in cases where the tax rate provided in RCW 82.04.260(11) for manufacturing was not in effect during the full calendar year before the calendar year in which the credit under this section is earned. (D) No credit is available under (b)(i)(A) or (B) of this subsection (2) if either the numerator or the denominator of the fraction is zero. If the fraction is greater than or equal to nine-tenths, then the fraction is rounded to one. (E) As used in (b)(ii)(C) of this subsection (2), "returns" means the tax returns for which the tax imposed under this chapter is reported to the department.

(3) The definitions in this subsection apply throughout this section, unless the context clearly indicates otherwise.(a) "Aerospace product development" has the same meaning as provided in RCW 82.04.4461.(b) "Aerospace services" has the same meaning given in RCW 82.08.975.(c) "Commercial airplane" and "component" have the same meanings as provided in RCW 82.32.550.

(4) A credit earned during one calendar year may be carried over to be credited against taxes incurred in a subsequent calendar year, but may not be carried over a second year. No refunds may be granted for credits under this section.

(5) In addition to all other requirements under this title, a person claiming the credit under this section must file a complete annual tax performance report with the department under RCW 82.32.534.

(6) This section expires July 1, 2040.

[2017 c 135 § 16; 2013 3rd sp.s. c 2 § 10; 2010 1st sp.s. c 23 § 515; (2010 1st sp.s. c 23 § 514 expired June 10, 2010); 2010 c 114 § 116; 2008 c 81 § 8; 2006 c 177 § 10; 2005 c 514 § 501; 2003 2nd sp.s. c 1 § 15.]

SELECTED NOTES:

Contingent effective date—2013 3rd sp.s. c 2: See RCW 82.32.850.

Findings—Intent—2013 3rd sp.s. c 2: See note following RCW 82.32.850.

Findings—Savings—Effective date—2008 c 81: See notes following RCW 82.08.975.

Finding—2003 2nd sp.s. c 1: See note following RCW 82.04.4461

Aerospace Product Development Computer Expenditures (Sales and Use Tax)

RCW 82.08.975

Exemptions—Computer parts and software related to the manufacture of commercial airplanes. (Expires July 1, 2040.)

(1) The tax levied by RCW 82.08.020 does not apply to sales of computer hardware, computer peripherals, or software, not otherwise eligible for exemption under RCW 82.08.02565, used primarily in the development, design, and engineering of aerospace products or in providing aerospace services, or to sales of or charges made for labor and services rendered in respect to installing the computer hardware, computer peripherals, or software.

(2) The exemption is available only when the buyer provides the seller with an exemption certificate in a form and manner prescribed by the department. The seller must retain a copy of the certificate for the seller's files.

(3) The definitions in this subsection apply throughout this section unless the context requires otherwise.

(a) "Aerospace products" means:(i) Commercial airplanes and their components;(ii) Machinery and equipment that is designed and used primarily for the maintenance, repair, overhaul, or refurbishing of commercial airplanes or their components by federal aviation regulation part 145 certificated repair stations; and(iii) Tooling specifically designed for use in manufacturing commercial airplanes or their components.

(b) "Aerospace services" means the maintenance, repair, overhaul, or refurbishing of commercial airplanes or their components, but only when such services are performed by a FAR part 145 certificated repair station.

(c) "Commercial airplane" and "component" have the same meanings provided in RCW 82.32.550.

(d) "Peripherals" includes keyboards, monitors, mouse devices, and other accessories that operate outside of the computer, excluding cables, conduit, wiring, and other similar property.

(4) This section expires July 1, 2040.

[2013 3rd sp.s. c 2 § 11; 2008 c 81 § 2; 2003 2nd sp.s. c 1 § 9.]

SELECTED NOTES:

Contingent effective date—2013 3rd sp.s. c 2: See RCW 82.32.850.

Findings—Intent—2013 3rd sp.s. c 2: See note following RCW 82.32.850.

Findings—2008 c 81: "The legislature finds that the aerospace industry provides good wages and benefits for the thousands of engineers, mechanics, support staff, and other employees working directly in the industry throughout the state. The legislature further finds that suppliers and vendors that support the aerospace industry in turn provide a range of well-paying jobs. In 2003, and again in 2006, the legislature determined it was in the public interest to encourage the continued presence of this industry through the provision of tax incentives. However, the legislature recognizes that key elements of Washington's aerospace industry cluster were afforded few, if any, of the aerospace tax incentives enacted in 2003 and 2006. The comprehensive tax incentives in this act are intended to more comprehensively address the cost of doing business in Washington state compared to locations in other states for a larger segment of the aerospace industry cluster." [2008 c 81 § 1.]

Finding—2003 2nd sp.s. c 1: See note following RCW 82.04.4461.

Commercial Airplane Production Facilities (Sales and Use Tax)

RCW 82.08.980

Exemptions—Labor, services, and personal property related to the manufacture of commercial airplanes. (*Effective January 1, 2018, until July 1, 2040.*)

(1) The tax levied by RCW 82.08.020 does not apply to:

(a) Charges, for labor and services rendered in respect to the constructing of new buildings, made to (i) a manufacturer engaged in the manufacturing of commercial airplanes or the fuselages or wings of commercial airplanes or (ii) a port district, political subdivision, or municipal corporation, to be leased to a manufacturer engaged in the manufacturing of commercial airplanes or the fuselages or wings of commercial airplanes;

(b) Sales of tangible personal property that will be incorporated as an ingredient or component of such buildings during the course of the constructing; or

(c) Charges made for labor and services rendered in respect to installing, during the course of constructing such buildings, building fixtures not otherwise eligible for the exemption under RCW 82.08.02565(2)(b).

(2) The exemption is available only when the buyer provides the seller with an exemption certificate in a form and manner prescribed by the department. The seller must retain a copy of the certificate for the seller's files.

(3) No application is necessary for the tax exemption in this section. However, in order to qualify under this section before starting construction, the port district, political subdivision, or municipal corporation must have entered into an agreement with the manufacturer to build such a facility. A person claiming the exemption under this section is subject to all the requirements of chapter 82.32 RCW. In addition, the person must file a complete annual tax performance report with the department under RCW 82.32.534.

(4) The exemption in this section applies to buildings or parts of buildings, including buildings or parts of buildings used for the storage of raw materials or finished product, that are used primarily in the manufacturing of any one or more of the following products:

(a) Commercial airplanes;

(b) Fuselages of commercial airplanes; or

(c) Wings of commercial airplanes.

(5) For the purposes of this section, "commercial airplane" has the meaning given in RCW 82.32.550.

(6) This section expires July 1, 2040.

[2017 c 135 § 25; 2013 3rd sp.s. c 2 § 3; 2010 c 114 § 126; 2003 2nd sp.s. c 1 § 11.]

SELECTED NOTES:

Contingent effective date—2013 3rd sp.s. c 2: See RCW 82.32.850.

Findings—Intent—2013 3rd sp.s. c 2: See note following RCW 82.32.850.

Finding—2003 2nd sp.s. c 1: See note following RCW 82.04.4461.

Superefficient Airplane Production Facilities (Leasehold Excise Tax)

RCW 82.29A.137

Exemptions—Certain leasehold interests related to the manufacture of superefficient airplanes. (*Effective January 1, 2018, until July 1, 2040.*)

(1) All leasehold interests in port district facilities exempt from tax under RCW 82.08.980 or 82.12.980 and used by a manufacturer engaged in the manufacturing of superefficient airplanes, as defined in RCW 82.32.550, are exempt from tax under this chapter. A person claiming the credit under RCW 82.04.4463 is not eligible for the exemption under this section.

(2) In addition to all other requirements under this title, a person claiming the exemption under this section must file a complete annual tax performance report with the department under RCW 82.32.534.

(3) This section expires July 1, 2040.

[2017 c 135 § 35; 2013 3rd sp.s. c 2 § 13; 2010 c 114 § 134; 2003 2nd sp.s. c 1 § 13.]

SELECTED NOTES:

Contingent effective date—2013 3rd sp.s. c 2: See RCW 82.32.850.

Findings—Intent—2013 3rd sp.s. c 2: See note following RCW 82.32.850.

Finding—2003 2nd sp.s. c 1: See note following RCW 82.04.4461.

Superefficient Airplane Production Facilities (Property Tax)

RCW 84.36.655

Property related to the manufacture of superefficient airplanes. (*Effective January 1, 2018, until July 1, 2040.*)

(1) Effective January 1, 2005, all buildings, machinery, equipment, and other personal property of a lessee of a port district eligible under RCW 82.08.980 and 82.12.980, used exclusively in manufacturing superefficient airplanes, are exempt from property taxation. A person taking the credit under RCW 82.04.4463 is not eligible for the exemption under this section. For the purposes of this section, "superefficient airplane" and "component" have the meanings given in RCW 82.32.550.

(2) In addition to all other requirements under this title, a person claiming the exemption under this section must file a complete annual tax performance report with the department under RCW 82.32.534.

(3) Claims for exemption authorized by this section must be filed with the county assessor on forms prescribed by the department and furnished by the assessor. The assessor must verify and approve claims as the assessor determines to be justified and in accordance with this section. No claims may be filed after December 31, 2039. The department may adopt rules, under the provisions of chapter 34.05 RCW, as necessary to properly administer this section.

(4) This section applies to taxes levied for collection in 2006 and thereafter.(5) This section expires July 1, 2040.

[2017 c 135 § 46; 2013 3rd sp.s. c 2 § 14; 2010 c 114 § 151; 2003 2nd sp.s. c 1 § 14.]

SELECTED NOTES:

Contingent effective date—2013 3rd sp.s. c 2: See RCW 82.32.850.

Findings—Intent—2013 3rd sp.s. c 2: See note following RCW 82.32.850.

Finding—2003 2nd sp.s. c 1: See note following RCW 82.04.4461.

Appendix A: Tax preference details

Nine tax preferences comprise the aerospace package subject to this review

The nine tax preferences include preferential tax rates, credits, and exemptions, and affect four tax programs, the Business and Occupation (B&O) Tax, the Sales and Use Tax, the Property Tax, and the Leasehold Excise Tax. This appendix provides additional detail about each preference's public policy objectives, statutory provisions, and the estimated beneficiary savings.

The Legislature stated four public policy objectives

The Legislature initially created these tax preferences in 2003 with three stated policy objectives:

- To encourage the continued presence of the aerospace industry in Washington;
- To reduce the cost of doing business in Washington for the aerospace industry compared to locations in other states; and
- To provide jobs with good wages and benefits.

When extending and expanding the preferences in 2013, the Legislature stated an additional policy objective, to maintain and grow Washington's aerospace industry workforce.

The preferences share common definitions

Statute defines a "commercial airplane" as an airplane certified by the Federal Aviation Administration for transporting persons or property, and any military derivative of a commercial airplane. Private airplanes, helicopters, and military fighter aircraft do not qualify for the preferences.

Qualifying components must be federally certified for installation or assembly into a commercial airplane.

The statute defines a "superefficient airplane" as a twin aisle airplane that uses 15% to 20% less fuel than similar airplanes on the market. The statute also includes specifications that uniquely describe Boeing's 787 line of commercial airplanes.

Statute defines "aerospace products" as:

- Commercial airplanes and their components;

- Machinery and equipment designed and used primarily for the maintenance, repair, overhaul, or refurbishing of commercial airplanes or their components by federally certified aviation repair stations; and
- Tooling specifically designed for use in manufacturing commercial airplanes or their components.
- Generally, the preferences that apply to airplane manufacturers also apply to "processors for hire." A processor for hire is a business that manufactures products from materials owned by another business.

The preferences share a common expiration date

The aerospace preferences are scheduled to expire on July 1, 2040.

Most of the preferences were enacted in the same legislation in 2003, contingent on the location of a facility for assembling a superefficient airplane in Washington. On December 19, 2003, governor Locke signed an agreement with The Boeing Company to build the 787 airplane in Everett, which met the conditions for the preferences to become effective. The certified aircraft repair firms preferential B&O tax rate was also enacted in 2003, through different legislation.

In 2013, the Legislature extended the expiration dates for the preferences from July 1, 2024 to July 1, 2040 if a new commercial airplane manufacturing program was sited in Washington by June 30, 2017. This contingency was satisfied when the Department of Revenue certified that Boeing had selected Everett as the location of final assembly of the 777X as well as the company's composite wing center.

The preferences share common accountability reporting

Beneficiaries of the aerospace tax preferences must file an annual tax performance report with the Department of Revenue (DOR). The report requires information detailing employment and wages for positions in Washington, and taxpayers may authorize DOR to obtain this information directly from the Employment Security Department. Most information contained in the annual tax performance report is subject to public disclosure, including:

- Employment and wage information for employment positions in Washington.
- Total number of full-time, part-time, and temporary positions.
- Amount of tax preference claimed.

The preferences are subject to recurring JLARC review

Statute requires that JLARC review the nine tax preferences every five years, beginning in 2019.

Additional aerospace-related tax preferences reviewed in 2019

Two additional aerospace-related preference are not included in this review, and are presented in separate reports (Commercial Airplane Parts: Place of Sale and Aircraft Part Prototypes), for three reasons:

- They were enacted at different times than the majority of the above preferences.
- They do not have expiration dates.
- They are not required to be reviewed every five years.

For a detailed legislative history prior to 2013, refer to the 2014 JLARC study of the aerospace tax preferences.

Preferential B&O tax rates

Three of the preferences provide reduced business and occupation (B&O) tax rates for businesses that manufacture qualifying aerospace products and provide qualifying aerospace services.

Commercial Airplane Manufacturing - Preferential B&O Tax Rate (RCW 82.04.260)

Manufacturers and processors for hire of commercial airplanes and their components, and manufacturers of tooling specifically designed for use in manufacturing aerospace products are taxed at the aerospace manufacturing B&O tax rate of 0.2904%. When a manufacturer sells the product either at wholesale or retail in-state, the manufacturer owes aerospace retailing or wholesaling B&O tax at the same preferential rate of 0.2904%. A manufacturer subject to both the aerospace manufacturing B&O tax and the aerospace retailing or wholesaling B&O tax is allowed a Multiple Activities Tax Credit (MATC) against the aerospace retailing or wholesaling B&O tax for the aerospace manufacturing B&O tax paid per RCW 82.04.440(2). In general, manufacturers and wholesalers, not provided a special B&O tax rate, and retailers of tangible personal property used in interstate transportation, pay B&O tax at the rate of 0.484%.

Exhibit A1: Beneficiary Savings Estimate - Commercial Airplane Manufacturing - Preferential B&O Tax Rate

Biennium	Fiscal Year	Estimated Beneficiary Savings
2013-2015 7/1/2013 - 6/30/2015	2014	$110,400,000
	2015	$122,900,000
2015-2017 7/1/2015 - 6/30/2017	2016	$125,550,000
	2017	$112,140,000
2017-2019 7/1/2017 - 6/30/2019	2018	$109,570,000
	2019	$116,130,000
2019-2021 7/1/2019 - 6/30/2021	2020	$121,210,000
	2021	$126,210,000
2021-2023 7/1/2021 - 6/30/2023	2022	$131,530,000
	2023	$137,160,000
	2021-23 Biennium	**$268,690,000**

Source: JLARC analysis of DOR tax return data.

Aerospace Product Development – Preferential B&O Tax Rate (RCW 82.04.290)

Non-manufacturers that research, design, or engineer aerospace products for commercial airplanes for others to manufacture are taxed at 0.9%. Firms providing research, design, and engineering services for others are generally taxed at the rate of 1.5%.

Exhibit A2: Beneficiary Savings Estimate - Aerospace Product Development - Preferential B&O Tax Rate

Biennium	Fiscal Year	Estimated Beneficiary Savings
2013-2015 7/1/2013 - 6/30/2015	2014	$1,250,000
	2015	$1,150,000
2015-2017 7/1/2015 - 6/30/2017	2016	$1,570,000
	2017	$2,280,000

Biennium	Fiscal Year	Estimated Beneficiary Savings
2017-2019 7/1/2017 - 6/30/2019	2018	$2,520,000
	2019	$2,690,000
2019-2021 7/1/2019 - 6/30/2021	2020	$2,910,000
	2021	$3,060,000
2021-2023 7/1/2021 - 6/30/2023	2022	$3,040,000
	2023	$3,010,000
	2021-23 Biennium	**$6,050,000**

Source: JLARC analysis of DOR tax return data.

Certified Aircraft Repair Firms – Preferential B&O Tax Rate (RCW 82.04.250)

Federally certified aviation repair stations are taxed at a preferential business and occupation (B&O) tax rate of 0.2904% on sales of repair services and component parts. Other interstate transportation equipment repair services are taxed at the B&O rate of 0.484%.

Exhibit A3: Beneficiary Savings Estimate - Certified Aircraft Repair Firms - Preferential B&O Tax Rate

Biennium	Fiscal Year	Estimated Beneficiary Savings
2013-2015 7/1/2013 - 6/30/2015	2014	$540,000
	2015	$670,000
2015-2017 7/1/2015 - 6/30/2017	2016	$650,000
	2017	$670,000
2017-2019 7/1/2017 - 6/30/2019	2018	$710,000
	2019	$750,000
2019-2021 7/1/2019 - 6/30/2021	2020	$780,000
	2021	$810,000
2021-2023 7/1/2021 - 6/30/2023	2022	$850,000
	2023	$880,000
	2021-23 Biennium	**$1,730,000**

Source: JLARC analysis of DOR tax return data.

Exhibit A4: Summary of aerospace preferential rates

Beneficiaries	Preferential Rate	General Classifications	General Rate
Manufacturing and Selling			
Manufacturers or processors for hire of commercial airplanes and components	0.2904%	Manufacturing, wholesaling, or retailing	0.484%
Manufacturers of tooling for use in manufacturing commercial airplanes and components	0.2904%	Manufacturing, wholesaling, or retailing	0.484%
Retail sales of repair services and parts at federally certified aviation repair stations	0.2904%	Other interstate transportation equipment repair services and parts	0.484%
Providing Services			
Researchers, designers, and engineers of aerospace products	0.9%	Service and other	1.5%

Source: JLARC analysis of RCW.

B&O tax credits

Two preferences provide credits against a taxpayer's B&O tax liability. The amount of each credit that may be claimed depends on the level of certain business expenditures or taxes.

Aerospace Product Development Expenditures – B&O Tax Credit (RCW 82.04.4461)

A **B&O tax credit equal to 1.5% of qualifying expenditures** for businesses that develop aerospace products. Qualifying expenditures include wages and benefits, supplies, and computer expenses, but not capital costs and overhead, such as expenses for land, structures, or depreciable property. The credit must be taken in the year in which the qualifying expenditures occur, except for credits earned before July 1, 2005, which can be carried over and used at a later date. If the amount of credit exceeds tax liability, the credit cannot be carried over to reduce tax liability in subsequent years, and cannot be refunded.

Exhibit A.5: Beneficiary Savings Estimate - Aerospace Product Development Expenditures - B&O Tax Credit

Biennium	Fiscal Year	Estimated Beneficiary Savings
2013-2015 7/1/2013 - 6/30/2015	2014	$71,420,000
	2015	$94,940,000
2015-2017 7/1/2015 - 6/30/2017	2016	$111,370,000
	2017	$87,280,000
2017-2019 7/1/2017 - 6/30/2019	2018	$83,780,000
	2019	$89,500,000
2019-2021 7/1/2019 - 6/30/2021	2020	$96,820,000
	2021	$101,950,000
2021-2023 7/1/2021 - 6/30/2023	2022	$101,400,000
	2023	$100,360,000
	2021-23 Biennium	**$201,760,000**

Source: JLARC analysis of DOR tax return data.

Commercial Airplane Manufacturing - B&O Tax Credit for Property/Leasehold Excise Taxes Paid (RCW 82.04.4463)

Provides a **B&O tax credit for property taxes or leasehold excise taxes paid** on property used exclusively in manufacturing aerospace products, aerospace product development, or in providing aerospace services at certified aviation repair stations. The credit applies to new buildings, the land on which the buildings are located, and on the increase in assessed value from renovations and expansions. The credit is also available for property taxes paid on certain personal property.

To receive the B&O tax credit, buildings must be used exclusively in manufacturing commercial airplanes or their components, or tooling specifically designed for use in manufacturing. The credit may also be claimed for new buildings and land, renovations, and expansion for facilities used for aerospace product development and for maintenance, repair, overhaul, or refurbishing commercial airplanes or their components by federally certified aviation repair stations.

The B&O tax credit provided to aerospace businesses applies to manufacturing machinery and equipment, computer hardware, computer peripherals, and software if these items are exempt from sales and use taxes. The B&O tax credit for manufacturing machinery and equipment is calculated based on a firm's aerospace product income as a percentage of its total manufactured goods income.

The B&O tax credit cannot be claimed until the real and personal property taxes have been paid. If the credit exceeds B&O tax owed, it may be carried forward one year. Unused credits are not refundable.

Exhibit A6: Beneficiary Savings Estimate - Commercial Airplane Manufacturing - B&O Tax Credit for Property/Leasehold Excise Taxes Paid

Biennium	Fiscal Year	Estimated Beneficiary Savings
2013-2015 7/1/2013 - 6/30/2015	2014	$16,290,000
	2015	$29,550,000
2015-2017 7/1/2015 - 6/30/2017	2016	$39,360,000
	2017	$24,770,000
2017-2019 7/1/2017 - 6/30/2019	2018	$38,390,000
	2019	$34,180,000
2019-2021 7/1/2019 - 6/30/2021	2020	$34,180,000
	2021	$34,180,000
2021-2023 7/1/2021 - 6/30/2023	2022	$34,180,000
	2023	$34,180,000
	2021-23 Biennium	**$68,360,000**

Source: JLARC analysis of DOR tax return data.

Sales and Use Tax Exemptions

Two preferences exempt certain purchases from sales and use tax.

Aerospace Product Development Computer Expenditures – SUT Exemption (RCW 82.08.975)

A **sales and use tax exemption for sales of computer hardware, computer peripherals, and software** used primarily in developing, designing, and engineering aerospace products and providing aerospace services. Aerospace services are defined in statute as maintenance, repair, overhaul, or refurbishing of commercial airplanes or their components by federally certified repair stations. Sales of or charges made for labor and services for installing the computer hardware, computer peripherals, and software are also exempt.

Exhibit A7: Beneficiary Savings Estimate - Aerospace Product Development Computer Expenditures - SUT Exemption

Biennium	Fiscal Year	Estimated Beneficiary Savings
2013-2015 7/1/2013 - 6/30/2015	2014	$3,110,000
	2015	$3,080,000
2015-2017 7/1/2015 - 6/30/2017	2016	$3,100,000
	2017	$4,920,000
2017-2019 7/1/2017 - 6/30/2019	2018	$4,500,000
	2019	$4,500,000
2019-2021 7/1/2019 - 6/30/2021	2020	$4,500,000
	2021	$4,500,000
2021-2023 7/1/2021 - 6/30/2023	2022	$4,500,000
	2023	$4,500,000
	2021-23 Biennium	$9,000,000

Source: JLARC analysis of DOR tax return data.

Commercial Airplane Production Facilities – SUT Exemptions (RCW 82.08.980)

An **exemption from sales and use taxes on labor, services, and materials to construct new buildings used for manufacturing commercial airplanes.** The exemption also includes labor and services for installation of fixtures during construction of the new building. The exemption applies to either a manufacturer of commercial airplanes, fuselages, or wings, or to a port district, political subdivision, or municipal corporation leasing property to a manufacturer of those products.

Exhibit A8: Beneficiary Savings Estimate - Commercial Airplane Production Facilities - SUT Exemption

Biennium	Fiscal Year	Estimated Beneficiary Savings
2013-2015 7/1/2013 - 6/30/2015	2014	$19,590,000
	2015	$51,700,000
2015-2017 7/1/2015 - 6/30/2017	2016	$22,820,000
	2017	$6,800,000

Biennium	Fiscal Year	Estimated Beneficiary Savings
2017-2019 7/1/2017 - 6/30/2019	2018	$6,800,000
	2019	$6,800,000
2019-2021 7/1/2019 - 6/30/2021	2020	$6,800,000
	2021	$6,800,000
2021-2023 7/1/2021 - 6/30/2023	2022	$6,800,000
	2023	$6,800,000
	2021-23 Biennium	$13,600,000

Source: JLARC analysis of DOR tax return data.

Property and Leasehold Excise Tax Exemptions

Two preferences would exempt certain superefficient airplane (Boeing 787) manufacturing facilities from leasehold excise and property taxes if they were built on port property. Boeing chose to build its 787 final assembly facility on private property rather than property leased from a port. As such, no superefficient airplane manufacturing takes place on port district property, and these preferences are not currently being claimed.

Superefficient Airplane Production Facilities – Leasehold Excise Tax Exemption (RCW 82.29A.137)

Provides a **leasehold excise tax exemption** to the manufacturer of a "superefficient airplane" (Boeing 787) for a facility located on port district property.

This preference is not being claimed, and beneficiary savings are $0.

Superefficient Airplane Production Facilities – Property Tax Exemption (RCW 84.36.655)

Provides a **property tax exemption for all personal property** such as equipment and computers to the manufacturer of a "superefficient airplane" (Boeing 787) at a facility located on port district property.

This preference is not being claimed, and beneficiary savings are $0.

Appendix B: Ernst & Young tax competitiveness report

Ernst & Young estimated relative business tax competitiveness for aerospace manufacturing firms

JLARC staff contracted with Ernst & Young to perform business tax competitiveness analysis

Ernst & Young (EY) analyzed the state and local tax climate for aerospace manufacturing firms in Washington and a set of 13 benchmark states. The other states were selected based on their high relative concentration of aerospace employment or their high ranking in the Teal Group's Aerospace Competitive Economics Study[13]. The study estimated the tax burdens that would be faced by a representative small (50 employees) and large (10,000 employees) aerospace firm making investments in new facilities in Washington and these benchmark states:

- Arizona
- Alabama
- California
- Colorado
- Connecticut
- Georgia
- Kansas
- Missouri
- North Carolina
- Ohio
- South Carolina
- Texas
- Utah

Details of the Analysis

To perform the analysis, EY used a discounted cash flow model programmed with the financial features of the aerospace products and parts manufacturing industry (NAICS 3364) and the relevant tax features and rates in each state. The financial profiles estimate metrics such as employment, wages, business assets, income and expenses based on public data and EY calculations.

EY analyzed the systems in each of the benchmark states and coded them into its model. The model estimates the tax burdens resulting from corporate income tax, sales tax on business inputs, property tax, franchise tax, and gross receipts taxes such as the Washington B&O tax and Ohio Commercial Activities Tax. The burden of these taxes was combined to estimate the effective tax rate (ETR), expressed as the percentage change in the hypothetical business' rate of return due to taxes.

Next, EY analyzed the availability of statutory and negotiated tax incentives and evaluated their impact on the aerospace business' ETR in each state. The analysis included the following categories of statutory tax incentives, available to all businesses that meet statutory eligibility requirements:

- Tax credits due to job creation.
- Tax credits due to investment.
- Wage rebates.

[13] Commissioned by the Choose Washington New-Mid Market Airplane (NMA) council, the report addresses the competitive business environment that aerospace manufacturing companies face considering locating in the 50 U.S. states or the District of Columbia.

- Preferential tax rates.
- Tax credits due to research and experimentation (R&E) expenditures.
- Sales and use tax exemptions on capital investments.

The analysis also included a review of discretionary or negotiated incentives that may be available to the representative businesses. This portion of the review relies on the experience and knowledge of EY professionals and the typical incentive size for similar projects. Because of their discretionary nature, there is no formal source for the level of benefits and the impact of such potentially available incentives would not be verifiable public information.

The results are presented as a comparison of the states' effective tax rates for a small and a large representative business at three stages: before any tax incentives, after statutory tax incentives, and after statutory and negotiated incentives. Both the states' ETR and their relative rankings are reported for the small and the large firm.

Exhibit B1: Pre- and post-incentive effective tax rates for small firms

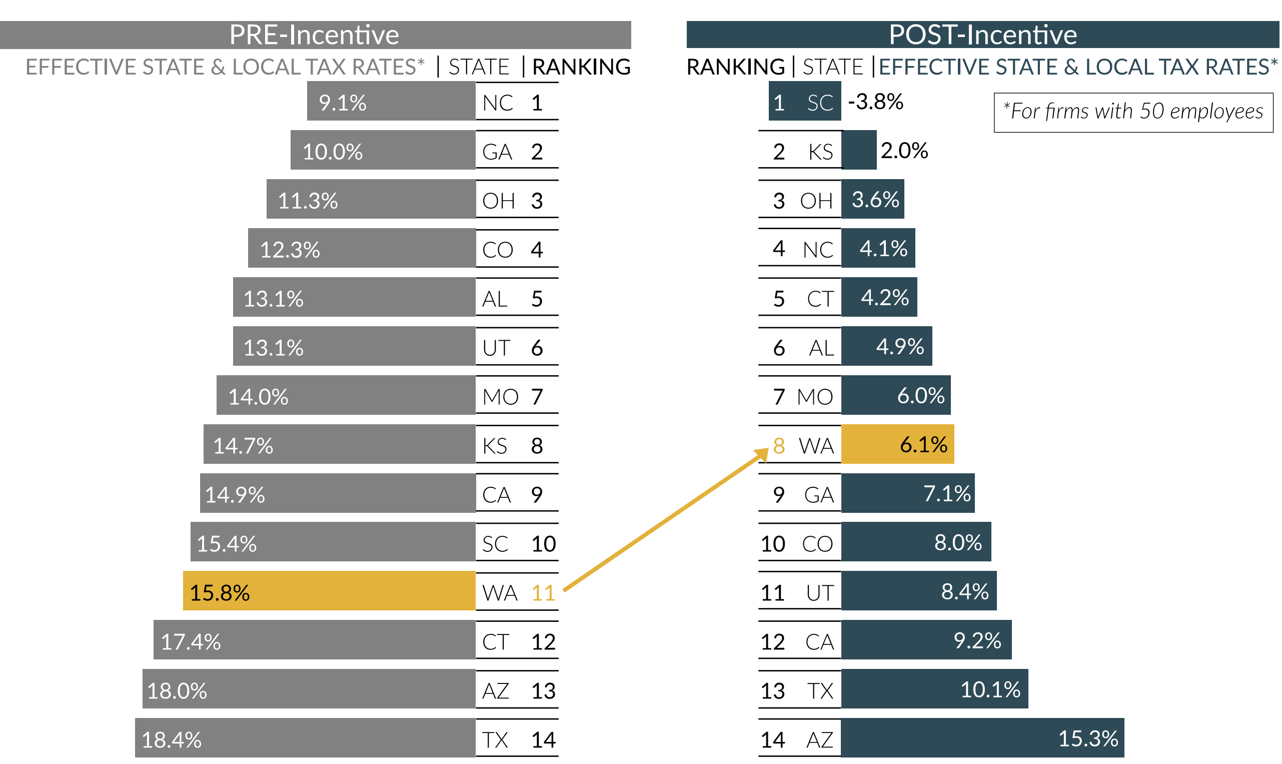
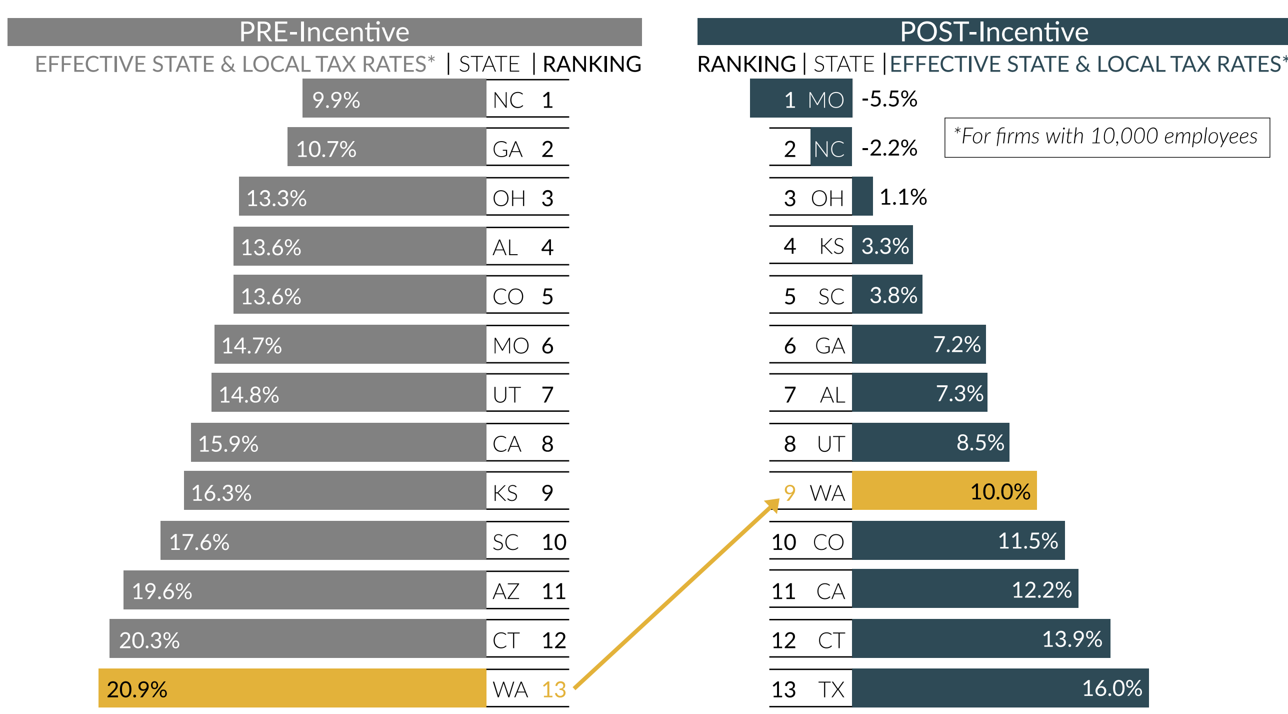


Exhibit B2: Pre- and post-incentive effective tax rates for large firms



Full Ernst & Young Report Available

Click here for the full EY report, which provides additional detail about the methodology, data sources, and results of the analysis.

Appendix C: REMI overview

What is REMI?

JLARC staff used Regional Economic Models, Inc.'s (REMI) Tax-PI software (version 2.2) to model the economic impacts for several tax preference reviews in 2019, including the aerospace tax preferences.

REMI software is used by approximately 30 state governments and dozens of private sector consulting firms, research universities, and international clients.

Model is tailored to Washington and includes government sector

Tax-PI is an economic impact tool used to evaluate the fiscal and economic effects and the demographic impacts of a tax policy change. The software includes various features that make it particularly useful for analyzing the economic and fiscal impacts of tax preferences:

- REMI staff consulted with staff from the Office of Financial Management (OFM) and customized a statewide model to reflect Washington's economy.

- The model contains 160 industry sectors, based on the North American Industry Classification System (NAICS) codes.
- In contrast to other modeling software, Tax-PI includes state and local government as a sector. This permits users to see the trade-offs associated with tax policy changes (e.g., effects on Washington's economy from both increased expenditures by businesses due to a tax preference, along with decreased spending by government due to the associated revenue loss).
- For current revenue and expenditure data, users can input information to reflect their state's economic and fiscal situation. This allows JLARC staff to calibrate a state budget using up-to-date information from the Economic and Revenue Forecast Council (ERFC) and the Legislative Evaluation and Accountability Program (LEAP).
- The model can forecast economic and revenue impacts multiple years into the future.

Model simulates the full impact of a tax policy change

The REMI model accounts for the direct, indirect, and induced effects as they spread through the state's economy, which allows users to simulate the full impact of a tax policy change over time.

- Direct effects are industry specific and capture how a target industry responds to a particular policy change (e.g., changes in industry employment following a change in tax policy).
- Indirect effects capture employment and spending decisions by businesses in the targeted industry's supply chain that provide goods and services.
- Induced effects capture the in-state spending and consumption habits of employees in targeted and related industries.

The REMI model produces year-by-year estimates of the total statewide effects of a tax policy change. Impacts are measured as the difference between a baseline economic and revenue forecast and the estimated economic and revenue effects after the policy change.

Model includes economic, demographic, and fiscal variables

The REMI model is a macroeconomic impact model that incorporates aspects of four major economic modeling approaches: input-output, general equilibrium, econometric, and new economic geography. The foundation of the model, the inter-industry matrices found in the input-output models, captures Washington's industry structure and the transactions between industries. Layered on top of this structure is a complex set of mathematical equations used to estimate how private industry, consumers, and state and local governments respond to a policy change over time.

- The supply side of the model includes many economic variables representing labor supply, consumer prices, and capital and energy costs with elasticities for both the consumer and business sectors.
- Regional competitiveness is modeled via imports, exports, and output.
- Demographics are modeled using population dynamics (births, deaths, and economic and retirement migration) and includes cohorts for age, sex, race, and retirement.

- Demographic information informs the model's estimates for economic consumption and labor supply.
- The dynamic aspect comes from the ability to adjust variables over time as forecasted economic conditions change.

While the model is complex and forecasting involves some degree of uncertainty, Tax-PI provides a tool for practitioners to simulate how tax policy and the resulting industry changes affect Washington's economy, population, and fiscal situation.

Appendix D: REMI analysis

REMI analysis illustrates range of potential employment impacts of not extending aerospace tax preferences in 2013

JLARC staff used REMI's Tax-PI to model three scenarios that illustrate potential employment impacts of not extending the aerospace tax preferences in 2013.

This technical appendix provides background detail and supporting information for the JLARC staff analysis that led to the results summarized in Tab 4.

This appendix is divided into three sections:

- **REMI methodology** details how JLARC staff set up and calibrated the Tax-PI program prior to using the model to analyze possible impacts.
- **Beneficiary industries** discusses baseline aerospace manufacturing employment in the REMI model of the Washington economy, and identifies the other industry classifications of beneficiaries that have used the preferences.
- **Scenarios modeled** describes the scenarios used to estimate the range of potential employment effects of the aerospace tax preferences on statewide employment.

REMI Methodology

User inputs in REMI

REMI's Tax-PI model allows users to model policy changes and analyze the estimated impacts to the Washington economy, both in terms of economic activity and government finances (see Appendix C for an overview of the REMI model).

Prior to running modeling scenarios, users must make a series of choices about how to set up the modeling environment by building a state budget and calibrating the model accordingly. JLARC staff used the November 2018 revenue estimates produced by the Economic and Revenue Forecast Council (ERFC) and budgeted expenditures for fiscal years 2016 through 2018, as reported by the Legislative Evaluation and Accountability Program (LEAP) Committee. This data represents the budget and revenue data in the model and serves as the "jump off" point for Tax-PI's economic and fiscal estimates.

In addition to establishing a budget and inputting expected revenue values, users must specify whether government expenditures are determined by demand or by revenue.

- "By demand" imposes a level of government spending in future years that is necessary to maintain the same level of service as the final year in which budget data is entered.
- "By revenue" ties government expenditures to estimated changes in revenue collections.

JLARC staff ran the scenarios with expenditures set to be determined **by demand**. By setting expenditures to be determined by demand, users avoid making assumptions about how policymakers may alter spending priorities in the future. In addition, users essentially establish the current budget allocation as carry-forward levels for each expenditure category.

Users also may elect to impose a balanced budget restriction (also known as the balanced budget feedback loop) or leave the model unconstrained. The balanced budget restriction forces revenue and expenditures to be equivalent and thus may impose some limitations on economic activity. JLARC staff ran the reported scenarios with the **balanced budget restriction** turned on.

Because Tax-PI is a forecasting tool, JLARC staff was unable to model the economic impact of the tax preferences beginning in 2013. Rather, JLARC staff modeled the potential impacts if the preferences had not been extended beginning in 2017.

Data for the REMI model

The REMI model comes with historical economic and demographic data back to 2001. The data comes from federal government agencies such as the U.S. Census Bureau, U.S. Energy Information Administration, the Bureau of Labor Statistics, and the Bureau of Economic Analysis. As described above, current revenue and expenditure data for Washington comes from ERFC and LEAP, respectively. The data to build the modeling scenarios described in Tab 4 is from various sources.

- Equivalent changes in production cost and government spending for scenarios in this report are based on JLARC staff estimates of beneficiary savings, developed from Department of Revenue tax records.
- JLARC staff estimates of potential employment changes in response to the tax preferences are based on documentation from OFM and Community Attributes[14], media coverage of employment at Boeing's composite wing facility, and discussions with an advisory panel concerning potential impacts of the tax preferences. JLARC staff thanks the members of this panel for their participation: Timothy Bartik, W. E. Upjohn Institute for Employment Research; Kriss Sjoblom, Washington Research Council; Greg Weeks, independent consulting economist; Stan Sorsher, Society of Professional Engineering Employees in Aerospace; Toby Paterson, Office of Financial Management; Jeff Robinson, Employment Security Department; Anna Yamada, Department of Revenue; Jeff Mitchell, Senate Committee Services; and Tracey O'Brien, House of Representatives Office of Program Research.

[14]Community Attributes is a consulting firm commissioned in 2003 by the Washington Aerospace Partnership to examine the economic and fiscal impacts of the aerospace industry on Washington.

- Capital expenditure changes are based on media coverage of the cost to build the Boeing composite wing center and on public disclosure of tax savings associated with commercial airplane manufacturing facilities. They are entered into the model as an increase in nonresidential investment spending.

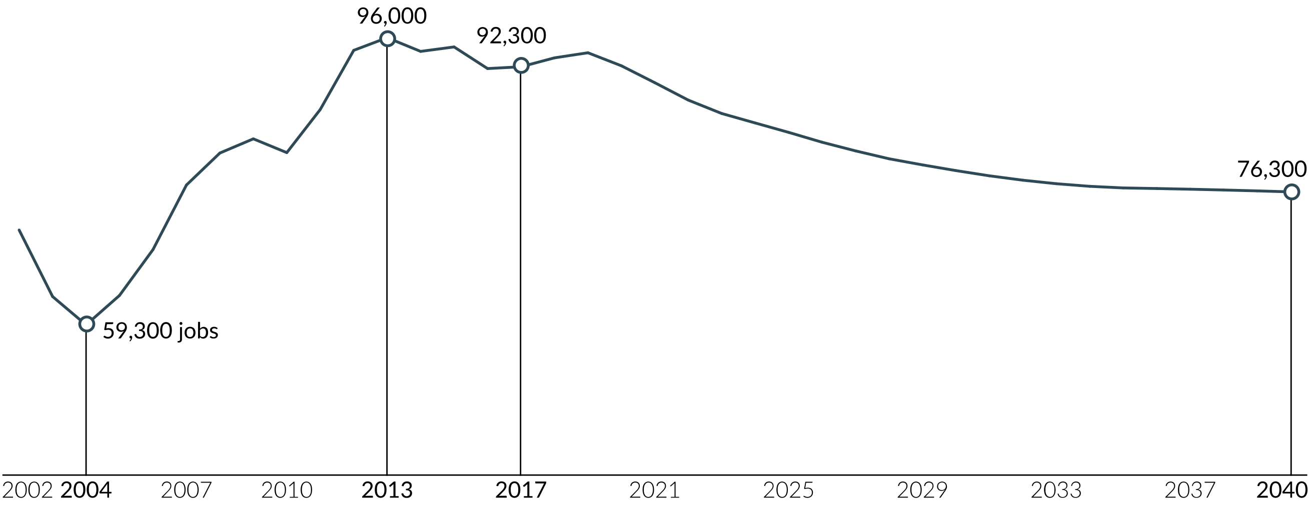
Aerospace tax preference beneficiary industries in REMI

The majority of tax savings attributable to the aerospace tax preferences are claimed by businesses in the aerospace product and part manufacturing industry that report under the North American Industry Classification System (NAICS) code 3364. However, businesses from many other industry classifications report claiming at least one of the aerospace tax preferences. JLARC staff entered production cost reductions into the model for the industries that report savings in the amount of tax savings they claimed. Because the public policy objectives of the tax preferences are directed toward the aerospace industry specifically, employment effects are reported at the NAICS 3364 level as well as at the other private industry and government levels.

Aerospace product and part manufacturing industry jobs fluctuated in Washington between 2001 and 2017

REMI's historical baseline and forecast employment data for the aerospace product and part manufacturing industry fluctuated from a low of 59,300 in 2004 to a high of 96,000 in 2013. Before simulating other policy changes, employment is projected to decline steadily from 92,300 in 2017 to 76,300 by 2040. Aerospace employment effects in the REMI model results are expressed as changes against this baseline.

Exhibit D1: REMI baseline and forecast data shows aerospace manufacturing jobs decline after 2013



Source: JLARC staff analysis of REMI baseline employment data for aerospace product and part manufacturing industry (NAICS code 3364).

Beneficiaries of the tax preferences report in 50 different industries included in REMI model

Data reported to the Department of Revenue shows the businesses that claimed the preferences between fiscal years 2015 and 2017 reported under 50 different industry classifications, listed below.

Exhibit D2: Aerospace tax preference beneficiary businesses report under many industry classifications

REMI NAICS	Industry Description
23	Construction
313, 314	Textile mills and textile product mills
3219	Other wood product manufacturing
3222	Converted paper product manufacturing
3252	Resin, synthetic rubber, and artificial synthetic fibers and filaments manufacturing
3259	Other chemical product and preparation manufacturing
3261	Plastics product manufacturing
3311	Iron and steel mills and ferroalloy manufacturing
3312	Steel product manufacturing from purchased steel
3313	Alumina and aluminum production and processing
3314	Nonferrous metal (except aluminum) production and processing
3315	Foundries
3321	Forging and stamping
3322	Cutlery and handtool manufacturing
3323	Architectural and structural metals manufacturing
3325	Hardware manufacturing
3326	Spring and wire product manufacturing
3327	Machine shops; turned product; and screw, nut, and bolt manufacturing
3328	Coating, engraving, heat treating, and allied activities

REMI NAICS	Industry Description
3329	Other fabricated metal product manufacturing
3333	Commercial and service industry machinery manufacturing, including digital camera manufacturing
3335	Metalworking machinery manufacturing
3336	Engine, turbine, and power transmission equipment manufacturing
3339	Other general purpose machinery manufacturing
3341	Computer and peripheral equipment manufacturing, excluding digital camera manufacturing
3344	Semiconductor and other electronic component manufacturing
3345	Navigational, measuring, electromedical, and control instruments manufacturing
3353	Electrical equipment manufacturing
3359	Other electrical equipment and component manufacturing
3363	Motor vehicle parts manufacturing
3364	Aerospace product and parts manufacturing
3371	Household and institutional furniture and kitchen cabinet manufacturing
3399	Other miscellaneous manufacturing
42	Wholesale trade
44-45	Retail trade
481	Air transportation
487, 488	Scenic and sightseeing transportation and support activities for transportation
5413	Architectural, engineering, and related services
5414	Specialized design services
5415	Computer systems design and related services
5416	Management, scientific, and technical consulting services
5417	Scientific research and development services
5419	Other professional, scientific, and technical services
5611, 5612	Office administrative services; Facilities support services

REMI NAICS	Industry Description
5613	Employment services
5614, 5616, 5619	Business support services; Investigation and security services; Other support services
61	Educational services; private
8112	Electronic and precision equipment repair and maintenance
8113	Commercial and industrial machinery and equipment (except automotive and electronic) repair and maintenance
8114	Personal and household goods repair and maintenance

Source: JLARC staff analysis of DOR tax return data, REMI industry detail.

Scenarios modeled to estimate the employment impact of the aerospace tax preferences

JLARC staff are unable to determine how Boeing would have responded if the tax preferences had not been extended in 2013. To illustrate the range of possible responses and their employment effects, JLARC staff modeled three scenarios:

- **Scenario 1**: Boeing locates 777X production out of state; Boeing employees currently working on the 777 line – estimated by Community Attributes at 12,100 employees – are phased out over a five year period as 777X production ramps up and the older model is discontinued. This scenario assumes that Boeing's decision to move the 777X out of state would have had no bearing on location decisions for future aircraft lines.
- **Scenario 2**: Boeing builds the 777X elsewhere as well as other new generations of airplanes, resulting in an 80% decrease in Boeing employment in Washington over a 15 year period. This scenario was considered by the Office of Financial Management (OFM) in its analysis for the 2003 aerospace tax preferences, and it was included in JLARC's 2014 report on the preferences.
- **Scenario 3**: Boeing locates 777X production in Washington despite the preferences not being expanded and extended. This scenario assumes that the preferences had no influence on Boeing's location decision. This scenario includes only the effects of the expiration of the preferences through a change in production costs and government spending.

For each scenario modeled, JLARC staff modeled a change in nominal state government spending in the amount of estimated beneficiary savings for FY 2025-2040. The amounts were also entered as production cost increases among beneficiary industry classifications, distributed in proportion to the savings claimed by businesses in each industry. These amounts are shown below. Importantly, these policy variables take effect in 2025, the year after the aerospace tax preferences were originally scheduled to expire. This supports the assumption that production cost and government spending would increase after this expiration. The beneficiary savings

estimates for Scenarios 1 and 2 in Exhibit D3 were reduced in proportion to the reduction in aerospace industry output caused by each respective scenario's employment reductions.

Exhibit D3: Estimated beneficiary savings entered into REMI model

Fiscal Year	Estimated Beneficiary Savings (millions of dollars)
2025	$312.9
2026	$322.8
2027	$333.9
2028	$345.5
2029	$357.2
2030	$369.4
2031	$382.2
2032	$396.0
2033	$410.7
2034	$426.4
2035	$443.3
2036	$461.5
2037	$480.4
2038	$500.0
2039	$520.4
2040	$541.5

Source: JLARC staff analysis of DOR tax return data.

In addition to the policy variables that estimate the opportunity cost of the use of beneficiary savings, the three scenarios included other policy variables to approximate potential responses to non-extension of the tax preferences.

Scenario 1: Boeing locates 777X production and the composite wing facility outside Washington. Boeing's decision to move the 777X out of state has no bearing on location decisions for future aircraft lines.

Assumption 1: JLARC staff assumed aerospace industry employment fell by 12,100 jobs over a 5-year period. In JLARC staff's analysis, this phase-out began in 2017. The employment changes

are applied at the industry (international exports) level. The values of this policy variable are shown below:

Exhibit D4: Scenario 1 employment changes entered into REMI model

Year	2017	2018	2019	2020	2021+
Employment Change - Aerospace (jobs)	-2,420	-4,840	-7,260	-9,680	-12,100

Source: JLARC staff analysis of Boeing, OFM data.

Assumption 2: The Washington economy loses the net effects of the construction of Boeing's $1 billion composite wing facility. This is entered into the model as a decrease in nonresidential investment spending and a decrease in aerospace employment. Modeling the loss of this investment, the scenario considers the effects of the following policy variables:

Exhibit D5: Scenario 1 capital spending changes entered into REMI model

Year	2017	2018	2019	2020	2021+
Investment Spending - Nonresidential ($ millions)	-$250	-$500	-$250		
Employment Change - Aerospace (jobs)			-250	-500	-500

Source: JLARC staff analysis of DOR tax return data, public information.

Scenario 2: Boeing locates 777X production and subsequent generations of airplanes outside Washington.

Assumption 1: JLARC staff assumed aerospace industry employment fell by 80% of Boeing's average 2016 employment (75,864 jobs) over a 15-year period. In JLARC staff's analysis, this phase-out began in 2017. The employment changes are applied at the industry (international exports) level. The values of this policy variable are shown below:

Exhibit D6: Scenario 2 employment changes entered into REMI model

Year	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031+
Employment Change - Aerospace (thousands of jobs)	-4.0	-8.1	-12.1	-16.1	-20.2	-24.2	-28.3	-32.3	-36.3	-40.4	-44.4	-48.4	-52.5	-56.5	-60.5

Source: JLARC staff analysis of Boeing, OFM data.

Assumption 2: The Washington economy loses the net effects of the construction of Boeing's $1 billion composite wing facility. This is entered into the model as a decrease in nonresidential

investment spending and a decrease in aerospace employment. Modeling the loss of this investment, the scenario considers the effects of the following policy variables:

Exhibit D7: Scenario 2 capital spending changes entered into REMI model

Year	2017	2018	2019	2020	2021+
Investment Spending - Nonresidential ($ millions)	-$250	-$500	-$250		
Employment Change - Aerospace (jobs)			-250	-500	-500

Source: JLARC staff analysis of DOR tax return data, public information.

Scenario 3: Boeing sites 777X production in Washington despite the preferences not being expanded and extended.

The third scenario assumes the preferences had no influence on Boeing's location decision. There are no changes to aerospace employment or capital spending, as the non-extension of the tax preferences is not assumed to have had an effect on either Boeing's location decision, nor its decision to construct the composite wing facility. However, the scenario does assume the construction of the composite wing facility would have been subject to sales and use tax, increasing the aerospace production cost in the first three years of the simulation. The main effects on employment in this scenario result from the change in nominal state government spending and production cost in the amount of estimated beneficiary savings for FY 2025-2040.

Exhibit D8: Scenario 3 assumes sales and use tax paid on composite wing facility construction

Year	2017	2018	2019	2020	2021+
Production Cost - Aerospace Product and Part Manufacturing ($ millions)	$25	$50	$25		

Source: JLARC staff analysis of DOR tax return data, public information.

Two Employment Data Sources

Different approaches in reporting employment

The employment and wage numbers used in the main report are from administrative data collected and maintained by the Washington Employment Security Department (ESD) and reported to the U.S. Department of Labor's Bureau of Labor Statistics (BLS). This data captures workers covered by state unemployment insurance and federal workers covered by unemployment compensation for federal employees. It omits some workers in the labor market, including self-employed and sole proprietors.

The REMI model, on the other hand, uses employment data from the U.S. Department of Commerce's Bureau of Economic Analysis (BEA). BEA makes a number of adjustments to employment and wage data for occupations not covered by the BLS system (see BEA's Frequently Asked Questions for further details).

Understanding the distinction between BEA and BLS employment data is important for two reasons:

1. The BEA jobs numbers tend to be higher, as they capture a wider selection of employment, including sole proprietors. However, it may count a person holding multiple jobs as a number greater than one, whereas the BLS data counts a person one time regardless of the number of jobs performed.
2. While BEA provides a more comprehensive picture, it has an approximate two-year lag behind BLS data, which is regularly updated throughout the year and receives more attention in the press. According to REMI, BEA employment data operates as a unit of demand related to the tasks a worker performs within a job, rather than a job itself.

RECOMMENDATIONS & RESPONSES

Legislative Auditor Recommendation

The Legislative Auditor recommends clarifying legislative expectations for the level of aerospace industry employment

The Legislature should clarify its expectations for the level of aerospace industry employment. Providing additional detail in the tax preference performance statement such as a baseline level of employment would facilitate future reviews of these preferences.

There is evidence that the public policy objectives for these preferences are being achieved. However, JLARC staff cannot determine whether there is a causal relationship between the preferences and the continued presence of the aerospace industry or the quality of aerospace jobs.

Further, JLARC staff cannot determine whether the preferences meet the public policy objective to maintain and grow Washington's aerospace industry workforce. Washington aerospace employment is lower than it was in 2013, but higher than when the preferences were first enacted in 2003. The preferences may have prevented greater job losses if they caused a major Boeing location decision.

Consistent with the Legislative Auditor's recommendation in 2014, the Legislature could facilitate future reviews by providing additional detail within the tax preference performance statement for these preferences. This additional detail would be consistent with the Legislative Auditor's January 2014 guidance for drafting performance statements in tax preference legislation. This additional detail would include:

- Identification of the tax preference logic chain and a specific employment baseline or target level the Legislature wants JLARC staff to use in future evaluations, such as a specific industry job numbers or a percentage increase from a specific point in time.
- Direction to JLARC staff whether to evaluate the preferences' effectiveness ***based on achieving targets*** or ***determining causality***. It is much more likely that an evaluation will have a conclusive answer to whether a target was achieved than an answer to whether there was a causal relationship between a tax preference and a target.

Legislation Required: Yes

Fiscal Impact: Depends on legislative action.

Letter from Commission Chair

Available October 2019.

Commissioners' Recommendation

Available October 2019.

Agency Response

If applicable, available October 2019.

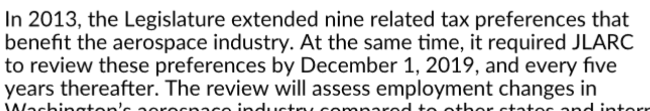
MORE ABOUT THIS REVIEW
Study questions

WASHINGTON JLARC
Proposed Study Questions: Aerospace Tax Preferences

State of Washington Joint Legislative Audit and Review Committee • September 2018

Legislature requires JLARC study of the aerospace tax preferences

The 2006 Legislature directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct performance audits of tax preferences. These preferences are included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.



In 2013, the Legislature extended nine related tax preferences that benefit the aerospace industry. At the same time, it required JLARC to review these preferences by December 1, 2019, and every five years thereafter. The review will assess employment changes in Washington's aerospace industry compared to other states and internationally.

Study will include nine preferences that benefit companies that manufacture, develop, and repair aerospace products

The review includes three preferential business and occupation (B&O) tax rates, two B&O tax credits, two sales and use tax exemptions, a property tax exemption, and a leasehold excise tax exemption.

The preferences are directed to businesses that perform any of these three activities:

- Manufacturing commercial airplanes, including superefficient airplanes.
- Developing aerospace products, including airplanes and their components, airplane repair equipment, and tooling used in manufacturing commercial airplanes.
- Repairing aircraft.

The Department of Revenue estimates that the combined biennial savings for beneficiaries of these preferences was $531 million in 2015-17.

Study will answer questions based on the Legislature's objectives

Legislature's objectives	JLARC's study questions
Encourage the continued presence of the aerospace industry in Washington.	1. Has Washington retained the presence of the aerospace industry?
Reduce the cost of doing business in Washington for the aerospace industry compared to other states.	2. How have the preferences affected the cost of business for Washington's aerospace industry compared with other states?
Maintain and grow Washington's aerospace industry workforce.	3. How has aerospace industry employment changed since the 2013 extension of tax preferences? 4. How much of the estimated employment change is attributed to the tax preferences, and how much may be related to other factors? 5. How do changes in Washington employment compare to changes in other locations?
Provide jobs with good wages and benefits.	6. What wages and benefits do the beneficiaries of the preference provide their employees?

Joint Legislative Audit & Review Committee, 106 11th Ave SW, Olympia, WA 98501
(360) 786-5171 • (360)786-5180 (fax) • JLARC@leg.wa.gov • www.jlarc.leg.wa.gov
Keenan Konopaski, Washington State Legislative Auditor

Proposed Study Questions: Aerospace Tax Preferences

Study timeframe

Preliminary Report: July 2019 Proposed Final Report: December 2019

Study team

Team Lead:	Pete van Moorsel	360.786.5185	pete.vanmoorsel@leg.wa.gov
Research Analyst:	Zack Freeman	360.786.5179	zack.freeman@leg.wa.gov
Project Coordinator:	Eric Thomas	360.786.5182	eric.thomas@leg.wa.gov

JLARC Study Process

Study Mandate
Budget, legislation, committee direction

→ **Proposed Study Questions**

→ Legislative Auditor's Preliminary Report

→ **For Tax Preferences:**
- Citizen Commission meeting
- Public testimony
- Commission adopts comments

→ Legislative Auditor's Proposed Final Report
Agency response included

→ Final Report
Option to append committee comment

Committee votes to distribute completed audit

Washington Joint Legislative Audit and Review Committee

106 11th Avenue SW, Suite 2500
PO Box 40910
Olympia, WA 98504-0910

Phone: 360-786-5171
Fax: 360-786-5180
Email: JLARC@leg.wa.gov

Aircraft Part Prototypes

2019 JLARC TAX PREFERENCE REVIEW

Estimated 2021-23 beneficiary savings: $0

Sales and use tax

Preference applies to the sale of materials used to make prototypes of aircraft parts and equipment

The exemption applies to sales or use of:

- Materials incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications.
- Materials that are incorporated into a prototype but later destroyed in the testing or development of the prototype.

The preference is limited to businesses whose gross income and value of products manufactured was $20 million or less in the previous year. A business may not claim more than $100,000 in tax savings in a calendar year. To claim the preference, a business must first pay the tax on a sale subject to the preference, and then apply to the Department of Revenue (DOR) for a refund.

The preference has no expiration date.

A 2014 JLARC review of the preference includes additional detail and history.

Full 2014 report: leg.wa.gov/jlarc/AuditAndStudyReports/documents/14-2.pdf

In 2014, the Legislative Auditor found no businesses were claiming the tax preference and recommended termination

The Legislature stated two public policy objectives when it enacted the tax preference in 1996. The preference was part of a larger bill that addressed machinery and equipment used in research, development, and testing. The objectives applied to all exemptions in the bill.

LEGISLATURE'S STATED PUBLIC POLICY OBJECTIVES	2014 JLARC REVIEW RESULTS
Encourage, develop, and expand opportunities for family wage employment in manufacturing industries.	*No businesses claim the tax preference.*
Solidify and enhance the state's competitive position.	

With no legislative changes to the preference and no beneficiaries, the Legislative Auditor's 2014 recommendation to terminate remains applicable

No substantive legislative changes. Since 2014, there has been no legislation considered that is specific to the provisions of this preference.

No businesses claimed the preference. Beneficiaries must pay the sales or use tax and then apply for a refund from DOR. This process allows DOR to track the number of firms that claim the exemption. DOR reports that there have been no requests for refunds, and thus, no beneficiaries. Efforts to reach two Washington companies that supported the legislation to create the preference in 1996 were unsuccessful. In 2014 these same companies indicated they were not claiming the preference.

LEGISLATIVE AUDITOR'S RECOMMENDATION

Terminate

- The Legislature should terminate the sales and use tax exemption for prototypes for aircraft parts, auxiliary equipment, and modifications because the tax preference is not being used and has not contributed to the stated public policy objectives.
- The Legislature may wish to consider other strategies beyond this tax incentive to accomplish the public policy objectives.

The complete report is on the JLARC web site: www.leg.wa.gov/jlarc

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
keenan.konopaski@leg.wa.gov • (360) 786-5187

Follow us on Twitter @WaLegAuditor

July 2019

PRELIMINARY REPORT: 2019 TAX PREFERENCE PERFORMANCE REVIEWS

Aircraft Part Prototypes

LEGISLATIVE AUDITOR'S CONCLUSION:

The preference has not been claimed and does not contribute to the public policy objectives, so the Legislative Auditor continues to recommend termination.

July 2019

Preference applies to the sale of materials used to make prototypes of aircraft parts and equipment

The exemption applies to sales or use of:

- Materials incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications.
- Materials that are incorporated into a prototype but later destroyed in the testing or development of the prototype.

Estimated Biennial Beneficiary Savings
None
Tax Type
Sales & Use Tax
RCWs 82.08.02566, 82.12.02566
Applicable Statutes

The preference is limited to businesses whose gross income and value of products manufactured had a combined total value of $20 million or less in the previous year, minus any multiple activities tax credit claims[1]. A business may not claim more than $100,000 in tax savings from this preference in a calendar year. To claim the preference, a business must first pay the tax on a sale subject to the preference, and then apply to the Department of Revenue (DOR) for a refund. A 2014 JLARC review of the preference includes additional detail.

The preference does not have an expiration date.

In 2014, the Legislative Auditor found no businesses were claiming the tax preference and recommended termination

The Legislature stated two public policy objectives when it enacted the tax preference in 1996. The preference was part of a larger bill that addressed machinery and equipment used in research, development, and testing. The objectives applied to all exemptions in the bill.

[1]The multiple activities tax credit is specified in RCW 82.04.440

JLARC staff reviewed the preference in 2014. Because the review found no businesses were claiming the tax preference, the Legislative Auditor recommended that the Legislature terminate the preference as it had not contributed to the stated public policy objectives.

Objectives (Stated)	2014 JLARC Review Results
Encourage, develop, and expand opportunities for family wage employment in manufacturing industries.	No businesses claim the tax preference.
Solidify and enhance the state's competitive position.	

With no legislative changes to the preference and no beneficiaries, the Legislative Auditor's 2014 conclusions and recommendations remain applicable

No substantive legislative changes. Since 2014, three bills have proposed broad changes to all tax preferences. While each bill would have affected this preference, none included provisions specific to it. None of the bills passed.

No businesses claim the preference. Beneficiaries must pay the sales or use tax and then apply for a refund from DOR. This process allows DOR to track the number of firms that claim the exemption. DOR reports that there have been no requests for refunds, and thus, no beneficiaries. Efforts to reach two Washington companies that supported the legislation to create the preference in 1996 were unsuccessful. In 2014 these same companies indicated they were not claiming the preference.

Recommendations

Legislative Auditor's Recommendation: Terminate

The Legislature should terminate the sales and use tax exemption for prototypes for aircraft parts, auxiliary equipment, and modifications because the tax preference is not being used and has not contributed to the stated public policy objectives.

The Legislature may wish to consider other strategies beyond this tax incentive to accomplish the public policy objectives.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2019.

ADDITIONAL DETAILS
Applicable statutes

RCWs 82.08.02566, 82.12.02566

Sales Tax

RCW 82.08.02566

Exemptions - Sales of tangible personal property incorporated in prototype for parts, auxiliary equipment, and aircraft modification - limitation on yearly exemption.

(1) The tax levied by RCW 82.08.020 shall not apply to sales of tangible personal property incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications; or to sales of tangible personal property that at one time is incorporated into the prototype but is later destroyed in the testing or development of the prototype.

(2) This exemption does not apply to sales to any person whose total taxable amount during the immediately preceding calendar year exceeds twenty million dollars. For purposes of this section, "total taxable amount" means gross income of the business and value of products manufactured, less any amounts for which a credit is allowed under RCW 82.04.440.

(3) State and local taxes for which an exemption is received under this section and RCW 82.12.02566 shall not exceed one hundred thousand dollars for any person during any calendar year.

(4) Sellers shall collect tax on sales subject to this exemption. The buyer shall apply for a refund directly from the department.

[2003 c 168 § 208; 1997 c 302 § 1; 1996 c 247 § 4.]

SELECTED NOTES:

Findings—Intent—1996 c 247: "The legislature finds that the health, safety, and welfare of the people of the state of Washington are heavily dependent upon the continued encouragement, development, and expansion of opportunities for family wage employment in the state's manufacturing industries.

The legislature also finds that sales and use tax exemptions for manufacturing machinery and equipment enacted by the 1995 legislature have improved Washington's ability to compete with other states for manufacturing investment, but that additional incentives for manufacturers need to be adopted to solidify and enhance the state's competitive position.

The legislature intends to accomplish this by extending the current manufacturing machinery and equipment exemptions to include machinery and equipment used for research and development with potential manufacturing applications." [1996 c 247 § 1.]

Use Tax

RCW 82.12.02566

Exemptions—Use of tangible personal property incorporated in prototype for aircraft parts, auxiliary equipment, and aircraft modification—Limitations on yearly exemption.

(1) The provisions of this chapter shall not apply with respect to the use of tangible personal property incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications; or in respect to the use of tangible personal property that at one time is incorporated into the prototype but is later destroyed in the testing or development of the prototype.

(2) This exemption does not apply in respect to the use of tangible personal property by any person whose total taxable amount during the immediately preceding calendar year exceeds twenty million dollars. For purposes of this section, "total taxable amount" means gross income of the business and value of products manufactured, less any amounts for which a credit is allowed under RCW 82.04.440.

(3) State and local taxes for which an exemption is received under this section and RCW 82.08.02566 shall not exceed one hundred thousand dollars for any person during any calendar year.

(4) Sellers obligated to collect use tax shall collect tax on sales subject to this exemption. The buyer shall apply for a refund directly from the department.

[2003 c 168 § 209; 1997 c 302 § 2; 1996 c 247 § 5.]

SELECTED NOTES:

Findings—Intent—1996 c 247: See note following RCW 82.08.02566.

RECOMMENDATIONS & RESPONSES
Legislative Auditor's Recommendation

Legislative Auditor's Recommendation: Terminate

The Legislature should terminate the sales and use tax exemption for prototypes for aircraft parts, auxiliary equipment, and modifications because the tax preference is not being used and has not contributed to the stated public policy objectives.

Legislation Required: Yes

Fiscal Impact: None

Letter from Commission Chair

Available October 2019.

Commissioners' Recommendation

Available October 2019.

Agency Response

If applicable, available October 2019.

MORE ABOUT THIS REVIEW
Study questions

State of Washington Joint Legislative Audit and Review Committee ● September 2018

Citizen Commission scheduled a JLARC study of the sales and use tax exemption for aircraft part prototypes

The 2006 Legislature directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct performance audits of tax preferences. This preference is included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.

The preference is a sales and use tax exemption for sales of materials used to make prototypes for aircraft parts and auxiliary equipment. A prototype is an original model of a product that may be developed in the future.

The exemption is available to businesses whose taxable income and value of manufactured products was $20 million or less in the previous year. Businesses may claim up to $100,000 annually in tax savings from this preference. Eligible businesses must first pay the tax, and then apply to the Department of Revenue (DOR) for a refund.

Sales and use tax exemption to encourage family-wage employment and improve the state's competitive position

The preference has two stated public policy objectives:

- To encourage, develop, and expand opportunities for family-wage employment in manufacturing industries.
- To solidify and enhance the state's competitive position for aerospace manufacturing.

Legislative Auditor recommended terminating this preference in 2014

JLARC staff previously reviewed the preference in 2014 and determined that no businesses used it. In that review, the Legislative Auditor recommended terminating the preference.

DOR reports no other businesses have applied for a refund for this sales & use tax exemption since 2014.

Study will answer two questions

1) Has there been legislative action, change, or discussion of the preference since 2014?
2) Are the Legislative Auditor's 2014 conclusions and recommendations still applicable to current circumstances?

Study Timeframe

Preliminary Report: July 2019 Proposed Final Report: December 2019

Study Team

Team Lead:	Pete van Moorsel	360.786.5185	pete.vanmoorsel@leg.wa.gov
Research Analyst:	Zack Freeman	360.786.5179	zack.freeman@leg.wa.gov
Project Coordinator:	Eric Thomas	360.786.5182	eric.thomas@leg.wa.gov

JLARC Study Process

Study Mandate	Proposed Study Questions	Legislative Auditor's Preliminary Report	For Tax Preferences:	Legislative Auditor's Proposed Final Report	Final Report
Budget, legislation, committee direction			• Citizen Commission meeting • Public testimony • Commission adopts comments	Agency response included	Option to append committee comment
					Committee votes to distribute completed audit

Joint Legislative Audit & Review Committee, 106 11th Ave SW, Olympia, WA 98501
(360) 786-5171 ● (360)786-5180 (fax) ● JLARC@leg.wa.gov ● www.jlarc.leg.wa.gov
Keenan Konopaski, Washington State Legislative Auditor

Washington Joint Legislative Audit and Review Committee

106 11th Avenue SW, Suite 2500
PO Box 40910
Olympia, WA 98504-0910

Phone: 360-786-5171
Fax: 360-786-5180
Email: JLARC@leg.wa.gov

Commercial Airplane Parts: Place of Sale

2019 JLARC TAX PREFERENCE REVIEW

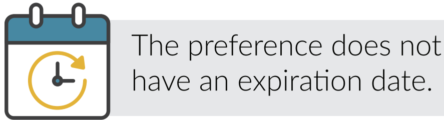
Estimated 2021-23 beneficiary savings: $620,000

Business and occupation (B&O) tax

With preference, sales of certain airplane parts whose final inspection takes place outside of Washington are exempt from B&O tax

MANUFACTURER	PLACE OF SALE
In-state manufacturer	Outside WA
	In WA
Out-of-state manufacturer	Outside WA
	In WA

Preference applies only to out-of-state manufacturers, when place of sale (final inspection) is outside WA.



2014 review concluded that the preference appeared to conflict with a public policy objective to reduce the cost of doing business in state

When the Legislature expanded aerospace preferences to in-state suppliers in 2008, it stated **three broad public policy objectives:**

ONE More comprehensively address the cost of doing business in Washington compared to other states.

TWO Encourage the continued presence of the aerospace industry for a broader group of suppliers.

THREE Provide well-paying jobs.

When reviewing this preference in 2014, JLARC staff inferred a fourth objective:

FOUR Clarify place of sale of certain airplane parts. The preference met this objective by defining place of sale.

The 2014 review also found that it appeared to conflict with the stated objective reducing the cost of doing business in Washington as compared to other states. The preference provided greater tax advantages to out-of-state part manufacturers.

In 2014 review, Legislative Auditor recommended reviewing & clarifying the preference.

Limited data is available to analyze use of the tax preference

Because there is no specific reporting line for the preference, it is difficult to determine the exact number of beneficiaries that claim the preference or the actual amount of tax savings.

JLARC staff identified three businesses that claimed the preference in fiscal years 2016 and 2017.

Legislative Auditor's conclusions and recommendations from 2014 remain applicable

The Legislature has made no substantive changes to the preference since 2014.

As a result, the preference continues to provide greater tax advantages to out-of-state airplane part manufacturers than to in-state manufacturers.

LEGISLATIVE AUDITOR'S RECOMMENDATION

Review and clarify

As recommended in 2014, the Legislature should review and clarify the preferential tax treatment provided to out-of-state manufacturers because it seems to run counter to the Legislature's stated policy objective of reducing the cost of doing business for Washington compared to locations in other states.

In addition, the Legislature may want to consider adding reporting or other accountability requirements that would provide better information on out-of-state manufacturers' use of this preference.

The complete report is on the JLARC web site: www.leg.wa.gov/jlarc

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
keenan.konopaski@leg.wa.gov • (360) 786-5187

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July 2019

PRELIMINARY REPORT:
2019 TAX PREFERENCE PERFORMANCE REVIEWS

Commercial Airplane Parts: Place of Sale

LEGISLATIVE AUDITOR'S CONCLUSION:

While the preference clarifies place of sale of certain airplane parts, it appears to conflict with policy objectives by providing more advantageous tax treatment to out-of-state manufacturers of airplane parts than to in-state manufacturers.

July 2019

With preference, sales of certain airplane parts whose final inspection takes place outside of Washington are exempt from B&O tax

Estimated Biennial Beneficiary Savings $620,000
Tax Type Business & Occupation Tax
RCW 82.04.627 Applicable Statutes

The preference applies to certain airplane parts that are made by out-of-state manufacturers and sold to a Washington manufacturer of commercial airplanes. Sale of these parts is exempt from B&O tax if the place of sale — defined for the preference as the location of final testing or inspection — is outside Washington. A 2014 JLARC staff review of the preference includes additional detail.

The preference does not have an expiration date.

2014 review concluded that the preference appeared to conflict with a public policy objective to reduce the cost of doing business in state

When the Legislature expanded aerospace preferences to in-state suppliers in 2008, it stated three broad public policy objectives:

1. More comprehensively address the cost of doing business in Washington compared to other states.
2. Encourage the continued presence of the aerospace industry for a broader group of suppliers.
3. Provide well-paying jobs.

When reviewing this preference in 2014, JLARC staff also inferred a fourth objective – to clarify place of sale of certain airplane parts. The preference met this objective by defining place of sale. However, JLARC staff found that it appeared to conflict with the Legislature's stated objective of reducing the cost of doing business in Washington as compared to other states. Specifically, the preference provided greater tax advantages to out-of-state airplane part manufacturers than to in-state manufacturers. A Washington commercial airplane manufacturer could still benefit indirectly to the extent that the out-of-state parts manufacturer chose to pass on its taxpayer savings to the buyer.

PARTS MANUFACTURER	PLACE OF SALE	TAX RATE
In-state manufacturer	Outside WA	0.29%
	In WA	0.29%
Out-of-state manufacturer	Outside WA	0%
	In WA	0.29%

Preference applies only to out-of-state manufacturers, when place of sale (final testing or inspection) is outside WA.

Source: JLARC Analysis of RCW 82.04.627 and WAC 458-20-193.

In 2014 review, Legislative Auditor recommended reviewing and clarifying the preference

The Legislative Auditor recommended that the Legislature review and clarify the preferential tax treatment provided to out-of-state manufacturers and consider adding reporting or other accountability requirements to provide better information on use of this preference.

Limited data is available to analyze use of the tax preference for 2019 review

There is no specific reporting line for the preference, and out-of-state beneficiaries may not need to register with the Department of Revenue. For these reasons, it is difficult to determine the exact number of beneficiaries that claim the preference or the actual amount of tax savings.

However, based on the available data, JLARC staff identified three businesses that claimed the preference in fiscal years 2016 and 2017. Based on this data, estimated beneficiary savings are $620,000 per biennium. JLARC staff found fewer than three beneficiaries that claimed the preference in fiscal year 2018. Actual figures may be higher.

Legislative Auditor's conclusions and recommendations from 2014 remain applicable

The Legislature has made no substantive changes to the preference since the 2014 review.

- One bill, enacted in 2015, updated Federal Aviation Regulation (FAR) citations and references in the statute governing the preference. The bill did not substantively change any of the provisions governing the preference.
- Three other bills were proposed, but did not pass. Each would have made broad changes to all tax preferences, but included no substantive provisions specific to this preference.

As a result, the preference continues to provide greater tax advantages to out-of-state airplane part manufacturers than to in-state manufacturers.

Recommendations

Legislative Auditor's Recommendation: Review and Clarify

The Legislature should review and clarify the preferential tax treatment provided to out-of-state manufacturers because it seems to run counter to the Legislature's stated policy objective of reducing the cost of doing business for Washington compared to locations in other states.

In addition, the Legislature may want to consider adding reporting or other accountability requirements that would provide better information on out-of-state manufacturers' use of this preference.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2019.

REVIEW DETAILS

Applicable statutes

RCW 82.04.627

Exemptions - Commercial airplane parts.

(1) Except as provided in subsection (2) of this section, for purposes of the taxes imposed under this chapter on the sale of parts to the manufacturer of a commercial airplane, the sale is deemed to take place at the site of the final testing or inspection under federal aviation regulation part 21, subpart F or G.

(2) This section does not apply to:

(a) Sales of a standard part, such as a nut or bolt, manufactured in compliance with a government or established industry specification;

(b) Sales of a product produced under a technical standard order authorization or letter of technical standard order design approval pursuant to federal aviation regulation part 21, subpart O; or

(c) Sales of parts in respect to which final testing or inspection under federal aviation regulation part 21, subpart F or G takes place in this state.

(3) "Commercial airplane" has the same meaning given in RCW 82.32.550.

[2015 c 86 § 301; 2008 c 81 § 15.]

NOTES:
Findings—Savings—Effective date—2008 c 81: See notes following RCW 82.08.975.

RECOMMENDATIONS & RESPONSES

Legislative Auditor's Recommendation

Legislative Auditor's Recommendation: Review and Clarify

The Legislature should review and clarify the preferential tax treatment provided to out-of-state manufacturers because it seems to run counter to the Legislature's stated policy objective of reducing the cost of doing business for Washington compared to locations in other states.

In addition, the Legislature may want to consider adding reporting or other accountability requirements that would provide better information on out-of-state manufacturers' use of this preference.

Legislation Required: Yes

Fiscal Impact: None

Letter from Commission Chair

Available October 2019.

Commissioners' Recommendation

Available October 2019.

Agency Response

If applicable, available October 2019.

MORE ABOUT THIS REVIEW
Study questions

State of Washington Joint Legislative Audit and Review Committee ● September 2018

Citizen Commission scheduled a JLARC study of exemption for the sale of certain commercial airplane parts

The 2006 Legislature directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct performance audits of tax preferences. This preference is included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.

With preference, sales of certain airplane parts are exempt from B&O tax if "place of sale" is outside WA

The preference:

- Applies to parts that are made by out-of-state manufacturers and sold to a Washington manufacturer of commercial airplanes.
- Provides an exemption if the place of sale – defined for the preference as the location of final testing or inspection – is outside Washington.

Exemption intended to support the aerospace industry and clarify the meaning of "place of sale"

This preference was one of many aerospace tax preferences included in legislation that passed in 2008. The Legislature stated three public policy objectives for the preferences:

- Encourage the continued presence of the aerospace industry for a broader group of suppliers.
- More comprehensively address the cost of doing business in Washington compared to other states.
- Provide well-paying jobs.

JLARC staff also infer from public testimony that the Legislature wanted to clarify the Department of Revenue's existing interpretation of "place of sale" for sales of commercial airplane parts made by out-of-state manufacturers.

In 2014, Legislative Auditor recommended reviewing and clarifying preference

When this preference was reviewed in 2014, JLARC staff found that the preference appeared to conflict with the Legislature's stated policy objective of reducing the cost of doing business in Washington compared to other states. The Legislative Auditor also recommended that the Legislature consider adding reporting or other accountability requirements that would provide better information about out-of-state manufacturers' use of this preference.

Study will answer two questions

1) Has there been legislative action, change, or discussion of the preference since 2014?
2) Are the Legislative Auditor's 2014 conclusions and recommendations still applicable to current circumstances?

Joint Legislative Audit & Review Committee, 106 11th Ave SW, Olympia, WA 98501
(360) 786-5171 ● (360)786-5180 (fax) ● JLARC@leg.wa.gov ● www.jlarc.leg.wa.gov
Keenan Konopaski, Washington State Legislative Auditor

Proposed Study Questions: Commercial Airplane Part Place of Sale

Study Timeframe

Preliminary Report:	July 2019	Proposed Final Report: December 2019

Study Team

Team Lead:	Pete van Moorsel	360.786.5185	pete.vanmoorsel@leg.wa.gov
Research Analyst:	Zack Freeman	360.786.5179	zack.freeman@leg.wa.gov
Project Coordinator:	Eric Thomas	360.786.5182	eric.thomas@leg.wa.gov

Washington Joint Legislative Audit and Review Committee

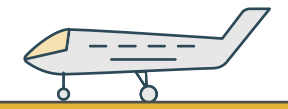
106 11th Avenue SW, Suite 2500
PO Box 40910
Olympia, WA 98504-0910

Phone: 360-786-5171
Fax: 360-786-5180
Email: JLARC@leg.wa.gov

Commuter Air Carrier Airplanes (Property Tax)

2019 JLARC TAX PREFERENCE REVIEW

Estimated 2021-23 beneficiary savings: $186,000 - $254,000 | Property tax



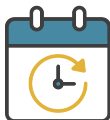
COMMUTER AIR CARRIERS:

- Operate aircraft with 60 or fewer seats
- Carry passengers on at least 5 round-trip flights per week
- Fly according to published flight schedules

Qualifying commuter air carriers are exempt from property tax on airplanes if they pay special aircraft excise tax

Preference is limited to commuter air carriers primarily located on privately owned property – **1 of the 3 Washington commuter air carriers qualify.**

The Legislature enacted this preference in 2013.



The preference has no expiration date.

Preference has two inferred objectives:

Streamline reporting and collect similar amount that would be collected in property tax.

Tax reporting is streamlined and simplified for the one commuter air carrier that qualifies

The preference established special aircraft excise tax rates in lieu of property tax to simplify and streamline a complicated process for determining market values for airplanes.

Kenmore Air and the Department of Revenue have benefited. **Kenmore Air is the only qualifying carrier** because it is located primarily on private property.

AIRCRAFT EXCISE TAX:

- Paid in lieu of property tax for airplanes used in Washington.
- Special rates for commuter air carriers, ranging from $500 to $4,000, are based on the airplane's weight.

However, the qualifying carrier pays an estimated 50% to 63% less than it would have paid in property tax

Aircraft excise tax fees are based on an airplanes' weight and remain the same each year. In contrast, airplane market values and property tax rates fluctuate from year to year. While the amount may have been similar when the preference was passed, they no longer align.

The special aircraft excise tax **was intended to be an alternative** to property tax that resulted in a similar amount of tax being paid.

The one qualifying commuter air carrier is estimated to have **paid less in aircraft excise tax than it would have paid in property tax** in fiscal year 2018.

LEGISLATIVE AUDITOR'S RECOMMENDATION

Modify

The preference is meeting one of two inferred objectives. While it is simplifying reporting for one taxpayer and the Department of Revenue, it is not providing an alternative to property tax that results in a similar amount of tax paid. The Legislature should modify the preference to:

- Provide a method to equalize commuter air carrier excise tax fees on airplanes with property taxes over time.
- Clarify why the preference is limited to commuter air carriers primarily located on private property.
- Provide a performance statement with stated objectives and metrics to determine if objectives are met.

The complete report is on the JLARC web site: www.leg.wa.gov/jlarc
For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
keenan.konopaski@leg.wa.gov • (360) 786-5187

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July 2019

PRELIMINARY REPORT:
2019 TAX PREFERENCE PERFORMANCE REVIEWS

Commuter Air Carrier Airplanes (Property Tax)

LEGISLATIVE AUDITOR'S CONCLUSION:

The preference streamlines tax reporting for one of three commuter air carriers in Washington. However, the qualifying carrier is paying an estimated 50% to 63% less in excise tax than it would have paid in property tax.

July 2019

Qualifying commuter air carriers are exempt from property tax if they pay a special excise tax on their airplanes

Estimated Biennial Beneficiary Savings
$186,000 to $254,000
Tax Type
Property Tax
RCW 84.36.133 Applicable Statutes

The preference provides a property tax exemption for commuter air carriers if they pay a special aircraft excise tax on the airplanes they own and operate. The preference is limited to commuter air carriers that are primarily located on privately owned property.

Commuter air carriers:

- Operate "small aircraft" with 60 or fewer seats.
- Carry passengers on at least 5 round-trip flights per week.
- Fly according to published flight schedules.

The preference took effect January 1, 2014, and has no expiration date.

JLARC staff separately reviewed a sales and use tax exemption for commuter air carriers that purchase and repair airplanes used primarily for in-state travel. The 2019 review can be found here.

Inferred public policy objectives

The Legislature did not state a public policy objective when it passed this preference in 2013. JLARC staff infer two public policy objectives based on testimony to the Legislature.

Objectives (Inferred)	Results
1. Streamline and simplify tax reporting for qualifying commuter air carriers.	**Met**. The preference is streamlining and simplifying tax reporting for one beneficiary and the Department of Revenue.
2. Provide an alternative to property tax for certain commuter air carriers if they pay an aircraft excise tax that is similar to the amount they would have paid in property tax.	**No longer met**. JLARC staff estimate the one qualifying commuter air carrier pays between 50% to 63% less in excise tax than it would have paid in property tax.

Recommendations

Legislative Auditor's Recommendation: Modify

The preference is meeting one of two inferred objectives. While it is simplifying reporting for one taxpayer and the Department of Revenue, it is not providing an alternative to property tax that results in a similar amount of tax paid.

The Legislature should modify the preference to:

- Provide a method to equalize commuter air carrier excise tax fees on airplanes with property taxes over time.
- Clarify why the preference is limited to commuter air carriers primarily located on private property.
- Provide a performance statement with stated objectives and metrics to determine if objectives are met.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2019.

REVIEW DETAILS

1. What is the preference?

Qualifying commuter air carriers pay special aircraft excise tax in lieu of property tax on their airplanes

This preference, in combination with related statutes, provides a property tax exemption for qualifying commuter air carriers. Qualifying carriers pay a special aircraft excise tax in lieu of property tax on the airplanes they own and operate.

The two inferred objectives for the preference are to streamline and simplify tax reporting, and ensure that beneficiaries continue to pay a similar amount in excise tax that they would have paid in property tax.

Commuter air carriers:

- Operate "small aircraft" with 60 or fewer seats.
- Carry passengers on at least 5 round-trip flights per week.
- Fly according to published flight schedules.

Legislature created special aircraft excise tax to be paid in lieu of property tax

In 2013, the Legislature established a special aircraft excise tax fee schedule for qualifying commuter air carriers. The fees are based on an airplane's weight and do not change over time. The Department of Revenue (DOR) and stakeholders testified when the legislation was passed that the amount collected from the excise tax would be similar to the amount carriers would pay if they owed property tax on their airplanes.

Exhibit 1.1: Special excise tax fees are based on airplane weight

Gross Maximum Weight of Airplane at Take-Off	Annual Excise Tax Fee
4,000 pounds or less	$500
4,001 - 6,000 pounds	$1,000
6,001 - 8,000 pounds	$2,000
8,001 - 9,000 pounds	$3,000
9,001 - 12,500 pounds	$4,000

Source: JLARC staff analysis of RCW 82.48.030(1)(b).

To qualify, commuter air carriers must locate their airplanes primarily on privately owned land

The preference is limited to carriers that are "primarily" located on privately owned land, rather than publicly owned airports. DOR interprets "primarily" to mean more than 50% of the time.

Legislative staff and stakeholders testified in 2013 that one commuter air carrier, Kenmore Air, qualified for the preference. The Washington State Department of Transportation Aviation Division also identified Kenmore Air in their fiscal note for the 2013 legislation.

There was no public discussion on why the preference was limited to carriers that are primarily located on private property. The two other commuter air carriers currently based in Washington do not qualify for this preference because they are primarily located on publicly owned property.

Exhibit 1.2: One of three Washington-based commuter air carriers qualifies for preference

Corporate Name	Commuter Air Carrier Business Name	Base City	Qualifies for Preference?
Kenmore Air Harbor, Inc.	Kenmore Air Express; Kenmore Air	Kenmore	Yes
Rugby Aviation, Inc.	San Juan Airlines	Bellingham	No
West Isle Air, Inc.	Friday Harbor Seaplanes	Renton	No

Source: JLARC staff analysis of Federal Department of Transportation data, viewed 12/07/2018, and interviews with commuter air carriers.

Preference has no expiration date

The preference took effect January 1, 2014, and has no expiration date.

2. Tax reporting is streamlined

Inferred objective of streamlining and simplifying tax reporting is achieved for one beneficiary and the Department of Revenue

The Legislature did not state a public policy objective when it passed this preference in 2013. Based on testimony to the Legislature, JLARC staff infer that one objective was to streamline and simplify tax reporting.

The preference is achieving this inferred objective for the Department of Revenue (DOR) and Kenmore Air, the only qualifying commuter air carrier.

In 2013, DOR and Kenmore Air representatives testified that the process to establish mutually agreed-upon market values for their airplanes was burdensome and time consuming. They noted that establishing aircraft excise tax fees in lieu of property tax rates would result in a similar amount of tax being paid, while simplifying and streamlining the process.

For most air transportation companies, including commuter air carriers, DOR auditors conduct an annual "central assessment" audit. A central assessment audit determines the market value of all of the company's real and personal property, which is then subject to applicable state and local property taxes.

The 2013 legislation specifically exempted a commuter air carrier primarily located on private property from paying property tax if they paid an alternative aircraft excise tax. To date, Kenmore Air is the only commuter air carrier that has qualified to pay the aircraft excise tax in lieu of property tax.

3. Excise tax no longer equal to estimated property tax

Second objective of having commuter air carriers pay similar amount in aircraft excise tax no longer being achieved

When the Legislature considered this preference in 2013, Kenmore Air and the Department of Revenue described the preference as an alternative method for tax collection that would result in a similar amount of tax paid. The second inferred objective is to provide a tax alternative to qualifying commuter air carriers that results in a similar amount of tax paid.

JLARC staff estimate that the one qualifying commuter air carrier pays between 50% to 63% less in excise tax for its airplanes than it would pay in property tax.

Preference impacts state revenues and individual tax reporting in several ways

There are several revenue impacts from allowing commuter air carriers to pay aircraft excise tax in lieu of property tax:

- **The net tax paid by the qualifying commuter air carrier decreases**. JLARC staff estimate the aircraft excise tax paid in 2018 was between 50% to 63% less than what the property tax bill would likely have been on the same fleet of airplanes.
- While state property tax collections do not change, **the preference shifts the burden for paying the property tax onto other county taxpayers**, increasing their tax bill slightly. Since Kenmore Air is based in King County, this shift impacts other King County taxpayers. For calendar years 2018 through 2021, the state property tax levy is collected on a rate-based system. During this time, the exemption results in a tax revenue loss. Beginning in calendar year 2022, the exemption will result in a shift.
- **Aircraft excise tax collections increase**. The excise tax paid by the one qualifying commuter air carrier is deposited into the Aeronautics Account, a dedicated fund used directly for aviation purposes.

In 2021-23 biennium, estimated aircraft excise taxes are $94,000 compared to beneficiary property tax savings of between $186,000 and $254,000

Kenmore Air is the only carrier that has qualified for and used the preference. To estimate the beneficiary savings, JLARC staff consulted with several entities to establish current market values for the fleet of airplanes that were subject to excise tax in 2018:

- Washington State Department of Transportation's Aviation Division to identify all of Kenmore Air's airplanes that were subject to 2018 excise tax.
- Department of Revenue (DOR) to estimate the current (2018) market value for those airplanes.
- Representatives from the commuter air carrier industry to determine the accuracy of the market values established with the assistance of DOR staff. In many cases, the industry representatives provided alternative market values for the airplanes.

Based on these consultations, JLARC staff estimate a range for property tax beneficiary savings. For fiscal year 2018, the range is between $93,000 and $127,000. For the 2021-23 biennium, the estimated range is between $186,000 and $254,000.

Any business that benefits from this preference must pay commuter air carrier aircraft excise tax in lieu of property tax. The excise tax fees paid in lieu of property tax in 2018 were $46,417. This amount is between 50% to 63% less than what JLARC staff estimates would have been paid in property tax for fiscal year 2018.

The aircraft excise tax fees are based on an airplane's weight and remain the same each year. In contrast, the market value of airplanes and property tax rates may fluctuate from year to year. While the amount Kenmore Air paid in aircraft excise tax may have been similar to property tax rates when the tax preference began, the amounts are no longer aligned.

Exhibit 3.1 Estimated property tax beneficiary savings do not equal aircraft excise tax payments

Biennium	Fiscal Year	Range of Estimated State and Local Property Tax	Aircraft Excise Tax Paid (Actual for 2018; estimated for 2019 and beyond)	Estimated Gap Between Aircraft Excise Tax Paid and Estimated Property Tax
2017-19 *7/1/17-6/30/19*	2018	$93,000 - $127,000	$46,417	$46,583 - $80,583
	2019	$91,000 - $126,000	$47,000	$44,000 - $79,000
2019-21 *7/1/19-6/30/21*	2020	$91,000 - $126,000	$47,000	$44,000 - $79,000
	2021	$93,000 - $127,000	$47,000	$46,000 - $80,000
2021-23 *7/1/21-6/30/23*	2022	$93,000 - $127,000	$47,000	$46,000 - $80,000
	2023	$93,000 - $127,000	$47,000	$46,000 - $80,000
	2021-23 Biennium	$186,000 - $254,000	$94,000	$92,000 - $160,000

Source: JLARC staff analysis of data based on consultations with staff from: 1. Department of Revenue Property Tax and Research and Fiscal Analysis divisions, 2. King County Assessor's Office, 3. Washington State Department of Transportation Aviation Division, and 4. Kenmore Air personnel. Estimated property tax due in fiscal years 2019 and 2020 are lower than 2018 due to a required $0.30 property tax rate decrease in calendar year 2019 per RCW 84.52.065(2)(a)(I).

4. Applicable statutes

RCW 84.36.133

Aircraft owned and operated by a commuter air carrier.

(1) An aircraft owned and operated by a commuter air carrier in respect to which the tax imposed under RCW 82.48.030 has been paid for a calendar year is exempt from property taxation for that calendar year.

(2) For the purposes of this section, "aircraft" and "commuter air carrier" have the same meanings as provided in RCW 82.48.010.

Additional statutes were passed in the 2013 legislation that work together to create this targeted preference.

RCW 84.12.200

Definitions.

The definitions in this section apply throughout this chapter unless the context clearly requires otherwise.

(1)(a) "Airplane company" means and includes any person owning, controlling, operating or managing real or personal property, used or to be used for or in connection with or to facilitate the conveyance and transportation of persons and/or property by aircraft, and engaged in the business of transporting persons and/or property for compensation, as owner, lessee or otherwise.

(b) "Airplane company" does not include a "commuter air carrier" as defined in RCW 82.48.010, whose ground property and equipment is located primarily on privately held real property . . .

RCW 82.48.010

Definitions.

The definitions in this section apply throughout this chapter unless the context clearly requires otherwise.

(1) "Aircraft" means any weight-carrying device or structure for navigation of the air which is designed to be supported by the air.

(2) "Commuter air carrier" means an air carrier holding authority under Title 14, Part 298 of the code of federal regulations that carriers passengers on at least five round trips per week on at least one route between two or more points according to its published flight schedules that specify the times, days of the week, and places between which those flights are performed.

RECOMMENDATIONS & RESPONSES

Legislative Auditor's Recommendation

Legislative Auditor's Recommendation: Modify

The preference is meeting one of two inferred objectives. While it is simplifying reporting for one taxpayer and the Department of Revenue , it is not providing an alternative to property tax that results in a similar amount of tax paid.

The Legislature should modify the preference to:

- Provide a method to equalize commuter air carrier excise tax fees on airplanes with property taxes over time.
- Clarify why the preference is limited to commuter air carriers primarily located on private property.
- Provide a performance statement with stated objectives and metrics to determine if objectives are met.

Legislation Required: Yes

Fiscal Impact: Depends on legislation.

Letter from Commission Chair

Available October 2019.

Commissioners' Recommendation

Available October 2019.

Agency Response

If applicable, available October 2019.

MORE ABOUT THIS REVIEW
Study questions

Proposed Study Questions: Commuter Air Carriers Paying Aircraft Excise Tax

State of Washington Joint Legislative Audit and Review Committee ● September 2018

Citizen Commission scheduled a JLARC study of a property tax exemption for airplanes owned by certain Washington commuter air carriers

The 2006 Legislature directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct performance audits of tax preferences. This preference is included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.

In 2013, the Legislature provided a property tax exemption for airplanes owned by certain commuter air carriers. Instead, they are subject to a special aircraft excise tax. The preference has no expiration date.

Eligible carriers must:

- Locate their aircraft primarily on privately held land (e.g., land that is not owned by a governmental entity or port).
- Pay a special aircraft excise tax on their airplanes.

Commuter air carriers:

- Operate "small aircraft" with 60 or fewer seats.
- Carry passengers on at least 5 round-trip flights per week.
- Fly according to published flight schedules

JLARC staff are also separately reviewing a sales and use tax exemption in 2019 for commuter air carriers that use airplanes to provide in-state travel.

2019 study will address whether this preference streamlined and simplified tax reporting and provided a revenue-neutral alternative for eligible carriers

The Legislature did not state an objective for this preference when it was enacted. Based on objectives inferred from comments made by the Department of Revenue and stakeholders, JLARC staff will answer two study questions.

Inferred objectives	Study questions
Streamline and simplify tax reporting	1) Has the tax preference streamlined and simplified tax reporting for the state and taxpayers?
Provide a revenue-neutral alternative to personal property tax for certain commuter air carriers	2) Is the amount of revenue generated from aircraft excise tax similar to the amount that would be collected if the same air carriers paid personal property tax?

Joint Legislative Audit & Review Committee, 106 11th Ave SW, Olympia, WA 98501
(360) 786-5171 ● (360)786-5180 (fax) ● JLARC@leg.wa.gov ● www.jlarc.leg.wa.gov
Keenan Konopaski, Washington State Legislative Auditor

Proposed Study Questions: Commuter Air Carriers Paying Aircraft Excise Tax

Study Timeframe

Preliminary Report:	July 2019	Proposed Final Report: December 2019

Study Team

Team Lead:	Dana Lynn	360.786.5177	dana.lynn@leg.wa.gov
Research Analyst:	Eric Whitaker	360.786.5618	eric.whitaker@leg.wa.gov
Project Coordinator:	Eric Thomas	360.786.5182	eric.thomas@leg.wa.gov

Washington Joint Legislative Audit and Review Committee

106 11th Avenue SW, Suite 2500
PO Box 40910
Olympia, WA 98504-0910

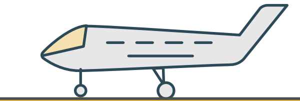
Phone: 360-786-5171
Fax: 360-786-5180
Email: JLARC@leg.wa.gov

Commuter Air Carrier Airplanes (Sales & Use Tax)

2019 JLARC TAX PREFERENCE REVIEW

Estimated 2021-23 beneficiary savings: $447,000

Sales and use tax



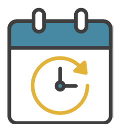
COMMUTER AIR CARRIERS:

- Operate aircraft with 60 or fewer seats
- Carry passengers on at least 5 round-trip flights per week
- Fly according to published flight schedules

Sales and use tax exemption for commuter air carriers to encourage in-state service, maintain service to small or rural airports, and level the playing field

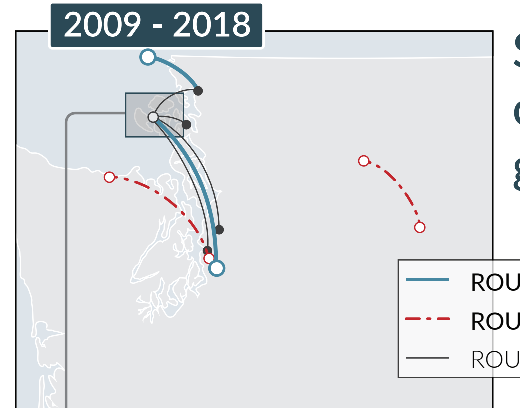
Commuter air carriers are exempt from sales and use tax on purchases of airplanes, parts, maintenance and repairs.

The Legislature enacted this preference in 2009.



The preference has no expiration date.

2009 - 2018



ROUTES ADDED

ROUTES LOST

ROUTES UNCHANGED

Since 2009, the number of commuter air carriers has increased by one. Some areas gained service, while other areas lost it

Number of commuter air carriers **has increased from 2 to 3.**

Service increased to San Juan Islands and ended in Eastern WA and Olympic Peninsula.

2018

EASTSOUND

WESTSOUND

ROSARIO

DEER HARBOR

ROCHE HARBOR

BLAKELY ISLAND

FRIDAY HARBOR

Commuter Air Carriers Added

No change in the number of small or rural airports served, but service locations have shifted

- Service now concentrated in San Juan Islands.
- No out-of-state carriers have entered market.

LEGISLATIVE AUDITOR'S RECOMMENDATION

Clarify expectations for levels of service and locations served

The Legislature should add a performance statement and clarify expectations for the frequency of flights and locations served.

The complete report is on the JLARC web site: www.leg.wa.gov/jlarc
For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
keenan.konopaski@leg.wa.gov • (360) 786-5187

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July 2019

PRELIMINARY REPORT:
2019 TAX PREFERENCE PERFORMANCE REVIEWS

Commuter Air Carrier Airplanes (Sales and Use Tax)

LEGISLATIVE AUDITOR'S CONCLUSION:

Since 2009, the number of commuter air carriers has increased by one. There has been no change in the total number of small or rural airports served, but service has increased in some locations and ended in others.

July 2019

Sales and use tax exemption for commuter air carriers on purchases of airplanes, airplane parts, maintenance, and repairs

The preference provides a sales and use tax exemption for commuter air carriers when they purchase airplanes, or parts, maintenance, and repair services for airplanes, that are used primarily for in-state flights.

Commuter air carriers:

- Operate "small aircraft" with 60 or fewer seats.
- Carry passengers on at least 5 round-trip flights per week.
- Fly according to published flight schedules.

The preference was enacted in 2009 and has no expiration date.

Estimated Biennial Beneficiary Savings
$447,000

Tax Type
Sales and Use Tax
RCWs 82.08.0262(1)(a)(iii), 82.12.0254(1)(a)(ii)
Applicable Statutes

One of three inferred public policy objectives met

The Legislature did not state a public policy objective when it passed this preference in 2009. JLARC staff infer three public policy objectives based on legislative testimony by the primary sponsors and industry representatives.

Objectives (Inferred)	Results
1. Encourage expanded in-state commuter air carrier service.	**Unclear**. The number of commuter air carriers has increased by one. Flight service has increased to the San Juan Islands, but service has ended in other areas of the state.

Objectives (Inferred)	Results
2. Maintain air service to Washington's small or rural airports.	**Unclear**. The total number of airports and airfields served has remained the same between 2009 and 2018, but service locations have shifted. More flights are concentrated in the San Juan Islands.
3. "Level the playing field" with potential out-of-state competition from an Oregon-based commuter air carrier.	**Met**. Preference removes a potential competitive disadvantage. No out-of-state carriers have directly competed with Washington carriers since 2009.

Recommendations

Legislative Auditor's Recommendation: Clarify expectations for levels of service and locations served

The Legislature should clarify its expectations for this preference by adding a performance statement that clearly states the public policy objectives and metrics to determine whether the objectives have been met. The Legislature should clarify what it hopes to achieve in terms of frequency of flights and locations served.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2019.

REVIEW DETAILS

1. What is the preference?

Sales and use tax exemption for commuter air carriers on purchases of airplanes, airplane parts, maintenance, and repairs

Preference has three inferred objectives

The Legislature did not state a public policy objective when it passed this preference. The preference was passed before the Legislature required a performance statement for new tax preferences.

JLARC staff infer three public policy objectives based on legislative testimony by the primary sponsors and industry representatives.

1. Encourage expanded in-state commuter air carrier service by providing a sales and use tax exemption on airplanes used primarily for in-state transportation.
2. Maintain air service at Washington's small or rural airfields.

3. "Level the playing field" with potential out-of-state competition from an Oregon-based commuter air carrier.

Sales and use tax exemption for airplanes used primarily for in-state travel

Commuter air carriers:

- Operate small airplanes with 60 or fewer seats.
- Carry passengers on at least five round-trip flights per week.
- Fly according to published flight schedules.

This sales and use tax exemption applies to carriers that purchase airplanes, or parts, maintenance, and repairs for airplanes, that are used primarily for in-state travel (i.e., more than 50% of flights).

Under separate statutes, carriers are already exempt from sales and use tax for airplanes that are used primarily for out-of-state travel, such as flights between Washington and other states.

Preference has no expiration date

The preference was enacted in 2009 and has no expiration date.

2. Gains and losses for in-state flight service

Since preference began, there is one new commuter air carrier in Washington. Service has increased to the San Juan Islands and ceased in other locations.

Since 2009, the total number of commuter air carriers in Washington has increased from two to three. The number of flights and locations served in the San Juan Islands has increased, but service has been lost in other areas of the state.

Preference was described as removing a disincentive to expand in-state flight service

Representatives for Kenmore Air, a Washington commuter air carrier, testified at 2009 legislative hearings that the preference would potentially allow it to expand its in-state flight service.

At the time, Kenmore Air used its seaplane fleet to fly between in-state locations (e.g., between Kenmore and the San Juan Islands) and out-of-state (e.g., between Lake Washington and Victoria, B.C.). State law already provided a sales and use tax exemption for airplanes used more than 50% of the time for out-of-state flights.

Kenmore Air representatives explained that its in-state flights were close to the 50% mark. If it increased the number of in-state flights, Kenmore risked losing the sales and use tax exemption it

currently received on its entire seaplane fleet. Increasing in-state flights meant that its ratio of out-of-state to in-state travel would fall below 50%.

With the preference, Kenmore Air's entire fleet would be exempt under the existing or the new sales and use tax exemption. The air carrier representatives indicated that the preference would encourage it to expand its in-state flight service.

Commuter air carriers report that the bulk of their revenue is from passenger service, not freight transportation.

Number of commuter air carriers has increased by one

When the preference was enacted in 2009, two commuter air carriers operated in Washington. As of 2018, there are now three commuter air carriers in the state.

Exhibit 2.1: Three commuter air carriers operating in 2018

Corporate Name	Doing Business As	Based Out Of
Kenmore Air Harbor, Inc.	Kenmore Air Express, Kenmore Air	Kenmore
Rugby Aviation, Inc.	San Juan Airlines	Bellingham
West Isle Air, Inc.	Friday Harbor Seaplanes	Renton

Source: JLARC staff analysis of U.S. Department of Transportation data and interviews with Washington commuter air carriers.

Flights have increased to San Juan Island locations and have begun to serve Point Roberts, but flights have ended in other locations

JLARC staff identified the following changes to in-state flight service since the preference began:

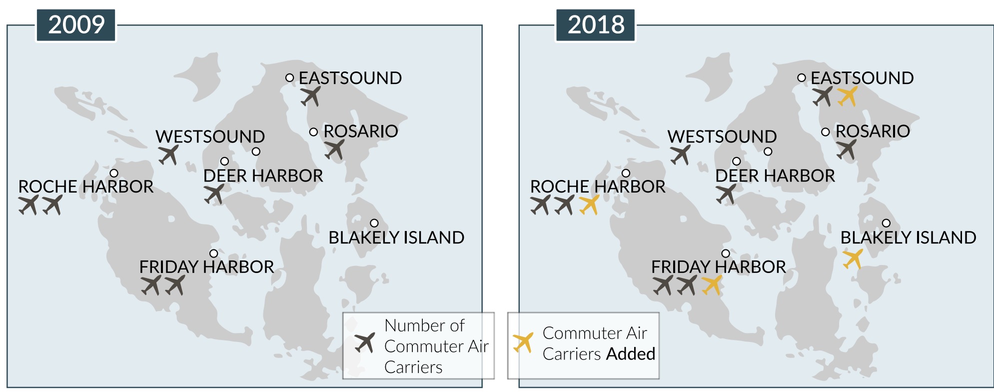
- There are more commuter air carriers flying to more locations in the San Juan Islands in 2018 than in 2009.
- A route between Bellingham and Point Roberts was added.
- Service was lost to Port Angeles.
- Service was lost between locations on Lake Chelan.

JLARC staff were unable to directly compare the number of scheduled flights offered by commuter air carriers in 2009 to the number of flights offered in 2018 because sufficient 2009 data was not available.

Exhibit 2.2: Olympic Peninsula and Eastern Washington lost flight service, Point Roberts and San Juan Islands gained service

Source: JLARC staff analysis of 2009 and 2018 flight schedules, interviews with various airport and commuter air carrier personnel.

Exhibit 2.3: More commuter air carriers with additional flights are serving the San Juan Islands



Source: JLARC staff analysis of 2009 and 2018 flight schedules and interviews with various airport and commuter air carrier personnel.

3. Same number of airports served; shift in locations

No change in the total number of small, rural airports served, but flights are now concentrated in the San Juan Islands

An industry representative testified in 2009 that the preference would help maintain air service to small or rural airports in Washington.

At the time, there were concerns about maintaining this service. The Washington State Department of Transportation Aviation Division projected that smaller commercial service airports could be at risk of losing service in the future if they relied on a single air carrier for scheduled flights.

As of 2018, two small, rural airports (Point Roberts and Blakely Island) and one urban airport (Renton) have gained commuter air carrier service. During the same time frame, commuter air

carrier service was lost in Port Angeles and between two points on Lake Chelan. Overall, there has been no net change in the number of locations served.

Exhibit 3.1: No net change in number of locations served by commuter air carriers between 2009 and 2018

Small or Rural Airports with Scheduled Commuter Air Carrier Service	2009	2018
Port Angeles (land)	Kenmore Air Express	No service
Chelan (sea)	Chelan Seaplanes	No service
Stehekin (sea)	Chelan Seaplanes	No service
Blakely Island (land)	No service	San Juan Airlines
Port Roberts (land)	No service	San Juan Airlines
Renton (sea)	No service	Friday Harbor Air
Kenmore (sea)	Kenmore Air	Kenmore Air
Seattle Lake Union (sea)	Kenmore Air	Kenmore Air
Bellingham (land)	San Juan Airlines	San Juan Airlines
Anacortes (land)	San Juan Airlines	San Juan Airlines
Friday Harbor (San Juan Island) (land and sea)	Kenmore Air Express (land), San Juan Airlines (land)	Kenmore Air Express (land), San Juan Airlines (land), Friday Harbor Air (sea)
Roche Harbor (San Juan Island) (land and sea)	Kenmore Air (sea), San Juan Airlines (land)	Kenmore Air (sea), San Juan Airlines (land), Friday Harbor Air (sea)
Rosario (Orcas Island) (sea)	Kenmore Air	Kenmore Air
West Sound (Orcas Island) (sea)	Kenmore Air	Kenmore Air
Deer Harbor (Orcas Island) (sea)	Kenmore Air	Kenmore Air
Eastsound (Orcas Island) (land)	Kenmore Air Express	Kenmore Air Express, San Juan Airlines
Lopez Island (land and sea)	Kenmore Air (sea)	Kenmore Air (sea), San Juan Airlines (land)

Source: JLARC staff analysis of 2009 WSDOT Aviation Division system plan, commuter air carrier web-based schedules as of November 2018, and interviews with Washington's three commuter air carriers.

Unclear if commuter air carrier service to small or rural airports has been maintained as envisioned by Legislature

As of 2018, most commuter air carrier service in Washington is to or from destinations in the San Juan Islands. Three commuter air carriers now serve the San Juan Islands. As of January 2019, there is no commuter air service to the Olympic Peninsula, Southwest Washington, or Eastern Washington.

While there has been no net change in the number of small, rural airports served, it is unclear if the shift in locations is what the Legislature envisioned for maintaining service.

Potential for new or resumed service in future years

As of January 2019, Oak Harbor and Port Angeles airport personnel report that the airports are working to re-establish commuter air carrier service in the near future.

- Port Angles was last served by a commuter air carrier in 2014.
- Oak Harbor was last served by a commuter air carrier in 2008.

West Isle Air has indicated that it hopes to resume scheduled flights between points on Lake Chelan in 2020. The service has not operated since 2016.

4. Preference removes potential competitive disadvantage

No out-of-state carriers have directly competed with Washington carriers since 2009

In 2009, bill sponsors from the House and Senate noted the preference was needed to "level the playing field" with an Oregon-based commuter air carrier. Out-of-state carriers typically do not pay Washington sales or use tax on their airplanes, or airplane parts, maintenance, or repairs.

Potential out-of-state competition never entered market

SeaPort Airlines, an Oregon-based carrier, started providing direct flights between Portland International Airport and Boeing Field in June 2008. In 2011, it ceased those flights.

SeaPort never directly competed with any Washington commuter air carrier routes since the preference was enacted. The Oregon-based air carrier filed for bankruptcy and ultimately liquidated in September 2016. No other out-of-state commuter air carriers have entered the Washington market since then.

5. Three commuter air carriers benefit

Washington's three commuter air carriers benefit from the preference

Tax preferences have direct beneficiaries (entities whose state tax liabilities are directly affected) and may have indirect beneficiaries (entities that may receive benefits from the preference, but are not the primary recipient of the benefit).

Three commuter air carriers are direct beneficiaries

According to the U.S. Department of Transportation and industry sources, three commuter air carriers currently operate in Washington and benefit from the preference:

- **Kenmore Air Harbor, Inc.**, doing business as Kenmore Air (seaplanes) and Kenmore Air Express (land-based).
- **Rugby Aviation, Inc.**, doing business as San Juan Airlines.
- **West Isle Air, Inc.**, doing business as Friday Harbor Seaplanes. Chelan Seaplanes is also owned by West Isle Air, but has not operated since 2016.

Indirect beneficiaries are located in areas served by flights

Residents and local businesses of communities serviced by commuter air carriers, as well as tourists, may indirectly benefit from the preference.

6. Estimated biennial savings: $447,000

In 2021-23 biennium, the estimated direct beneficiary savings is $447,000

JLARC staff estimate the direct beneficiary savings for fiscal year 2018 is $202,000. The estimated beneficiary savings for the 2021-23 Biennium is $447,000.

JLARC staff based these estimates on average expenditure data for a two-year period provided by industry representatives. The estimates are for expenditures on airplane maintenance, engine purchases, and other capital costs. They do not include any airplane purchases because the representatives did not anticipate any during this time period.

Exhibit 6.1: Estimated direct beneficiary savings from sales and use tax exemption

Biennium	Fiscal Year	Estimated Parts, Maintenance, and Repair Costs	State Sales Tax	Local Sales Tax	Estimated Total Beneficiary Savings
2017-19 *(7/1/17-6/30/19)*	2018	$2,112,000	$137,000	$65,000	$202,000
	2019	$2,165,000	$141,000	$66,000	$207,000
2019-21 *(7/1/19-6/30/21)*	2020	$2,215,000	$144,000	$68,000	$212,000
	2021	$2,258,000	$147,000	$69,000	$216,000

Biennium	Fiscal Year	Estimated Parts, Maintenance, and Repair Costs	State Sales Tax	Local Sales Tax	Estimated Total Beneficiary Savings
2021-23 (7/1/21-6/30/23)	2022	$2,310,000	$150,000	$71,000	$221,000
	2023	$2,364,000	$154,000	$72,000	$226,000
	2021-23 Biennium	$4,674,000	$304,000	$143,000	$447,000

Source: JLARC staff analysis of average expenditure data for two-year period provided by industry representatives for estimated maintenance, engine purchases, and other capital expenditures for airplanes. Estimate does not include any airplane purchases during the three biennia covered, per discussions with industry representatives. Growth for 2019 and beyond is calculated using I.H.S. Markit Growth Factor, Tables 1118, Prices and Wages, Consumer Prices All Urban, November 2018.

7. Applicable statutes

RCWs 82.08.0262(1)(a)(iii), 82.12.0254(1)(a)(ii)

RCW 82.08.0262

Exemptions - Sales of airplanes, locomotives, railroad cars, or watercraft for use in interstate or foreign commerce or outside the territorial waters of the state or airplanes sold to United States government - Components thereof and of motor vehicles or trailers used for constructing, repairing, cleaning, etc. - Labor and service for constructing, repairing, cleaning, etc.

(1) The tax levied by RCW 82.08.020 does not apply to:

(a) Sales of airplanes (i) to the United States government; (ii) for use in conducting interstate or foreign commerce by transporting property or persons for hire or by performing services under a contract with the United States government; or (iii) for use in providing intrastate air transportation by a commuter air carrier;

(b) Sales of locomotives, railroad cars, or watercraft for use in conducting interstate or foreign commerce by transporting property or persons for hire or for use in conducting commercial deep sea fishing operations outside the territorial waters of the state;

(c) Sales of tangible personal property that becomes a component part of such airplanes, locomotives, railroad cars, or watercraft, and of motor vehicles or trailers whether owned by or leased with or without drivers and used by the holder of a carrier permit issued by the interstate commerce commission or its successor agency authorizing transportation by motor vehicle across the boundaries of this state, in the course of constructing, repairing, cleaning, altering, or improving the same; and

(d) Sales of or charges made for labor and services rendered in respect to such constructing, repairing, cleaning, altering, or improving.

(2) The term "commuter air carrier" means an air carrier holding authority under Title 14, Part 298 of the code of federal regulations that carriers passengers on at least five round trips per week on at least one route between two or more points according to its published flight schedules that specify the times, days of the week, and places between which those flights are performed.

RCW 82.12.0254

Exemptions - Use of airplanes, locomotives, railroad cars, or watercraft used in interstate or foreign commerce or outside state's territorial waters - Components - Use of vehicles in the transportation of persons or property across state boundaries - Conditions - Use of vehicle under trip permit to point outside state.

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

(a) Any airplane used primarily in (i) conducting interstate or foreign commerce by transporting property or persons for hire or by performing services under contract with the United States government or (ii) providing intrastate air transportation by a commuter air carrier as defined in RCW 82.08.0262.

(b) Any locomotive, railroad car, or watercraft used primarily in conducting interstate or foreign commerce by transporting property or persons for hire or used primarily in commercial deep sea fishing operations outside the territorial waters of the state;

(c) Tangible personal property that becomes a component part of any such airplane, locomotive, railroad car, or watercraft in the course of repairing, cleaning, altering, or improving the same; and

(d) Labor and services rendered in respect to such repairing, cleaning, altering, or improving.

(2) The provisions of this chapter do not apply in respect to the use by a nonresident of this state of any vehicle used exclusively in transporting persons or property across the boundaries of this state and in intrastate operations incidental thereto when such vehicle is registered in a foreign state and in respect to the use by a nonresident of this state of any vehicles so registered and used within this state for a period not exceeding fifteen consecutive days under such rules as the department must adopt. However, under circumstances determined to be justifiable by the department a second fifteen day period may be authorized consecutive with the first fifteen day period; and for the purposes of this exemption the term "nonresident" as used herein includes a user who has one or more places of business in this state as well as in one or more other states, but the exemption for nonresidents applies only to those vehicles which are most frequently dispatched, garaged, services, maintained, and operated from the user's place of business in another state.

(3) The provisions of this chapter do not apply in respect to the use by the holder of a carrier permit issued by the interstate commerce commission or its successor agency of any vehicles whether owned by or leased with or without driver to the permit holder and used in substantial part in the normal and ordinary course of the user's business for transporting therein persons or property for hire across the boundaries of this state; and in respect to the use of any vehicles

while being operated under the authority of a trip permit issued by the director of licensing pursuant to RCW 46.16A.320 and moving upon the highways from the point of delivery in this state to a point outside this state; and in respect to the use of tangible personal property which becomes a component part of any vehicle used by the holder of a carrier permit issued by the interstate commerce commission or its successor agency authorizing transportation by motor vehicle across the boundaries of this state whether such vehicle is owned by or leased with or without driver to the permit holder, in the course of repairing, cleaning, altering, or improving the same; also the use of labor and services rendered in respect to such repairing, cleaning, altering, or improving.

RECOMMENDATIONS & RESPONSES

Legislative Auditor's Recommendation

Legislative Auditor's Recommendation: Clarify expectations for levels of service and locations served

The Legislature should clarify its expectations for this preference by adding a performance statement that clearly states the public policy objectives and metrics to determine whether the objectives have been met. The Legislature should clarify what it hopes to achieve in terms of frequency of flights and locations served.

Legislation Required: Yes

Fiscal Impact: Depends on legislative action.

Letter from Commission Chair

Available October 2019.

Commissioners' Recommendation

Available October 2019.

Agency Response

If applicable, available October 2019.

Study questions

Proposed Study Questions: Commuter Air Carrier Airplanes

State of Washington Joint Legislative Audit and Review Committee • September 2018

Citizen Commission scheduled a JLARC study of a sales and use tax exemption for commuter air carriers that use airplanes to provide in-state travel

Commuter air carriers:

- Operate "small aircraft" with 60 or fewer seats.
- Carry passengers on at least 5 round-trip flights per week.
- Fly according to published flight schedules specifying the times and routes.

The 2006 Legislature directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct performance audits of tax preferences. This preference is included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.

In 2009, the Legislature established a sales and use tax exemption for commuter air carriers that purchase and repair aircraft used primarily for in-state air transportation. The preference has no expiration date.

JLARC staff are also separately reviewing a property tax exemption in 2019 for commuter air carriers paying aircraft excise tax on their airplanes.

2019 study will address whether this preference led to expanded in-state airline service or any changes in airline service at smaller airports

The Legislature did not state an objective for this preference when it was enacted. Based on objectives inferred from statements by the prime sponsor and stakeholders, JLARC staff will answer three questions.

Inferred objectives	Study questions
Provide tax relief to encourage expanded in-state commuter air service.	1) Have commuter air carriers expanded their schedules to add more in-state flights or locations since the preference was enacted?
Help maintain air service that connects small, rural airports throughout Washington.	2) Has there been a change in the number of Washington's small airfields served by in-state commuter air carriers since the preference was enacted?
"Level the playing field" for Washington-based carriers competing with an Oregon-based commuter air carrier.	3) How does the tax burden for commuter air carriers compare between Washington and Oregon?

Joint Legislative Audit & Review Committee, 106 11th Ave SW, Olympia, WA 98501
(360) 786-5171 • (360)786-5180 (fax) • JLARC@leg.wa.gov • www.jlarc.leg.wa.gov
Keenan Konopaski, Washington State Legislative Auditor

Proposed Study Questions: Commuter Air Carrier Airplanes

Study Timeframe

Preliminary Report:	July 2019	Proposed Final Report: December 2019

Study Team

Team Lead:	Dana Lynn	360.786.5177	dana.lynn@leg.wa.gov
Research Analyst:	Eric Whitaker	360.786.5618	eric.whitaker@leg.wa.gov
Project Coordinator:	Eric Thomas	360.786.5182	eric.thomas@leg.wa.gov

JLARC Study Process

Study Mandate — Budget, legislation, committee direction
→ **Proposed Study Questions**
→ **Legislative Auditor's Preliminary Report**
→ **For Tax Preferences:**
- Citizen Commission meeting
- Public testimony
- Commission adopts comments

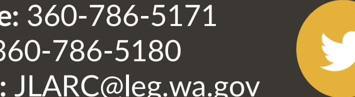
→ **Legislative Auditor's Proposed Final Report** — Agency response included
→ **Final Report** — Option to append committee comment

Committee votes to distribute completed audit

Washington Joint Legislative Audit and Review Committee

106 11th Avenue SW, Suite 2500
PO Box 40910
Olympia, WA 98504-0910

Phone: 360-786-5171
Fax: 360-786-5180
Email: JLARC@leg.wa.gov



Financial Institutions' Income from Certain Airplane Loans

2019 JLARC TAX PREFERENCE REVIEW

Estimated 2021-23 beneficiary savings: $2.1 million - $3.4 million

Business and occupation (B&O) tax

Preference provides B&O tax deduction to out-of-state financial institutions when they make loans to Washington-based commercial airlines

The loans must be used to **purchase commercial airplanes. Out-of-state lenders pay no B&O tax** on the interest and fees they earn from the loans they provide.

Without the preference, airline representatives indicate they would be required to reimburse lenders for B&O taxes during the life of the loan.

The Legislature enacted this preference in 2010.

The preference has no expiration date.

Inferred objective achieved

Preference provides targeted financial relief to two Washington-based airlines and about 32 out-of-state financial institutions

THE BENEFICIARIES ARE:

TWO AIRLINES
Alaska Airlines and Horizon Air Industries are the only commercial airlines headquartered in WA that have benefited to date.

LEGISLATIVE AUDITOR'S RECOMMENDATION

Clarify the intent and duration

If the preference is intended to provide targeted financial relief to Washington-based airlines, the Legislature should add a performance statement and determine whether the relief is meant to be permanent or time-limited.

The complete report is on the JLARC web site: www.leg.wa.gov/jlarc

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
keenan.konopaski@leg.wa.gov • (360) 786-5187

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@WaLegAuditor
Updated August 20, 2019

PRELIMINARY REPORT:

2019 TAX PREFERENCE PERFORMANCE REVIEWS

Financial Institutions' Income from Certain Airplane Loans

LEGISLATIVE AUDITOR'S CONCLUSION:

The preference provides targeted financial relief to two airlines headquartered in Washington. The Legislature should add a performance statement to clearly state the public policy objective.

Updated August 20, 2019

Preference provides B&O tax deduction to out-of-state financial institutions when they make loans to Washington-based commercial airlines

The Legislature enacted this preference in 2010. The preference provides a business and occupation (B&O) tax deduction to out-of-state financial institutions when they make loans to commercial airlines headquartered in Washington. The loans must be secured by commercial airplanes. Out-of-state lenders do not pay B&O tax on income they earn from interest and fees on these loans.

Estimated Biennial Beneficiary Savings
$2.1 Million - $3.4 Million
Tax Types
Business and Occupation Tax
RCW 82.04.43391
Applicable Statutes

The preference was included as part of broader legislation that extended the B&O tax to service businesses that were not physically present in Washington. The tax applied to businesses that met minimum thresholds for receipts from Washington. As a result, some out-of-state lenders became subject to B&O tax. The preference exempts out-of-state lenders from owing B&O tax on income from airplane loans they make to Washington-based commercial airlines.

The preference does not have an expiration date.

Preference achieves inferred public policy objective

The Legislature did not state a public policy objective when the preference passed in 2010. JLARC staff infer an objective based on information provided by the Department of Revenue and the airlines impacted.

Objective (Inferred)	Results
Provide targeted financial relief to commercial airlines headquartered in Washington by exempting out-of-state lenders from owing B&O tax on their loan income. The airlines typically pay these taxes as part of their loan agreements with the financial institutions.	**Met.** The preference is providing targeted financial relief to two commercial airlines headquartered in Washington. Alaska Airlines and Horizon Air Industries have both benefited to date.

Recommendations

Legislative Auditor's Recommendation: Clarify the intent and duration

The Legislature should clarify the intent and duration of the tax preference. If the preference is intended to provide targeted financial relief to Washington-based airlines, the Legislature should add a performance statement and determine whether the relief is meant to be permanent or time-limited.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2019.

This report was updated on July 19, 2019 to revise beneficiary savings as a result of new legislation, and on August 20, 2019, to clarify the preference's beneficiaries.

REVIEW DETAILS

1. Preference achieves inferred objective

Preference provides targeted financial relief to Washington-based airlines by exempting out-of-state lenders from owing B&O tax on airplane loans they provide

JLARC staff infer public policy objective

The Legislature did not state a public policy objective when it passed this preference. The preference passed before the Legislature's requirement to provide a performance statement for each preference. Although the underlying bill was heavily debated in the Legislature, the section establishing this tax preference was never discussed in the public record.

Based on information obtained from the airlines impacted by the preference and the Department of Revenue, JLARC staff infer the preference was intended to provide targeted financial relief to airlines headquartered in Washington.

Washington-based airlines benefit when out-of-state lenders are not taxed on income they earn from airplane loans

The preference provides a business and occupation (B&O) tax deduction to out-of-state lenders on income they earn from airplane loans made to Washington-based airlines.

Airline representatives indicate that their loan contracts with lenders require them to reimburse the financial institutions for any additional costs, including state taxes, that may occur during the life of the loan. Because out-of-state lenders are exempt from B&O tax on airplane loans, this cost is not passed on to the Washington-based airlines receiving the loans.

The preference applies to lenders located outside of Washington. Financial institutions with locations in Washington continue to owe B&O tax on the income they earn from airplane loans. Out-of-state lenders may receive advantageous tax treatment compared to in-state lenders.

Preference included in 2010 legislation that changed tax rules for service businesses

The preference was included in broader legislation that changed how B&O tax was applied to certain income earned by service businesses, including financial institutions.

Until 2010, financial businesses with Washington customers were generally not subject to B&O tax if the business had no physical presence in the state.

In 2010, the Legislature extended the B&O tax to service businesses that are not physically present in Washington. The tax applied to businesses that met minimum thresholds for property, payroll, and receipts from Washington. As a result, some out-of-state lenders became subject to B&O tax. However, this preference exempts out-of-state lenders from owing B&O tax on airplane loans they make to Washington-based commercial airlines.

Preference has no expiration date

The preference took effect June 1, 2010, and has no expiration date.

2. Two airlines and 32 lenders benefit

Two airlines headquartered in Washington and approximately 32 out-of-state financial institutions benefit from the preference

Tax preferences have **direct beneficiaries** (entities whose state tax liabilities are directly affected) and may have **indirect beneficiaries** (entities that may receive benefits from the preference, but are not the primary recipient of the benefit). Because JLARC staff infer this preference was primarily intended to benefit the indirect beneficiary, the indirect beneficiary is discussed first.

Indirect beneficiaries: Washington-based Alaska Airlines and Horizon Air Industries

The indirect beneficiaries of this preference are Alaska Airlines and Horizon Air Industries, the only commercial airlines headquartered in Washington that have benefited to date. Alaska Airlines and Horizon Air Industries are subsidiaries of Alaska Air Group.

Alaska Air Group representatives state that the terms of their loan agreements require them to reimburse the lenders for any additional costs, including state taxes, that may occur during the

life of the loan. Because of this preference, the out-of-state lenders do not owe business and occupation (B&O) tax on their loan income, and no additional tax is passed on to the two airlines.

Other industries may use similar contract agreements that pass on taxes and other costs to their customers. JLARC staff did not investigate the contract terms of other industries, which involve private legal agreements between numerous parties and across multiple business sectors.

Direct beneficiaries: Out-of-state lenders

In addition to the two Washington-based airlines, approximately 32 financial institutions located outside of Washington directly benefited from this tax preference in 2018. These businesses were exempt from B&O tax on income they earned from loans made to Alaska Airlines and Horizon Air Industries.

Without this preference, these businesses would be subject to B&O tax if they met minimum thresholds for property, payroll, or receipts from Washington.

3. Estimated biennial savings: $2.1 million - 3.4 million

Estimated direct revenue impact ranges between $2.1 million and $3.4 million in 2021-23 Biennium

JLARC staff estimate the direct beneficiary savings for out-of-state lenders in Fiscal Year 2018 was $857,000. The estimated beneficiary savings for the 2021-23 biennium is between $2.1 million and $3.4 million.

The estimated beneficiary savings increase in future years due to a 20% surcharge added to the service activities business and occupation (B&O) tax rate and another B&O tax increase that applies to specified financial institutions. Both increases take effect January 1, 2020.

Exhibit 3.1: Estimated direct beneficiary savings from B&O tax deduction

Biennium	Fiscal Year	Estimated Income Earned by Out-of-State Lenders from Loans to WA-Based Airline Company	Range for Estimated Direct Beneficiary Savings
2017-19 *7/1/17-6/30/19*	2018	$57,100,000	$857,000
	2019	$57,100,000	$857,000
2019-21 *7/1/19 - 6/30/21*	2020	$57,100,000	$942,000 - $1,285,000
	2021	$57,100,000	$1,028,000 - $1,713,000
2021-23 *7/1/21-6/30/23*	2022	$57,100,000	$1,028,000 - $1,713,000
	2023	$57,100,000	$1,028,000 - $1,713,000
	2021-23 Biennium	$114,200,000	$2,056,000 - $3,426,000

Source: JLARC staff analysis and calculations based on detail provided by Alaska Air Group.

As noted in this report, the B&O taxes owed by out-of-state lenders would typically be passed on to the airlines. Because of this preference, both the out-of-state lenders and the Washington-based airlines receive benefits. Alaska Air Group's annual adjusted net income for 2018 was $554 million, compared to $791 million in 2017.

4. Applicable statutes

RCW 82.04.43391, RCW 82.04.080(2)

Business and Occupation Tax

RCW 82.04.43391

Deductions - Commercial aircraft loan interest and fees

(1) In computing tax there may be deducted from the measure of tax interest and fees on loans secured by commercial aircraft primarily used to provide routine air service and owned by:

(a) An air carrier as defined in RCW 82.42.010, which is primarily engaged in the business of providing passenger air service;

(b) An affiliate of such air carrier; or

(c) A parent entity for which such air carrier is an affiliate.

(2) The deduction authorized under this section is not available to any person who is physically present in this state as determined under RCW 82.04.067(6).

(3) For purposes of this section, the following definitions apply:

(a) "Affiliate" means a person is "affiliated," as defined in RCW 82.04.645, with another person; and

(b) "Commercial aircraft" means a commercial airplane as defined in RCW 82.32.550.

RCW 82.04.080(2)

(1) "Gross income of the business" means the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

(2) Financial institutions must determine gains realized from trading in stocks, bonds, and other evidences of indebtedness on a net annualized basis. For purposes of this subsection, a financial institution means a person within the scope of the rule adopted by the department under the authority of RCW 82.04.460(2).

RECOMMENDATIONS & RESPONSES

Legislative Auditor's Recommendation

Legislative Auditor's Recommendation: Clarify the intent and duration

The Legislature should clarify the intent and duration of this preference.

If the preference is intended to provide targeted financial relief to Washington-based airlines, the Legislature should add a performance statement and determine whether the relief is meant to be permanent or time-limited.

Legislation Required: Yes

Fiscal Impact: Depends on legislative action.

RECOMMENDATIONS & RESPONSES

Letter from Commission Chair

Available October 2019.

RECOMMENDATIONS & RESPONSES

Commissioners' Recommendation

Available October 2019.

RECOMMENDATIONS & RESPONSES

Agency Response

If applicable, available October 2019.

Washington Joint Legislative Audit and Review Committee

106 11th Avenue SW, Suite 2500
PO Box 40910
Olympia, WA 98504-0910

Phone: 360-786-5171
Fax: 360-786-5180
Email: JLARC@leg.wa.gov

Hog Fuel to Produce Energy

2019 JLARC TAX PREFERENCE REVIEW

Estimated 2021-23 beneficiary savings: $5.6 million

Sales and use tax

Beneficiaries are exceeding the goal of retaining 75% of jobs at participating facilities

Sales and use tax exemption for businesses that purchase hog fuel to produce energy.

WHAT IS "HOG FUEL"?

Wood waste or residuals from lumber mills, construction or demolition sites.

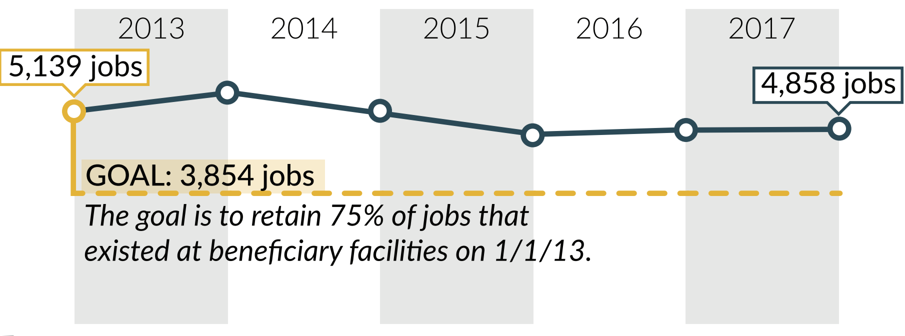
Tree parts and other woody debris from timber harvesting or forest thinning (also known as "forest-derived biomass").

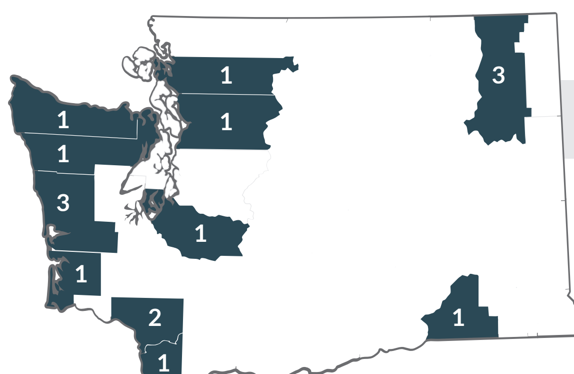
Enacted in 2009, extended in 2013.

Scheduled to expire June 30, 2024.

Facilities kept 94.5% of the jobs they reported in January 2013

Preference enacted Jan. 1, 2013 and measured Dec. 31 of each year therafter.





16 facilities used the preference in 2017

47% of beneficiary employees' annual wages were **$60,000 or more.**

Average annual wage in the counties where facilities are located was **$51,000.**

In 2017, over 80% of facility employees enrolled in employer-provided medical, dental, and retirement plans

51% of Washington private sector employees enrolled in employer-provided medical plans. State-level dental and retirement enrollment data is not available.

LEGISLATIVE AUDITOR'S RECOMMENDATION

Continue

The Legislature should continue the preference by extending the expiration date before it expires on June 30, 2024.

- Facilities throughout Washington are using the preference. To date, beneficiaries are exceeding the stated goal of retaining at least 75 percent of the jobs at the facilities where the preference is used.

The complete report is on the JLARC web site: www.leg.wa.gov/jlarc

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
keenan.konopaski@leg.wa.gov • (360) 786-5187

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July 2019

PRELIMINARY REPORT: 2019 TAX PREFERENCE PERFORMANCE REVIEWS

Hog Fuel to Produce Energy

LEGISLATIVE AUDITOR'S CONCLUSION:

The Legislature should continue this preference because beneficiaries are exceeding the goal of retaining 75% of the jobs at participating facilities.

July 2019

Sales and use tax exemption for businesses that purchase hog fuel to produce energy

Estimated Biennial Beneficiary Savings
$5.6 Million
Tax Type
Sales and Use Tax
RCWs 82.08.956, 82.12.956
Applicable Statutes

Businesses that purchase hog fuel to produce electricity, steam, heat, or biofuel do not pay sales or use tax on their fuel purchases.

The term "hog fuel" is used to describe:

- Wood waste and other wood residuals, including forest-derived biomass, that are ground into small wood chips.
- These wood remnants are used in boilers and furnaces to produce energy.

The preference originally took effect July 1, 2009. In 2013, the Legislature extended the expiration date to June 30, 2024.

Beneficiaries are meeting stated public policy objective

The Legislature stated an objective for this preference in 2013 when it revised the existing sales and use tax exemption for businesses that purchase hog fuel to produce energy.

Objective (Stated)	Result
Retain "relatively high wage jobs" in counties with facilities that purchase and use hog fuel. Specifically, each of the facilities that use the exemption should retain 75% of the jobs it had on January 1, 2013.	**Meeting objective**. Between January 2013 and December 2017, facilities that used the exemption have retained 94.5% of their jobs. In 2017, 47% of beneficiary employees earned $60,000 or more, which is $9,000 more than the average wage in counties where beneficiary facilities are located. In addition, the percent of employees earning $60,000 or more per year increased in each county cohort between 2013 and 2017. The Legislature's job retention goal continues through 2024, when the preference is scheduled to expire.

Recommendations

Legislative Auditor's Recommendation: Continue if facilities keep achieving the 75% job retention goal

The Legislature should continue the preference because the statutory employment goal is being met.

The Legislature should monitor facility employment levels through 2023 to determine if they continue to meet the statutory goal.

- If employment levels continue to meet the statutory goal, then the Legislature will need to decide in the 2024 legislative session whether to extend the preference and re-state or update employment goals.
- If employment levels do not continue to meet the statutory goal, then the Legislature should allow the preference to expire on June 30, 2024.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2019.

REVIEW DETAILS

1. What is the preference?

Businesses do not pay sales or use tax when they purchase hog fuel to produce energy

Legislature stated its intent to retain manufacturing jobs in rural areas

In 2013, the Legislature extended an existing sales and use tax exemption for businesses that purchase hog fuel to produce energy. The Legislature stated its intent to retain "relatively high wage jobs" in counties where these businesses are located.

This preference only applies to businesses that purchase hog fuel from others

The preference applies to businesses that purchase hog fuel from other entities in order to produce electricity, steam, heat, or biofuel. When wood scraps and forest debris are ground into small pieces, the remnants can be used to fuel boilers and furnaces that generate energy.

The term "hog fuel" came from a device known as a "hog" that was once commonly used to process wood and forest debris. "Hog fuel" is now used to describe the ground remnants made from:

- Wood waste and other wood residuals that often come from lumber mills and construction and demolition sites.
- Tree limbs, tree tops, needles, leaves, and other woody debris that are generated from timber harvesting, forest thinning, fire suppression, and other forest health activities. This debris is also known as "forest-derived biomass."

A different statute exempts businesses that produce their own hog fuel

When hog fuel is produced and used within the same facility or manufacturing operation, it is exempt from use tax under a different statute[1].

For example, if a lumber mill generates wood chips as a byproduct of its manufacturing activities, and then uses those wood chips to create steam or energy within its manufacturing facility, the wood chip byproducts are not taxed.

2013 legislation established a job retention goal and a penalty for facilities that close after using the exemption

The 2013 Legislature revised an existing sales and use tax exemption for businesses that purchase hog fuel. The Legislature set a job retention goal for each of the facilities that use the preference, and directed JLARC staff to review the preference by October 31, 2019.

The goal for beneficiaries is to retain 75% of the jobs that they reported having in January 2013. This goal was set in response to concerns raised by the industry about economic pressure to close industrial mills in rural areas of Washington and move the economic activity out-of-state or overseas.

Statute also directed JLARC staff to report on the following job-related metrics for the facilities that were using the preference on January 1, 2013:

- Baseline job numbers and employee wages and benefits as of January 1, 2013.
- Changes in job numbers during the years reviewed.
- Job retention rates and whether facilities have achieved the goal of retaining 75% of their jobs compared to their baseline job numbers.
- Wages and benefits (including medical, dental, and retirement) of employees at these facilities compared to average wages and benefits in the counties where they are located.

The Legislature also included a penalty or "clawback" provision. If a facility uses the preference and later closes (resulting in job losses), then the Department of Revenue must bill the facility for the amount of sales and use tax exempted during the prior two calendar years.

[1] RCW 82.12.0263

Preference scheduled to expire in 2024

The preference originally took effect July 1, 2009. In 2013, the Legislature revised the preference to add a public policy objective, metrics, and a penalty provision. It also extended the expiration date to June 30, 2024.

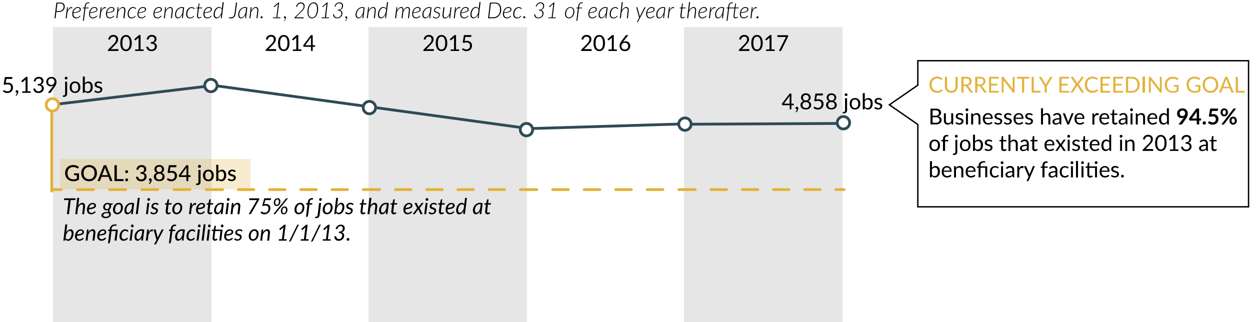
2. Facilities are exceeding 75% job retention goal

Facilities that use the preference retained 94.5% of their jobs between 2013 and 2017

The Legislature set a goal for each of the facilities using the preference: retain 75% of the jobs that they reported having on January 1, 2013.

As of December 31, 2017, beneficiaries maintained 94.5% of their jobs. This percentage is based on the total jobs reported by all facilities using the preference in 2013 compared to the total jobs reported by facilities using the preference in 2017. The percentage of jobs maintained at each facility using the preference ranged from 82% to 112%.

Exhibit 2.1: Businesses retained 94.5% of the jobs they had in 2013



Source: JLARC staff analysis of Department of Revenue Annual Survey data for hog fuel sales and use tax exemption and consultation with Department of Revenue staff.

During the same time period, the Washington wood product and paper product manufacturing industry reported a high job retention rate. The industry includes businesses that use the preference and businesses that do not. Many of Washington's wood and paper product manufacturers use hog fuel, but produce enough for their own needs that they do not need to purchase it from other sources.

Most facilities using the preference are located in rural areas of Western Washington

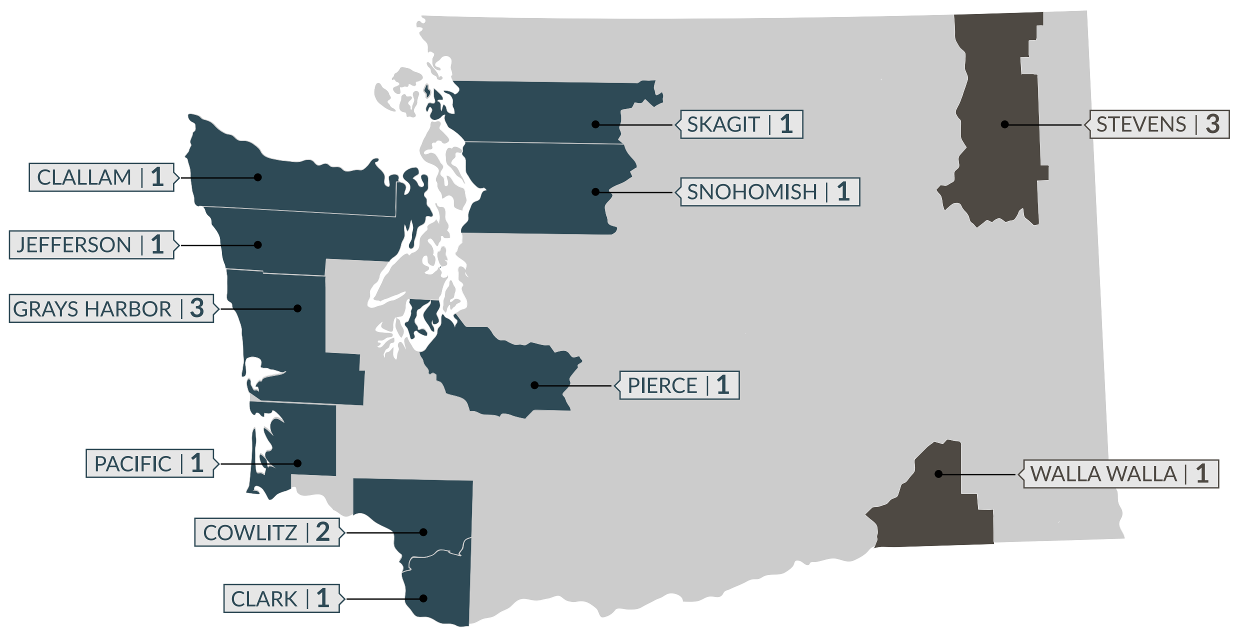
Beneficiary facilities are located throughout the state, but the majority are in rural areas of Western Washington. In 2017, beneficiaries included wood product manufacturers, paper product manufacturers, and a facility producing electrical energy.

Exhibit 2.2: Statewide employment for wood and paper product manufacturing industry in 2017 was 97.5% of 2013 employment levels

Source: JLARC staff analysis of Employment Security Department Quarterly Census of Employment and Wages, annual reports, 2013 through 2017.

There was a total of 16 facilities in 11 counties that used the preference in 2017. Due to ownership changes in two facilities, a total of 18 businesses claimed the exemption.

Exhibit 2.3: Twelve of the 16 facilities using the preference in 2017 are located in Western Washington



Source: JLARC staff analysis of Department of Revenue 2017 annual survey detail and online business information detail.

3. Nearly half of beneficiary employees earned over $60,000

In 2017, 47% of employees' annual wages were above $60,000

In 2017, almost half of the employees at beneficiary facilities earned more than the average county wage. The actual percentages ranged from 34% to 54% of all employees, depending on the county. The average annual wage for the 11 counties where facilities operated was $51,000.

Beneficiaries are grouped into five geographic cohorts and three wage bands

State law prohibits public disclosure of wage data reported by facilities using the preference. In order to provide information on wages, JLARC staff grouped facilities from a similar geographic area into cohorts. Below is the wage detail for five cohorts made up of three or more facilities each. Facilities report their employee wages in three wage bands:

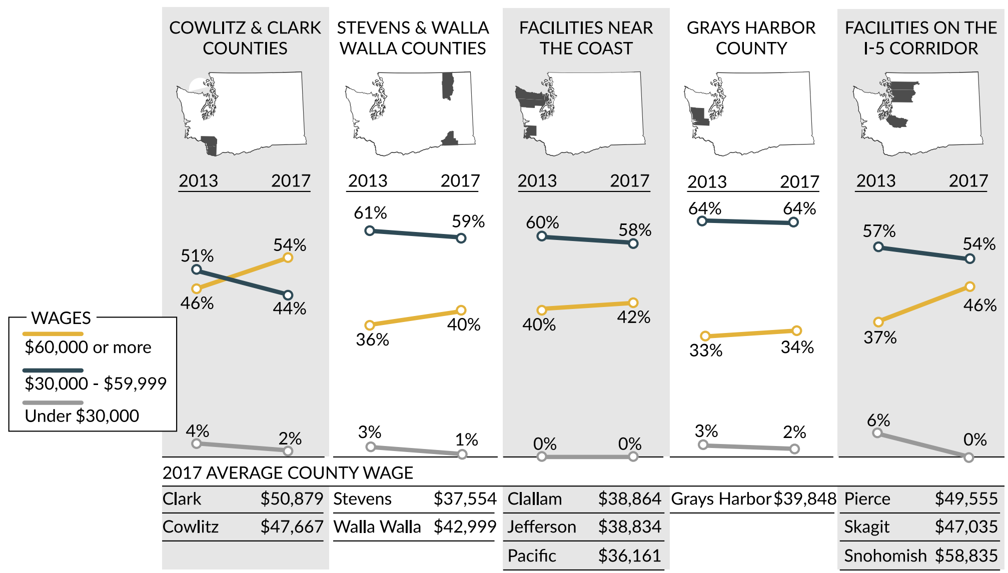
1) Under $30,000.

2) $30,000 to $59,999.

3) $60,000 or more.

JLARC staff also looked at how wages at beneficiary facilities compared to the average wages in the counties where the facilities are located. In 2017, the average wage in all counties with beneficiary facilities fell within the medium wage band of $30,000 to $59,999.

Exhibit 3.1: The percentage of jobs with wages of $60,000 or more increased in all of the cohorts



Source: JLARC staff analysis of confidential Department of Revenue annual survey wage detail, 2013 through 2017 and of Employment Security Quarterly Census of Employment and Wages Annual Report for 2017.

4. Benefit enrollment rates exceeded state, national averages

Enrollment rates for medical, dental, and retirement plans offered by beneficiaries exceeded 80% in 2017

The Legislature directed JLARC staff to compare employer-provided benefits at facilities that use the preference with employer-provided benefits in the counties where the facilities are located. However, county-level detail on private sector benefit coverage is not available.

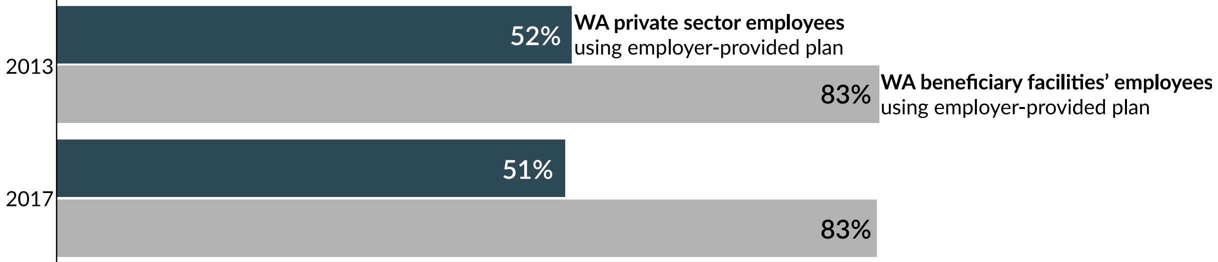
In the absence of county-level data, JLARC staff used the best available data: state and national data on benefit enrollment rates for employees. These rates were compared to enrollment rates among beneficiary employees.

Medical plan enrollment rates were higher for beneficiary employees than statewide rates

In 2017, beneficiary employees enrolled in their employer-provided medical plans at a higher rate than private-sector employees statewide. About 83% of beneficiary employees enrolled in medical plans compared to 51% of private sector employees who enrolled in employer-provided medical plans. The comparison rates were similar in 2013.

Beneficiaries only report whether an employee uses an employer-provided plan. The data does not indicate if an employee has medical insurance through other means, such as a plan provided through a spouse's employer.

Exhibit 4.1: In 2017, 83% of beneficiary employees enrolled in medical plans compared to 51% of Washington's private-sector employees



Source: JLARC staff analysis of Department of Revenue annual survey detail for 2013, 2017; detail provided by the State Health Data Assistance Center for Washington employer-provided insurance use for 2013, 2017.

83% of beneficiary employees were enrolled in dental plans in 2017

In 2017, 83% of beneficiary employees enrolled in dental benefits provided by their employer. This is an increase from a 72% enrollment rate in 2013. No county or state-level detail is available on private-sector employee dental coverage.

According to the U.S. Department of Health & Human Services' Medical Expenditure Panel Survey, 52% of U.S. private-sector employers offered dental benefits to their employees in 2017. This is a slight increase from 50% of employers offering plans in 2013.

87% of beneficiary employees were enrolled in retirement plans in 2017

Beneficiary employees have increased their use of employer-provided retirement benefits over time. Retirement plan enrollment rates went from 58% in 2013 to 87% in 2017.

For perspective, a 2013 Employment Security Department survey found that 40% of all Washington private-sector employers offered retirement plans in 2012. This is the most recent year for which state-level data is available. On a national level, 48% of private-sector employers offered retirement benefits to their employees in 2017.

5. Beneficiary savings: $2.8 million in 2017

Estimated biennial beneficiary savings is $5.6 million

JLARC staff estimate that beneficiaries will save $5.6 million in the 2021-2023 biennium. This estimate is based on several factors:

- Department of Revenue data indicates that the beneficiary savings for calendar year 2017 was $2.8 million.
- JLARC staff assume that the number of facilities using the preference and the value of hog fuel purchases will remain consistent over time.

Exhibit 5.1: Estimated beneficiary savings assume consistent use of preference

Biennium	Fiscal Year	Estimated Beneficiary Savings
2015-2017 *7/1/15-6/30/17*	2016	$3.0 million
	2017	$2.8 million
2017-2019 *7/1/17-6/30/19*	2018	$2.8 million
	2019	$2.8 million
2019-2021 *7/1/19 - 6/30/21*	2020	$2.8 million
	2021	$2.8 million
2021-2023 *7/1/21-6/30/23*	2022	$2.8 million
	2023	$2.8 million
	2021-23 Biennium	$5.6 million

Source: JLARC staff analysis of Department of Revenue hog fuel annual survey data 2013-2017. Estimate for 2018 and beyond based on industry interviews on expected future use.

Preference has been used by 16 to 19 facilities each year since 2013

The number of facilities using the preference each year has remained fairly consistent, ranging from 16 to 19 between 2013 and 2017.

Facilities that use the preference are required to report the value of their sales and use tax exemption on a calendar year basis. This information is publicly available.

Exhibit 5.2: Most facilities that used the preference in 2013 continued to do so in 2017

		Value of hog fuel tax exemption by calendar year				
Business	County location	2013	2014	2015	2016	2017
Avista Corporation	Stevens	$390,360	$541,584	$407,593	$498,568	$490,419
Boise Cascade Plywood Plant - Kettle Falls	Stevens	$57,442	$72,896	$71,892	$67,244	$71,893
Boise Cascade Wood Products - Kettle Falls	Stevens	$14,486	$25,389	$24,306	$23,063	$24,505
Boise White Paper, LLC	Walla Walla	$373,564	$526,491	$378,835	$268,228	$428,736
Cosmo Specialty Fibers, Inc.	Grays Harbor	$119,743	$84,860	$78,884	$117,111	$124,983
Enwave Seattle	King	Did not report	*Not disclosed (ND)	*Not disclosed (ND)	Did not report	Did not report
Georgia Pacific Consumer Products	Clark	$107,481	$105,267	$76,704	$63,759	$50,235
Georgia Pacific Consumer Operations, LLC	Clark	Did not report	Did not report	Did not report	Did not report	$4,567
Hampton Lumber Mills - Darrington	Snohomish	$12,220	$13,701	$9,754	$7,219	$5,528
Longview Fibre Paper & Packaging, Inc.	Cowlitz	$288,394	$341,107	$406,942	$304,451	$279,738
McKinley Paper Co.	Clallam	Did not report	Did not report	Did not report	Did not report	$0

Business	County location	Value of hog fuel tax exemption by calendar year				
		2013	2014	2015	2016	2017
Nippon Dynawave Packaging Co. LLC	Cowlitz	Did not report	Did not report	Did not report	$89,145	$310,327
Nippon Paper Industries US Co., Ltd.	Clallam	Did not report	Did not report	$492,830	$415,844	$117,861
Pacific Veneer (Willis Enterprises)	Grays Harbor	$20,787	$20,072	$14,003	$15,892	$21,436
Port Townsend Paper Corporation	Jefferson	$51,270	$29,618	Did not report	$470,000	$469,138
Seattle Steam Co.	King	$90,542	$46,984	Did not report	Did not report	Did not report
Sierra Pacific Industries - Aberdeen	Grays Harbor	$7,129	$19,948	$18,181	$4,448	$3,933
Sierra Pacific Industries - Burlington	Skagit	$78,579	$120,489	$104,561	$111,690	$96,486
Simpson Shelton Lumber Mill	Mason	$140,513	$82,129	$41,065	Did not report	Did not report
Simpson Tacoma Craft	Pierce	$229,463	$91,785	Did not report	Did not report	Did not report
Westrock CP, LLC	Pierce	Did not report	$204,821	$347,985	$354,673	$284,172
Weyerhaeuser Longview Liquid Packaging	Cowlitz	$226,699	$268,427	$258,924	$172,507	Did not report
Weyerhaeuser Co. - Raymond Sawmill	Pacific	$29,484	$26,691	$29,968	$32,278	$24,276

Source: JLARC staff analysis of Department of Revenue public disclosure web site detail on tax incentive use; JLARC staff analysis of facility location detail.

***ND - Through 2017, if beneficiary savings were under $10,000, a business could elect to not disclose the value of the sales and use tax exemption.**

Use of clawback provision cannot be disclosed

The Department of Revenue reports it has attempted to use the penalty ("clawback") provision of the tax preference that requires facilities to pay back two calendar years' worth of savings if the business closes and jobs are lost. However, due to confidentiality laws, JLARC staff cannot disclose any further details.

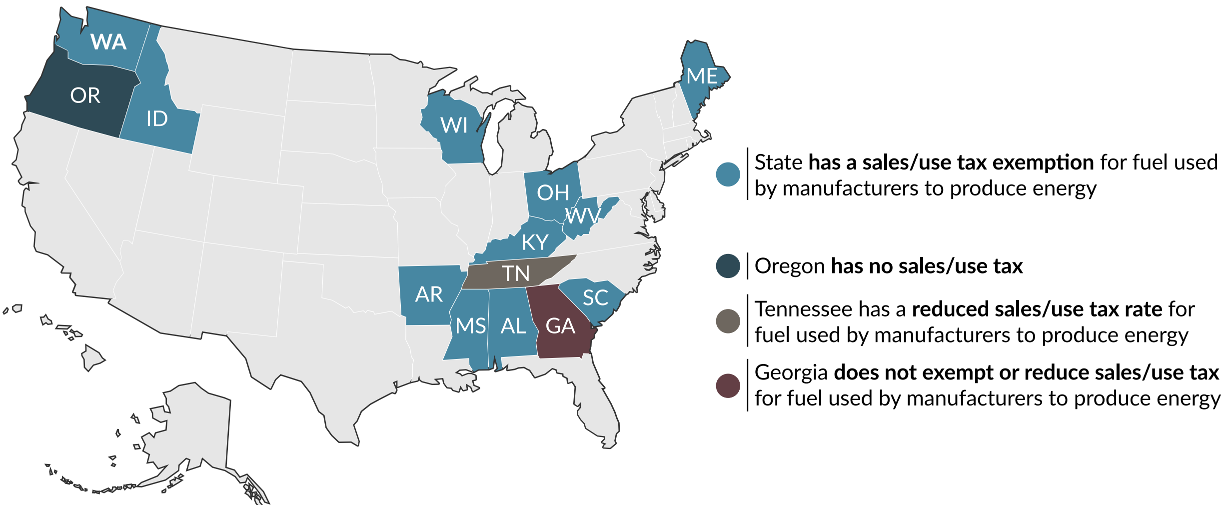
6. Other states have similar exemptions

Ten states with a large wood or paper manufacturing industry provide similar exemptions

Ten of 13 states that rank nationally in wood or paper product manufacturing provide a sales and use tax exemption for manufacturers that purchase and use fuel to produce energy. According to stakeholders and national industry data, these businesses are concentrated in the southeastern United States. The comparison includes states that are ranked nationally for their concentration of employment in wood product or paper product manufacturing, as well as Oregon and Idaho.

Seven of the 13 states offer an exemption for any fuel used to produce energy in the manufacturing process.

Exhibit 6.1: 10 out of 13 leading wood or paper product manufacturing states provide exemptions to manufacturers that purchase fuel to produce energy



Source: JLARC staff analysis of other state statutes, sales and use tax exemptions; JLARC staff analysis of Bureau of Labor and Statistics Location Quotient detail for paper product and wood product manufacturing.

7. Applicable statutes

RCWs 82.08.956, 82.12.956, 43.136.057

Exemptions-Hog fuel used to generate electricity, steam, heat, or biofuel.

RCW 82.08.956

(Expires June 30, 2024.)

(1) The tax levied by RCW 82.08.020 does not apply to sales of hog fuel used to produce electricity, steam, heat, or biofuel. This exemption is available only if the buyer provides the

seller with an exemption certificate in a form and manner prescribed by the department. The seller must retain a copy of the certificate for the seller's files.

(2) For the purposes of this section the following definitions apply:

(a) "Hog fuel" means wood waste and other wood residuals including forest derived biomass. "Hog fuel" does not include firewood or wood pellets; and

(b) "Biofuel" has the same meaning as provided in *RCW 43.325.010.

(3) If a taxpayer who claimed an exemption under this section closes a facility in Washington for which employment positions were reported under RCW 82.32.605, resulting in a loss of jobs located within the state, the department must declare the amount of the tax exemption claimed under this section for the previous two calendar years to be immediately due.

(4) This section expires June 30, 2024.

[2013 2nd sp.s. c 13 § 1002; 2009 c 469 § 301.]

NOTES:

***Reviser's note:** RCW 43.325.010 expired June 30, 2016.

Intent - 2013 2nd sp.s. c 13: "It is the intent of the legislature to retain and grow family-wage jobs in rural, economically distressed areas; to promote healthy forests; and to utilize Washington's abundant natural resources to promote diversified renewable energy use in the state." [2013 2nd sp.s. c 13 § 1001.]

Effective date - 2013 2nd sp.s. c 13: "Parts III, X, XV, and XVI of this act are necessary for the immediate preservation of the public peace, health, or safety of the state government and its existing public institutions, and take effect July 1, 2013." 2013 2nd sp.s. c 13 § 1903.]

Effective date - 2009 c 469: See note following RCW 82.08.962.

Exemptions - Hog fuel used to generate electricity, steam, heat, or biofuel.

RCW 82.12.956

(Expires June 30, 2024.)

(1) The provisions of this chapter do not apply with respect to the use of hog fuel for production of electricity, steam, heat, or biofuel.

(2) For the purposes of this section:

(a) "Hog fuel" has the same meaning as provided in RCW 82.08.956; and

(b) "Biofuel" has the same meaning as provided in *RCW 43.325.010.

(3) This section expires June 30, 2024.

[2013 2nd sp.s. c 13 § 1003; 2009 c 469 § 302.]

NOTES:

***Reviser's note:** RCW 43.325.010 expired June 30, 2016.

Intent - Effective date - 2013 2nd sp.s. c 13: See notes following RCW 82.08.956.

Effective date - 2009 c 469: See note following RCW 82.08.962.

Review of hog fuel tax exemption by joint legislative audit and review committee.

RCW 43.136.057

(Expires June 30, 2024.)

(1) The intent of the tax exemption provided in RCW 82.08.956 and 82.12.956 is to promote the retention of relatively high wage jobs in the counties where facilities who purchase and use hog fuel are located. Specifically, in a time when there is increasing pressure to close industrial facilities like mills and relocate this economic activity out of state or overseas, rural areas of the state are at risk of losing critical jobs that directly, or indirectly, support entire communities. The legislature, in enacting the hog fuel tax exemption, hopes to retain seventy-five percent of the jobs at each facility in the state at which the exemption is claimed, between now and June 30, 2024.

(2) The joint legislative audit and review committee must review the performance through July 1, 2018, of the tax preferences established in RCW 82.08.956 and 82.12.956, and prepare a report to the legislature by October 31, 2019.

(3) The department of revenue must provide the committee with annual survey information and any other tax data necessary to conduct the review required in subsection (2) of this section. The employment security department and other agencies, as requested, must cooperate with the committee by providing information about the average wage of employment in the county where each facility owned or operated by a company claiming the exemption is located. The report is not limited to, but must include, the following information:

(a) Identification of the baseline number of jobs existing as of January 1, 2013, in facilities where the preference has been claimed, as well as related wage and benefit information;

(b) Identification of how the number of jobs at these facilities has changed during the duration of the credit;

(c) Analysis of how the wages provided to employee at affected facilities compare to the average wages in the county in which the facility is located;

(d) Analysis of how the benefits, including medical and other health care benefits, provided to employees at affected facilities compare to the average wages in the county in which the facility is located; and

(e) Whether and to what extent the goal has been achieved, of retaining seventy-five percent of employment at the facilities at which the exemption has been claimed.

(4) This section expires June 30, 2024.

[2013 2nd sp.s. c 13 § 1005.]

NOTES:
Intent - Effective date - 2013 2nd sp.s. c 13: See notes following RCW 82.08.956.

RECOMMENDATIONS & RESPONSES

Legislative Auditor's Recommendation

The Legislative Auditor recommends continuing the preference if facilities keep achieving the 75% job retention goal

The Legislature should continue the preference because the statutory employment goal is being met.

The Legislature should monitor facility employment levels through 2023 to determine if they continue to meet the statutory goal.

- If employment levels continue to meet the statutory goal, then the Legislature will need to decide in the 2024 legislative session whether to extend the preference and re-state or update employment goals.
- If employment levels do not continue to meet the statutory goal, then the Legislature should allow the preference to expire on June 30, 2024.

Legislation Required: Yes, if Legislature wants to extend the preference beyond the current 2024 expiration date.

Fiscal Impact: Depends on legislation.

Letter from Commission Chair

Available October 2019.

Commissioners' Recommendation

Available October 2019.

Agency Response

If applicable, available October 2019.

MORE ABOUT THIS REVIEW
Study questions

Proposed Study Questions: Hog Fuel to Produce Energy

State of Washington Joint Legislative Audit and Review Committee ● September 2018

Legislature directed JLARC to review a sales and use tax exemption for hog fuel purchases

The 2006 Legislature directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct performance audits of tax preferences. This preference is included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.

The 2013 Legislature extended an existing sales and use tax exemption for businesses operating facilities that purchase hog fuel to produce energy. It required JLARC to review the preference by October 31, 2019. The preference is scheduled to expire June 30, 2024.

"Hog fuel" is wood waste, wood residual, or forest derived biomass product that is ground and used as a commercial energy source. It is used in boilers to generate electric power at lumber mills and also to generate power for sale.

Sales and use tax exemption established with goal of retaining jobs in Washington

The Legislature stated its objective in extending the preference was to retain "relatively high wage jobs" in counties where businesses that purchase and use hog fuel are located. The Legislature set a goal of retaining 75 percent of the jobs at each business facility that has used the preference.

This study will answer the following questions in July 2019:

1) Have the businesses using this preference maintained at least 75 percent of the jobs they reported at their qualifying facilities as of January 1, 2013?
2) How do the wages and benefits provided to employees at these facilities compare to the average wages and benefits provided in the counties where the facilities are located?

Study Timeframe

Preliminary Report: July 2019 Proposed Final Report: December 2019

Study Team

Team Lead:	Dana Lynn	360.786.5177	dana.lynn@leg.wa.gov
Research Analyst:	Eric Whitaker	360.786.5618	eric.whitaker@leg.wa.gov
Project Coordinator:	Eric Thomas	360.786.5182	eric.thomas@leg.wa.gov

JLARC Study Process

Study Mandate — Budget, legislation, committee direction → Proposed Study Questions → Legislative Auditor's Preliminary Report → For Tax Preferences: • Citizen Commission meeting • Public testimony • Commission adopts comments → Legislative Auditor's Proposed Final Report — Agency response included → Final Report — Option to append committee comment

Committee votes to distribute completed audit

Joint Legislative Audit & Review Committee, 106 11th Ave SW, Olympia, WA 98501
(360) 786-5171 ● (360)786-5180 (fax) ● JLARC@leg.wa.gov ● www.jlarc.leg.wa.gov
Keenan Konopaski, Washington State Legislative Auditor

Washington Joint Legislative Audit and Review Committee

106 11th Avenue SW, Suite 2500
PO Box 40910
Olympia, WA 98504-0910

Phone: 360-786-5171
Fax: 360-786-5180
Email: JLARC@leg.wa.gov

Modifying Large Private Airplanes Owned by Nonresidents

2019 JLARC TAX PREFERENCE REVIEW

Estimated 2019-21 beneficiary savings: $11.6 million

Sales and use tax

Sales and use tax exemption for modification work performed on large airplanes owned by nonresidents

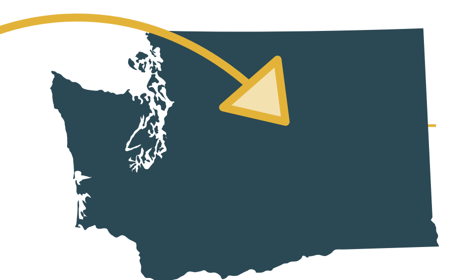
Preference benefits **nonresident** airplane owners and **Washington businesses.**

The Legislature enacted this preference in 2013.

The preference is scheduled to expire July 1, 2021.

This activity did not take place in WA before the preference was passed. After the preference passed, nonresidents started bringing airplanes to WA for modification work.

As of January 2019,
SEVEN AIRPLANES
have been or are currently being modified in WA.



Resulted in new jobs in Moses Lake and elsewhere in the state.

Washington's experience suggests nonresident owners take their airplanes to places with no sales tax on airplane modifications

If preference expires,
economic modeling tool estimates:

Statewide job losses ranging between **347** to **569** jobs	*State tax revenue losses ranging between* **$1.8** to **$3.3 million**

Economic modeling tool estimates preference had **negligible impact** on Washington's broader aerospace manufacturing industry.

LEGISLATIVE AUDITOR'S RECOMMENDATION

Continue and clarify

The Legislature should:

- Continue the preference by extending the expiration date before the preference expires on July 1, 2021.
- Clarify whether the objective of growing the broader aerospace manufacturing industry is relevant.

The complete report is on the JLARC web site: www.leg.wa.gov/jlarc

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
keenan.konopaski@leg.wa.gov • (360) 786-5187

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July 2019

PRELIMINARY REPORT:
2019 TAX PREFERENCE PERFORMANCE REVIEWS

Modifying Large Private Airplanes Owned by Nonresidents

LEGISLATIVE AUDITOR'S CONCLUSION:

The preference has likely resulted in new jobs and increased state tax revenues by $1.8 million to $3.3 million annually. It has had a negligible impact on Washington's aerospace manufacturing industry.

July 2019

Sales and use tax exemption for nonresidents who modify their large private airplanes in Washington

When nonresidents bring their large private airplanes to Washington for modification work, such as customized interiors, they do not pay sales and use tax. These private planes are the size of a Boeing 737 or larger.

The preference took effect January 1, 2014, and is scheduled to expire July 1, 2021.

Estimated Biennial Beneficiary Savings
$11.6 million

Tax Type
Sales and Use Tax
RCWs 82.08.215, 82.12.215
Applicable Statutes

After preference passed, Washington businesses began performing modification work

The Legislature stated two objectives for this preference when it was enacted in 2013.

Objectives (Stated)	Results
Promote economic development in Washington's aerospace cluster	**Partly met**. After the preference passed, nonresidents started to bring their airplanes to Washington for modification work. This resulted in new jobs in Moses Lake and elsewhere in the state. However, the preference has had a negligible impact on Washington's broader aerospace manufacturing industry.

Objectives (Stated)	Results
Increase tax revenues by promoting a competitive marketplace for modifying large airplanes	**Met**. Based on economic models, the estimated range in new statewide tax revenue is between $1.8 million and $3.3 million per year.

Recommendations

Legislative Auditor's Recommendation: Continue and clarify the objective

The Legislature should continue the preference by extending the expiration date before it is scheduled to expire on July 1, 2021.

Since the preference was enacted, several large private airplanes have been modified, or are currently being modified, in Washington. This work was not conducted in Washington prior to the preference. This work has created new jobs and increased economic activity in Moses Lake and elsewhere in the state.

The preference has had a negligible impact on Washington's broader aerospace manufacturing industry. The Legislature should clarify whether the objective of growing the broader aerospace manufacturing industry is relevant.

If the preference is allowed to expire, the modification activity would likely cease.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2019.

REVIEW DETAILS

1. Preference is for airplane modifications

Nonresidents do not pay sales or use tax when they modify their large private airplanes in Washington

Legislative goals: grow Washington's aerospace cluster and increase tax revenues

The Legislature passed this preference in 2013 with two stated objectives:

- Promote economic development in Washington's aerospace cluster.
- Increase tax revenues by promoting a competitive marketplace for storing and modifying large, privately owned airplanes.

The Legislature noted that Washington was losing modification work to other states, resulting in losses of high-wage jobs and additional tax revenues. It concluded that the state's tax laws hindered aerospace manufacturing growth in Washington.

During legislative hearings, industry stakeholders and executive branch staff testified that the preference would remove competitive "barriers" and help Washington compete with other states for airplane modification work.

Nonresidents do not pay sales or use tax when they modify their airplanes in Washington

Nonresident owners of large private airplanes are exempt from sales and use tax when they pay to have their planes modified in Washington. Generally, the modifications involve complete interior renovations and technological and electronic upgrades.

This exemption applies to airplanes that meet the following criteria:

- Are not used commercially.
- Are not owned or leased by a government entity.
- Weigh more than 41,000 pounds (Boeing 737 and larger airplanes).
- Meet certain federal Federal Aviation Administration (FAA) standards.

Legislature directed JLARC staff to estimate the preference's economic impact

The Legislature specifically directed JLARC staff to:

- Estimate the **net impact** of the preference on **state tax revenues.** This includes a comparison of the loss in state tax revenues to any gains in tax revenue generated from the direct, indirect, and induced economic impacts of the preference.
- Estimate **job growth** in the **aerospace manufacturing industry,** to the extent practicable, resulting from the preference.

This review focused on airplane modification work in Washington

The preference was part of a larger bill intended to "remove barriers" to growth in Washington's aerospace industry. This review focused on airplane modification work because it was expected to grow Washington's aerospace industry cluster.

The larger bill included the following additional regulatory and taxation changes:

- A sales and use tax exemption for nonresidents who buy and take possession of large private airplanes in Washington.
- An exemption from registering large private airplanes with the Washington State Department of Transportation Aviation Division when the airplane is continuously stored in Washington for at least one year or in-state exclusively for repairs or alterations.
- A change in taxation for commercial (not private) airplanes that are continuously stored in Washington for at least one year. The planes are taxed under aircraft excise tax instead of property tax.

2016 review lacked sufficient data to evaluate impact

JLARC staff first reviewed this preference in 2016. At that time, airplane modification work was just beginning in the state and there was insufficient data to measure the preference's economic impact. The Legislative Auditor noted that JLARC would review the preference again prior to its expiration date.

Preference set to expire in 2021

The preference took effect on January 1, 2014, and is scheduled to expire July 1, 2021.

2. New modification activity in WA

Washington businesses began performing modification work after the preference passed

Before the Legislature passed the preference, it appears there was no modification activity performed in the state on large private airplanes owned by nonresidents.

Greenpoint Technologies, Inc. (GTI), headquartered in Kirkland, was serving as a general contractor for airplane modification contracts prior to 2014. However, GTI was subcontracting with out-of-state businesses to perform the actual modification work at locations outside of Washington.

Modification-related activities in Washington before 2014 were limited to the following:

- GTI prepared conceptual models, designs, and project plans for airplane modifications on behalf of nonresident clients.
- GTI or a Washington-based subcontractor performed engineering and manufacturing work prior to the actual modifications.

Modification-related activities after January 1, 2014, expanded to include the following additional activities:

- GTI and its primary in-state subcontractor, Aviation Technical Services, Inc. (ATS), began performing airplane modification and installation activities in Moses Lake.
- GTI began performing ground and flight testing in Moses Lake before delivering the planes to their nonresident owners.

As of January 2019, four modification projects have been completed in-state and three others were underway.

Modification work has resulted in new jobs

The airplane modification work in Moses Lake has resulted in new jobs for GTI and its subcontractors. GTI and ATS gave JLARC staff permission to report the number of jobs created and retained at their Moses Lake location since the preference passed. The job numbers reflect the total number of jobs reported each year by these two businesses. There are likely additional

jobs indirectly related to the new modification activities that are not included in the numbers reported below.

Exhibit 2.1 Jobs at Moses Lake facility directly tied to airplane modification work

Year	Jobs reported by GTI	Jobs reported by ATS	Total jobs
2014	0	58	58
2015	8	78	86
2016	16	116	132
2017	16	58	74
2018	11	47	58

Note: The numbers reported above are a point in time count that capture employees associated with the qualifying work at a given time of the year. The numbers fluctuate up and down throughout the year, based on the schedule of airplanes being modified and the specific type of work being done.

Source: JLARC staff analysis of detail provided by Greenpoint Technologies, Inc., and Aviation Technical Services, Inc., through November 2018.

Modifications involve full interior and electronic renovations

Modifications involve fully customized interiors, lighting, electrical re-wiring, and technological and electronic renovations.

Each modification project is unique, and designed and built to meet its owner's needs. The interior modifications may include customized living, sleeping, dining, and bathroom quarters and enhanced technology.

Qualifying modification projects have ranged from $60 million to $150 million, depending on the airplane's size, extent of modifications, materials used, and other factors.

Modification work can take between 24 to 36 months from project conception to completion. Timeframes vary depending on the complexity of the work and the size of the airplane.

Exhibit 2.2: Fully modified large private airplanes feature customized interiors, electronics, and technology

Source: Images provided by Greenpoint Technologies, Inc.

3. Jobs and tax revenues would likely decrease if preference expires

The estimated gains in jobs and revenues would likely go away if the preference expires

Since the preference began, at least two businesses have started to perform airplane modification work in Washington. They report that they have added jobs to their workforce. JLARC staff used these job numbers to model the economic impact of the preference.

Economic models show potential range of net employment and net revenue changes if the preference expires

JLARC staff used an economic modeling tool that predicts future impacts of a change rather than estimating current or previous impacts. As a result, the estimated changes described below are based on the assumption that the preference will expire on July 1, 2021, as it is currently scheduled to do. Appendices A and B provide additional detail about the economic modeling tool and analysis.

The model assumes that all modification activities in Washington will end once the preference expires. This reflects the state's recent experience of having no businesses performing airplane modification work before the preference began.

The model estimates a range of statewide net fiscal and employment changes under two different scenarios. The fiscal and employment changes include direct, indirect, and induced changes if the preference expires. The model estimates the impact over a 10-year period, from 2022 through 2031.

The analysis includes estimates for:

- Net job changes based on the assumption that jobs will be lost when airplane modification work ends in Moses Lake.
- Net tax revenue changes based on the assumption that the loss in specialized modification work will lead to reduced business tax revenues related to that activity, as well as reduced taxes on indirect and induced economic activity (e.g., taxes from suppliers and employees).

Depending on the scenario modeled, the table below shows a range in job losses between 347 and 569 jobs per year. The estimated loss in state tax revenue ranges from $1.8 million to $3.3 million.

If the preference is extended, and airplane modification activities remain at current levels, Washington will likely avoid this level of estimated job and revenue losses.

Exhibit 3.1: Estimated statewide job and revenue losses if the preference ends

	Scenario assumes preference expires July 1, 2021	Average statewide net job decrease between 2022 and 2031	Average statewide net tax revenue decrease between 2022 and 2031
Scenario 1	In-state modification work ceases, modeled as a reduction in qualifying sales. The two in-state businesses currently performing modification work maintain a presence in Washington and continue to perform work unrelated to the preference.	347 jobs per year	$1.8 million per year
Scenario 2	In-state modification work ceases, modeled as a reduction in qualifying sales. One of the two in-state businesses currently performing most of the modification work also moves its entire business operation out of Washington. The other business maintains a presence in Washington and continues to perform work unrelated to the preference.	569 jobs per year	$3.3 million per year

Source: JLARC staff analysis of jobs created by two businesses primarily doing large private airplane modifications in-state. JLARC staff estimated impact on statewide employment and tax revenue using REMI economic modeling tool.

Preference has a negligible impact on Washington's aerospace manufacturing industry

Large private airplane modification is a specialized activity. While it involves airplanes, the modification work has no direct ties to, and is minimally connected to, the broader Washington aerospace manufacturing industry.

The economic modeling tool estimated a negligible impact on Washington's airplane manufacturing industry if the tax preference for airplane modifications expires in 2021. Although some businesses that perform modifications may also be involved in the general aerospace manufacturing industry, the modeling tool and industry supplier information suggest there is not a close relationship between this specific modification activity and the broader manufacturing industry.

4. Nonresidents and WA businesses benefit

The preference benefits nonresident airplane owners and in-state businesses

Seven nonresident airplane owners have directly benefited

Nonresident airplane owners directly benefit from the preference because they do not pay sales or use tax on the modification work performed in Washington. According to industry representatives, these airplane owners are typically private individuals or foreign heads of state who replace their large customized airplanes every five to eight years.

As of January 2019, four airplane modifications have been completed in Moses Lake, with three more airplane modifications in progress.

Washington businesses also benefit from the preference

Although the preference provides a tax exemption to nonresidents, Washington businesses benefit from the economic activity generated by the specialized modification work performed in Moses Lake and at other locations around the state. Two businesses perform most of the qualifying modification work in Washington:

- **Greenpoint Technologies, Inc. (GTI)** works with owners to develop and manage large private airplane modification projects. Headquartered in Kirkland, GTI operates shops where specially designed materials and items are created. The shops are located in Marysville and Denton, Texas. GTI also manages the airplane modification and installation work in Moses Lake.
- **Aviation Technical Services (ATS)** is involved in many aerospace-related activities. Headquartered in Everett, ATS is a subcontractor of GTI and performs large airplane modifications in Moses Lake.

  ATS also provides maintenance, repair, and overhaul services for commercial and military transport jet airplanes in Everett and Kansas City, Missouri. In addition, it operates airplane component shops in Everett and Fort Worth, Texas, and performs in-house engineering in Everett.

5. Biennial beneficiary savings: $11.6 million

Nonresident owners will save an estimated $11.6 million in 2019-2021

JLARC staff estimate the direct beneficiary savings for nonresident owners was $7.3 million in fiscal year 2018. This is the estimated amount that nonresidents were exempt from paying in Washington sales and use tax. The estimated beneficiary savings for the 2019-2021 biennium is $11.6 million. The preference is currently set to expire on July 1, 2021.

JLARC staff used Department of Revenue tax data on qualifying modification work to estimate the beneficiary savings.

The Department's taxpayer confidentiality policy prohibits disclosing tax return data when there are fewer than three taxpayers. For this review, the two Washington businesses that perform airplane modification work specifically authorized JLARC staff to disclose their tax return detail for fiscal years 2016 through 2018, and to use this data to estimate future beneficiary savings.

Exhibit 5.1: Estimated beneficiary savings through 2021

Biennium	Fiscal Year	Estimated Value of In-State Modification Work	Estimated Total Beneficiary Savings
2015-17 *7/1/15-6/30/17*	2016	$372,000	$33,000
	2017	$46,000,000	$4,289,000
2017-2019 *7/1/17 - 6/30/19*	2018	$78,000,000	$7,274,000
	2019	$62,000,000	$5,782,000
2019-21 *7/1/19-6/30/21*	2020	$62,000,000	$5,782,000
	2021	$62,000,000	$5,782,000
	2019-21 Biennium	**$124,000,000**	**$11,564,000**
	Preference *currently scheduled to expire July 1, 2021.*		

Source: JLARC staff analysis of Department of Revenue tax return data. Taxpayers authorized JLARC staff to disclose beneficiary savings and use the data to estimate future years' savings.

6. Other states also provide exemptions

Owners likely take their airplanes to locations that do not tax modification work

Industry representatives indicate that modification work on large private airplanes is only performed by a few businesses at a small number of locations worldwide. All of the U.S. locations identified below provide a sales and use tax exemption for airplane modifications, repairs, and refurbishments. While it is possible that modifications occur elsewhere, JLARC staff found no sources that could independently verify whether this work is performed in other locations.

Businesses in Texas, Indiana, and Europe are currently performing airplane modifications

According to industry representatives, Washington is one of three states where businesses are currently performing modification work on large private airplanes. The other two are Texas and Indiana. These states also provide specific sales and use tax exemptions for airplane purchases, repairs, and modifications. Like Washington, Indiana's modification exemption is limited to airplanes owned by nonresidents.

Large airplane modifications are also performed at three facilities outside the U.S.: two in Switzerland and one in Germany.

Experience shows that nonresident owners go to locations where modification work is not taxed

Washington's experience suggests that nonresident owners take their airplanes to locations where they do not pay sales tax on modification work. These owners tend to be foreign residents or heads of state.

Industry representatives testified that these nonresidents can take their airplanes to locations across the world.

Eight other states do not tax airplane modification work

In addition to Indiana and Texas, three states provide a sales and use tax exemption similar to Washington's. Modification work on large private airplanes is not currently being performed in these three states:

- Connecticut
- Kansas
- Oklahoma

Another three states have exemptions that are different than Washington's:

- New Mexico exempts modifications on commercial or military airplanes, but not on private airplanes.
- Arizona does not consider modification of property an activity subject to sales tax.
- California does not consider modification of property an activity subject to sales tax.

7. Applicable statutes

RCWs 82.08.215, 82.12.215

Sales and Use Tax

RCW 82.08.215

Exemptions - Large private airplanes. (Expires July 1, 2021.)

(1)(a) The tax levied by RCW 82.08.020 does not apply to:

(i) Sales of large private airplanes to nonresidents of this state; and

(ii) Sales of or charges made for labor and services rendered in respect to repairing, cleaning, altering, or improving large private airplanes owned by nonresidents of this state.

(b)The exemption provided by this section applies only when the large private airplane is not required to be registered with the department of transportation, or its successor, under chapter 47.68 RCW. The airplane owner or lessee claiming an exemption under this section must provide the department, upon request, a copy of the written statement required under RCW 47.68.250(5)(c)(ii) documenting the airplane's registration exemption and any additional information the department may require.

(2) Sellers making tax-exempt sales under this section must obtain an exemption certificate from the buyer in a form and manner prescribed by the department. The seller must retain a copy of the exemption certificate from the seller's files. In lieu of an exemption certificate, a seller may capture the relevant data elements as allowed under the streamlines sales and use tax agreement. For sellers who electronically file their taxes, the department must provide a separate tax reporting line for exemption amounts under this section.

(3) Upon request, the department of transportation must provide to the department of revenue information needed by the department of revenue to verify eligibility under this section.

(4) For purposes of this section "large private airplane" means an airplane not used in interstate commerce, not owned or leased by a government entity, weighing more than forty-one thousand pounds, and assigned a category A, B, C, or D test flow management system aircraft weight class by the federal aviation administration's office of aviation policy and plans.

[2013 2nd sp.s. c 13 § 1103.]

RCW 82.12.215

Exemptions - Large private airplanes. (Expires July 1, 2021.)

(1)(a) The tax levied by RCW 82.12.020 does not apply to the use of:

(i) Large private airplanes owned by nonresidents of this state; and

(ii) Labor and services rendered in respect to repairing, cleaning, altering, or improving large private airplanes owned by nonresidents of this state.

(b) The exemption provided by this section applies only when the large private airplane is not required to be registered with the department of transportation, or its successor, under chapter 47.68 RCW. The airplane owner or lessee claiming an exemption under this section must provide the department, upon request, a cop of the written statement required under RCW 47.68.250(5)(c)(ii) documenting the airplane's registration exemption and any additional information the department may require.

(2) Upon request, the department of transportation must provide to the department of revenue information needed by the department of revenue to verify eligibility under this section.

(3) For purposes of this section, the conditions, limitation, and definitions in RCW 82.08.215 apply to this section.

[2013 2nd sp.s. c 13 § 1104.]

Non-codified session law, 2013 2nd sp.s. c 13 § 1101

PART XI

Large Airplanes

NEW SECTION. **Sec. 1101.** (1) The legislature intends to promote the economic development of our state's aerospace cluster and increase the tax revenues collected by the state through promoting a competitive marketplace for storing and modifying unfurnished, noncommercial aircraft. The legislature finds that Washington is currently losing these types of jobs to other states, resulting in the loss of high-wage jobs and new tax revenue. Further, the legislature finds that the current tax statutes are an impediment to encouraging the development of aerospace clusters in our state. Therefore, the legislature intends to modify our state's tax policy to encourage aerospace cluster development with the state and increase tax revenues.

(2) The joint legislative audit and review committee, as part of its tax preference review process, must estimate the net impact on state tax revenues by comparing the decrease in state revenues resulting from the changes made in part XI of this act to the additional tax revenues generated from the direct, indirect, and induced economic impacts from those changes. The committee must also, to the extent practicable, estimate job growth in the aerospace cluster resulting from the changes made in part XI of this act. The committee must conduct its tax preference review of part XI of this act during calendar year 2016 and report its finding and recommendations to the legislature by January 1, 2017.

Appendix A: REMI overview

What is REMI?

JLARC staff used Regional Economic Models, Inc.'s (REMI) Tax-PI software (version 2.2) to model the economic impacts for several tax preference reviews in 2019, including the sales and use tax exemption for large private airplanes owned by nonresidents.

Multiple state governments, private sector consulting firms, and research universities also use REMI's dynamic economic modeling to evaluate policy impacts.

Model is tailored to Washington and includes a government sector

Tax-PI is an economic impact tool used to evaluate the fiscal and economic effects and the demographic impacts of a tax policy change. The software includes various features that make it particularly useful for analyzing the economic and fiscal impacts of tax preferences:

- REMI staff consulted with staff from the Office of Financial Management (OFM) and customized a statewide model to reflect Washington's economy.
- The model contains 160 industry sectors, based on the North American Industry Classification System (NAICS) codes.
- In contrast to other modeling software, Tax-PI includes state and local government as a sector. This permits users to see the trade-offs associated with tax policy changes (e.g., effects on Washington's economy from both increased expenditures by businesses due to a tax preference, along with decreased spending by government due to the associated revenue loss).
- For current revenue and expenditure data, users can input information to reflect their state's economic and fiscal situation. This allows JLARC staff to calibrate a state budget using up-to-date information from the Economic and Revenue Forecast Council (ERFC) and the Legislative Evaluation and Accountability Program (LEAP).
- The model can forecast economic and revenue impacts multiple years into the future.

Model simulates the full impact of a tax policy change

The REMI model accounts for the direct, indirect, and induced effects as they spread through the state's economy, which allows users to simulate the full impact of a tax policy change over time.

- Direct effects are industry specific and capture how a target industry responds to a particular policy change (e.g., changes in industry employment following a change in tax policy).
- Indirect effects capture employment and spending decisions by businesses in the targeted industry's supply chain that provide goods and services.
- Induced effects capture the in-state spending and consumption habits of employees in targeted and related industries.

The REMI model produces year-by-year estimates of the total statewide effects of a tax policy change. Impacts are measured as the difference between a baseline economic and revenue forecast and the estimated economic and revenue effects after the policy change.

Model includes economic, demographic, and fiscal variables

The REMI model is a macroeconomic impact model that incorporates aspects of four major economic modeling approaches: input-output, general equilibrium, econometric, and new economic geography. The foundation of the model, the inter-industry matrices found in the input-output models, captures Washington's industry structure and the transactions between industries. Layered on top of this structure is a complex set of mathematical equations used to estimate how private industry, consumers, and state and local governments respond to a policy change over time.

- The supply side of the model includes many economic variables representing labor supply, consumer prices, and capital and energy costs with elasticities for both the consumer and business sectors.
- Regional competitiveness is modeled via imports, exports, and output.
- Demographics are modeled using population dynamics (births, deaths, and economic and retirement migration) and includes cohorts for age, sex, race, and retirement.
- Demographic information informs the model's estimates for economic consumption and labor supply.
- The dynamic aspect comes from the ability to adjust variables over time as forecasted economic conditions change.

While the model is complex and forecasting involves some degree of uncertainty, Tax-PI provides a tool for practitioners to simulate how tax policy and the resulting industry changes effect Washington's economy, population, and fiscal situation.

Appendix B: REMI analysis

REMI analysis shows range of potential employment and tax revenue impacts of the sales and use tax exemption for large private airplanes owned by nonresidents

JLARC staff used REMI’s Tax-PI to model two scenarios that illustrate the potential statewide employment and tax revenue impacts if the sales and use tax preference for large private airplanes owned by nonresidents expires in 2021.

This technical appendix provides context and supporting information for the analysis that led to the results summarized in Tab 3.

This appendix is divided into three sections:

- **REMI methodology** details how JLARC staff set up and calibrated the Tax-PI program prior to using the model to analyze possible impacts.
- **Beneficiary industries** describes the primary industries and businesses currently benefiting from the sales and use tax preference for large private airplanes owned by nonresidents.
- **Scenarios modeled** describes the scenarios used to estimate the range of potential effects on statewide employment and tax revenues of the sales and use tax preference.

REMI methodology

User inputs in REMI

REMI's Tax-PI model allows users to model policy changes and analyze the estimated impacts to the Washington economy, both in terms of economic activity and government finances (see Appendix A for an overview of the REMI model).

Prior to running modeling scenarios, users must make a series of choices about how to set up the modeling environment by building a state budget and calibrating the model accordingly. JLARC staff used the November 2018 revenue estimates produced by the Economic and Revenue Forecast Council (ERFC) and budgeted expenditures for fiscal years 2016 through 2018, as reported by the Legislative Evaluation and Accountability Program (LEAP) Committee. This data represents the budget and revenue data in the model and serves as the starting point for Tax-PI's economic and fiscal forecasts.

In addition to establishing a budget and inputting expected revenue values, users must specify whether government expenditures are determined by demand or by revenue.

- "By demand" imposes a level of government spending in future years that is necessary to maintain the same level of service as the final year in which budget data is entered.
- "By revenue" ties government expenditures to estimated changes in revenue collections.

JLARC staff ran the scenarios with expenditures set to be determined **by demand**. This allows users to avoid making assumptions about how policymakers may alter spending priorities in the future. In addition, users essentially establish the current budget allocations as carry-forward levels for each expenditure category.

Users may also elect to impose a **balanced budget restriction** (also known as the balanced budget feedback loop) or leave the model **unconstrained**. The balanced budget restriction forces revenue and expenditures to be equivalent and thus may impose some limitations on economic activity. JLARC staff ran the scenarios with the balanced budget restriction option turned on because Washington requires a balanced budget.

Because Tax-PI is a forecasting tool, JLARC staff were unable to model the economic and employment impacts of the tax preference beginning in 2016. Rather, JLARC staff modeled the potential effects of changes in the qualifying activity assuming the current tax preference expires in 2021, its current expiration date.

Data for the REMI model

The REMI model comes with historical economic and demographic data back to 2001. The data comes from federal government agencies, such as the U.S. Census Bureau, U.S. Energy Information Administration, the Bureau of Labor Statistics, and the Bureau of Economic Analysis. As described above, current revenue and expenditure data for Washington comes from ERFC and LEAP, respectively. The data to build the modeling scenarios described below includes information provided by the two businesses performing the majority of in-state airplane modification work.

- Changes in industry sales are based on JLARC staff estimates of beneficiary savings, developed from Department of Revenue (DOR) tax records and information provided by the two businesses.
- Changes in government revenue are based on JLARC staff estimates of qualifying airplane modification work, using DOR tax records.

Beneficiary industries in REMI

The scenarios described below estimate the economic activity and tax revenue impact using the beneficiary's primary North American Industry Classification System (NAICS) code, as reported to DOR. The scenic and sightseeing transportation and support activities for transportation grouping, as recorded by REMI, combines the 487 and 488 NAICS codes into a single broad category capturing transportation support activities in subindustries based on land, water, rail, and air. This appendix uses the term **"transportation support activities industry"** to describe this broad category.

The scenarios capture the inter-industry purchases by the transportation support activities industry. These interactions are unique to this industry and distinct from the other 159 industry sectors in the REMI model. JLARC staff updated relevant model inputs based on feedback from the two Washington businesses benefiting from the tax preference.

Scenarios modeled to estimate the revenue and employment impact if the tax preference expires

JLARC staff requested information from the two current beneficiaries, Greenpoint Technologies, Inc. (GTI) and Aviation Technical Services, Inc. (ATS), detailing their inter-industry supply chain purchases in Washington, current and recent annual employment, and current salary information. The taxpayers specifically authorized JLARC staff to use this information to evaluate the economic and employment effects of the sales and use tax preference for large privately owned airplanes.

To illustrate the potential responses by the two current beneficiaries and the associated revenue and employment effects, JLARC staff assumed the Legislature did not alter or extend the current tax preference and allows it to expire in 2021. The scenarios assume different levels of response by the beneficiaries when the preference expires:

- **Scenario 1:** Assumes that current beneficiaries stop performing the airplane modification work directly related to the tax preference, but maintain their presence in Washington. They continue to perform work unrelated to the tax preference. JLARC staff modeled this potential response by removing an amount of industry output equivalent to the estimated qualifying modification activity.
- **Scenario 2:** Assumes one of the two current beneficiaries, GTI, moves their entire operation out of Washington while the other beneficiary, ATS, remains in Washington, but no longer performs the airplane modification work. JLARC staff modeled these potential responses by reducing the aggregate sales for the transportation support activities industry by an amount equal to GTI's estimated statewide business activity and ATS's estimated qualifying modification activity.

The results below focus on the two areas the Legislature identified as the primary public policy objectives for this preference: the estimated impact to economic development in Washington's aerospace cluster and state tax revenues. For this report, JLARC staff defined the aerospace cluster as the aerospace parts and products manufacturing industry (NAICS 3364), also referred to as the "aerospace manufacturing industry." The results also describe the estimated impact on statewide employment if the preference expires.

Model forecasts future impacts

The REMI model is a forecasting tool. It cannot be used to model the effects from the tax preference beginning in 2016. According to REMI, the change in economic activity and reduction in government revenues from the preference are captured in the underlying model data and the budget updates entered by JLARC staff.

The modeling approach assumes the current tax preference expires July 1, 2021. The potential responses from industries and businesses to this policy change are estimates beginning at the start of the 2021-2023 biennium.

Scenario 1: Businesses cease qualifying airplane modification work, but maintain other operations in Washington

To model this scenario, JLARC staff assume the following:

- Changes in sales at the industry level begin the first day of fiscal year 2022 (July 1, 2021) when the current tax preference expires.
- Both businesses maintain their presence in Washington and sales decrease by the sum of the estimate of all instate activity for both businesses.
- The values entered into the model grow 2% per year, consistent with the REMI model's estimated average output growth by the transportation support activities industry through 2031.

JLARC staff also worked with REMI staff to correct one of the built-in revenue assumptions of the model. The model assumes that a decrease in industry sales is associated with a decrease in sales tax and a decrease in state revenues. However, airplane modification work was not taking

place in Washington before the tax preference was enacted, and both businesses indicated that the work would very likely be moved out of state if the tax preference expires. To address this, JLARC staff included a positive revenue shock to offset the default assumptions of the model.

The estimated change in industry sales are shown below ($ in millions):

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Estimated change in Industry Sales ($millions)	-31.1	-62.2	-63.5	-64.7	-66.0	-67.3	-68.7	-70.1	-71.5	-72.9	-74.3

Note: 2021 represents the last six months of the calendar year after the preference expires.

Source: JLARC staff analysis of DOR tax return data.

Results: No change in aerospace manufacturing industry jobs. Tax revenues expected to decrease by an average of $1.8 million per year and employment by an average of 347 jobs per year between 2022-2031.

No change in aerospace industry jobs. The estimates for this scenario indicate that employment in the aerospace parts and products manufacturing industry (NAICS 3364) is not significantly impacted by the possible loss of business activity related to the tax preference. Specifically, REMI estimates that the employment change in the aerospace manufacturing industry will be flat, with no additional jobs lost between 2022 and 2031.

Statewide tax revenues decrease by $1.8 million per year on average. Under the assumptions of this scenario, aggregate statewide tax revenues are expected to decrease by $1.8 million, on average, between 2022 and 2031, relative to the baseline estimate. The revenue estimate captures the tax impact associated with decreases in all induced and indirect economic activity.

Statewide employment decreases by 347 jobs per year on average. Statewide employment is estimated to decrease by 347 jobs, on average, between 2022 and 2031. Losses peak at 404 jobs in 2023 followed by small rebounds in employment in subsequent years.

Scenario 2: Qualifying airplane modification work ceases and one business relocates out of Washington

To model this scenario, JLARC staff made the same assumptions described under scenario 1 except for estimated sales. Under this scenario, the assumption is that sales decrease by the sum of the estimated value of all instate activity for one business and the estimated value of the qualifying airplane modification activity for the other business. The former captures the possible relocation of the business outside of Washington.

The estimated change in industry sales are shown below ($ in millions):

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Estimated change in Industry Sales ($millions)	-42.7	-87.1	-88.8	-90.6	-92.4	-94.2	-96.1	-98.1	-100	-101	-104

Note: 2021 represents the last six months of the calendar year after the preference expires.

Source: JLARC staff analysis of DOR tax return data.

Results: No change in aerospace manufacturing industry jobs. Tax revenues expected to decrease by an average of $3.3 million per year and employment by an average of 569 jobs per year between 2022-2031.

No change in aerospace industry jobs. The estimates for this scenario indicate that employment in the aerospace parts and products manufacturing sector (NAICS 3364) is not significantly impacted by the possible loss of business activity related to the tax preference. Specifically, REMI estimates that the employment change in the aerospace manufacturing industry will be flat, with no additional jobs lost between 2022 and 2031.

Statewide tax revenues decrease by $3.3 million per year on average. Under the assumptions of this scenario, aggregate statewide tax revenues are expected to decrease by $3.3 million, on average, between 2022 and 2031, relative to the baseline estimate. The revenue estimate captures the impact of lost indirect and induced economic activity related to the likely loss of qualifying large airplane modification work.

Statewide employment decreases by 569 jobs per year on average. Statewide employment is estimated to decrease by 569 jobs, on average, between 2022 and 2031. Losses peak at 665 jobs in 2023 followed by modest employment rebounds in subsequent years.

RECOMMENDATIONS & RESPONSES

Legislative Auditor's Recommendation

Legislative Auditor's Recommendation: Continue and clarify the objective

The Legislature should continue this preference by extending the expiration date before the preference expires on July 1, 2021.

Since the preference was enacted, Washington businesses have received several modification projects for large private airplanes. This has created new jobs and economic activity in Moses Lake and other areas in Washington where modification-related activities are performed. Economic models estimate that state tax revenues have increased between $1.8 million to $3.3 million per year due to the preference.

The preference has had a negligible impact on Washington's broader aerospace manufacturing industry. The Legislature should clarify whether the objective of growing the broader aerospace manufacturing industry is relevant.

If the preference is allowed to expire, in-state modification activity would likely cease. This would result in job losses and a decrease in tax revenues.

Legislation Required: Yes.

Fiscal Impact: Depends on legislative action.

Letter from Commission Chair

Available October 2019.

Commissioners' Recommendation

Available October 2019.

Agency Response

If applicable, available October 2019.

MORE ABOUT THIS REVIEW
Study questions

Proposed Study Questions: Modifying Large Private Airplanes Owned by Nonresidents

State of Washington Joint Legislative Audit and Review Committee • September 2018

Citizen Commission scheduled a JLARC study of a sales and use tax exemption for modifications made to large private airplanes owned by nonresidents

The 2006 Legislature directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct performance audits of tax preferences. This preference is included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.

The Legislature provided a sales and use tax exemption for nonresidents who pay Washington businesses to modify (e.g., repair, clean, alter, or improve) their large private airplanes. The preference began January 1, 2014, and is scheduled to expire July 1, 2021.

2019 study will address whether sales and use tax exemption is promoting economic development of Washington's aerospace cluster

The Legislature stated its objectives for this tax preference when it was originally established. The study will answer questions based on these objectives.

Stated objectives	Study questions
Promote economic development of the state's aerospace cluster	1. To what extent has employment in Washington's aerospace cluster changed due to this tax preference?
Increase tax revenues by providing a competitive marketplace for storing and modifying large, privately owned aircraft	2. What is the estimated net impact to state revenues as a result of any economic activity stimulated by the tax preference?

Study Timeframe

Preliminary Report: July 2019 Proposed Final Report: December 2019

Study Team

Team Lead:	Dana Lynn	360.786.5177	dana.lynn@leg.wa.gov
Research Analyst:	Eric Whitaker	360.786.5618	eric.whitaker@leg.wa.gov
Project Coordinator:	Eric Thomas	360.786.5182	eric.thomas@leg.wa.gov

JLARC Study Process

Study Mandate — Budget, legislation, committee direction → Proposed Study Questions → Legislative Auditor's Preliminary Report → For Tax Preferences: • Citizen Commission meeting • Public testimony • Commission adopts comments → Legislative Auditor's Proposed Final Report — Agency response included → Final Report — Option to append committee comment

Committee votes to distribute completed audit

Joint Legislative Audit & Review Committee, 106 11th Ave SW, Olympia, WA 98501
(360) 786-5171 • (360)786-5180 (fax) • JLARC@leg.wa.gov • www.jlarc.leg.wa.gov
Keenan Konopaski, Washington State Legislative Auditor

Washington Joint Legislative Audit and Review Committee

106 11th Avenue SW, Suite 2500
PO Box 40910
Olympia, WA 98504-0910

Phone: 360-786-5171
Fax: 360-786-5180
Email: JLARC@leg.wa.gov

Multifamily Housing in Urban Areas

2019 JLARC TAX PREFERENCE REVIEW

Estimated beneficiary savings in calendar years 2022 and 2023: $262 million | Property tax

Developers have created housing using the Multifamily Housing Tax Exemption (MFTE) in 26 cities and Pierce County

Available in cities meeting population requirements and Pierce County.

Cities designate targeted area where exemption is offered, and may customize to meet city needs.

8-year exemption for market rate housing or 12-year exemption with 20% affordable units.

The preference has no expiration date.

424
Developments have received an exemption

34,885
New housing units have been created

82%
Units located in Seattle, Tacoma, Spokane or Renton

21%
Units designated as affordable

Does this use represent a net increase in development? Inconclusive

To evaluate how the preference might affect the decision to build, we contracted with real estate economists to model the impact on the financial performance of developments.

Actual project costs and income were not available, so economists modeled various scenarios in the targeted areas.

Models identified:

Scenarios where the preferences may make a project financially feasible

Scenarios where projects were likely feasible without the preference

UNCLEAR As a result, it is unclear whether and how the preference affected decisions to develop. Without financial analysis by cities on proposed developments, some projects may be unnecessarily subsidized.

Cities have opportunities to maximize the impact of the exemption

At least 12 cities include financial analysis as a factor in offering or approving exemptions.

To improve affordability, **at least ten cities** have adopted maximum rental prices that are lower than those required by statute. These limits apply to units rented to low and moderate income households.

Without reporting improvements, the Legislature will lack critical information for monitoring the program

At least 11 cities have failed to report. As a result, the state lacks critical information such as the exemption value and units created.

Statute does not require cities to report data needed to assess compliance with affordability requirements.

Cities have implemented some provisions in ways that may differ from statutory intent or state guidance.

JLARC staff conducted extensive data collection with local governments to obtain this information.

LEGISLATIVE AUDITOR'S RECOMMENDATION

Modify

The Legislature should modify the preference to direct cities to include analysis of profitability as a consideration for the exemption.

The Department of Commerce should report annually to the Legislature on city compliance, the metrics in statute, and affordability measures.

The Department of Revenue should report to the Legislature on which statutory ambiguities require legislative changes.

The complete report is on the JLARC web site: www.leg.wa.gov/jlarc

For more information, contact: Keenan Konopaski, Washington State Legislative Auditor
keenan.konopaski@leg.wa.gov • (360) 786-5187

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July 2019

PRELIMINARY REPORT:
2019 TAX PREFERENCE PERFORMANCE REVIEWS

Property Tax Exemption for Multifamily Housing in Urban Areas

LEGISLATIVE AUDITOR'S CONCLUSION:

Developers have created housing using the Multifamily Housing Tax Exemption. It is inconclusive whether this use represents a net increase in development. Cities have opportunities to maximize the impact of the exemption and improve reporting on results.

July 2019

Property tax exemption offered by cities for multifamily housing

The Multifamily Housing Tax Exemption (MFTE) is a property tax exemption program that allows eligible cities to target specific areas for multifamily housing development. Pierce County also is eligible. If a city or Pierce County chooses to create a program, it may create additional requirements or restrictions.

Property owners may apply for an 8-year or 12-year property tax exemption for building or rehabilitating multifamily housing. The 12-year exemption requires owners to offer at least 20% of their units as affordable housing, as defined by statute. Cities have the authority to approve and reject individual projects.

Estimated Beneficiary Savings
$262 million in Calendar Years 2022-23
Tax Type
Property Tax
RCW 84.14.007
Applicable Statutes

The preference has no expiration date.

JLARC staff reviewed a similar preference for multifamily housing in Mason County in 2018.

The preference is intended to encourage multifamily housing development

The preference was intended to stimulate development of new and rehabilitated multifamily housing – including affordable housing – in cities that plan under the Growth Management Act. It also aimed to allow unincorporated areas within urban growth areas to stimulate housing development near college campuses.

424	34,885	82%	21%
Developments have received an exemption	New housing units have been created	Units located in Seattle, Tacoma, Spokane or Renton	Units designated as affordable

Cities have opportunities to maximize the impact of the exemption

Cities may adopt additional requirements for the exemption so that it meets local planning goals.

- Models indicate that the preference can increase the financial performance of developments. It's unclear how often MFTE provides an incentive to projects that would not otherwise be built. At least 12 cities include financial analysis as a factor when deciding whether to offer or approve an exemption.
- Even with statutory rent limits, households earning less than 80% of the area median income (AMI) in their county could pay more than 30% of their income on housing. At least ten cities have adopted income requirements that are lower than the statutory limits (e.g., 60% instead of 80% AMI).

Without reporting improvements, the Legislature will continue to lack critical information for monitoring the program

Statute requires cities and Pierce County to report information to the Department of Commerce each year. At least 11 cities have failed to report in one or more years, while others submitted incomplete reports that make the data unreliable overall. While reports must include information such as number of housing units, rental prices, and tenant income, Commerce's required reporting, even if followed, lacks the detail needed to evaluate compliance with affordability and other requirements.

JLARC staff collected data from multiple other sources (e.g., city staff, county assessors) to provide the information in this report.

Recommendations

Legislative Auditor's Recommendation: Modify

The Legislature should modify the preference to direct cities to include analysis of profitability as a consideration in offering or approving exemptions.

The Department of Commerce should report annually to JLARC and the relevant policy committees on city compliance with the requirements, as well as the metrics in statute and affordability measures.

The Department of Revenue should report to JLARC and the relevant policy committees on which statutory ambiguities can be resolved through guidance and which require statutory changes.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

Available October 2019.

REVIEW DETAILS

1. Preference to stimulate multifamily housing development

Tax preference was created to stimulate multifamily housing development. Projects have been approved by Pierce County and 26 of 102 eligible cities.

The law has a broad goal: increase multifamily housing, including affordable housing, in urban centers that need it

The Multifamily Housing Property Tax Exemption (MFTE) provides an 8- or 12-year property tax exemption on new, expanded, or updated multifamily housing.

- The exemption applies only to the residential portions of newly constructed improvements, not the value of the land, retail space, or existing improvements.
- For mixed-use development, permanent housing[1] must make up at least 50% of the space.
- The housing must have at least four units, which may be rented or sold.
- The 8-year exemption does not require affordable housing, while the 12-year exemption requires that at least 20% of the units are affordable to low- and moderate-income households, as defined in statute (see Section 4 for explanation).
- Cities and one county may adopt MFTE programs.

The preference was enacted in 1995 and was modified to its present form in 2007. It is not scheduled to expire.

Since 2007, 26 cities and one county have approved exemptions for 424 developments

Cities that meet population thresholds set in statute are eligible to offer the exemption. Of the 102 cities that are eligible, 49 have adopted an MFTE program and 26 have approved exemptions. Pierce County also is eligible and has approved exemptions. A map and list of participating local governments are in Appendix A.

These local governments must designate a targeted area where they will offer the exemption. These areas must be within an urban center and lack housing to meet the needs of households who would likely live there. The established targeted areas range in size from 5 acres to 19 square miles. At least 22 cities have designated more than one targeted area.

[1] owner-occupied housing or rental housing that is leased for a period of at least one month

Use of the preference has increased — in 2009, developments with 2,457 units were approved. There were 5,337 units approved in 2018. A development can remain eligible for the exemption for 8 to 12 years.

Exhibit 1.1: Developers have created at least 34,885 housing units, including affordable units, using the MFTE

424	34,885	82%	21%
Developments have received an exemption	New housing units have been created	Units located in Seattle, Tacoma, Spokane or Renton	Units designated as affordable

Source: JLARC staff analysis of information compiled from the Department of Commerce, county assessors, and cities. The data is not maintained by one agency. See Section 5 for more detail.

2. Local MFTE programs vary

Local MFTE program requirements and characteristics vary

Cities may adopt additional requirements for the exemption and vary the program characteristics

State statute outlines the baseline requirements for developments built with the exemption. A development must add at least four new housing units, be in a targeted area, and comply with all local rules. In addition, to qualify for the 12-year exemption, the developments must meet affordability requirements for 20% of the units.

Statute also requires developments to meet additional requirements that the city or county deems necessary. These requirements typically come from three sources:

1. **Municipal code**. These include specifications on parking, height, density, environmental impact, amenities, and compatibility with surrounding properties. Some also have more stringent affordable housing requirements than state law.
2. **Contracts.** Statute requires owners to enter into a contract with the cities. The contract may add further requirements specific to the development.
3. **Zoning regulations.** These regulations may prohibit some types of development that would otherwise qualify for the preference. For example, while low-rise housing may qualify, it may not be allowed in certain areas based on city zoning.

Exhibit 2.1: Variations in city programs include size of targeted area, focus on affordable housing, which exemption(s) is offered, and building requirements

Program Characteristic	Examples of Variation
Size of targeted area	• 1 property (Issaquah). • 3.9 square miles (Vancouver). • 19 square miles (Seattle).
Affordable housing focus	• All units must be affordable (Snoqualmie). • No more than 30% of units may be affordable (Lacey). • Affordable rent limits vary by unit size and neighborhood (Bellevue).
Exemption offered	• 8-year exemption only (Ferndale). • 12-year exemption only (Edmonds). • Both 8- and 12-year exemption (Spokane).
Building requirements	• LEED certification required (Woodinville). • Include public civic or cultural use (Newcastle). • Invest at least $25,000 per unit (Yakima).

Source: JLARC staff analysis of information compiled from the Department of Commerce, county assessors, and cities.

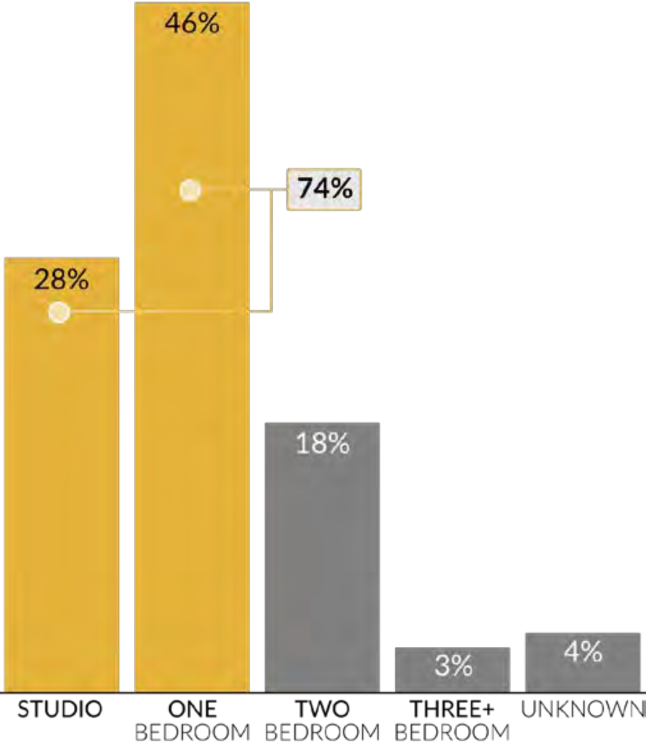
Majority of housing units appear intended for small families or individuals

State law does not limit the type or size of units that may qualify. About 75% of the units created between 2007 and 2018 are studios or one bedroom. The median Washington household is 2.6 people.

At least four cities have enacted local policies to encourage larger units:

- Bellevue requires at least 15% of units to have two or more bedrooms.
- Seattle, Bellingham, and Shoreline encourage large units by applying stricter affordability requirements for smaller units:
    - All three require that units with fewer than two bedrooms be affordable at

Exhibit 2.2: 75% of the 34,885 units created are studios or one bedroom



Source: JLARC staff analysis. Total may not equal 100% due to rounding.

lower income thresholds. This has the effect of lowering the maximum monthly rental price for smaller units.

- Seattle also requires that a development that does not have at least four larger units[2] out of every hundred must include more affordable units overall.

3. MFTE has inconclusive effect on development

MFTE's effect on the decision to build varies by development.
All cities should include an analysis of a development's profitability as one of the factors they consider when determining whether to approve an exemption.

Real estate economists developed a model to evaluate how the preference might affect a hypothetical development's profitability

The Multifamily Housing Property Tax Exemption (MFTE) aims to stimulate housing development by lowering operating costs and thereby improving profitability. JLARC staff did not have access to approved developments' actual costs and rental income needed to test this. Given this limitation, JLARC staff sought assistance from consultants with housing finance expertise at Community Attributes, Inc. (CAI).

Consultants modeled scenarios with varying rental income and land costs

Detailed information about the methods and definitions are in Appendix B.
For the rental models:

- Four multifamily development types are considered in the model: low-rise, mid-rise (residential), mid-rise (mixed use), and high-rise.
- The consultant developed scenarios that represent a combination of development type, land cost, and rental income.
- Each scenario was tested without the MFTE, with the 8-year exemption, and with the 12-year exemption as described in statute (i.e., not reflecting city-level variation).

The consultants developed a model to test the potential impact the preference may have on profitability for a variety of potential development types, costs, and rents charged in local markets where the preference is used.

The premise is that a given development would be built only if it is sufficiently profitable, as measured by the rate of return on investment. The model assumed that most developments must generate a rate of return between 15-20% to be financially feasible.

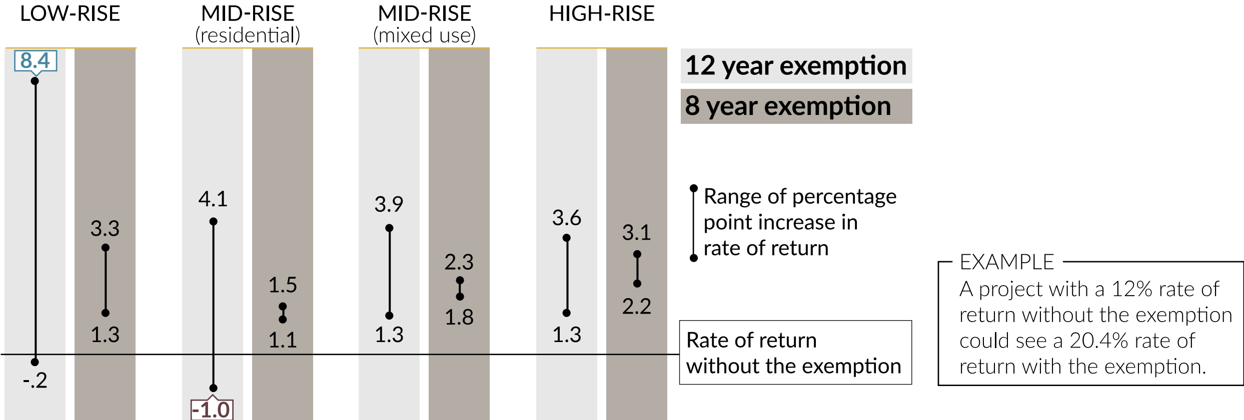
[2] 2 or more bedrooms

Model indicates that MFTE can improve a development's financial performance, as measured by the rate of return on investment

The model identified a range of possible increases in profitability for each category of exemption (blue shading in the exhibit below). The range varied depending on the development type, and was a function of land acquisition costs and local market rental prices.

- **8-year exemption (market rate units):** The model showed that overall, the 8-year exemption increases rate of return by between 1.1 and 3.3 percentage points.
- **12-year exemption (market rate and affordable units):** Overall, the 12-year exemption changes rate of return by between -1.0 and 8.4 percentage points. For each development type, this exemption increases profitability most at lower rent levels where operating income would be lowest.
- Which exemption is more attractive depends on rental prices. When affordable rent limits are close to market rate rent, the 12-year exemption is more profitable than the 8-year exemption. As market rent increases, the 12-year exemption becomes less profitable.

Exhibit 3.1: Rate of return may change between -1.0 and 8.4 percentage points with MFTE



Source: JLARC staff analysis of CAI multifamily housing development financial models.

The model indicates it is inconclusive how often the increase in profitability made developments feasible

Assuming that most developments must generate a rate of return between 15-20% to be financially feasible:

- If a development had a 12% rate of return without the exemption, the 8-year exemption could increase it to 13.1-15.3%. On the low end of this range, the project may be financially infeasible, but on the high end it may be feasible.

- For a similar development, the 12-year exemption could change the rate of return to 11-20.4%. On the low end of this range, the project would also likely be financially infeasible, but on the high end it may be feasible.
- In both of these examples, it is possible the preferences made the project feasible. However, it is also possible that it was insufficient to spur the development to take place.
- The model also indicated examples where development in the eligible areas may already be financially feasible without the incentive.

The model found enough variation across these examples in each jurisdiction that a definitive answer on feasibility is inconclusive. Without more specific information on the actual projects built in the eligible areas, it's not possible to be more conclusive about the effect the preference has had on causing an increase in development that would not otherwise occur.

At least 12 cities use financial analysis when offering or approving exemptions

Statute does not require that cities analyze the impact of the exemption on a development's profitability. However, some cities incorporate the evaluation into their approval process. In interviews with JLARC staff, city planners reported the following:

- Lakewood performs a detailed analysis on each proposed project. The analysis uses assumptions similar to those used by the consultants on this report.
- Seattle recognizes that many projects would be built without the preference, so it uses MFTE to improve the profitability of developments that will include affordable housing units.
- Cities that are part of A Regional Coalition for Housing (ARCH) assess the tax benefit in comparison to the reduction in rent.
- Auburn requires audited expense records before granting the exemption.

As noted in Section 2, cities have different requirements for MFTE programs. Other considerations also may influence either a developer's decision to build or a city's decision to approve an exemption.

- A city may need to offer the exemption to attract development to the targeted area. For example, some locations may be perceived as riskier for development, and therefore require greater profitability to attract developers.
- Housing markets differ in zoning restrictions and city planning goals. For instance, some cities and some markets require developers to include parking. This can increase building costs and affect a developer's decision to build.

In 2018 JLARC staff reviewed a similar preference for Mason County and found no multifamily construction had occurred since that preference had been enacted in 2013. Staff noted at the time that this review may provide further information. CAI included the city of Shelton in their

modeling work and found market rents were too low to support any of their modeled development types, with or without the MFTE.

4. Statutory rent limits may not improve affordability

The statutory rent limits may not improve affordability for low- and moderate-income households. Ten cities have adopted lower rent limits.

Statutory affordable rent limit is based on each county's area median income, adjusted for household size

The statutory affordable rent limit is a formula that sets the maximum rental price for an affordable housing unit.

The limit states that the maximum rental price of an affordable housing unit may not exceed 30% of the monthly income of a hypothetical low- or moderate-income household. To qualify for these units, a household's income must be at or below these qualifying levels:

Exhibit 4.1: Sample Affordable Rent Calculations

	AREA MEDIAN INCOME (AMI) $64,600	
	Low income	Moderate income
Qualifying annual income level	$51,680	$74,290
Maximum rental price *(30% monthly income)*	**$1,290**	**$1,860**

Source: JLARC staff analysis. Calculations reflect a 3-person household in Spokane County.

- Low-income level: 80% of the county's area median income (AMI) or 100% of AMI in high cost counties[3].
- Moderate-income level: 115% of the county AMI, or 150% of AMI in high cost counties.

The Department of Housing and Urban Development (HUD) calculates each county's AMI and adjusts it for family size.

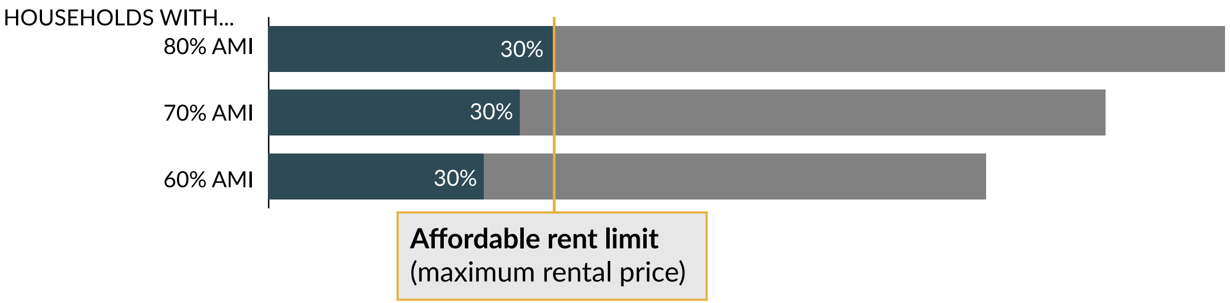
Statutory affordable rent limits are based on a county's median income and are not adjusted down to an individual household's actual income

Within a county, all low-income households have the **same** affordable rent limit, adjusted for family size. Continuing the example from Exhibit 4.1, this means that in a housing unit designated for low-income households, a family making 60% AMI ($3,230 per month) has the same maximum rental price as a family of the same size making 80% AMI ($4,307 per month). The same is true for moderate-income households. As a result, the maximum rental price calculated

[3]Counties with particularly high median housing prices, as reported by the Washington Center for Real Estate Research

in statute can exceed 30% of income for certain low- and moderate-income renters. A household earning less than 60% AMI may be eligible for other housing assistance programs. It is unclear the degree to which this affects renters in the targeted areas.

Exhibit 4.2: The maximum rental price does not change, so households earning less than the qualifying income level could pay a greater percentage of income for housing



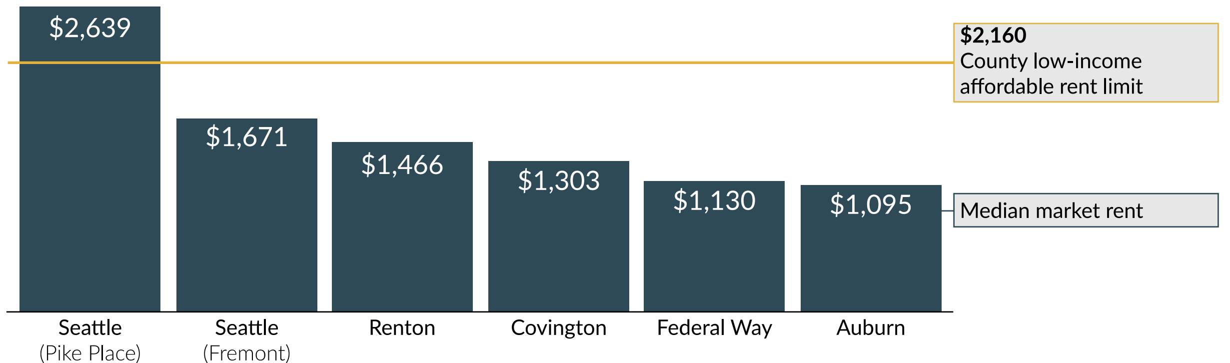
Source: JLARC staff analysis of RCW 84.14.020 and HUD guidance.

Statutory maximum rental prices may be higher than median market rents

To qualify for the 12-year exemption, 20% of new units must be affordable to low- and moderate-income households. Because of the way affordable rent limits are calculated, some property owners are receiving the preference for units that can be rented at or above median market rent.

Cities in King County offer a clear example. The higher household income in Seattle increases the county median income. As a result, median market rents in other communities are below the statutory affordable rent limits. The below exhibit details the low-income affordable rent limit and median market rent of a two-bedroom unit by zip code in 2017, the most recent year for which data was available. The rent limit for a two-bedroom unit is calculated for a three-person household.

Exhibit 4.3: Example of how high-cost cities increase the maximum rent limits for surrounding communities



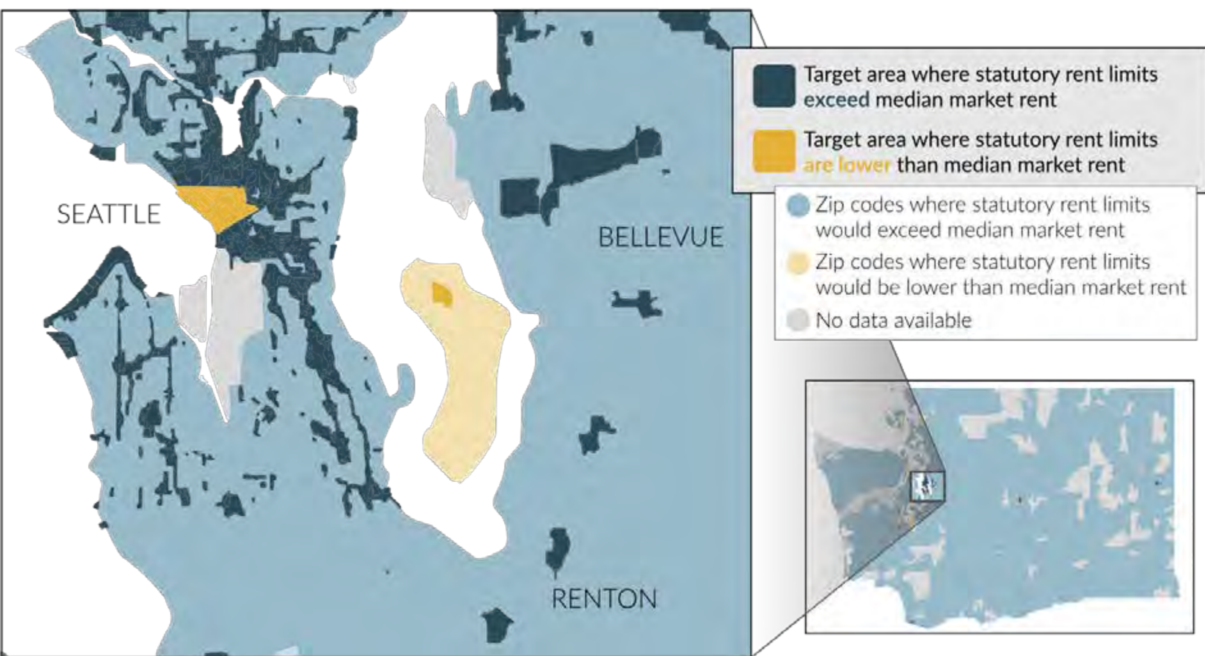
Source: JLARC staff analysis of American Community Survey (ACS) data, HUD 2017 Income Limits, and city ordinances.

The statutory maximum rental price for low-income households exceeded market rent in all targeted areas except downtown Seattle, downtown Tacoma, and Mercer Island

Data does not exist to determine how frequently this occurs across the entire state. However, JLARC staff analysis of American Community Survey (ACS) data shows the potential for this situation in targeted areas and statewide, including cities that have not yet adopted an MFTE program. Data was available for 512 of the 685 zip codes in Washington.

- The statutory maximum rental price for **low-income households** was higher than the median market rent in at least 498 zip codes statewide.
- The statutory maximum rental price for **moderate-income households** was higher than the median market rent in all targeted areas and at least 512 zip codes.

Exhibit 4.4: The statutory maximum rental price for low-income households was higher than median market rent in at least 498 zip codes statewide, including all but three targeted areas



Source: JLARC staff analysis of ACS data 2017, HUD 2017 income limits and city ordinances.

Ten cities in King County use lower qualifying income levels than those in statute

Of the 19 King County cities with an MFTE program, 10 have adopted stricter income requirements that allow fewer households to qualify for affordable housing. For example:

- Seattle uses a range of income limits, depending on the number of bedrooms. The lowest limit is 40% of AMI for a small efficiency dwelling unit[4], while the highest is 90% of AMI for a three bedroom unit.
- Kirkland also uses a range of income limits. Its lowest limit is 50% of AMI and its highest is 100% of AMI.
- Bellevue uses a range of income limits, between 45% of AMI and 70% of AMI depending on the location of the project and unit size.
- Bellingham, Issaquah, Mercer Island, Redmond, Shoreline, Snoqualmie, and Woodinville also have income requirements lower than 80% of AMI.

However, statute also allows cities in counties with high median housing prices to use higher qualifying income levels (e.g., 100% AMI for low-income households). Ten cities — Marysville, Snoqualmie, Tukwila, Auburn, Burien, Everett, Federal Way, Lynnwood, SeaTac, and Covington — have incorporated this provision into their programs.

5. Tax savings may be shifted to other taxpayers

Savings are estimated to grow from $80 million to $137 million by 2023 as cities exempt more developments. The amount shifted to other taxpayers ranged from 0% to 100% depending on levy limits and differing county assessor practices.

In calendar year 2018, beneficiaries saved $19 million in state property taxes and $61 million in local property taxes

The owners of exempt multifamily housing properties are the direct beneficiaries of this preference. JLARC staff estimate their savings in calendar year 2018 was $80 million. As shown in the table below, this amount is expected to increase each year. Over the past four years, an average of $1.1 billion in new property value became exempt each year. In 2020, approximately $232 million in property value will lose the exemption and become taxable. If the development trend continues, JLARC staff expect new exemptions to outpace expiring exemptions.

[4]Also known as micro-housing, with a minimum size of 150 square feet

Exhibit 5.1: Estimated beneficiary savings are expected to increase annually

Calendar Year	Est. Direct Beneficiary Savings (State)	Est. Direct Beneficiary Savings (Local)	Total Direct Beneficiary Savings
2018	$19 million	$61 million	$80 million
2019	$20 million	$70 million	$90 million
2020	$25 million	$79 million	$105 million
2021	$28 million	$88 million	$116 million
2022	$30 million	$95 million	$125 million
2023	$32 million	$105 million	$137 million

Source: JLARC staff analysis of county assessor data.

The beneficiary savings per housing unit varies by city, depending on policy choices and the size and type of developments.

As shown above, most of the beneficiary savings comes from local property taxes. Statewide, on developments that are fully market rate, beneficiaries save an average of $2,096 per unit, per year for the life of the exemption. For developments that include affordable housing, beneficiaries save an average of $10,651 per affordable housing unit per year. The amount varies widely by city. For example, the savings per affordable unit in Spokane is $2,269 while the savings per unit in Tacoma is $6,091. This is due in part to the different proportions of market rate and affordable units. See Appendix C for detail on each city.

Beneficiary savings could result in a property tax shift or forgone revenue

- A property tax shift means that the amount that would have been collected on the exempt property is paid by other taxpayers.
- Forgone revenue means that the tax is not collected from any taxpayers.

Until 2021, the state portion of the beneficiary savings will be forgone revenue. This is due to temporary legislative changes in school funding that changed state property taxes to a rate-based system for four years. After 2021, state property tax will shift back to a budget-based system and some of the savings will increase taxes paid by other property owners.

The amount of local tax savings that will be shifted to other taxpayers cannot be determined

The degree to which this preference led to a local tax shift or a revenue loss depends on multiple factors including local levy limits and the timing of assessment.

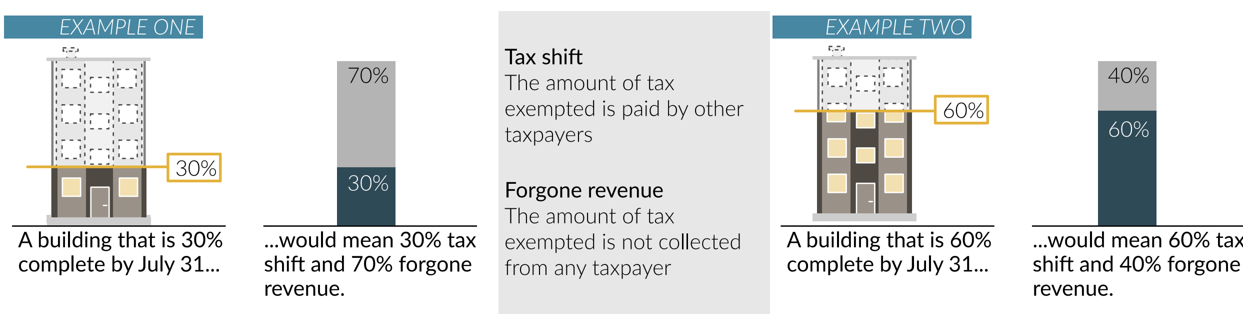
- **Local levy limits:** State law limits both the levy amount and levy rate that a taxing district may impose. It also limits the amount by which a taxing jurisdiction may increase its levy

each year, excluding new construction values. If a jurisdiction is already at its highest possible levy rate, the exemption results in forgone revenue rather than a tax shift.

- **Assessment timing:** Per RCW 84.14.020, the exemption begins on January 1 after the year in which the city approves it. The Department of Revenue (DOR) notes that RCW 36.21.080 requires county assessors to value all new construction each year. Under the DOR's interpretation of these statutes, assessors should value the completed portions of the property as new construction, as of July 31, and add them to the tax rolls for calculating levy limits for the year. After the exemption is approved, the beneficiary savings would include both forgone revenue and a tax shift.

Because many local taxing jurisdictions extend beyond city limits, some of the impact—both shift and loss—happens outside the cities granting exemptions.

Exhibit 5.2: The tax savings shifted onto other taxpayers depends on the timing of construction and assessment for each development



Source: JLARC staff analysis.

6. Reporting improvements needed for accountability

Without reporting improvements, the Legislature will continue to lack critical information for monitoring the program (e.g., exemption value, units created, participating cities)

Reporting does not meet statutory requirements and is unreliable for program evaluation and compliance monitoring

RCW 84.14.100(2) requires that Pierce County and cities report information to the Department of Commerce each year. However, because of inconsistent reporting and unclear forms, Commerce lacks the information required by statute.

- At least five cities have not submitted a report during the period reviewed, and at least 11 failed to report in one or more years. Statute does not grant Commerce the authority to compel cities to submit reports, and it cannot identify all participating jurisdictions.
- Most reports were incomplete. Cities used different calculations in the reports, making the overall data unreliable. As a result, Commerce cannot provide reliable information about the number of exempt properties, the number of affordable units, the total value of exemptions granted, or other metrics listed in statute.
- The reporting form created by Commerce lacks some of the detail required by statute (e.g., monthly rent by unit).

Because of these reporting problems, Commerce cannot report critical information to the Legislature such as confirmation that affordable housing units were rented or sold to qualifying households.

JLARC staff conducted independent data collection

Due to the data problems identified in this section, JLARC staff did not rely solely on Commerce reports for this report. Additional collection methods include:

- **Phone interviews** with county assessors and city staff.
- **Compiling data** from assessor and apartment web sites.
- **Requesting MFTE-related data** from county assessors, cities, and Commerce.

Exhibit 6.1: Commerce lacks information required by statute

Cities must report	Data status	JLARC analysis
Number of tax exemptions granted	Partial	At least 11 of the 26 cities have failed to report at some point.
Total number and type of units produced or to be produced	Partial	At least 11 of the 26 cities have failed to report at some point.
Number and type of units meeting affordable housing requirements	Partial	Form does not provide for unit type.
Income of each renter household for each unit	Partial	Form asks only for income on affordable units and some cities did not report this information.
Value of tax exemption for each development	Unreliable	Some cities report for one year, others for the length of the exemption. Four cities reported they did not know the value of the exemption.
Actual development cost of each unit	Unreliable	Some cities reported by unit and others by development. The methodologies vary and it is unclear what costs are included.
Total monthly rent or total sale amount of each unit	Not available	Form allows for only one rent/sale amount per development.

Source: RCW 84.14.100; JLARC staff analysis.

The state lacks detailed data to monitor the program and ensure compliance

Statute does not require cities to report detailed data that would be needed to monitor the program or assess compliance with affordability requirements. For example:

- Cities must report tenant incomes. However, whether the income reported satisfies affordability requirements depends on household size and unit size, which is not reported.
- Cities are not required to link their data to records in the county assessors' offices. As a result, the data used to evaluate the tax impact of the exemption is difficult to compare with the housing impact. JLARC staff relied on internet searches and property sales histories to connect the records.

In 2010, Commerce produced a report to the Governor's office that identified some of these issues.

Local government oversight of the programs varies

Statute grants cities and Pierce County the authority to implement and manage their programs. Local oversight varies. For example:

- After an internal audit revealed a lack of internal controls and cases of noncompliance with state and city policies, Seattle established a compliance and monitoring program that requires substantial documentation and on-site audits.
- In contrast, at least one city has never collected the compliance reports that property owners are required to file annually.
- Longview requires on-site verification of compliance annually.

Cities and Pierce County have implemented some provisions of the exemption in ways that may differ from statutory intent or state guidance

Both Commerce and the Department of Revenue (DOR) provide guidance to cities and county assessors upon request. Some statutory provisions have been interpreted differently by cities.

- To qualify for a twelve-year exemption, a project must make at least 20% of its units affordable to "low- and moderate-income households." According to DOR, the requirement may be satisfied if at least one unit is affordable to low-income households, as long as the rest of the 20% are affordable to moderate-income households. However, at least one city allows the requirement to be satisfied if units are affordable only to moderate-income households.
- According to DOR, assisted living facilities are not eligible for the exemption. At least two properties that provide assisted living are receiving the exemption.
- Exempt rental housing must provide "permanent residential occupancy," excluding hotels and motels that provide daily or weekly rental accommodations. At least one property claiming the exemption has rented out units on Airbnb, the short-term rental platform. At the time of this report, the city stated it was investigating the matter and that the question of short-term rentals was not clearly addressed by statute.

7. Applicable statutes

RCW 84.14

Findings

84.14.005

The legislature finds:

(1) That in many of Washington's urban centers there is insufficient availability of desirable and convenient residential units, including affordable housing units, to meet the needs of a growing

number of the public who would live in these urban centers if these desirable, convenient, attractive, affordable, and livable places to live were available;

(2) That the development of additional and desirable residential units, including affordable housing units, in these urban centers that will attract and maintain a significant increase in the number of permanent residents in these areas will help to alleviate the detrimental conditions and social liability that tend to exist in the absence of a viable mixed income residential population and will help to achieve the planning goals mandated by the growth management act under RCW 36.70A.020; and

(3) That planning solutions to solve the problems of urban sprawl often lack incentive and implementation techniques needed to encourage residential redevelopment in those urban centers lacking a sufficient variety of residential opportunities, and it is in the public interest and will benefit, provide, and promote the public health, safety, and welfare to stimulate new or enhanced residential opportunities, including affordable housing opportunities, within urban centers through a tax incentive as provided by this chapter.

[2007 c 430 § 1; 1995 c 375 § 1.]

Purpose

84.14.007

It is the purpose of this chapter to encourage increased residential opportunities, including affordable housing opportunities, in cities that are required to plan or choose to plan under the growth management act within urban centers where the governing authority of the affected city has found there is insufficient housing opportunities, including affordable housing opportunities. It is further the purpose of this chapter to stimulate the construction of new multifamily housing and the rehabilitation of existing vacant and underutilized buildings for multifamily housing in urban centers having insufficient housing opportunities that will increase and improve residential opportunities, including affordable housing opportunities, within these urban centers. To achieve these purposes, this chapter provides for special valuations in residentially deficient urban centers for eligible improvements associated with multiunit housing, which includes affordable housing. It is an additional purpose of this chapter to allow unincorporated areas of rural counties that are within urban growth areas to stimulate housing opportunities and for certain counties to stimulate housing opportunities near college campuses to promote dense, transit-oriented, walkable college communities.

[2014 c 96 § 2; 2012 c 194 § 1; 2007 c 430 § 2; 1995 c 375 § 2.]

Definitions

84.14.010

The definitions in this section apply throughout this chapter unless the context clearly requires otherwise.

(1) "Affordable housing" means residential housing that is rented by a person or household whose monthly housing costs, including utilities other than telephone, do not exceed thirty

percent of the household's monthly income. For the purposes of housing intended for owner occupancy, "affordable housing" means residential housing that is within the means of low or moderate-income households.

(2) "Campus facilities master plan" means the area that is defined by the University of Washington as necessary for the future growth and development of its campus facilities for campuses authorized under RCW 28B.45.020.

(3) "City" means either (a) a city or town with a population of at least fifteen thousand, (b) the largest city or town, if there is no city or town with a population of at least fifteen thousand, located in a county planning under the growth management act, or (c) a city or town with a population of at least five thousand located in a county subject to the provisions of RCW 36.70A.215.

(4) "County" means a county with an unincorporated population of at least three hundred fifty thousand.

(5) "Governing authority" means the local legislative authority of a city or a county having jurisdiction over the property for which an exemption may be applied for under this chapter.

(6) "Growth management act" means chapter 36.70A RCW.

(7) "High cost area" means a county where the third quarter median house price for the previous year as reported by the Washington center for real estate research at Washington State University is equal to or greater than one hundred thirty percent of the statewide median house price published during the same time period.

(8) "Household" means a single person, family, or unrelated persons living together.

(9) "Low-income household" means a single person, family, or unrelated persons living together whose adjusted income is at or below eighty percent of the median family income adjusted for family size, for the county where the project is located, as reported by the United States department of housing and urban development. For cities located in high-cost areas, "low-income household" means a household that has an income at or below one hundred percent of the median family income adjusted for family size, for the county where the project is located.

(10) "Moderate-income household" means a single person, family, or unrelated persons living together whose adjusted income is more than eighty percent but is at or below one hundred fifteen percent of the median family income adjusted for family size, for the county where the project is located, as reported by the United States department of housing and urban development. For cities located in high-cost areas, "moderate-income household" means a household that has an income that is more than one hundred percent, but at or below one hundred fifty percent, of the median family income adjusted for family size, for the county where the project is located.

(11) "Multiple-unit housing" means a building having four or more dwelling units not designed or used as transient accommodations and not including hotels and motels. Multifamily units may result from new construction or rehabilitated or conversion of vacant, underutilized, or substandard buildings to multifamily housing.

(12) "Owner" means the property owner of record.

(13) "Permanent residential occupancy" means multiunit housing that provides either rental or owner occupancy on a nontransient basis. This includes owner-occupied or rental accommodation that is leased for a period of at least one month. This excludes hotels and motels that predominately offer rental accommodation on a daily or weekly basis.

(14) "Rehabilitation improvements" means modifications to existing structures, that are vacant for twelve months or longer, that are made to achieve a condition of substantial compliance with existing building codes or modification to existing occupied structures which increase the number of multifamily housing units.

(15) "Residential targeted area" means an area within an urban center or urban growth area that has been designated by the governing authority as a residential targeted area in accordance with this chapter. With respect to designations after July 1, 2007, "residential targeted area" may not include a campus facilities master plan.

(16) "Rural county" means a county with a population between fifty thousand and seventy-one thousand and bordering Puget Sound.

(17) "Substantial compliance" means compliance with local building or housing code requirements that are typically required for rehabilitation as opposed to new construction.

(18) "Urban center" means a compact identifiable district where urban residents may obtain a variety of products and services. An urban center must contain:

(a) Several existing or previous, or both, business establishments that may include but are not limited to shops, offices, banks, restaurants, governmental agencies;

(b) Adequate public facilities including streets, sidewalks, lighting, transit, domestic water, and sanitary sewer systems; and

(c) A mixture of uses and activities that may include housing, recreation, and cultural activities in association with either commercial or office, or both, use.

[2017 c 52 § 16; 2014 c 96 § 3. Prior: 2012 c 194 § 2; prior: 2007 c 430 § 3; 2007 c 185 § 1; 2002 c 146 § 1; 2000 c 242 § 1; 1997 c 429 § 40; 1995 c 375 § 3.]

Exemption - Duration - Valuation.

84.14.020

(1)(a) The value of new housing construction, conversion, and rehabilitation improvements qualifying under this chapter is exempt from ad valorem property taxation, as follows:

(i) For properties for which applications for certificates of tax exemption eligibility are submitted under chapter 84.14 RCW before July 22, 2007, the value is exempt for ten successive years beginning January 1 of the year immediately following the calendar year of issuance of the certificate; and

(ii) For properties for which applications for certificates of tax exemption eligibility are submitted under chapter 84.14 RCW on or after July 22, 2007, the value is exempt:

(A) For eight successive years beginning January 1st of the year immediately following the calendar year of issuance of the certificate; or

(B) For twelve successive years beginning January 1st of the year immediately following the calendar year of issuance of the certificate, if the property otherwise qualifies for the exemption under chapter 84.14 RCW and meets the conditions in this subsection (1)(a)(ii)(B). For the property to qualify for the twelve-year exemption under this subsection, the applicant must commit to renting or selling at least twenty percent of the multifamily housing units as affordable housing units to low and moderate-income households, and the property must satisfy that commitment and any additional affordability and income eligibility conditions adopted by the local government under this chapter. In the case of projects intended exclusively for owner occupancy, the minimum requirement of this subsection (1)(a)(ii)(B) may be satisfied solely through housing affordable to moderate-income households.

(b) The exemptions provided in (a)(i) and (ii) of this subsection do not include the value of land or nonhousing-related improvements not qualifying under this chapter.

(2) When a local government adopts guidelines pursuant to RCW 84.14.030(2) and includes conditions that must be satisfied with respect to individual dwelling units, rather than with respect to the multiple-unit housing as a whole or some minimum portion thereof, the exemption may, at the local government's discretion, be limited to the value of the qualifying improvements allocable to those dwelling units that meet the local guidelines.

(3) In the case of rehabilitation of existing buildings, the exemption does not include the value of improvements constructed prior to the submission of the application required under this chapter. The incentive provided by this chapter is in addition to any other incentives, tax credits, grants, or other incentives provided by law.

(4) This chapter does not apply to increases in assessed valuation made by the assessor on nonqualifying portions of building and value of land nor to increases made by lawful order of a county board of equalization, the department of revenue, or a county, to a class of property throughout the county or specific area of the county to achieve the uniformity of assessment or appraisal required by law.

(5) At the conclusion of the exemption period, the new or rehabilitated housing cost shall be considered as new construction for the purposes of chapter 84.55 RCW.

[2007 c 430 § 4; 2002 c 146 § 2; 1999 c 132 § 1; 1995 c 375 § 5.]

Application - Requirements

84.14.030

An owner of property making application under this chapter must meet the following requirements:

(1) The new or rehabilitated multiple-unit housing must be located in a residential targeted area as designated by the city or county;

(2) The multiple-unit housing must meet guidelines as adopted by the governing authority that may include height, density, public benefit features, number and size of proposed development, parking, income limits for occupancy, limits on rents or sale prices, and other adopted requirements indicated necessary by the city or county. The required amenities should be relative to the size of the project and tax benefit to be obtained;

(3) The new, converted, or rehabilitated multiple-unit housing must provide for a minimum of fifty percent of the space for permanent residential occupancy. In the case of existing occupied multifamily development, the multifamily housing must also provide for a minimum of four additional multifamily units. Existing multifamily vacant housing that has been vacant for twelve months or more does not have to provide additional multifamily units;

(4) New construction multifamily housing and rehabilitation improvements must be completed within three years from the date of approval of the application;

(5) Property proposed to be rehabilitated must fail to comply with one or more standards of the applicable state or local building or housing codes on or after July 23, 1995. If the property proposed to be rehabilitated is not vacant, an applicant must provide each existing tenant housing of comparable size, quality, and price and a reasonable opportunity to relocate; and

(6) The applicant must enter into a contract with the city or county approved by the governing authority, or an administrative official or commission authorized by the governing authority, under which the applicant has agreed to the implementation of the development on terms and conditions satisfactory to the governing authority.

[2012 c 194 § 3; 2007 c 430 § 5; 2005 c 80 § 1; 1997 c 429 § 42; 1995 c 375 § 6.]

Designation of residential targeted area—Criteria—Local designation—Hearing—Standards, guidelines.

84.14.040

(1) The following criteria must be met before an area may be designated as a residential targeted area:

(a) The area must be within an urban center, as determined by the governing authority;

(b) The area must lack, as determined by the governing authority, sufficient available, desirable, and convenient residential housing, including affordable housing, to meet the needs of the public who would be likely to live in the urban center, if the affordable, desirable, attractive, and livable places to live were available;

(c) The providing of additional housing opportunity, including affordable housing, in the area, as determined by the governing authority, will assist in achieving one or more of the stated purposes of this chapter; and

(d) If the residential targeted area is designated by a county, the area must be located in an unincorporated area of the county that is within an urban growth area under RCW 36.70A.110 and the area must be: (i) In a rural county, served by a sewer system and designated by a county prior to January 1, 2013; or (ii) in a county that includes a campus of an institution of higher education, as defined in RCW 28B.92.030, where at least one thousand two hundred students live on campus during the academic year.

(2) For the purpose of designating a residential targeted area or areas, the governing authority may adopt a resolution of intention to so designate an area as generally described in the resolution. The resolution must state the time and place of a hearing to be held by the governing authority to consider the designation of the area and may include such other information pertaining to the designation of the area as the governing authority determines to be appropriate to apprise the public of the action intended.

(3) The governing authority must give notice of a hearing held under this chapter by publication of the notice once each week for two consecutive weeks, not less than seven days, nor more than thirty days before the date of the hearing in a paper having a general circulation in the city or county where the proposed residential targeted area is located. The notice must state the time, date, place, and purpose of the hearing and generally identify the area proposed to be designated as a residential targeted area.

(4) Following the hearing, or a continuance of the hearing, the governing authority may designate all or a portion of the area described in the resolution of intent as a residential targeted area if it finds, in its sole discretion, that the criteria in subsections (1) through (3) of this section have been met.

(5) After designation of a residential targeted area, the governing authority must adopt and implement standards and guidelines to be utilized in considering applications and making the determinations required under RCW 84.14.060. The standards and guidelines must establish basic requirements for both new construction and rehabilitation, which must include:

(a) Application process and procedures;

(b) Requirements that address demolition of existing structures and site utilization; and

(c) Building requirements that may include elements addressing parking, height, density, environmental impact, and compatibility with the existing surrounding property and such other amenities as will attract and keep permanent residents and that will properly enhance the livability of the residential targeted area in which they are to be located.

(6) The governing authority may adopt and implement, either as conditions to eight-year exemptions or as conditions to an extended exemption period under RCW 84.14.020(1)(a)(ii)(B), or both, more stringent income eligibility, rent, or sale price limits, including limits that apply to a higher percentage of units, than the minimum conditions for an extended exemption period under RCW 84.14.020(1)(a)(ii)(B). For any multiunit housing located in an unincorporated area of a county, a property owner seeking tax incentives under this chapter must commit to renting or selling at least twenty percent of the multifamily housing units as affordable housing units to low and moderate-income households. In the case of multiunit housing intended exclusively for

owner occupancy, the minimum requirement of this subsection (6) may be satisfied solely through housing affordable to moderate-income households.

[2014 c 96 § 4; 2012 c 194 § 4; 2007 c 430 § 6; 1995 c 375 § 7.]

NOTES: Tax preference performance statement—2014 c 96: "This section is the tax preference performance statement for the tax preference contained in RCW 84.14.040 and 84.14.060. This performance statement is only intended to be used for subsequent evaluation of the tax preference. It is not intended to create a private right of action by any party or be used to determine eligibility for preferential tax treatment.

(1) The legislature categorizes this tax preference as one intended to induce certain designated behavior by taxpayers, as indicated in RCW 82.32.808(2)(a).

(2) It is the legislature's specific public policy objective to stimulate the construction of new multifamily housing in urban growth areas located in unincorporated areas of rural counties where housing options, including affordable housing options, are severely limited. It is the legislature's intent to provide the value of new housing construction, conversion, and rehabilitation improvements qualifying under chapter 84.14 RCW an exemption from ad valorem property taxation for eight to twelve years, as provided for in RCW 84.14.020, in order to provide incentives to developers to construct new multifamily housing thereby increasing the number of affordable housing units for low to moderate-income residents in certain rural counties.

(3) If a review finds that at least twenty percent of the new housing is developed and occupied by households making at or below eighty percent of the area median income, at the time of occupancy, adjusted for family size for the county where the project is located or where the housing is intended exclusively for owner occupancy, the household may earn up to one hundred fifteen percent of the area median income, at the time of sale, adjusted for family size for the county where the project is located, then the legislature intends to extend the expiration date of the tax preference.

(4) In order to obtain the data necessary to perform the review in subsection (3) of this section, the joint legislative audit and review committee may refer to data provided by counties in which beneficiaries are utilizing the preference, the office of financial management, the department of commerce, the United States department of housing and urban development, and other data sources as needed by the joint legislative audit and review committee." [2014 c 96 § 1.]

Application - Procedures

84.14.050

An owner of property seeking tax incentives under this chapter must complete the following procedures:

(1) In the case of rehabilitation or where demolition or new construction is required, the owner must secure from the governing authority or duly authorized representative, before

commencement of rehabilitation improvements or new construction, verification of property noncompliance with applicable building and housing codes;

(2) In the case of new and rehabilitated multifamily housing, the owner must apply to the city or county on forms adopted by the governing authority. The application must contain the following:

(a) Information setting forth the grounds supporting the requested exemption including information indicated on the application form or in the guidelines;

(b) A description of the project and site plan, including the floor plan of units and other information requested;

(c) A statement that the applicant is aware of the potential tax liability involved when the property ceases to be eligible for the incentive provided under this chapter;

(3) The applicant must verify the application by oath or affirmation; and

(4) The application must be accompanied by the application fee, if any, required under RCW 84.14.080. The governing authority may permit the applicant to revise an application before final action by the governing authority.

[2012 c 194 § 5; 2007 c 430 § 7; 1999 c 132 § 2; 1997 c 429 § 43; 1995 c 375 § 8.]

Approval - Required findings

84.14.060

(1) The duly authorized administrative official or committee of the city or county may approve the application if it finds that:

(a) A minimum of four new units are being constructed or in the case of occupied rehabilitation or conversion a minimum of four additional multifamily units are being developed;

(b) If applicable, the proposed multiunit housing project meets the affordable housing requirements as described in RCW 84.14.020;

(c) The proposed project is or will be, at the time of completion, in conformance with all local plans and regulations that apply at the time the application is approved;

(d) The owner has complied with all standards and guidelines adopted by the city or county under this chapter; and

(e) The site is located in a residential targeted area of an urban center or urban growth area that has been designated by the governing authority in accordance with procedures and guidelines indicated in RCW 84.14.040.

(2) An application may not be approved after July 1, 2007, if any part of the proposed project site is within a campus facilities master plan, except as provided in RCW 84.14.040(1)(d).

(3) An application may not be approved for a residential targeted area in a rural county on or after January 1, 2020.

[2014 c 96 § 5; 2012 c 194 § 6. Prior: 2007 c 430 § 8; 2007 c 185 § 2; 1995 c 375 § 9.]

Processing - Approval - Denial - Appeal

84.14.070

(1) The governing authority or an administrative official or commission authorized by the governing authority must approve or deny an application filed under this chapter within ninety days after receipt of the application.

(2) If the application is approved, the city or county must issue the owner of the property a conditional certificate of acceptance of tax exemption. The certificate must contain a statement by a duly authorized administrative official of the governing authority that the property has complied with the required findings indicated in RCW 84.14.060.

(3) If the application is denied by the authorized administrative official or commission authorized by the governing authority, the deciding administrative official or commission must state in writing the reasons for denial and send the notice to the applicant at the applicant's last known address within ten days of the denial.

(4) Upon denial by a duly authorized administrative official or commission, an applicant may appeal the denial to the governing authority within thirty days after receipt of the denial. The appeal before the governing authority must be based upon the record made before the administrative official with the burden of proof on the applicant to show that there was no substantial evidence to support the administrative official's decision. The decision of the governing body in denying or approving the application is final.

[2012 c 194 § 7; 1995 c 375 § 10.]

Fees

84.14.080

The governing authority may establish an application fee. This fee may not exceed an amount determined to be required to cover the cost to be incurred by the governing authority and the assessor in administering this chapter. The application fee must be paid at the time the application for limited exemption is filed. If the application is approved, the governing authority shall pay the application fee to the county assessor for deposit in the county current expense fund, after first deducting that portion of the fee attributable to its own administrative costs in processing the application. If the application is denied, the governing authority may retain that portion of the application fee attributable to its own administrative costs and refund the balance to the applicant.

[1995 c 375 § 11.]

Filing requirements for owner upon completion—Determination by city or county—Notice of intention by city or county not to file—Extension of deadline—Appeal.

84.14.090

(1) Upon completion of rehabilitation or new construction for which an application for a limited tax exemption under this chapter has been approved and after issuance of the certificate of occupancy, the owner must file with the city or county the following:

(a) A statement of the amount of rehabilitation or construction expenditures made with respect to each housing unit and the composite expenditures made in the rehabilitation or construction of the entire property;

(b) A description of the work that has been completed and a statement that the rehabilitation improvements or new construction on the owner's property qualify the property for limited exemption under this chapter;

(c) If applicable, a statement that the project meets the affordable housing requirements as described in RCW 84.14.020; and

(d) A statement that the work has been completed within three years of the issuance of the conditional certificate of tax exemption.

(2) Within thirty days after receipt of the statements required under subsection (1) of this section, the authorized representative of the city or county must determine whether the work completed, and the affordability of the units, is consistent with the application and the contract approved by the city or county and is qualified for a limited tax exemption under this chapter. The city or county must also determine which specific improvements completed meet the requirements and required findings.

(3) If the rehabilitation, conversion, or construction is completed within three years of the date the application for a limited tax exemption is filed under this chapter, or within an authorized extension of this time limit, and the authorized representative of the city or county determines that improvements were constructed consistent with the application and other applicable requirements, including if applicable, affordable housing requirements, and the owner's property is qualified for a limited tax exemption under this chapter, the city or county must file the certificate of tax exemption with the county assessor within ten days of the expiration of the thirty-day period provided under subsection (2) of this section.

(4) The authorized representative of the city or county must notify the applicant that a certificate of tax exemption is not going to be filed if the authorized representative determines that:

(a) The rehabilitation or new construction was not completed within three years of the application date, or within any authorized extension of the time limit;

(b) The improvements were not constructed consistent with the application or other applicable requirements;

(c) If applicable, the affordable housing requirements as described in RCW 84.14.020 were not met; or

(d) The owner's property is otherwise not qualified for limited exemption under this chapter.

(5) If the authorized representative of the city or county finds that construction or rehabilitation of multiple-unit housing was not completed within the required time period due to

circumstances beyond the control of the owner and that the owner has been acting and could reasonably be expected to act in good faith and with due diligence, the governing authority or the city or county official authorized by the governing authority may extend the deadline for completion of construction or rehabilitation for a period not to exceed twenty-four consecutive months.

(6) The governing authority may provide by ordinance for an appeal of a decision by the deciding officer or authority that an owner is not entitled to a certificate of tax exemption to the governing authority, a hearing examiner, or other city or county officer authorized by the governing authority to hear the appeal in accordance with such reasonable procedures and time periods as provided by ordinance of the governing authority. The owner may appeal a decision by the deciding officer or authority that is not subject to local appeal or a decision by the local appeal authority that the owner is not entitled to a certificate of tax exemption in superior court under RCW 34.05.510 through 34.05.598, if the appeal is filed within thirty days of notification by the city or county to the owner of the decision being challenged.

[2012 c 194 § 8; 2007 c 430 § 9; 1995 c 375 § 12.]

Report - Filing

84.14.100

(1) Thirty days after the anniversary of the date of the certificate of tax exemption and each year for the tax exemption period, the owner of the rehabilitated or newly constructed property must file with a designated authorized representative of the city or county an annual report indicating the following:

(a) A statement of occupancy and vacancy of the rehabilitated or newly constructed property during the twelve months ending with the anniversary date;

(b) A certification by the owner that the property has not changed use and, if applicable, that the property has been in compliance with the affordable housing requirements as described in RCW 84.14.020 since the date of the certificate approved by the city or county;

(c) A description of changes or improvements constructed after issuance of the certificate of tax exemption; and

(d) Any additional information requested by the city or county in regards to the units receiving a tax exemption.

(2) All cities or counties, which issue certificates of tax exemption for multiunit housing that conform to the requirements of this chapter, must report annually by December 31st of each year, beginning in 2007, to the department of commerce. The report must include the following information:

(a) The number of tax exemption certificates granted;

(b) The total number and type of units produced or to be produced;

(c) The number and type of units produced or to be produced meeting affordable housing requirements;

(d) The actual development cost of each unit produced;

(e) The total monthly rent or total sale amount of each unit produced;

(f) The income of each renter household at the time of initial occupancy and the income of each initial purchaser of owner-occupied units at the time of purchase for each of the units receiving a tax exemption and a summary of these figures for the city or county; and

(g) The value of the tax exemption for each project receiving a tax exemption and the total value of tax exemptions granted.

[2012 c 194 § 9; 2007 c 430 § 10; 1995 c 375 § 13.]

Cancellation of exemption—Notice by owner of change in use—Additional tax—Penalty—Interest—Lien—Notice of cancellation—Appeal—Correction of tax rolls.

84.14.110

(1) If improvements have been exempted under this chapter, the improvements continue to be exempted for the applicable period under RCW 84.14.020, so long as they are not converted to another use and continue to satisfy all applicable conditions. If the owner intends to convert the multifamily development to another use, or if applicable, if the owner intends to discontinue compliance with the affordable housing requirements as described in RCW 84.14.020 or any other condition to exemption, the owner must notify the assessor within sixty days of the change in use or intended discontinuance. If, after a certificate of tax exemption has been filed with the county assessor, the authorized representative of the governing authority discovers that a portion of the property is changed or will be changed to a use that is other than residential or that housing or amenities no longer meet the requirements, including, if applicable, affordable housing requirements, as previously approved or agreed upon by contract between the city or county and the owner and that the multifamily housing, or a portion of the housing, no longer qualifies for the exemption, the tax exemption must be canceled and the following must occur:

(a) Additional real property tax must be imposed upon the value of the nonqualifying improvements in the amount that would normally be imposed, plus a penalty must be imposed amounting to twenty percent. This additional tax is calculated based upon the difference between the property tax paid and the property tax that would have been paid if it had included the value of the nonqualifying improvements dated back to the date that the improvements were converted to a nonmultifamily use;

(b) The tax must include interest upon the amounts of the additional tax at the same statutory rate charged on delinquent property taxes from the dates on which the additional tax could have been paid without penalty if the improvements had been assessed at a value without regard to this chapter; and

(c) The additional tax owed together with interest and penalty must become a lien on the land and attach at the time the property or portion of the property is removed from multifamily use or the amenities no longer meet applicable requirements, and has priority to and must be fully paid and satisfied before a recognizance, mortgage, judgment, debt, obligation, or responsibility to or with which the land may become charged or liable. The lien may be foreclosed upon expiration of the same period after delinquency and in the same manner provided by law for foreclosure of liens for delinquent real property taxes. An additional tax unpaid on its due date is delinquent. From the date of delinquency until paid, interest must be charged at the same rate applied by law to delinquent ad valorem property taxes.

(2) Upon a determination that a tax exemption is to be canceled for a reason stated in this section, the governing authority or authorized representative must notify the record owner of the property as shown by the tax rolls by mail, return receipt requested, of the determination to cancel the exemption. The owner may appeal the determination to the governing authority or authorized representative, within thirty days by filing a notice of appeal with the clerk of the governing authority, which notice must specify the factual and legal basis on which the determination of cancellation is alleged to be erroneous. The governing authority or a hearing examiner or other official authorized by the governing authority may hear the appeal. At the hearing, all affected parties may be heard and all competent evidence received. After the hearing, the deciding body or officer must either affirm, modify, or repeal the decision of cancellation of exemption based on the evidence received. An aggrieved party may appeal the decision of the deciding body or officer to the superior court under RCW 34.05.510 through 34.05.598.

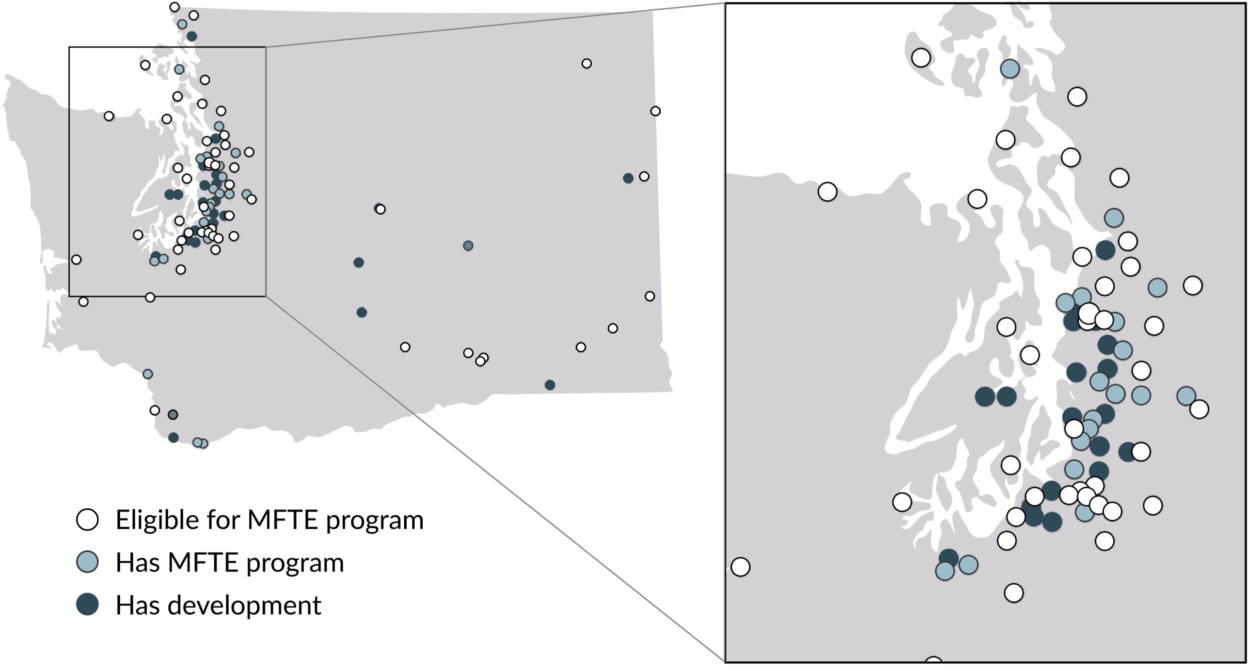
(3) Upon determination by the governing authority or authorized representative to terminate an exemption, the county officials having possession of the assessment and tax rolls must correct the rolls in the manner provided for omitted property under RCW 84.40.080. The county assessor must make such a valuation of the property and improvements as is necessary to permit the correction of the rolls. The value of the new housing construction, conversion, and rehabilitation improvements added to the rolls is considered as new construction for the purposes of chapter 84.55 RCW. The owner may appeal the valuation to the county board of equalization under chapter 84.48 RCW and according to the provisions of RCW 84.40.038. If there has been a failure to comply with this chapter, the property must be listed as an omitted assessment for assessment years beginning January 1 of the calendar year in which the noncompliance first occurred, but the listing as an omitted assessment may not be for a period more than three calendar years preceding the year in which the failure to comply was discovered.

[2012 c 194 § 10; 2007 c 430 § 11; 2002 c 146 § 3; 2001 c 185 § 1; 1995 c 375 § 14.]

Appendix A. Overview of MFTE Programs

Of the 102 cities that are eligible, 49 have adopted an MFTE program and 26 have approved exemptions. Pierce County also is eligible and has approved exemptions.

Exhibit A.1: Pierce County and 27 cities have approved (exempt) developments (2019 data)



Source: JLARC staff analysis.

Exhibit A.2: Sortable list of cities eligible to create MFTE programs

City Name	Has MFTE program?	Has Development?
Seattle	Yes	Yes
Aberdeen	No	No
Anacortes	Expired in 2015	No
Arlington	No	No
Auburn	Yes	Yes
Bainbridge Island	No	No
Battle Ground	No	No
Bellevue	Yes	Yes
Bellingham	Yes	Yes
Blaine	No	No
Bonney Lake	No	No
Bothell	No	No
Bremerton	Yes	Yes
Brier	No	No
Burien	Yes	Yes
Camas	Yes	No
Centralia	No	No
Colville	No	No
Covington	Yes	Yes
Dayton	No	No
Des Moines	Yes	No
DuPont	No	No
Duvall	No	No

City Name	Has MFTE program?	Has Development?
East Wenatchee	No	No
Edgewood	No	No
Edmonds	Yes	No
Ellensburg	Yes	Yes
Enumclaw	No	No
Everett	Yes	Yes
Federal Way	Yes	No
Ferndale	Yes	No
Fife	No	No
Fircrest	No	No
Friday Harbor	No	No
Gig Harbor	No	No
Issaquah	Yes	No
Kenmore	Yes	Yes
Kennewick	No	No
Kent	Yes	Yes
Kirkland	Yes	Yes
Lacey	Yes	No
Lake Forest Park	No	No
Lake Stevens	No	No
Lakewood	Yes	Yes
Longview	Yes	No
Lynden	No	No
Lynnwood	Yes	No

City Name	Has MFTE program?	Has Development?
Maple Valley	No	No
Marysville	Expired in 2018	No
Mercer Island	Yes	No
Mill Creek	No	No
Milton	No	No
Monroe	Yes	No
Moses Lake	Yes	Yes
Mount Vernon	No	No
Mountlake Terrace	Yes	Yes
Mukilteo	No	No
Newcastle	Yes	No
Newport	No	No
Normandy Park	No	No
North Bend	No	No
Oak Harbor	No	No
Olympia	Yes	Yes
Orting	No	No
Pacific	No	No
Pasco	No	No
Pierce County	Yes	Yes
Pomeroy	No	No
Port Angeles	No	No
Port Orchard	Yes	Yes
Port Townsend	Yes	No
Poulsbo	No	No

City Name	Has MFTE program?	Has Development?
Pullman	No	No
Puyallup	Yes	No
Raymond	No	No
Redmond	Yes	No
Renton	Yes	Yes
Richland	No	No
Ridgefield	No	No
Sammamish	No	No
SeaTac	Yes	No
Shelton	No	No
Shoreline	Yes	Yes
Snohomish	No	No
Snoqualmie	Yes	No
Spokane	Yes	Yes
Spokane Valley	No	No
Stanwood	No	No
Steilacoom	No	No
Sultan	No	No
Sumner	No	No
Sunnyside	No	No
Tacoma	Yes	Yes
Tukwila	Yes	Yes
Tumwater	Yes	No
University Place	Yes	Yes
Vancouver	Yes	Yes
Walla Walla	Yes	Yes

City Name	Has MFTE program?	Has Development?	City Name	Has MFTE program?	Has Development?
Washougal	Yes	No	Yakima	Yes	Yes
Wenatchee	Yes	Yes	Yelm	No	No
Woodinville	Yes	No			

Source: JLARC staff analysis.

Appendix B. Methodology

JLARC staff worked with real estate economists to determine the effect of the MFTE on development

JLARC staff contracted with Community Attributes, Inc. (CAI) to conduct an analysis of the effect of the multifamily tax exemption on a development's financial performance as measured by the rate of return on investment. The consultants developed financial models that estimated the rate of return for different development types, in different markets across the state.

Download

Link to CAI methodology

Link to CAI assumptions and limitations

RECOMMENDATIONS & RESPONSES

Legislative Auditor's Recommendation

Legislative Auditor recommends modifying the preference to direct cities to include analysis of profitability as a consideration in offering or approving exemptions

This will help ensure the exemption targets developments that fulfill state and local housing objectives and minimize unnecessary subsidization. The appropriate type of analysis may vary depending on the city, and should include:

- Analysis of a development's profitability with and without the exemption.
- For affordable housing, city-specific income and rent limits.

The Department of Commerce should report annually to JLARC and the relevant policy committees on city compliance with the requirements, as well as the metrics in statute and affordability measures. The report should include the metrics needed to assess affordability, such as income, household size and rent at the per unit level. In its first report in July 2020, in addition to providing data on compliance and metrics, if Commerce believes it needs additional

resources or authority to ensure this takes place, Commerce should report back to the Legislature on what it needs.

The Department of Revenue should report to JLARC and the relevant policy committees on which statutory ambiguities can be resolved through guidance and which require statutory changes. These include items such as the timing of new construction, eligibility of assisted living facilities, composition of low- and moderate-income households in affordable units, and inclusion of short-term rental units.

Legislation Required: Yes

Fiscal Impact: Depends on Legislation.

Letter from Commission Chair

Available October 2019.

Commissioners' Recommendation

Available October 2019.

Agency Response

If applicable, available October 2019.

Study questions

Proposed Study Questions: Property Tax Exemption for Multifamily Housing in Urban Areas

State of Washington Joint Legislative Audit and Review Committee 7/23/2018

Citizen Commission scheduled a JLARC study of the property tax exemption for multifamily housing in urban areas

The 2006 Legislature directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct performance audits of tax preferences. This preference is included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.

The Multifamily Housing Tax Exemption (MFTE) is a property tax exemption program that allows eligible cities and counties to target specific areas for more multifamily housing development. Eligibility is based on population and certain urban planning requirements. Property owners may apply for an 8-year or 12-year property tax exemption for building or rehabilitating multifamily housing. The 12-year exemption requires owners to offer at least 20% of their units as affordable housing (i.e., costs no more than 30% of a household's income). The 8-year exemption may or may not require affordable housing, depending on the jurisdiction. If a city or county chooses to create a program, it may create additional requirements or restrictions.

Property tax exemption to encourage multifamily housing development or redevelopment

The preference has three stated public policy objectives for eligible jurisdictions:

1. Encourage more residential options by stimulating development of new and rehabilitated multifamily housing in jurisdictions that plan under the Growth Management Act.
2. Encourage affordable housing in areas where local jurisdictions have found a need for it.
3. Allow unincorporated areas within urban growth areas to stimulate housing development near college campuses.

At this time, 102 cities and one county are eligible to create programs using the preference. Twenty cities reported that at least one project was built using the program.

Study Questions

This study will seek answers to the following questions:

1. How much multifamily housing has been created using the program, where is it located, and how much of it meets affordability requirements?

Joint Legislative Audit & Review Committee, 106 11th Ave SW, Olympia, WA 98501
(360) 786-5171 ● (360)786-5180 (fax) ● JLARC@leg.wa.gov ● www.jlarc.leg.wa.gov
Keenan Konopaski, Washington State Legislative Auditor

Proposed Study Questions: Multifamily Property Tax Exemption in Urban Areas

2. In jurisdictions where the program is used, how much estimated multifamily housing would exist without the program?
3. Do the new units meet the housing needs of the local population?
4. Why is the MFTE program used in some cities but not in others?
5. What is the value of the exemption, and how does it impact state and local tax revenue and the tax burden on other property owners?

Study Timeframe

Preliminary Report: July 2019 Proposed Final Report: December 2019

Study Team

Team Lead:	Rachel Murata	360-786-5293	rachel.murata@leg.wa.gov
Research Analyst:	Joshua Karas	360-786-5298	joshua.karas@leg.wa.gov
Project Coordinator:	Eric Thomas	360-786-5182	eric.thomas@leg.wa.gov

Washington Joint Legislative Audit and Review Committee

106 11th Avenue SW, Suite 2500
PO Box 40910
Olympia, WA 98504-0910

Phone: 360-786-5171
Fax: 360-786-5180
Email: JLARC@leg.wa.gov

More about 2019 reviews

Audit authority

The Joint Legislative Audit and Review Committee (JLARC) works to make state government operations more efficient and effective. The Committee is comprised of an equal number of House members and Senators, Democrats and Republicans.

JLARC's non-partisan staff auditors, under the direction of the Legislative Auditor, conduct performance audits, program evaluations, sunset reviews, and other analyses assigned by the Legislature and the Committee.

The statutory authority for JLARC, established in Chapter 44.28 RCW, requires the Legislative Auditor to ensure that JLARC studies are conducted in accordance with Generally Accepted Government Auditing Standards, as applicable to the scope of the audit. This study was conducted in accordance with those applicable standards. Those standards require auditors to plan and perform audits to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on the audit objectives. The evidence obtained for this JLARC report provides a reasonable basis for the findings and conclusions, and any exceptions to the application of audit standards have been explicitly disclosed in the body of this report.

Timeframe for the study

A preliminary audit report will be presented at the July 2019 JLARC meeting and at the August 2019 meeting of the Commission. A final report will be presented to JLARC in December 2019.

More about 2019 reviews

Study process

What is a tax preference?

Tax preferences are defined in statute (RCW 43.136.021) 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. Washington has approximately 600 tax preferences.

Why a review of tax preferences?

Legislature creates a process to review tax preferences

In 2006, the Legislature 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 (RCW 43.136).

Statute assigns specific roles to two different entities:

- The Citizen Commission for Performance Measurement of Tax Preferences ("The Commission") 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 Commission 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 may also exclude preferences from review that the Commission determines are a critical part of the tax structure.

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.

In 2019, JLARC staff reviewed 17 preferences compiled into nine reports (similar preferences may be combined into one report). The Commission's website includes analysis of preferences completed in previous years: See http://www.citizentaxpref.wa.gov/.

JLARC staff's approach to the tax preference reviews

Statute guides the main topics 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)

JLARC staff's analysis process

JLARC staff carefully analyze a variety of evidence in conducting these reviews:

- Legal and public policy history of the tax preferences.
- Beneficiaries of the tax preferences.
- Government and other relevant data pertaining to the utilization of these tax preferences.
- Economic and revenue impact of the tax preferences.
- Other states' laws to identify similar tax preferences.

Key: understanding the purpose of the preference

The Legislature now requires that any legislation creating a new preference, or expanding or extending an existing preference, must include a tax preference performance statement. The performance statement must contain a statement of legislative purpose as well as metrics to evaluate the effectiveness of the preference (RCW 82.32.808).

Some of the preferences included in this report were passed before the 2013 legislation that requires performance statements. When a preference's purpose or objective is identified in statute, staff are able to affirmatively state the public policy objective. Sometimes the objective may be found in intent statements or in other parts of statute if there is no tax preference performance statement.

When the Legislature did not state the public policy objective of a preference, JLARC staff may be able to infer what the implied public policy objective might be. To arrive at this inferred policy objective, staff review the following:

- Legislative history, including

    - Final bill reports for any statements on the intent or public policy objectives.
    - Bills prior to the final version and legislative action on bills related to the same topic.
    - Bill reports and testimony from various versions of the bill.
    - Records of floor debate.
- Relevant court cases that provide information on the objective.
- Department of Revenue information on the history of tax preferences, including rules, determinations, appeals, audits, and taxpayer communication.
- Press reports during the time of the passage of the bill which may indicate the intention of the preference.
- Other historic documents, such as stakeholder statements, that may address the issue addressed by the tax preference.

JLARC staff also interview the agencies that administer the tax preferences or are knowledgeable of the industries affected by the tax. Agencies may 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.

If there is sufficient information in this evidence to infer a policy objective, JLARC staff state that in the reviews. In these instances, the purpose may be a more generalized statement than when there is explicit statutory language.

More about 2019 reviews

Contact information

JLARC staff members

Dana Lynn, **Research Analyst** - 360-786-5177

Rachel Murata, **Research Analyst** - 360-786-5293

Pete van Moorsel, **Research Analyst** - 360-786-5185

Eric Whitaker, **Research Analyst** - 360-786-5618

Zack Freeman, **Research Analyst** - 360-786-5179

Josh Karas, **Research Analyst** - 360-786-5298

Aaron Cavin, **Research Analyst** - 360-786-5194

Eric Thomas, Audit Coordinator

Keenan Konopaski, Legislative Auditor

JLARC members on publication date

Senators
Bob Hasegawa
Mark Mullet
Rebecca Saldaña
Shelly Short
Dean Takko
Lynda Wilson
Keith Wagoner

Representatives
Paul Harris
Larry Hoff
Jake Fey
Noel Frame
Christine Kilduff
Vicki Kraft
Ed Orcutt
Gerry Pollet

Citizen Commission for Performance Measurement of Tax Preferences

Voting members
Dr. Grant D. Forsyth
Ronald L. Bueing
Diane Lourdes Dick
Dr. Justin Marlowe
Andi Nofziger-Meadows

Non-voting members
Pat McCarthy, State Auditor

Washington Joint Legislative Audit and Review Committee

106 11th Avenue SW, Suite 2500
PO Box 40910
Olympia, WA 98504-0910

Phone: 360-786-5171
Fax: 360-786-5180
Email: JLARC@leg.wa.gov