State of Washington
Joint Legislative Audit and Review Committee (JLARC)

2007 Expedited Tax Preference Performance Reviews

Report 07-15

November 28, 2007

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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 enclosed findings and conclusions, and any exceptions to the application of audit standards have been explicitly disclosed in the body of this report.

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2007 EXPEDITED TAX PREFERENCE PERFORMANCE REVIEWS

REPORT 07-15

NOVEMBER 28, 2007

STATE OF WASHINGTON

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Report Summary

What Is a Tax Preference?

Tax preferences are exemptions, exclusions, or deductions from the base of a state tax; a credit against a state tax; a deferral of a state tax; or a preferential state tax rate. Washington has more than 500 tax preferences.

Why a JLARC Review of Tax Preferences?

Legislature Creates a Process to Review Tax Preferences

In 2006, the Legislature expressly stated that periodic reviews of tax preferences are needed to determine if their continued existence or modification serves the public interest. The Legislature enacted Engrossed House Bill 1069 to provide for an orderly process for the review of tax preferences. The legislation assigns specific roles in the process to two different entities. The Legislature assigns the job of scheduling tax preferences, holding public hearings, and commenting on the reviews to a new Citizen Commission for Performance Measurement of Tax Preferences. The Legislature assigns responsibility for conducting the reviews to the staff of the Joint Legislative Audit and Review Committee (JLARC).

Citizen Commission Sets the Schedule

EHB 1069 directs the Citizen Commission for Performance Measurement of Tax Preferences to develop a schedule to accomplish a review of tax preferences at least once every ten years. The legislation directs the Commission to omit certain tax preferences from the schedule such as those required by constitutional law.

The Legislature also directs the Commission to consider two additional factors in developing its schedule. First, the Commission is to schedule tax preferences for review in the order in which the preferences were enacted into law, except that the Commission must schedule tax preferences that have a statutory expiration date before the preference expires. This means that Washington's longest-standing tax preferences are evaluated first.

Second, the legislation gives the Commission the option to schedule an expedited review for any tax preference that has an estimated biennial fiscal impact of $10 million or less. Expedited reviews incorporate a less detailed analysis than the full reviews of tax preferences.

In January 2007, the Commission adopted its first ten-year schedule for the tax preference reviews. The schedule for 2007 included a total of 22 tax preferences with 14 property tax, four business and occupation tax, three fuel tax, and one sales tax deferral. Of these 22, 16 tax preferences were slated to undergo the expedited review process.

JLARC Staff Conduct the Tax Preference Reviews

JLARC's assignment from EHB 1069 is to conduct the reviews of tax preferences according to the schedule developed by the Commission and consistent with the guidelines set forth in statute. This report presents JLARC's reviews for the 16 tax preferences scheduled by the Commission for expedited review.

JLARC's Approach to the Tax Preference Reviews

Consistent with the Scope and Objectives for conducting the expedited tax preference reviews, JLARC has evaluated the answers to a set of seven questions for each tax preference:

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?
2. Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present, or future)?

Beneficiaries:

3. Who are the entities whose state tax liabilities are directly affected by the tax preference?
4. To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

Revenue and Economic Impacts:

5. What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?
6. What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

Other States:

7. Do other states have a similar tax preference?

For two of the tax preferences in this volume (Contributions and Donations and Refunded Fuel Tax for Nonhighway Use), JLARC staff have provided answers to three additional questions, which makes the review a full review. During the course of the reviews, staff determined that these tax preferences exceeded $10 million in biennial fiscal impact, the threshold used to make a tax preference a candidate for an expedited review. To maintain the consistency with the Commission schedule and Scope & Objectives documents, these two reviews remain in this volume.

Methodology

JLARC staff analyzed the following evidence in conducting these expedited reviews: 1) legal and public policy history of the tax preferences; 2) public policy objectives of the tax preferences; 3) beneficiaries of the tax preferences; 4) government data pertaining to the utilization of these tax preferences and other relevant data; 5) economic and revenue impacts of the tax preferences; and 6) other states' laws to identify any similar tax preferences.

Staff placed particular emphasis on the legislative history of the tax preferences, researching the original enactments as well as any subsequent amendments. Staff reviewed State Supreme Court, lower court, or Board of Tax Appeals decisions relevant to each tax preference. JLARC staff conducted extensive research on other state practices using the Commerce Clearing House database of state laws and regulations.

Staff interviewed the agencies that administer the tax preferences (primarily the Department of Revenue and the Department of Licensing), as well as several county assessors. These parties provided data on the value and usage of the tax preference and the beneficiaries. Data was also obtained from other state and federal agencies to which the beneficiaries are required to report. In several cases, additional information was provided to JLARC staff from the beneficiaries of the tax preference or other agencies that had special knowledge of either the tax preference or the beneficiaries.

It is not within the purview of these reviews to resolve or draw definitive conclusions regarding any legal issues that are discussed within the reviews.

Summary of the Results from JLARC's Reviews

The table on page 5 provides a summary of the results from JLARC's analysis of the tax preferences scheduled for expedited review in 2007. Of the 16 tax preferences included in this volume, this report recommends that the Legislature continue 11 of the current tax preferences. The report raises issues for the Legislature's consideration for five of the current tax preferences.

Organization of This Report

This report includes a separate section for each of the 16 tax preferences. Each section begins with a summary of the findings and recommendations from JLARC's analysis of that individual tax preference. Then, each chapter provides additional detail on that tax preference, including additional information supporting the answers to the questions outlined in the approach. Appendices provide the text of current law for each preference as well as an explanation of JLARC's property tax estimation procedure.

Additional Background Information on Charitable and Nonprofit Organizations

At the Legislature's direction, many of Washington's oldest tax preferences are being reviewed first in this overall tax preference review process. Several of these date back to legislative actions in early statehood or even Territorial days. The majority of these earliest exemptions reviewed in 2007 involve charitable and nonprofit organizations. To provide context for the individual sections that follow, this report summary concludes with some general information about tax preferences for charitable and nonprofit organizations.

Some of the oldest tax preferences in Washington are property tax exemptions for charitable organizations such as churches, cemeteries, orphanages, hospitals, homes for the aged, and libraries. This is consistent with the general history of the United States and with the treatment of such institutions in the colonies under British law, with some exemptions dating as far back as 1601.

By 1904, the State of Washington had recorded 250 charitable organizations. Charitable organizations have grown and diversified over the ensuing years. In 2006, the Secretary of State registered 21,850 exempt public charities, as well as more than 50,000 nonprofit corporations. Nonprofit organizations cover a wide variety of institutions including entities that provide services in education, health care, credit unions, labor unions, chambers of commerce, and many others.

It is common to describe charitable organizations as nonprofit organizations. However, the term "nonprofit" comes with several specific qualifications. In state law, all regular nonprofit corporations have guidelines outlined in Chapter 24.03 RCW. There are various types of nonprofit organizations distinguished in federal law. Nonprofit organizations apply to the federal Internal Revenue Service (IRS) to establish their tax exempt status. A public benefit nonprofit organization is organized and eligible for tax exempt status under 26 U.S.C. 501(c)(3). These nonprofit organizations are common and are referred to as "public charities." Nonprofit organizations have a wide range of public charitable activities and purposes. According to federal law, the promotion of health for the benefit of the community is considered a charitable purpose.

Some of the primary requirements that all nonprofits must meet are organizational restrictions on what can be done with the organizations' profits. Essentially, a nonprofit may not lawfully pay its profits to owners or to anyone associated with the organization. In addition, upon dissolution of the nonprofit, its assets must be distributed exclusively for charitable purposes. Another requirement is that the organization must have only a small part of its activities which is not furthering its charitable purpose. In addition to a restriction on the distribution of profits, a "nonprofit" designation also requires limitations on lobbying efforts and in political activities or efforts to influence legislation.

For charitable health care providers, there is an additional requirement of demonstrating community benefits. The standard adopted in 1969, and still in place today, does not require health care organizations to provide a specific level of care to the poor in order to qualify for the tax exemption. Instead, the IRS has established a "community benefit" standard, allowing the IRS to weigh several factors regarding provision of services to the community as a whole.

In exchange for the constraints on distribution of profits and business activities, nonprofits receive a variety of tax and subsidy benefits. At the federal level, nonprofits do not pay corporate taxes. At the state and local level, many nonprofits are eligible for one of several property tax exemptions. Nonprofits also receive an exemption for the state business and occupation tax for their income from contributions and donations, membership dues and fees, and grants.

Summary of Recommendations—2007 Expedited Tax Preference Reviews*

Tax Preference	Year Enacted	RCW Citation	# of Claimants in 2006 ($ amount)	Summary of Recommendation
Nonprofit libraries (p. 7)	1854	RCW 84.36.040(1)(b)	10 ($36,000)	Legislature should continue the tax preference
Fire companies (p. 15)	1890	RCW 84.36.060(1)(c)	1 ($5,500)	
Growing crops (p. 21)	1890	RCW 84.40.030(3)	1,179 ($2.6 million)	
Humane societies (p. 55)	1915	RCW 84.36.060(1)(d)	22 ($170,000)	
Collections and museums (p. 63)	1915	RCW 84.36.060(1)(a)	145 ($3.1 million)	
Veterans organizations (p. 71)	1929	RCW 84.36.030(4)	159 ($570,000)	
Nonprofit youth organizations (p. 77)	1933	RCW 84.36.030(3)	115 ($1.9 million)	
Contributions and donations (p. 85)	1935	RCW 82.04.4282	Unknown ($56 million)	
Boxing and wrestling matches (p. 125)	1935	RCW 82.04.340	14 ($18,000)	
Lost or destroyed fuel (p. 155)	1923	RCW 82.36.370 RCW 82.38.180(4)-(6)	**	
Historic auto museums (p. 163)	2005	RCW 82.32.580	0 ($0)	
Nonprofit nursing homes (p. 29)	1891	RCW 84.36.040(1)(d)	42 ($2.8 million)	Legislature should re-examine or clarify the intent of the tax preference***
Orphanages (p. 47)	1891	RCW 84.36.040(1)(c)	2 ($138,000)	
Membership dues and fees (p. 99)	1935	RCW 82.04.4282	218 ($2 million)	
Horse racing (p. 115)	1933	RCW 82.04.350	5 ($2 million)	
Refunded fuel tax for nonhighway use (p. 133)	1923	RCW 82.36.280 RCW 82.38.180(1)	4,967 ($20.3 million)	

* Two of the reviews in this volume are actually full reviews rather than expedited reviews.

**No specific data maintained; there are very few claims for refunds of lost or destroyed fuel in a given year, and the fiscal impact is in the hundreds or low thousands of dollars.

*** See specific sections for detail on the issues recommended for the Legislature's consideration.

NONPROFIT LIBRARIES - SUMMARY

Current Law

Under current law, all real and personal property of nonprofit free public libraries are exempt from property taxes. One main requirement for this tax exemption is that the property be used exclusively for the purposes of the libraries. Another requirement is that the benefit of the exemption is passed onto the user and that the libraries be free to the public. In Appendix 3 is the current law statute, RCW 84.36.040(1)(b), which provides for the property tax exemption. This tax preference under review applies to nonprofit libraries only and other government owned public libraries are exempt under another tax preference specified in RCW 84.36.010.

Findings and Recommendations

This review of Washington's nonprofit libraries' property tax exemption has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- The property tax exemption for free nonprofit libraries dates back to an 1854 section exempting "benevolent, charitable, literary, or scientific" institutions, various government properties, schools, cemeteries, and public libraries from the tax base. One public policy objective for this tax preference is to exclude the libraries' property value from the property tax base. This tax base defining objective has been achieved.
- The exemption was originally for all free public libraries and was narrowed to nonprofit organizations in 1973. There are other tax exemptions for public government owned libraries, which is the large majority of Washington's libraries.
- The requirement that the nonprofit libraries be free and accessible to the public was retained in this tax preference so local communities would be directly benefiting from the libraries.
- There is a public policy objective that only property used exclusively for library purposes should be exempt.
- This tax preference provides equal property tax treatment to free nonprofit libraries that is also provided to free public libraries run by government entities.

Beneficiaries

- In property tax year 2006-07, the entities benefiting from this property tax exemption are ten nonprofit libraries and other literary and historic societies.
- There does not appear to be any unintended tax benefits to any entities other than nonprofit libraries and historical societies.

Economic and Revenue Impacts

- In 2006, the ten nonprofit libraries had an annual property tax savings of approximately $36,000.
- The future property tax savings for nonprofit libraries over the next three years is between $36,000 and $38,000 per year.

Other States

- Exempting nonprofit libraries from property tax is a common practice in other states.

Due to the fact that this tax preference was originally enacted to exclude all libraries from the property tax base and the beneficiaries of the tax preference are nonprofit libraries, this tax preference achieves its objectives. This tax preference along with the property tax exemption for government run libraries provides equal tax treatment to all free and public libraries. The tax exemption requires libraries to be open to the public and be free so the public receives benefits from these nonprofit organizations. Since this tax exemption simply excludes this property from taxation, it is relatively easy to administer this tax exemption. In addition, this tax preference provides some equity in taxation to nonprofit organizations that are running public libraries like the government entities which also receive a property tax exemption.

Recommendation

The Legislature should continue the property tax exemption for nonprofit libraries.

Legislation Required: None

Fiscal Impact: None

NONPROFIT LIBRARIES – REPORT DETAIL

Statutory History

The exemption for public libraries dates back to an 1854 section exempting "benevolent, charitable, literary, or scientific" institutions, various government properties, schools, cemeteries, and public libraries from the tax base.

Exemptions for libraries were common and this is illustrated by the attitude expressed by the U.S. Supreme Court in 1877 in *Adams v. Nashville,* where the Court recognized that:

> Homesteads, to a specified value, a certain amount of household furniture (the six plates, six knives and forks, six teacups and saucers, of the old statutes), the property of clergymen to some extent, schoolhouses, academies, and libraries, are generally exempt from taxation. [1]

Although the statute was amended in 1886 to include a statement that "whereas 'religion, morality, and knowledge being necessary for good government and the happiness of mankind'" "institutions of learning, benevolent, charitable, and scientific institutions" were exempt from property tax, the exemption for libraries had been separate prior to that point and was separated again immediately following statehood in 1890.

There have been some changes from the establishment of the libraries' specific property tax exemption in 1890. In 1893, there was a size requirement placed on libraries claiming the property tax exemption. In addition, the library had to be used exclusively for the purposes of the organization.

In 1895, the law placed a requirement on free public libraries that they must be supported in whole by public appropriation or by private charity or are supported in part by charity and all of the income and profits are devoted to charitable purposes. In addition, in order to qualify for the property tax exemption, the state Board of Health, county and city officials may have access to the financial records of the institutions and the manager of the library must make oath before the county assessor that all income have been applied to actual expenses of maintaining it and to charitable purposes. The library must annually file a report to the state Board of Health describing the source of its receipts and the expenses that were paid. The 1895 law required that the public libraries allow the mayor of the city and the chairman of the board of the county commissioners, where the institution is located, to be on its board of trustees. In 1925, the law was clarified stating that if libraries rent or leased property for use in their institutions, all the property used will qualify for the property tax exemption. In 1933, the requirement that the mayor and chairman of the county commissioners needed to serve on its board was deleted. The new law allowed just the state board of health, not the city and county officers, access to the libraries' financial records.

[1] Adams v. Nashville, 95 U.S. 19, 22 (1877).

In 1969, the reporting and auditing requirement for libraries was changed from the state Department of Health to the Department of Revenue. In addition, the requirement that the manager of the library make oath before the assessor and replace that requirement with a signed statement requirement from the library manager that the income and receipts have been applied to the actual expenses of maintaining the institution was changed. The new law in 1969 deleted the requirement of showing the sources of the library's receipts to the state Department of Health. Four years later, in 1973, all annual report filing requirements for libraries were deleted and the law just stated that all real and personal property is exempt for nonprofit organizations running free public libraries provided the property is used exclusively for the purposes of the organizations and the benefit of the exemption is passed onto the users. In 1984, the law was clarified that all property must be used exclusively for the purposes for which the exemption is granted.

Organizations Providing Library Services

Libraries may be organized as part of a city or county government, as a nonprofit organization, as a separate governmental entity, such as a library district, or as a private company. Typically, libraries are either governmental or quasi-governmental organizations. A quasi-governmental organization is one that is partly governmental or essentially governmental in character, for example the agency performs government functions but is not operated by the government. Libraries that are quasi-governmental are typically run by nonprofit organizations. In Washington the large majority of the libraries are government run libraries and there are only a few nonprofit libraries in the state. This tax preference covers nonprofit libraries but the property of libraries which are part of the city or county government would be exempt under the general exemption for government property.

Public Policy Objectives

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?

Tax base defining theory states that at the time legislatures are developing a tax, they will define the elements that will be subject to the tax and the elements excluded. According to the legal history on the property tax preference for nonprofit libraries, the first Territorial Legislature enacted a single exemption clause that excluded federal, Territorial, and local government property, burial grounds and schools, as well as any "*benevolent, charitable, literary, or scientific institution*" and "*public libraries.*"[2] This tax preference is a straightforward exemption from the property tax base. A public policy objective of this property tax exemption for free libraries is that these organizations are being excluded from the taxable base as quasi-public properties. A Washington Supreme Court case in 1897 justified exemptions from the property tax base as properties that provide a benefit to the public and relieve the state of an expense. Historically,

[2] 1854 Laws of Washington Territory p. 331 §2, italics added.

libraries had annual reporting requirements in which they had to provide information on their revenue sources and expenses. The property tax exemption for libraries was restricted to nonprofit libraries in 1973. It appears that the Legislature assumed that in restricting the property tax exemption to nonprofits, it would be meeting the requirements that the libraries were charitable literary organizations.

The property tax exemption also requires the benefit of the tax exemption be retained by the nonprofit entity and that it is free and open to the public. The Legislature had a public policy objective that the libraries had to be providing benefits to the local communities.

This property tax exemption for libraries run by nonprofit organizations provides these libraries with the same tax benefit as other public libraries run by local library taxing districts or city/county taxing districts which also have property tax exemptions for their library property.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

According to the Department of Revenue's property tax exemption database, the entities claiming this property tax exemption are nonprofit libraries. This tax preference has achieved its objective of providing property tax relief to nonprofit public libraries in the past and present. This tax preference has achieved the objective of passing the benefits of the tax preference onto the community by having the tax preference restricted to just nonprofit libraries that are free and open to the public. This tax preference achieves the public policy objective of providing equal tax treatment to all free public libraries regardless of ownership.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

All entities benefiting from this property tax exemption are nonprofit libraries and historical societies. According to past Department of Revenue's Tax Exemption Reports, since 1984, the number of beneficiaries of the property tax exemption for nonprofit libraries has ranged from ten to 17 libraries. From the most recent 2007 Department of Revenue (DOR) data on the nonprofit libraries, there were ten nonprofit libraries and thirteen parcels qualifying for the property tax exemption. All nonprofit libraries are in the following seven counties: Chelan, Cowlitz, Kitsap, San Juan, Thurston, Whatcom and Yakima. The following is a list of the nonprofit libraries claiming the property tax exemption from the 2007 DOR exemption database.

Table 1: Nonprofit Libraries in Washington Receiving a Property Tax Exemption

Bainbridge Island Public Library Inc
Deming Community Library
Friends of Peshastin Library Inc
Friends of the Library – White Swan Inc
Island Library (Branch of Whatcom Co.)
Media Island International
Ryderwood Improvement & Service Association Inc
Shaw Island Library & Historical Society Inc
Tracyton Public Library Foundation
Yakima Valley Genealogical Society

Source: Washington Department of Revenue Nonprofit Property Tax Database.

Some of the organizations receiving this tax exemption may be providing other services besides a nonprofit library so not all the entities receiving the property tax exemption run libraries exclusively. The property that is exempt is just the property used for library purposes.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

There does not appear to be any unintended tax benefits to any entities other than nonprofit libraries and historical societies.

Revenue and Economic Impacts

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

Over the past 12 years, the property tax savings for nonprofit libraries has been growing from a little more than $10,000 in state and local tax savings in 1992 to more than $43,000 in 2005. These historical property tax savings estimates are based on various editions of the Department of Revenue's Tax Exemption studies from 1990 to 2004.

In 2006, the ten nonprofit libraries had an annual property tax savings of approximately $36,000. This estimate was based on collecting all the counties' real market value for the nonprofit libraries. This 2006 property tax savings estimate is below the DOR 2004 and 2005 estimates for this tax preference. One reason for this lower estimate is because this 2006 property tax savings estimate was based on collecting all the counties' assessed value for these nonprofit libraries instead of relying on a survey of selected counties and then estimating the exempt value of these libraries.

If this tax preference is continued and the exempt property value is not added to the tax roll, then nonprofit libraries will continue to not pay property taxes and other local taxpayers will pay slightly higher property taxes annually. There will be a shift in the tax burden in specific locations where the libraries are found statewide. Governments will not see a change in their overall property tax revenue collected due to this tax preference because of the shifting of tax liability among taxpayers unless the taxing districts are at their maximum tax rate limit. If taxing districts are at the maximum tax rate, then local governments might not be able to shift all the tax liability onto other taxpayers and they will experience a small loss in property tax revenue from having nonprofit libraries exempt from property taxes.

Table 2: Forecast of Local and State Property Tax Savings for Nonprofit Libraries

Year	Exempt Value ($ millions)	State Property Tax Savings	Local Property Tax Savings	Total Property Tax Savings
2006-07	$3.38	$9,000	$27,000	$36,000
2007-08	$3.48	$9,000	$28,000	$37,000
2008-09	$3.58	$9,000	$29,000	$38,000
2009-10	$3.69	$9,000	$29,000	$38,000

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

In examining the 2005 employment data for all libraries statewide, it was found that 66 libraries had employees. Of these libraries with employees, statewide there were a total of 6,640 employees which represents .2 percent of the total statewide employment. The total wages of all libraries statewide was $180.8 million or .15 percent of total wages statewide in 2005. Of the ten nonprofit libraries receiving a property tax exemption, these libraries' employees total less than 30 employees statewide. The nonprofit libraries' economic impact on the state and regional economy is nearly 0. These public libraries and historical societies are providing other valuable historical, social and literary benefits for the local communities that are not easily identifiable in statewide and regional economic statistics of the economy.

Other States

Do other states have a similar tax preference?

JLARC staff used the CCH Tax Research network and database of other states' laws and administrative rules to conduct the survey of other states' similar tax preferences. After conducting this survey, it was revealed that 35 states were providing this type of property tax exemption including Washington. Most of the states with specific exemptions for libraries were restricting the property tax exemption to nonprofit libraries. In the majority of the other 16 states, which did not specifically exempt library property, those states had other nonprofit charitable or educational organization property tax exemptions which may apply to nonprofit libraries. There were only two states that appeared to not exempt nonprofit libraries: Texas and Minnesota.

FIRE COMPANIES – SUMMARY

Current Law

Under current law, all real and personal property of fire companies owned by nonprofit organizations, associations, or corporations whose purpose is to extinguish or prevent fires in any city or town within Washington are property tax exempt. The main requirement for this tax exemption is that the buildings be used exclusively to store or to safeguard fire fighting equipment or for meetings of fire companies. If any portion of the fire company's property is used for commercial rather than exempt purposes, that portion of the building must be segregated and taxed. In Appendix 3 is the current law statute, RCW 84.36.060(1)(c), which provides for the property tax exemption.

Findings and Recommendations

This review of Washington's fire companies' property tax exemption has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- This property tax exemption for fire companies dates back to 1890 and has not been substantially modified.
- This tax preference is an exclusion from the property tax base. The first Legislature recognized the critical nature of fire protection to the existence of the state and ultimately exempted all fire protection property from the tax base.
- This tax preference provides the same property tax treatment to all fire protection organizations either government or nonprofit owned.

Beneficiaries

- In property tax year 2006-07, there was one fire company benefiting from this property tax exemption.
- There does not appear to be any unintended tax benefits to any other entities.

Economic and Revenue Impacts

- In property tax year 2006-07, the one fire company benefiting from this exemption had an annual property tax savings of approximately $5,500.
- The future property tax savings for the fire company over the next three years is between $5,700 and $6,000 per year.

Other States

- Exempting fire protection property is a common practice in other states.

Due to the fact that this tax preference was originally enacted to exclude all fire companies from the property tax base and the beneficiary of the tax preference is a fire company, this tax preference achieves its objectives. Since this tax exemption simply excludes the property from taxation, it is relatively easy to administer the tax exemption. In addition, this tax preference provides equity in taxation for fire companies administering fire protection services like the government fire entities which also receive a property tax exemption.

Recommendation

The Legislature should continue the property tax exemption for fire companies.

Legislation Required: None

Fiscal Impact: None

FIRE COMPANIES – REPORT DETAIL

Statutory History

The tax exemption for fire companies was enacted in 1890 during the first Legislature of the state. In the section of law describing how property was to be valued, the exemption for fire companies was provided:

> All property described in this section, to the extent herein limited, shall be exempt from taxation, that is to say—
>
> *First,… sixth*, all fire engines and other implements used for the extinguishment of fires, with the buildings used exclusively for the safekeeping thereof, and for the meeting of fire companies, whether belonging to any town or any fire company organized therein;

This original language remains nearly unchanged today.

1889 Great Seattle Fire

The first Legislature's action to exempt fire companies from property taxes followed a major fire in Seattle in 1889. The Great Seattle Fire on June 6, 1889, destroyed most of the business district in the city. Seattle organized a professional fire department and Kirkland organized a fire brigade in direct response to that fire.[3] Although Seattle recovered quickly, the recovery was fueled by donations from Tacoma and others. While it is not possible to say that this is the reason for the exemption, it is unlikely that legislative members in 1890 would not have been aware of the impact of that fire or the fire-fighting failures that resulted.

Organizations Providing Fire Protection

Fire companies may be organized as part of a city or county government, as a volunteer organization, or as a separate governmental entity, such as a fire district. As such, they are either governmental or quasi-governmental organizations. A quasi-governmental organization is one that is partly governmental or essentially governmental in character, for example the agency performs government functions but is not operated by the government. In this case, volunteer fire departments would fall within the quasi-governmental category. The property of fire companies which are part of the city or county government would be exempt under the general exemption for government property. Fire companies, however, that were organized separately from the city or county government, as quasi-governmental agencies, would not necessarily fall

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[3] As reported in the City of Kirkland's Fire Department's History located at the following web site http://www.ci.kirkland.wa.us/depart/Fire_and_Building/Fire___Medical_Services/History___Profile.htm.

under the government property exemption. Under these circumstances they would need a separate property tax exemption for their property to be exempt.[4]

In 2006, there were 392 fire taxing districts statewide assessing $501.6 million in property taxes.

In addition, there was one fire company, Westgate Volunteers Corporation, located in Kitsap County, which was leasing property to the local county fire district.

Public Policy Objectives

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?

The fire company exemption appears to be an extension, at least in concept, of the general exemption for federal, state, county, school district, and municipal property. It applies to real and personal property used for fire fighting that is belonging to "any city or town or to a fire company."[5] This remains consistent with the provision as enacted, which exempted the engines, implements and buildings used for their safekeeping, "whether belonging to any town or any fire company organized therein."[6] One of the public policy objectives of this property tax exemption is to provide quasi-governmental fire companies with the same tax exempt status as the governmental fire taxing districts statewide. This tax preference is an exclusion from the property tax base. The first Legislature recognized the critical nature of fire protection to the existence of the state and ultimately exempted all fire protection property from the tax base.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

According to the Department of Revenue's property tax exemption database, the one entity claiming this property tax exemption is a fire company. This tax preference has achieved its objective of providing property tax relief to fire companies in the past and present. This tax preference achieves the objective of providing equal tax treatment for this fire company that is equal to the tax treatment of governmental fire companies.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

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[4] *See, e.g.*, Ensminger v. Powers, 108 U.S. 292, 304 (1883)(citing 1859-60 Tenn. Priv. Acts 70 for the proposition that "all buildings and grounds owned by said city of Memphis and used exclusively for public purposes, such as for fire-companies and fire-engines…and their grounds" were exempt from taxes).

[5] RCW 84.36.060(1)(c).

[6] 1890 Wash. L. p.532 §5.

Currently, there is one fire company, Westgate Volunteers Corporation, which benefits from this property tax exemption. The fire company leases its building and personal property to Kitsap County Fire District 4. Since 1990, Washington has not had many fire companies statewide, and the number has declined. In 1990, DOR Tax Exemption Report stated that there were only three fire companies claiming this property tax exemption, and now there is one.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

There are no unintended tax benefits to any entities other than one fire company.

Revenue and Economic Impacts

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

Due to the small number of fire companies claiming this property tax exemption, the local property tax savings has been $2,000 or less and the state property tax savings has been $1,000 or less annually since 1990 according to the Department of Revenue Tax Exemption Reports. According to Kitsap County, the assessed value of the fire company was $564,000 in property tax year 2006-07 and the total state and local property tax savings is $5,500. The projections for this tax exemption are listed in Table 3 below.

Table 3: Forecast of Local and State Property Tax Savings for Fire Companies

Year	Exempt Value ($ millions)	State Property Tax Savings	Local Property Tax Savings	Total Property Tax Savings
2006-07	$.56	$1,000	$4,500	$5,500
2007-08	$.59	$1,000	$4,700	$5,700
2008-09	$.61	$1,000	$4,800	$5,800
2009-10	$.63	$1,000	$5,000	$6,000

If this tax preference is continued and the exempt property value is not added to the tax roll, then this fire company will continue to not pay property taxes and other local taxpayers will pay only slightly higher property taxes annually. There will be a shift in the tax burden in the location where the exempt property is found in Kitsap County. Local governments will not see a change in their overall property tax revenue collected due to this tax preference because of the shifting of tax liability among taxpayers unless the taxing districts are at their maximum tax rate limit. If taxing districts are at the maximum tax rate, then local governments will not be able to shift all the tax liability onto other taxpayers and they could experience a small loss in property tax revenue from having the fire company property exempt from taxes.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

Since this tax preference is claimed by only one fire company statewide, the impact of the beneficiaries on the state and regional economy is nearly zero.

Other States

Do other states have a similar tax preference?

All states exempt real and personal property of government owned fire districts. This JLARC CCH survey found 27 states including Washington that have specific tax preferences for fire equipment and property of nonprofit volunteer fire departments. There were also a few states, like West Virginia and Montana, which allow privately owned fire companies the same property tax exemption for fire equipment under certain conditions. Wyoming provides a property tax exemption for all fire control equipment. Even though the other states do not appear to have a specific property tax exemption for nonprofit volunteer fire companies, they may qualify under the charitable organizations' property tax law.

GROWING CROPS - SUMMARY

Current Law

Current law specifies that, in determining the value of farmland for assessment purposes, the value of crops as of January 1 each year shall be excluded. The reason for this exclusion from the value of agricultural land is because it would be very difficult to assess the actual value of the inventory of crops until it is harvested. In Appendix 3 is the current law statute, RCW 84.40.030(3), which provides for the property tax exemption.

Findings and Recommendations

This review of Washington's growing crops exclusion from the calculation of land values has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- This property tax exemption for growing crops dates back to 1890 and has not been substantially modified.
- This tax preference is an exclusion from the calculation of property values and the overall tax base. The first Legislature recognized the critical nature of farming to the existence of the state and wanted to enact a property tax system that uniformly and fairly valued farmland regardless of which crops were found in the ground as of January 1.
- This tax preference achieved the objective of easing the administration of setting agricultural land values and lowering efficiency costs. It achieved the objective of providing equal tax treatment to all farmers regardless of when they were planting crops.

Beneficiaries

- There were 1,159 farms in the oilseed and grain production sectors which would benefit directly from this tax preference because they could potentially have winter crops growing in the ground as of January 1 each year. This property tax exemption also benefits more than 34,500 Washington farms by having a uniform and fair assessment of farmland statewide.
- There are no unintended beneficiaries of this tax preference other than the farmers with crop production in Washington.

Economic and Revenue Impacts

- In property tax year 2006-07, the additional net income value of growing crops was $231 million and the total state and local property tax savings to farmers is $2.6 million.
- The future property tax savings for the farmers over the next three years is estimated between $2.69 and $2.83 million per year.
- Washington agriculture has been a $5.5 - $6 billion industry for the past decade. In 2005, the total value of all corps produced in Washington was $3.99 billion and there were 73,069 workers in production agriculture.

Other States

- This is a common exemption among states to exclude the value of growing crops from the calculation agricultural land values.

Due to the fact that this tax preference was originally enacted to specifically exclude the value of growing crops from the land value for farmers and the fact that county assessors would have a very difficult time assessing growing crops, this tax preference achieves its objectives of easing tax administration. This tax exemption also achieves the objective of proving fair and equal treatment to all farmers growing crops regardless of when the crops are planted.

Recommendation

The Legislature should continue to exclude the value of growing crops from the farmland value.

Legislation Required: None

Fiscal Impact: None

GROWING CROPS – REPORT DETAIL

Statutory History

The exemption for growing crops was enacted in 1890 during the first Legislature of the state. In the section of law describing how property was to be valued, the exemption for growing crops was provided:

> In assessing any tract or lot of real property, the value of the land exclusive of improvements, shall be determined; also, the value of all improvements and structures thereon, and the aggregate value of the property, including all structures and other improvements, **excluding the value of crops growing upon cultivated land.**

There have been only minor changes ever since. In 1971, the language in the statue was slightly changed to state the following:

> In valuing agricultural land, growing crops shall be excluded.

This same language for the growing crops exemption remains in place today. Under current law, growing crops does not include nursery stock because the stock is not grown in the ground. A similar property tax exemption for nursery stock was enacted in 1971.

Background — Washington Fall Crops

Since most crops in Washington are planted in the spring and harvested in the summer and fall, there are only a few crops that are in the ground as of January 1 each year that could be included in the value of farmland. Winter wheat, fall barley and hay are examples of crops that are still planted in the fall and are in the ground in January in Washington State. According to USDA – NASS Olympia office, fall barley is a very small portion of the total barley grown in Washington State. Winter wheat is the primary commodity that would be in the ground as of January 1 each year. The number of acres of winter wheat harvested in Washington has grown from $1.8 million acres in 2000 to 1.85 million acres in 2006.[7] In 2006, the number of acres of winter wheat planted represented 50 percent of all the farmland with principal crops[8] and 81 percent of all wheat planted in Washington State. The cash value of production of winter wheat has increased from $344.3 million in 2000 to $516.8 million in 2006 due to the rising price of wheat. If assessors were required to include in the value of the land the crops in the ground as of January 1, that would mean that farmland with winter wheat, hay or fall barley would have higher values than similar farmland of spring wheat, barley or peas. This would create a very complicated tax to administer and an unfair tax for farmers who would likely rotate crops on their farmland each year.

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[7] USDA-NASS Crop Production 2006 Summary, January 2007 and USDA-NASS 2006 Washington Annual Agriculture Bulletin.

[8] Principal crops includes corn, sorghum, oats, barley, winter wheat, rye, durum wheat, other spring wheat, rice soybeans, peanuts, sunflower, cotton, dry edible beans, potatoes, canola, millet and sugar beets.

In addition to the property tax exemption, with the enactment of the business and occupation tax in 1935, agricultural producers were provided a similar business and occupation tax exemption for the agricultural products sold at wholesale.

Public Policy Objectives

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?

One reason legislatures define exemptions is to ensure uniformity by excluding from one tax property that is taxed elsewhere and by excluding items from a tax that would create a lack of uniformity in property values. The property tax exemption for growing crops was enacted at statehood. This exemption is further defining property tax values and the tax base. Given the enormous importance agricultural commodities had on the sustainability of the state in the late 1800s and early 1900s, one public policy objective of this property tax exemption initially was to enact a property tax system that was fair and equitable to farmers since their crops were supplying the food to feed the state's people. Without this exemption on growing crops, farmers could have been assessed a tax on growing crops that may not materialize or be a different value once harvested then as assessed on January 1. In addition, the land value of farmland would be dependent on the time of year the crop was to be harvested. A public policy objective for this property tax exemption would have been to ensure a fair land value for agricultural land regardless of when the crop was grown and harvested on the land. Due to the significant administrative difficulty in assessing all the crops on the ground each year statewide, another public policy objective would be to ensure an easily administered tax system.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

Since this exemption is just a removal from the base calculation of real market value for farmland, the only evidence that this tax preference is utilized is by the agricultural statistics collected by USDA on the number of acres of winter wheat and other commodities planted and harvested each year.[9] Since there has been winter wheat and hay planted in the fall and harvested in the spring, there is evidence that growing crops would be present in the ground as of January 1, and this tax preference has achieved its objective of providing a uniform and fair valuation of farmland in Washington for farmers.

This tax preference achieves the objective of easing the administration of setting agricultural values and lowers efficiency costs. It achieves the objective of providing equal tax treatment among all farmers.

[9] USDA-NASS, 2006 Washington Annual Agriculture Bulletin.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

According to the USDA – NASS, in 2005, there were 34,500 farms in Washington with a total of 15.1 million acres of land in farms. In 2004, based on the unemployment insurance wage files maintained by the Employment Security Department, it was estimated that 7,064 firms and 73,068 workers were in the production agriculture sector in Washington. In 2004, oilseed and grain farming comprised the largest sub-sector at 1,159 farms or 16 percent of the total production of agriculture firms. Even though not all farms produce a winter crop like winter wheat or fall barley each year, they would all benefit from having a uniform and fair assessment method of their land value. All farmers with cropland are benefiting from this tax exemption that excludes the value of growing crops in the assessment of the land value of farmland.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

This tax preference is not providing unintended tax benefits to any entities other than farmers in Washington.

Revenue and Economic Impacts

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

To estimate the value of growing crops, the crop production value per acre was found and then the cost of production per acre was subtracted from the total crop production value per acre to determine the net income per acre for each crop in the ground as of January 1. This per acre net income for each crop represents the net value of the crop when it would normally be harvested.

The local and state property tax savings for growing crops has fluctuated over the years depending on the spring crops assumed in the ground as well as the net value of each crop included in the estimates from various editions of the Department of Revenue Tax Exemption Reports. The value of growing crops estimates made in 2000 and prior reports included both barley and winter wheat. The taxpayer saving estimates ranged from $3 million to more than $5 million. Then beginning with the 2004 Tax Exemption Report, the local and state property tax savings dropped in 2002 to roughly $1 million. The 2004 report estimate was based on the value of winter wheat crop only. Since the last 2004 Property Tax Exemption Report, the value of winter wheat has increased significantly, and this increased the value of the property tax savings for growing crops for this new estimate. In property tax year 2006-07, the assessed value of growing crops was $231 million, and the total state and local property tax savings is $2.6 million. The projections for this tax exemption are listed below in Table 4. The taxpayer savings range from $2.7 million in 2007-08 to $2.8 million in 2009-10.

Table 4: Forecast of Local and State Property Tax Savings for Growing Crops

Year	Exempt Value ($ millions)	State Property Tax Savings	Local Property Tax Savings	Total Property Tax Savings
2006-07	$231	$590,000	$2,020,000	$2,610,000
2007-08	$240	$610,000	$2,080,000	$2,690,000
2008-09	$249	$630,000	$2,130,000	$2,760,000
2009-10	$258	$640,000	$2,190,000	$2,830,000

If this tax preference is continued and growing crops are excluded from the value of farmland, there will be a shift in the tax burden in specific locations where farmland value potentially could have been higher if growing crops had been incorporated into the land value. Governments will not see a change in their overall property tax revenue collected from this tax preference because of the shifting of tax liability among taxpayers unless the taxing districts are at their maximum tax rate limit.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

Annually, agriculture in Washington has been a $5.5 billion to $6 billion industry for the past decade. In 2005, the total value of all crops production was $3.99 billion or 69 percent of total Washington agriculture. The additional value the agriculture industry brings to the state economy is the difference between the total market value of the output sold and the total cost of the agricultural inputs purchased to create the output. Table 5 summarizes the USDA data for

Table 5: 2005 Composition of Washington's Total Value of Final Agricultural Output

Total Value of Final Agricultural Output- 2005	Dollar Value ($000)	Percent of Total Output (%)
Value of Final Agricultural Output	6,499,553	
Components of Agricultural Output		
Total Intermediate Consumption Outlays	3,329,016	51.2
Gross Value Added	3,203,509	49.3
Net Value Added	2,743,480	42.2
Employee Compensation – Total Hired Labor	1,217,255	18.7
Net Farm Income	957,473	14.7

Source: USDA-NASS, 2006 Washington Agricultural Statistics.

the most recent year, 2005. This table reveals that the gross value added is 49 percent of the value of the final agricultural output. The net value added, which is gross value minus capital consumption, was 42 percent of the value of the final agricultural output. The total cost of labor, employee compensation, was 18.7 percent of total value of final agricultural output and 23.8 percent of total costs in 2005. As a measure of the cost of labor to the farm operator, this employee compensation statistic can be considered the annual wage bill for agricultural labor in the state.[10]

In 2005, the total employment in the state is estimated at 3.1 million individuals. Of these, 79 percent work west of the Cascades and 21 percent work east of the Cascades. In 2005, there were 93,186 individuals working in agriculture fields with 79 percent of those working east of the Cascades and 21 percent working west of the Cascades.[11] In 2004, based on the unemployment insurance wage files maintained by the Employment Security Department, there was an average of 7,064 firms and 73,068 workers in the production agriculture sector in Washington. In 2004, oilseed and grain farming comprised the largest sub-sector at 1,159 farms or 16 percent of the total production agriculture firms. The oilseed and grain farms had a total of 1,961 jobs representing 2.7 percent of total jobs in 2004. The 2004 average annual earnings per worker ranged from a high of $25,152 for poultry and egg production to $14,273 per year for fruit and tree nut farming. The oilseed and grain farming average annual earnings per job is $18,332.

Other States

Do other states have a similar tax preference?

Exempting growing crops from the base value calculation of agricultural land is quite common among states. JLARC state research found that 30 states, including Washington, have specific provisions in law stating that the value of crops are excluded from the value of agricultural land. The District of Columbia does not have farmland. The other states within the U.S., which do not specify the exclusion of crops from the valuation of farmland, have a special assessment which includes valuing the land using the income approach of valuation. This approach produces lower land values so agricultural land is not assessed at the real market value and the property taxes imposed on agricultural land is reduced.

[10] 2005 Agricultural Workforce in Washington State, Washington State Employment Security Department.

[11] 2005 Agricultural Workforce in Washington State, Washington State Employment Security Department.

NONPROFIT NURSING HOMES - SUMMARY

Current Law

Under current law, all real and personal property of nonprofit nursing homes is exempt from property taxes. The main requirement for this tax exemption is that the property be used exclusively for the purposes of the nursing homes and that the benefits of the exemption must be retained by the nonprofit organization. In Appendix 3 is the current law statute, RCW 84.36.040(1)(d), which provides for the property tax exemption.

Findings and Recommendations

This review of Washington's nonprofit nursing homes' property tax exemption has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- The property tax exemption for nursing homes dates back to an 1854 section exempting "benevolent, charitable, literary, or scientific" institutions, various government properties, schools, cemeteries, and public libraries from the tax base. As it was initially written, this tax preference is a definition of the tax base.
- The law in 1895 placed a requirement on homes for the aged and infirm that they must be supported in whole by public appropriation or by private charity, or all of the income and profits are devoted to charitable purposes. This indicates an historic public policy objective that nursing facilities had to be performing charitable services to communities.
- The original property tax exemption applied to all nursing homes that met the charity conditions. In 1973, the Legislature narrowed the exemption to nonprofit nursing homes only. The 1973 legislation did not include a clear statement of the Legislature's intent in making this change.
- The 1973 legislation created a direct connection between qualifying for this tax preference and meeting the federal requirements for nonprofit organizations in order to receive the "nonprofit" designation. There are various federal requirements for nonprofit organizations, which restricts their distribution of income and includes a requirement to provide community benefits.
- In 1984, the Legislature created a public policy objective that this property tax exemption is only allowed for the property of a nursing home that is used exclusively for the operating a nursing home.

- A public policy objective of the property tax exemption for nonprofit nursing homes is to support quasi-public service activities performed for the aged and infirm. This tax preference has achieved its public policy objective of providing property tax relief to nonprofit nursing homes.
- It is not clear how well nonprofit nursing homes have performed charitable services and community benefits as compared to the performance of private for-profit nursing homes.

Beneficiaries

- The beneficiaries from this property tax exemption are 42 nonprofit nursing homes and 87 parcels of property statewide that received an exemption in property tax year 2006-07.
- There is no indication of this tax preference providing unintended benefits to other entities besides nonprofit nursing homes.

Economic and Revenue Impacts

- In property tax year 2006-07, the nonprofit nursing homes had an annual property tax savings of approximately $2.8 million.
- The future property tax savings for nonprofit nursing homes over the next three years is between $2.9 and $3.0 million per year.
- Washington's nursing home industry in the first three quarters of 2006 had on average 190 firms and 24,998 employees and $507 million in total wages.

Other States

- Twenty-three states, including Washington, have a specific property tax exemption for property used as homes for the sick or infirm. Most all states have property tax exemptions for nonprofit organizations when the property is used for charitable use so nursing homes may or may not fall into that charitable use category in those states.

Due to the fact that this tax preference was originally enacted to exclude all nursing homes from the property tax base and the beneficiaries of the tax preference are nursing homes, this tax preference has achieved that public policy objective of defining the tax base. It is less clear what the Legislature's additional intentions were in restricting this tax preference to nonprofits nursing homes beginning in 1973. The Legislature connected to the federal requirements of nonprofits in order to qualify for this tax preference but it is unclear what the expectations were for nonprofit organizations. The federal law has a "community benefit standard" to determine if health care organizations qualify as tax-exempt nonprofits. The "community benefits standard" does not specify a certain amount of care that must be provided to low income residents to qualify for tax-exempt status, even though it is a component of community benefit. In addition, there are limitations in federal law on the distribution of profits and assets of nonprofit organizations but it is unclear what characteristics the Legislature intended nonprofit nursing homes to possess.

In terms of meeting the charitable service requirements of nonprofits, JLARC's analysis shows that private for-profit nursing homes (that do not receive a property tax exemption) have traditionally had a higher percentage of total revenue from low-income Medicaid patients. In addition, the nonprofit nursing homes are charging private pay patients more than other private nursing homes that do not receive the tax exemption. Overall, the data do not support the premise that the nonprofit nursing homes are serving more low-income patients than other nursing homes. Information is not available that would allow for a comparison among all nursing homes of other community benefits that nursing homes may provide. So it is not clear that the current tax preference is accomplishing a public policy objective related to provision of additional charitable services or community benefits, as compared to other types of nursing home ownerships.

There is now different property tax treatment among homes for the sick and infirm and the aged. Other non-nursing home long-term care facilities must prove that a majority of their residents are low income residents or else their property tax exemption is prorated. In addition, nonprofit nonsectarian organizations have to meet a gift giving test that demonstrates that the nonprofit is performing charitable services to the local community it serves which is not required of nonprofit nursing homes. These issues raise questions about whether the tax preference is currently consistent with the charity care policy objective.

Recommendation 1

If the Legislature intended to provide the nonprofit nursing home property tax exemption under the assumption that these organizations were providing more charity or low-income care than other nursing homes, then the Legislature should modify the property tax exemption to be dependent on meeting a threshold of charity or low income care.

Legislation Required:	Yes
Fiscal Impact:	A change in revenue could be possible depending on how this is implemented.

Recommendation 2

If the Legislature wants information on community service activities performed by nursing homes, then it should require nursing homes to report an annual community service inventory.

Legislation Required:	Yes
Fiscal Impact:	None

NONPROFIT NURSING HOMES – REPORT DETAIL

Statutory History

The property tax exemption for nursing homes dates back to an 1854 section exempting "benevolent, charitable, literary, or scientific" institutions, various government properties, schools, cemeteries, and public libraries from the tax base. The specific tax exemption for nursing homes was initially an 1891 section stating that "homes for the aged and infirm" were not to be part of the tax base.

All property in this section shall be exempt from taxation:

> all free…, hospitals…, homes for the aged and infirm;

In 1893, the law restricted the size of the exempt parcel of the land to 120 feet by 200 feet. In 1895, the law placed a requirement on homes for the aged that they must be supported in whole by public appropriation or by private charity or supported in part by charity and all of the income and profits devoted to charitable purposes.

In addition to this specific requirement related to charitable purposes, the Legislature also added record-keeping requirements, which it then adjusted in the ensuing years. In order to qualify for the property tax exemption in 1895, the state Board of Health, county, and city officials had to have access to the financial records of the institutions, and the manager of the home had to swear before the county assessor that all income had been applied to actual expenses of maintaining the home and to charitable purposes. The homes for the aged and infirm had to annually file a report to the state Board of Health describing the source of its receipts and the expenses that were paid. The law required that the homes for the aged and infirm allow the mayor of the city and the chairman of the board of the county commissioners, where the institution was located, to be on its board of trustees.

In 1925, the law was changed to allow homes for the aged to rent or lease property for use in their institutions, and all the property used would qualify for the property tax exemption. In 1933, the Legislature removed the requirement that the mayor and chairman of the county commissioners needed to serve on its board. In addition, the law required that just the state Board of Health, not the city and county officers, had access to the nursing homes' financial records.

In 1969, the reporting and auditing requirement for the nonprofit homes for the aged and infirm changed from the state Department of Health to the Department of Revenue. The law deleted the requirement that the manager of the home for the aged take oath before the assessor and instead required the homes for the aged manager to sign a statement that the income and receipts have been applied to the actual expenses of maintaining the institution.

The Legislature made major changes in 1973 to the statues regarding the property tax exemption for the homes for aged and infirm. The Legislature narrowed the exemption from all homes for the aged and infirm to only nonprofit homes. The Legislature also defined "nonprofit" in statute to mean that no part of the business income could be paid directly or indirectly to members, directors, stockholders, officers, or trustees except for services rendered and the salaries paid to officiers had to be comparable to public officials.[12] The revised property tax exemption was dependent on the property being used exclusively for the purposes of the nonprofit organizations, and the benefits of the exemption had to accrue to the nonprofit organization. All of the annual report filing requirements for homes for the aged and infirm were moved to another section of law that required most organizations to report to the Department of Revenue annually in order to receive a property tax exemption.[13]

In 1984, the Legislature specified that all property must be used exclusively for the purposes for which the exemption is granted, which are exclusively homes for the aged and infirm purposes.

In 1989, the Legislature passed HB 1097 which created a separate property tax exemption for the homes for the aged distinct from the nonprofit nursing homes' property tax exemption. The property tax exemption for the homes for the aged was modified by requiring the nonprofit homes to have at least 50 percent of the dwelling units be occupied by eligible residents in order to receive a complete property tax exemption or the home must be subsidized by HUD. The eligibility guidelines for residents are based on the resident's annual household income and if the entire home fails to qualify, then the exemption for real property is prorated based on the number of eligible residents. The homes for the aged property tax preference will be reviewed in future years by JLARC.

Federal Requirements for Nonprofits

The state Legislature's change in 1973 to narrow the tax exemption to nonprofit homes for the aged and infirm created a direct connection between qualifying for this tax preference and meeting the federal requirements for organizations to receive the "nonprofit" designation. According to federal law, the promotion of health for the benefit of the community is a charitable purpose. A nursing home may qualify for tax-exempt status under IRC 501(c)(3) provided it is organized and operated exclusively for charitable purposes. There are various federal requirements for nonprofits including organizational tests and meeting a "community benefits" standard.

[12] RCW 84.35.800(4).

[13] RCW 84.36.840.

Organizational Test

The organizational test is the same for health care organizations as it is for any other IRC 501(c)(3) organizations.[14] The health care organization must be operated exclusively for charitable purposes and upon dissolution the nonprofit entity must distribute its assets exclusively for charitable purposes. Another requirement for nonprofit organizations is that the organization must have only a small part of its activities which is not furthering its charitable health purpose. The federal law also stipulates that no part of an organization's net earnings can be distributed in whole or part to benefit private shareholders or individuals. Essentially, a nonprofit may not lawfully pay its profits to owners or to anyone associated with the organization. These requirements are also in Washington State law.[15] Along with these tests, there are restrictions placed on lobbying efforts and political activities to influence legislation.

Community Benefits

Federal policy requires health care organizations to provide community benefits in order to qualify as tax exempt nonprofit entities. The standard adopted in 1969 and still in place today does not require health care organizations to provide a specific level of care to the poor in order to qualify for tax exemption.[16] Instead, health care organizations must demonstrate that they provide sufficient benefits to the community.[17] Other factors that demonstrate that the health care organization is operating for the benefit of the public may also be considered. Washington State does not require health care organizations to identify and inventory their community benefits but the Washington State Hospital Association (WSHA) has conducted surveys of 32 of their nonprofit hospitals to completed Community Benefits Inventory Reports on Washington Hospitals. This audit did not find a similar type community benefits inventory report documenting the community services provided by Washington's nonprofit nursing home facilities.

Washington Nursing Homes

Providing care to the aged and infirm has had a long history in Washington. The first hospital, St. Joseph Hospital, opened in 1858 at Fort Vancouver and provided a variety of health care services to pioneers, including long-term care for the aged and infirm.[18] By 1866, the Sisters had a contract with the Territory of Washington to provide care of the mentally ill and infirm at $8 a week per person.[19] Some of the earlier nursing homes were connected with a hospital. In examining a few nursing homes' individual histories in Washington, it was found that the Sisters of Providence nursing home claimed to have been in existence the longest at 150 years. Bethany

[14] "Health Care Provider Reference Guide," IRS by Janet Gitterman and Marvin Friedlander.

[15] RCW 24.03.

[16] IRS Ruling 69-545.

[17] "A Review of the Tax-Exempt Hospital Sector," written statement of Mark Everson Commissioner of Internal Revenue Before the Committee on Ways and Means United States House of Representatives May 26, 2005.

[18] A Century of Service 1858-1958 Washington Hospitals, Washington State Hospital Association, 1957.

[19] A Century of Service 1858-1958 Washington Hospitals, Washington State Hospital Association, 1957.

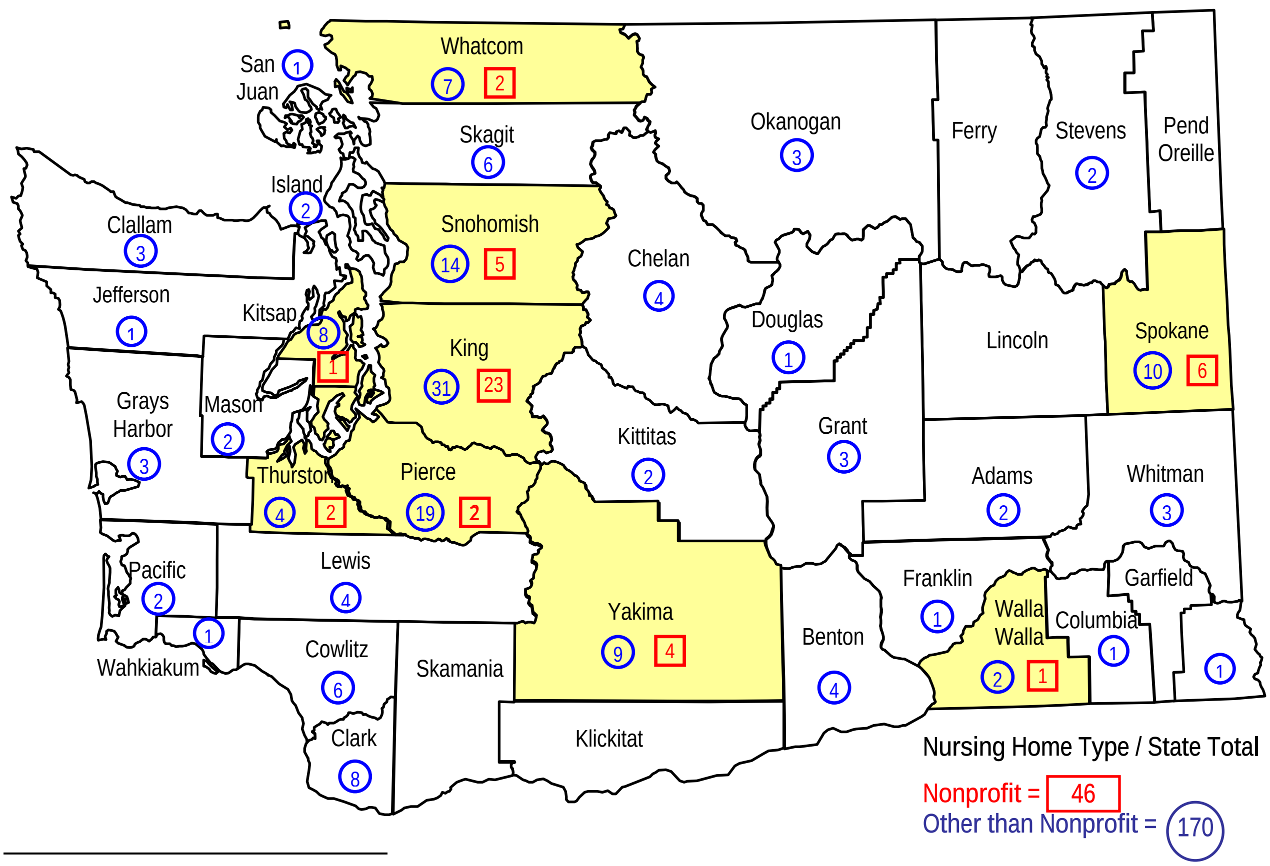
of the Northwest is also one of the oldest nonprofit nursing facilities that is still in operation as they have been in operation for 70 years.

More than 100 years later in 2005, according to DSHS data, there were 204 nursing facilities operating in the state. Forty-two homes or 22 percent of all nursing homes were managed by nonprofit corporations. Eighteen percent were owned by municipalities, and the remaining 60 percent were private for-profit companies. In 2005, with more than 60 percent of the Washington nursing home facilities owned by for-profit companies, these nursing facilities had on average larger nursing facilities (96 beds per facility) than the nonprofit nursing homes (86 beds per facility).

Nationwide for-profit companies have dominated the nursing home market as is also true in Washington. According to nationwide studies, on average in the early 1990s, for-profit nursing homes had 70 percent of all nursing facilities in the U.S. In the early 2000s, for-profit businesses owned 66 percent of all nursing homes.[20]

Washington nursing homes are located all throughout the state with the majority of the nonprofit nursing homes being in more urban counties like King, Snohomish, Spokane, Pierce and Thurston, see Figure 1. There are eight nonprofit nursing homes in rural counties like Whatcom, Walla Walla, Kitsap and Yakima.

Figure 1: Number of Nursing Homes in Washington by Type of Ownership – 2005



[20] How Nonprofits Matter In American Medicine, And What To Do About It, Mark Schlesinger and Bradford Gray, Health Affairs 25 (2006).

Public Policy Objectives

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?

The statutory history for this tax preference indicates several public policy objectives for this tax preference. The first objective is one of defining the property tax base since this tax preference was enacted at the time of statehood and is consistent with the general history of the U.S. and with exemptions for charitable institutions dating back to colonial days under British law. Since long-term care services for the aged and infirm were originally provided by hospitals, the public policy objectives for nursing homes are similar to hospitals. There has been a traditional public policy objective of exempting homes for the aged and infirm from the property tax base under one or more of the benevolent, charitable, or scientific institution categories. In an 1866 case, the U.S. Supreme Court recognized this long-standing exemption of hospitals from taxes:

> It is known as sound policy that, in every well regulated and enlightened state or government, certain descriptions of property, and also certain institutions—such as churches, hospitals, academies, cemeteries, and the like—are exempt from taxation; but these exemptions have never been regarded as disturbing the rates of taxation, even where the fundamental law had ordained that it should be uniform. [21]

The specific exemption for "homes for the aged and infirm" appeared immediately following statehood, in 1891 and remained that way until 1973.

A second public policy objective for homes for the aged and infirm relates to homes' work for charitable purposes and community benefits. In 1895, the Legislature placed a requirement on homes for the aged that they must be supported in whole by public appropriation or by private charity or are supported in part by charity and all of the income and profits are devoted to charitable purposes. This indicates a historic public policy objective for this tax preference that the nursing facilities had to be performing charitable services to communities. While this provision is no longer in place, in 1973, the Legislature narrowed the use of the tax exemption from all homes for the aged to nonprofit homes only. As discussed earlier, there are federal requirements related to charitable purposes and community benefits that the nonprofit nursing homes must meet in order to receive their official designation as a nonprofit organization.

Another public policy objective of the property tax exemption for nursing homes is that these organizations are being excluded from the taxable base as quasi-public properties. A Washington Supreme Court case in 1897 justified exemptions from the property tax base as properties that provide a benefit to the public and relieve the state of expense.[22] The property tax exemption for nursing homes is based on the service activities performed for the aged and infirm; if those services were not provided then the state would have to be performing those services.

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[21] People v. Commissioners, 71 U.S. 244, 256 (1866).

[22] Chamberlin v. Daniel, 17 Wash. 111, 113 (1897).

For 78 years, from 1895 until 1973, all for profit and nonprofit nursing homes and homes for the aged had annual reporting requirements in which they had to provide information on their revenue sources and expenditures. A fourth public policy objective for this property tax exemption was that this property tax exemption be limited to nonprofit nursing homes due to the profit and asset restrictions placed on these organizations so the net earnings will be used for charitable purposes. From the beginning of this tax preference, there was a public policy objective that these quasi-public institutions should be accountable for the sources of their revenue as well as their expenses. It appears that the Legislature assumed in 1973 that in restricting the property tax exemption to nonprofits, it would be meeting those requirements by connecting to the federal definition and requirements of charitable health care organizations. There was not a clear statement of any further change in public policy objective in the Legislature's narrowing of the exemption to nonprofit homes only.

A fifth public policy objective of this property tax exemption for nursing homes was that the exempt property had to be used exclusively for nursing home purposes. The property tax exemption does not apply to all property owned or used by nonprofit nursing homes but only that property which is used exclusively for nursing home purposes.

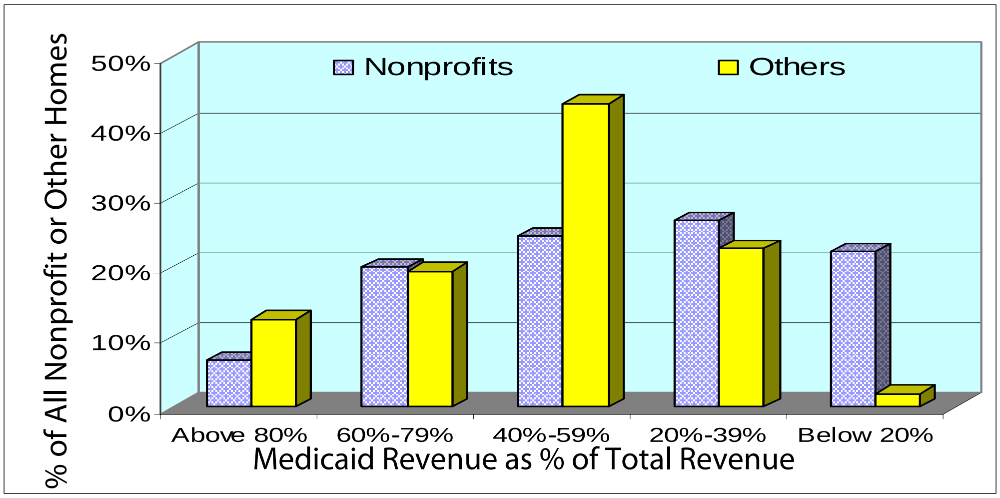
Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

After examining the Department of Revenue's property tax exemption database, the entities claiming this property tax exemption are nonprofit nursing homes. This tax preference has achieved the objective of defining the property tax base. Since there is a public policy objective for this tax preference that the exempt nursing home property be used exclusively for nursing home purposes and this audit did not uncover substantial evidence that this tax preference for property used for nursing home services were not implemented fairly uniform across homes throughout the state, this tax preference appears to have achieved this objective.

To assess whether the tax preference has achieved the second public policy objective of providing charitable services to low income residents, JLARC staff analyzed the available information on Washington nursing home data by different ownership types for Medicaid patients. Serving Medicaid patients is one way in which nursing homes serve their local communities. Medicaid is available for those individuals who cannot afford care. The Medicaid reimbursement rate in the state becomes a critical factor in nursing homes' financial picture. In Washington, Medicaid rates for long term care nursing facilities are set individually for each facility. It is a cost based rate system based on a facility's costs, its occupancy level, and the individual care needs of its residents. There are seven main cost components in the Medicaid rate: direct care, therapy care, support services, operations, variable return, property and financing allowance.

The accessibility to nursing care by low income residents was examined by comparing nonprofit and for-profit nursing homes Medicaid revenue as a percent of total revenue. In terms of serving low income residents, the nonprofit nursing homes have consistently over the past four years had a smaller portion of all patients being Medicaid eligible. This result is consistent with other studies in other states which also found that it is most likely that low income Medicaid recipients will be treated by for-profit nursing homes.[23]

Figure 2: Distribution of Nursing Homes by Ownership Type and Medicare Revenue as a Percent of Total Revenue - 2005



Source: Department of Health Annual Hospital Reports 2005.

On average in 2005, the nonprofit nursing homes had a lower number of Medicaid patients, (58.8 percent) than the for-profit nursing homes (64 percent). This average percentage of Medicaid patients has not changed much for nonprofit nursing homes over the past four years. Figure 2 reveals the distribution of nursing facilities by their percent of total revenue from Medicaid in 2005. For example, 7 percent of the nonprofit nursing homes had 80 percent of more of their total patient revenue from Medicaid patients where for-profit nursing homes had 12.5 percent of their facilities with 80 percent of more of their total patient revenue from Medicaid. Over 43 percent of the for-profit nursing homes versus 24 percent of the nonprofit nursing homes had between 40 and 69 percent of their total patient revenue from Medicaid revenue. Nonprofit nursing homes had their largest portion of their homes, 22 percent, with low Medicaid revenue to total patient revenue percentage, below 20 percent versus the for-profit nursing homes had less than two percent of their facilities with the Medicaid portion of total revenue at less than 20 percent.

There are other community benefits, besides serving low income patients, that nursing facilities provide that affect the health of the community. As of the time of this audit, the nonprofit nursing home industry in Washington had not completed an inventory of the other charitable services they provide in their local communties. Based on this review of the percent of total patients which are Medicaid patients and the lack of information on other community benefits, it is not clear that the nonprofit hospitals currently receiving this property tax exemption are providing relatively more charitable services and community benefits than nursing homes under other ownership types.

[23] How Nonprofits Matter In American Medicine, And What To Do About It, Mark Schlesinger and Bradford Gray, Health Affairs 25 (2006).

Tables 6a and 6b provide financial data about nursing homes in Washington, differentiated by type of ownership. The tables also allow for a comparison for changes in financial data over time, with one table in 2002 and the other in 2005 (the most recent data available). These statistics are cost reports that nursing homes must file annually with the Department of Social and Health Services (DSHS). There has been considerable debate at the federal level about whether there are differences in hospital financial performance due to the ownership of nursing homes. These two tables compare nursing home statistics by ownership type to determine if differences exist in Washington nursing homes by ownership type. Some other states have adopted thresholds related to some of these types of financial indicators as a basis for qualifying for nonprofit status and receiving a property tax exemption.

The two tables use the following seven financial measures:

1) **Routine Patient Revenue as Percent of Gross Revenue** – an indicator of share of revenue that is derived from providing routine care to patients

2) **Non-operating Revenue as Percent of Gross Revenue** – an indicator of share of revenue that is derived from other revenue sources like interest and dividend income and sales of real property or other financial assets and gifts and donations

3) **Average Charges to Private Pay Patients per day** – an indicator of how much the average private pay resident is charged per day while staying in the nursing home

4) **Expenses to Revenue (percent)** – a measure of the profit margin as total expenses are divided by total revenue

5) **Average Administrative Salaries and Fringe Benefits per hour** – an indicator of the average salaries and benefits to administrators only per hour

6) **Average Salaries and Fringe Benefits for all in-house employees per hour** - an indicator of the average salaries and benefits to all nursing home employees per hour

7) **Total Nursing Staff (RN, LPN and Nursing Aids) Hours per patient day** – an indicator of the amount of nursing staff time employed in the nursing home per patient day

The source of revenue for nursing facilities is different depending on the type of ownership. In 2002, for-profit and other nursing facilities routine patient revenue as a percent of gross revenue from all revenue sources (operating and non-operating revenue) was 12 percent higher at 89 percent then the routine patient revenue percent of gross revenue for nonprofit nursing homes at 78.5 percent, see indicator (1). In 2005, for-profit nursing facilities' percent of gross revenue that was routine patient revenue was slightly lower than in 2002 at 87 percent where the nonprofit nursing homes' percentage of gross revenue that was patient revenue declined 6.5 percentage points to 72 percent and the difference between the two types of nursing homes' percent of gross revenue that was routine patient revenue grew to 21 percent. This reveals that nonprofit nursing homes are receiving a larger share of their total revenue from other sources besides routing patient care.

Table 6a: Washington Nursing Home Statistics By Ownership Type - 2002

	Description of Organizational Performance	Nonprofits	Others
Measures of revenue sources and economic performance			
1	Routine Patient Revenue as Percent of Gross Revenue	78.5%	89.3%
2	Non-operating Revenue as Percent of Gross Revenue	10.6%	.41%
3	Average Charges to Private Pay Patients per day	$199	$158
4	Expense to Revenue (%)	101.7%	100.6%
Measures of employee salaries and hours of nursing care			
5	Average Administrative Salaries and Fringe Benefits per hour	$48.8	$41.6
6	Average Salaries and Fringe Benefits for all in-house employees per hour	$22.6	$22.8
7	Total Nursing Staff (RN, LPN and Nursing Aids) Hours per patient day	3.97	3.43

Source: Washington Department of Social and Health Services Cost Report Database.

Table 6b: Washington Nursing Home Statistics By Ownership Type -
Most Recent Year 2005

	Description of Organizational Performance	Nonprofits	Others
Measures of revenue sources and economic performance			
1	Routine Patient Revenue as Percent of Gross Revenue	72.0%	87.31%
2	Non-operating Revenue as Percent of Gross Revenue	14.3%	0.24%
3	Average Charges to Private Pay Patients per day	$242	$182
4	Expense to Revenue (%)	99.50%	97.95%
Measures of employee salaries and hours of nursing care			
5	Average Administrative Salaries and Fringe Benefits per hour	$52.12	$46.91
6	Average Salaries and Fringe Benefits for all in-house employees per hour	$25.87	$24.68
7	Total Nursing Staff (RN, LPN and Nursing Aids) Hours per patient day	3.99	3.44

Source: Washington Department of Social and Health Services Cost Report Database.

Other sources of revenue for nursing homes are non routine patient revenue and non-operating revenue, see indicator (2). Nonprofit nursing homes receive a sizably larger share of their gross revenue, 10.6 percent, from non-operating revenue than for-profit and other nursing homes which received .4 percent of their gross revenue from non-operating revenue in 2002. In 2005, the nonprofit nursing homes received a slightly higher percentage of gross revenue for non-operating revenue at 14 percent. This result is not surprising given the fact that nonprofits have a restriction on what they can do with their profits and that non-operating revenue includes gifts and endowments which is a more common source of revenue for nonprofits.

Due to the differences in the sources of revenue for nonprofit versus for-profit and other nursing homes, there are sizeable differences in the average charge to private pay patients, see indicator (3). In 2002, the average charge to private pay patients per day was $199 in nonprofit nursing homes versus $158 in other for-profit nursing facilities. This is a difference of 27 percent between for-profit and nonprofit private pay charges per day. In 2005, the nonprofit nursing homes' private pay charge per day was $242 and for-profit nursing homes' private pay charge was $182, and the difference between the two types of nursing homes' private pay charges is growing and is more than 30 percent.

Indicator (4) which is expenses to revenue percentage demonstrates the differences between the nonprofit and for-profit structure and the amount of profit or net income that the nursing homes receive. When the percentage is above 100 percent then the nursing homes have net income losses because expenses are above revenue. A percentage below 100 percent means the nursing homes have positive profits. Nonprofit nursing homes in 2002 has on average total expenses to revenue of 101.7 percent and in 2005, the percentage fell very slightly to 99.5 percent. Since nonprofits cannot distribute their income as profits to anyone, they may not have the same motivation for-profits to minimize expenses. Since the Medicaid reimbursement rate is based on costs, if nursing homes can spend more on their facilities or labor and increase costs, they can receive higher Medicaid reimbursement payments. Nonprofit nursing homes may operate under the assumption that if they spend their profits on nursing care services then this will likely lead to better care, resulting in new patients and higher Medicaid payments that will increase revenues. On the other hand, for-profit nursing homes have a bigger incentive to minimize costs because the profits can be distributed to share holders. In 2002, the average total expense to revenue for for-profit nursing homes was 100 percent and it improved slightly to 97.9 percent.

Other considerations between nonprofit and for-profit nursing homes are differences in wages and the amount of nursing care in each home, indicator (5) reveals that nonprofit nursing homes in 2002 paid their administrators on average $52 per hour which was approximately $7 more per hour than for-profit and other nursing homes. That wage difference has declined slightly to a difference of $5 per hour in 2005 between the different nursing home ownership types. The total average salaries and fringe benefits for all in-house employees, indicator (6), was nearly the same between nonprofit and for-profit nursing homes in 2002 at a little more than $22 per hour. Now, the difference between the average salaries and fringe benefits for all in-house employees has slightly grown so nonprofit nursing homes on average pay $25.9 per hour and for-profit nursing homes pay $24.7 per hour in 2005. The nonprofit nursing homes pay $1.20 more per hour on average for all their in-house employees. Some specific types of nursing care employees also receive higher wages in nonprofit nursing homes than in for-profit homes, like RNs and nursing assistants' who received more than $1 more per hour in nonprofit nursing homes in 2005.

The number of hours of nursing care, indicator (7), also varies between different ownership types of nursing homes. The number of hours of registered nurse (RN) care per patient day was higher, .6 per patient day, in nonprofit nursing homes than in for-profit homes, .2 per patient day. This difference in the number of hours of skilled RN care has been fairly consistent over the past four years. The total number of hours of all types of nursing providers (RN, LPN and nursing assistants) per patient day is higher in nonprofit nursing homes by .5 hours per patient day than in for-profit nursing homes in 2005.

Past nursing facility studies (e.g., Luksetich et al., 2000; Vitaliano, 2003) often assume that if costs are higher, number of nursing care hours and salaries, then the qualify of care goes up. Unfortunately cost is a poor proxy for qualify of care; and when independent measures of quality of care exist, they are only weakly correlated with measures of nursing inputs.[24] One would expect that the higher the number of hours of nursing care, the better the care will be for the patient. That expectation assumes that the nursing staff will be the same in one home versus another when there could be very distinct quality difference in staff, like years of experience and retention rate of staff, which would make the quality of care different between homes. Those additional characteristics of the nursing care employees are lacking from the comparison of the number of nursing care hours alone.

Based on this assessment of different financial indicators based on ownership type, it is not clear if the federal requirements for nonprofit charitable nursing homes currently receiving this property tax exemption are meeting the expectations that the Legislature had intended for nursing homes when they narrowed this tax preference to nonprofit organizations.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

Forty-two nonprofit nursing homes received a property tax exemption on a total of 87 parcels statewide in property tax year 2006-07. There were partial property tax exemptions provided on 93 parcels. As was illustrated in Figure 1, the majority of the nonprofit nursing homes are in heavily populated urban counties like King, Snohomish, Spokane, Pierce and Thurston. There are eight nonprofit nursing homes in rural counties like Whatcom, Walla Walla, Kitsap and Yakima.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

No nursing homes other than nonprofit nursing homes are receiving this tax preference. The question of whether all nonprofit nursing homes are meeting the expectations of nursing homes that the Legislature had envisioned when limiting this tax exemption to nonprofit nursing homes is a more difficult question to answer. The current property tax exemption for nursing homes run by nonprofit organizations provides these homes with the same tax benefit as government owned nursing homes. There is now unequal tax treatment among long term care facilities and nursing homes due to the divergence between the nursing home having a complete property tax exemption and homes for aged property being subject to a threshold test depending on the number of low income residents living within the facility.

[24] Comparative Performance and Quality Among Nonprofit Nursing Facilities in Texas, Kris Joseph Knox and Eric Blankmeyer and J.R. Stutzman, Nonprofit and Voluntary Sector Quarterly, vol. 35 no. 4, December 2006.

Revenue and Economic Impacts

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

Prior to 1990, this nursing home tax preference also included a property tax exemption for the homes for the aged which included a variety of long-term care residential living facilities. Prior years' reports of the Department of Revenue Tax Exemption Report revealed that 75 nursing homes were benefiting from this tax particular preference in 1990. The value of the tax preference grew in the mid-1990s due to growth in property values statewide. The number of nursing facilities was constant between 1990 and 1994 but six years later the number of nonprofit nursing homes had declined to less than 50 homes in the state. Since 2000, the number of nonprofit nursing homes has not changed significantly. In 2000, the number of nonprofit nursing homes was 45 homes and in the 2004 Tax Exemption Report, there were 41 nonprofit homes reported. In 2007, the number of nonprofit nursing homes claiming a property tax exemption is 42.

Table 7 provides the forecast for the local and state property tax savings for nonprofit nursing homes and this estimate is based on the merging of the sampled counties assessed value with the DOR nonprofit exemption database for 2007. The property tax saving for property tax year 2006-07 is estimated to be $2.8 million which is based on $252 million in exempt nursing home property. The forecast of the property tax exemption is estimated to be $2.9 million in property tax year 2007-08 and grow to $3 million by 2009-10.

Table 7: Forecast of Local and State Property Tax Savings for Nonprofit Nursing Homes

Year	Exempt Value ($ millions)	State Property Tax Savings	Local Property Tax Savings	Total Property Tax Savings
2006-07	$252	$510,000	$2,320,000	$2,830,000
2007-08	$262	$530,000	$2,370,000	$2,900,000
2008-09	$272	$550,000	$2,440,000	$2,990,000
2009-10	$283	$570,000	$2,520,000	$3,090,000

If this tax preference is continued and the exempt property value was not added to the tax roll, then nonprofit nursing homes would continue to not pay property taxes and other local taxpayers would pay slightly higher property taxes annually. It is estimated that in the counties with nonprofit nursing homes, on average the local property tax rate is higher by .08 percent with the largest difference in Thurston County's overall property tax rate of .48 percent. There would be a shift in the tax burden in specific locations where the nonprofit nursing homes are found statewide but the increase in the overall tax rate would be minimal to most taxpayers. The net revenue impact to local governments would depend on whether the taxing districts, where the nonprofit nursing homes are located, are at their maximum property tax rate limit or not. Governments will not see a change in their overall property tax revenue due to the continuation of this tax preference because of the shifting of tax liability among taxpayers if taxing districts are not at their maximum tax rate limit.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

To assess the economic impacts, this study first looked at that states' nursing home and residential care industry. According to 2004 data from IMPLAN on Washington's nursing home and residential care industry, the industry output was $2.66 billion in services. This industry represents .6 percent of total statewide industry output of goods and services of $460 billion in 2004. According to the Washington Employment Security Department data on the nursing home and residential care, in the third quarter of 2006, which is the most recent data available, there are 54,499 employees in this sector with 1,601 firms. This industry represents 1.9 percent of all employees statewide for the third quarter of 2006. Within the nursing home and residential care industry, the nursing facilities alone represent 46 percent of the entire nursing and residential care facilities industry sector employment. Table 8 reveals the number of firms, employees and total wages in the nursing home sector from 2002 through 2006 of which the data for 2006 only includes 3 quarters of data. Of the total nursing facilities statewide, this tax preference only benefits nonprofit nursing facilities. From the DSHS annual cost report data for nursing homes, there is information on the number of full-time and part-time employees. From that cost report data for 2005, the nonprofit organizations' portion of total full-time employees is 22 percent of total employees in all nursing homes statewide. It is estimated that nonprofit employees in 2005 totaled 4,680 full-time and part-time 2,373 employees for a total of 7,053 employees.

Table 8: Number of Firms, Employees and Wages in the Nursing Home Facilities Industry Sector

Year	Number of Firms	Total Employees	Total Wages ($ millions)
2002	192	24,906	$588.64
2003	191	24,789	$600.68
2004	189	24,175	$608.82
2005	183	24,074	$622.69
2006*	190	24,998	$506.96

Source: Washington Employment Security Department Covered Employment Data.
*2006 reflects 3 quarters of data.

Other States

Do other states have a similar tax preference?

According to the JLARC CCH state survey on other states' property tax exemptions for nursing homes, the results show that 23 states, including Washington, have a specific property tax exemption for property used by homes for the sick or infirm. All other states have property tax exemption provisions for charitable institutions of which a nursing home may qualify given the specific statutes in each state. Twelve states have restrictions on the charitable institutions in a variety of ways. For example, Colorado has adopted a gross revenue threshold test for nonprofit health care facilities to meet. Idaho has its own nonprofit status that must be met to qualify on the basis of charitable use. New Hampshire, Texas, Pennsylvania and Utah all require nonprofit nursing facilities to meet the charitable purpose tests, before it can be classified as exempt property. North Carolina requires a charitable purpose to have "human and philanthropic objectives." Oregon requires the facility to be an "essential community provider."

NONPROFIT ORPHANAGES – SUMMARY

Current Law

Under current law, all real and personal property of nonprofit orphanages are exempt from property taxes. According to Webster's' definition of orphanage it is an institution that is a home for orphans.[25] The main requirement for this tax exemption is that the property be used exclusively for the purposes of orphanages and the benefits should be passed onto the users. In Appendix 3 is the current law statute, RCW 84.36.040(1)(c), which provides for the property tax exemption.

Findings and Recommendations

This review of Washington's nonprofit orphanages' property tax exemption has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- This property tax exemption for nonprofit orphanages began in 1891 exempting "orphanages and orphan asylums" from the tax base.
- The public policy objective of the property tax exemption for orphanages is based on the service activities performed for children.
- This tax preference has achieved its public policy objective of providing property tax relief to orphanages.
- In the future, this tax preference may not achieve its public policy objectives if other residential care facilities replace orphanages for providing some of the basic functions that orphanages have traditionally performed, unless those other facilities qualify for other types of property tax exemptions.

Beneficiaries

- In property tax year 2006-07, the entities benefiting from this property tax exemption are two orphanages, one in King and the other in Spokane counties.
- There does not appear to be any unintended tax benefits to any entities.

[25] Webster's Dictionary, Second Edition 1982.

Economic and Revenue Impacts

- In property tax year 2006-07, the two orphanages had an annual property tax savings of approximately $138,000.
- The future property tax savings for nonprofit orphanages over the next three years is between $149,000 and $151,000 per year.

Other States

- There are ten other states besides Washington which have a specific property tax exemption for orphanages or homes for the children found in this across state review. All other states have property tax exemptions for nonprofit organizations when the property is used for charitable use which could apply to orphanages.

Due to the fact that this tax preference was originally enacted to exclude all orphanages from the property tax base and the beneficiaries of the tax preference are orphanages, this tax preference has achieved its public policy objectives. In the future, this tax preference may not be necessary if orphanages cease to exist or if these nonprofit organizations' primary functions are not exclusively "orphanage" related. This tax preference for orphanages could introduce some inequity in the taxation of nonprofit organizations that are performing similar services to children because not all of these nonprofits qualify as "orphanages." Other group homes for youth may qualify under the nonsectarian nonprofit property tax exemption but that exemption has a gift giving test that is not required in this property tax exemption for nonprofit orphanages.

Recommendation

If the Legislature is concerned with providing uniform and equitable tax treatment to all nonprofit organizations providing similar housing and care for children, the Legislature should terminate the orphanage property tax exemption and allow the orphanages to qualify for the nonsectarian property tax exemption.

Legislation Required:	Yes
Fiscal Impact:	Likely to be no impact to local and state government, since the beneficiaries may qualify for another property tax exemption already in current law.

NONPROFIT ORPHANAGES – REPORT DETAIL

Statutory History

The property tax exemption for orphanages originated in 1891 section stating that "orphanages and orphan asylums" were not to be part of the tax base. From that point forward, this exemption continued to be separated from other property tax exemptions. This tax preference is a definition of the property tax base.

There have been some changes from the establishment of the orphanages' specific property tax exemption since 1891. In 1893, the Legislature placed a size requirement on the parcels allowed a property tax exemption. In addition, the exempt property had to be used exclusively for the purposes of the organization.

In 1895, the law placed a requirement on orphanages that they must be supported in whole by public appropriation or by private charity or are supported in part by charity and all of the income and profits are devoted to charitable purposes. In addition, in order to qualify for the property tax exemption, the state Board of Health, county and city officials had to have access to the financial records of the institutions and the manager of the orphanage had to take an oath before the county assessor that all income had been applied to actual expenses of maintaining it and to charitable purposes. The orphanage had to annually file a report to the state Board of Health describing the source of its receipts and the expenses that were paid. The 1895 law required that the orphanages allow the mayor of the city and the chairman of the board of the county commissioners, where the institution was located, to be on its board of trustees.

In 1925, the law clarified that if orphanages rent or leased property for use in their institutions, all the property used qualified for the property tax exemption. In 1933, the Legislature removed the requirement that the mayor and chairman of the county commissioners needed to serve on its board. The new law allowed just the state Board of Health, not the city and county officers, access to the orphanages' financial records.

In 1969, the reporting and auditing requirement for orphanages was changed from the state Department of Health to the Department of Revenue. In addition, the requirement that the manager of the orphanage make oath before the assessor was replaced with a requirement that the manager sign a statement that the income and receipts have been applied to the actual expenses of maintaining the institution. The new law in 1969 deleted the requirement of showing the sources of the orphanage's receipts to the state Department of Health. Four years later, in 1973, the law stated that all real and personal property is exempt for nonprofit organizations running free orphanages, provided the property is used exclusively for the purposes of the organizations and the benefit of the exemption is passed onto the user. In 1984, the law was clarified that all property must be used exclusively for the purposes for which the exemption is granted. Some of the first homes for orphans were part of the first hospitals. By 1901, according to Washington's Index of Eleemosynary, there were at least two children's home formed: Baptist Missionaries Children's Home and Parkland Lutheran Children's Home.

Public Policy Objectives

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?

The public policy objective of this property tax exemption is to exclude orphanages' property from the tax base. To the extent that there were orphanages or orphan asylums during the Territorial years, this exemption predates statehood as the Territorial years' language would have included them as benevolent or charitable institutions. The specific exemption for "orphanages and orphan asylums" appeared immediately following statehood, in 1891. A public policy objective of the property tax exemption for orphanages is that these organizations are being excluded from the taxable base as quasi-public properties. A Washington Supreme Court case in 1897 justified exemptions from the property tax base as properties that provide a benefit to the public and they are relieving the state of expense.[26] The property tax exemption for orphanages is based on the service activities performed for children. The public policy objective of this tax preference for orphanages is to provide tax relief to organizations performing charitable quasi-public services like providing care and housing to children while they wait to be adopted.

Historically, orphanages had annual reporting requirements in which they had to provide information on their revenue sources and expenses. The property tax exemption for orphanages was restricted to nonprofit orphanages in 1973. It appears that the Legislature assumed that in restricting the property tax exemption to nonprofits, it would be meeting the requirements that orphanages were charitable organizations. A public policy objective of this tax preference is that orphanages be nonprofit and meet the federal requirements for nonprofit organizations. Another objective of this property tax exemption for orphanages requires the exempt property to be used exclusively for orphanage purposes.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

According to the Department of Revenue's property tax exemption database, the entities claiming this property tax exemption are orphanages. This tax preference has achieved that objective of excluding property of orphanages from the tax base in the past and present. It is unclear how the orphanages are passing on the benefits of their tax preferences onto the residents or local communities beyond providing care and housing for children.

Over time, the number of orphanages has declined in the United States and in Washington. New types of residential living settings have replaced orphanages to take care of children. Under

[26] Chamberlin v. Daniel, 17 Wash. 111, 113 (1897).

existing law, group homes or homes providing foster care that provide housing and care for needy children may or may not be allowed the same property tax exemption as orphanages. Some nonprofit group homes may qualify under the nonsectarian organizations' property tax exemption, provided they meet the gift giving test outlined in the administrative rule. (For further discussion on the property tax exemption for nonsectarian organizations, see the full tax preference review report.) The Legislature has not amended this statute to extend the property tax exemption to other institutions that have developed in recent years which provide similar housing and care to needy children. In the future, it is unclear if this tax preference will continue to achieve its public policy objectives and be relevant if there are not many orphanages in the state and the children in need are placed in other types of residential care. Some of these alternative residential care facilities may already qualify for other property tax exemptions like nonsectarian organizations or low income housing.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

There are two orphanages in Washington claiming the property tax exemption in property tax year 2006-07: Seattle Childrens Home in King County and Hutton Settlement in Spokane County. The number of orphanages receiving a property tax exemption has been declining over the past 20 years. According to the 1984 DOR Tax Exemption Report, there were 18 orphanages in Washington in 1984. There has been an 89 percent decline in orphanages over the past 20 years.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

After examining the Department of Revenue's property tax exemption database, the entities claiming this property tax exemption are nonprofit orphanages. This tax exemption has achieved its objective of giving orphanages, which provide housing to orphan children, a property tax exemption.

Revenue and Economic Impacts

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

Over the past 17 years, the property tax savings for orphanages has grown from $58,000 in 1988 to its peak in 1994 and 1995 of approximately $320,000 annually, according to the Department of Revenue estimates from various editions of the Tax Expenditure Reports. Since 1995, the value of the property tax savings has declined due to a reduction in the number of orphanages. In 2005, the local and state property tax savings was $81,000 assuming one orphanage.

In property tax year 2006-07, the two existing nonprofit orphanages had an annual property tax savings of approximately $138,000. This estimate was based on collecting the two counties' value for the nonprofit orphanages. This 2006-07 property tax savings estimate is higher than the DOR estimates for the tax preference in the 2004 Tax Exemption Report because in 2004, it was assumed by DOR that there was only one orphanage in the state instead of two. According to the Department of Revenue, in 2004, one of the orphanages was performing other functions that were inconsistent with running an orphanage so the nonprofit organization was classified under the nonsectarian property tax exemption. The projections for this property tax exemption are $149,000 in property tax year 2007-08 and rising slightly to $151,000 by 2009-10.

Table 9: Forecast of Local and State Property Tax Savings for Orphanages

Year	Exempt Value ($ millions)	State Property Tax Savings	Local Property Tax Savings	Total Property Tax Savings
2006-07	$13.2	$28,000	$110,000	$138,000
2007-08	$13.7	$29,000	$120,000	$149,000
2008-09	$14.2	$30,000	$120,000	$150,000
2009-10	$14.8	$31,000	$120,000	$151,000

If this tax preference is continued and the exempt property value is not added to the tax roll, then nonprofit orphanages will not pay property taxes and other local taxpayers in certain areas of King and Spokane Counties will pay slightly higher property taxes annually. There will be a shift in the tax burden in specific locations where the orphanages are found statewide. Governments will not see a change in their overall property tax revenue collected because of the shifting of tax liability among taxpayers unless the taxing districts are at their maximum tax rate limit. If this is the case, then there could a small reduction in local government revenue if the taxing districts can not increase tax rates and shift tax liability and compensate for the tax loss due to the orphanages' value being exempt.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

Since this tax preference is claimed by only two orphanages statewide, the Employment Security Department data on the number of employees and total wages cannot be disclosed for confidentiality reasons. Given the small size of the tax preference and the number of beneficiaries, the impact of the beneficiaries on the regional and state economy is nearly zero given the large scale of the Washington State economy.

Other States

Do other states have a similar tax preference?

There are ten other states besides Washington which have a specific property tax exemption for orphanages or homes for children including Connecticut, Illinois, Nevada, Oklahoma, Virginia, West Virginia, South Carolina, South Dakota, Wisconsin and Wyoming. All other states have property tax exemptions for nonprofit organizations when the property is devoted to charitable use; and orphanages may qualify for this property tax exemption. States vary in the standards that are required in order to qualify for the charitable use property tax exemption. In this JLARC research, it was found that six states, (TX, AZ, IN, KY, MI and NM), had legal opinions or court cases stating that orphanages did qualify as a charitable organization. New York had special provisions allowing a property tax exemption for fraternal organizations that build and furnish and maintain one or more homes for free education of its members, spouses and orphans.

HUMANE SOCIETIES – SUMMARY

Current Law

Under current law, all real and personal property of humane societies are exempt from property taxes. The main requirement for this tax exemption is that the property must be in actual use by humane societies and the organizations must meet the definition of humane society in the administrative rule. In Appendix 3 is the current law statute, RCW 84.36.060(1)(d), which provides for the property tax exemption.

Findings and Recommendations

This review of Washington's humane societies' property tax exemption has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- This property tax exemption for humane societies began in 1915 exempting property "owned by humane societies in this state in actual use by such societies."
- A public policy objective of the property tax exemption for humane societies is based on the animal shelter and protection services which the government otherwise would have had to perform. There are requirements that the organization must be a nonprofit and perform functions that humane societies typically perform to qualify. In addition, there are restrictions on the type of property that is allowed to be exempt under this tax exemption.
- This tax preference has achieved its public policy objective of providing property tax relief to targeted nonprofit organizations performing humane society functions.

Beneficiaries

- In property tax year 2006-07, 22 organizations benefited from this property tax exemption, and they were located in 17 counties statewide.
- Assuming that the Legislature intended all organizations which perform services similar to humane societies would receive the property tax exemption, then there does not appear to be any unintended tax benefits.

Economic and Revenue Impacts

- In property tax year 2006-07, the humane societies had an annual property tax savings of approximately $170,000.
- The future property tax savings for humane societies over the next three years is between $173,000 and $183,000 per year.

Other States

- Several other states have specifically provided property tax exemptions for humane societies.

Due to the fact that this tax preference was originally enacted to exclude humane societies from the property tax base and the beneficiaries of the tax preference are organizations performing typical humane society functions, this tax preference has achieved its public policy objectives in the past. Since the enactment of this tax preference for humane societies, the functions of these organizations has changed as well as the methods by which these organizations generate money has evolved. This property tax exemption remains limited to nonprofits and to the property that is used directly for the functions of humane societies as outlined in the administrative rule.

Recommendation

The Legislature should continue the property tax exemption for humane societies.

Legislation Required: None

Fiscal Impact: None

HUMANE SOCIETIES – REPORT DETAIL

Statutory History

This property tax exemption was enacted in 1915. The value of the humane societies' property was originally limited to $10,000 in taxable value.

In 1919, the Legislature permitted cities to authorize humane societies to spend tax revenues from the dog licensing tax on humane society purposes.[27] In 1973, the taxable value limit on the humane societies' property was eliminated so a complete exemption for these organizations existed. This same exemption language has been in place ever since.

Humane Societies Nationwide

Henry Bergh started the first American Society for the Prevention of Cruelty to Animals (SPCA) in 1866. [28] George Angell founded the Massachusetts Society for the Prevention of Cruelty to Animals (MSPCA) in 1868 and the "Bands of Mercy" in American schools beginning in 1882. In 1889, Angell founded the American Humane Education Society, "to carry Humane Education in all possible ways, into American schools and homes.[29] By the early twentieth century, many of the SPCAs and humane societies that emerged in the last half of the 1800s had shifted their focus from advocacy for improving the conditions of work horses and more humane treatment of animals, generally, to handling dog control.[30] The Seattle/King County nonprofit humane society began as an animal shelter in 1897.

Administrative Rule and Board of Tax Appeals Case

The term "humane societies" may be applied generally to both animal welfare organizations and animal rights organizations but they must be nonprofit organizations according to the rule. Administrative rule WAC 458-16-286 "humane society" means the following:

> a nonprofit organization, association or corporation, the primary purpose of which is to prevent cruelty to animals, place unwanted animals in homes, provide other services relating to "lost and found" pets and provide animal care education to the public, as well as sponsoring a neutering program to control the animal population.

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[27] 1919 Wash. L. p. 27 §1, *quoted in* McQueen v. Kittitas County, 115 Wash. 672, 673 (1921)("Provided, That in cities of the first, second and third class the license tax collected on dogs shall be credited to the funds as provided by ordinance of such city, and no other tax shall be levied or collected on dogs in such cities: *Provided*, that said cities may authorize their humane societies to expend such license tax in defraying the expenses of any carrying out the purposes of such societies. All fees and fines collected as aforesaid over and above the amount of expenses required to be met by such society shall be turned over by it to the city from whence such fines or fees were obtained.").

[28] History of Animal Shelters and Protection Societies, http://www.petcaretips.net/history-aspca.html.

[29] History of the ASPCA, http://www.aspca.org/site/PageServer?pagename=edu_history.

[30] History of Animal Shelters and Protection Societies, *supra,* note 1; The No Kill Advocacy Center, http://www.nokillsolutions.com/philosophy.htm.

In a Washington Board of Tax Appeals case, the Board found that property of a nonprofit humane society that is used for operating a thrift shop was not exempt from property taxes even though the proceeds from the shop were used to support the taxpayer.[31] The Board decided that the property did not meet the statutory requirement of being "in actual use" by a humane society.

Public Policy Objectives

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?

The public purpose for this tax exemption for humane societies may have been due to the quasi-governmental nature of these organizations as they were performing animal shelter and protection services which the government otherwise would have had to perform. Another public policy objective for this tax preference is that the property tax exemption is limited to just property actively used by these organizations and that the exempt organization must be conducting several animal protection and control functions. Because of these limitations on the type of property being exempt and the organizations qualifying for the exemption, the government is subsidizing these organizations for a function the government otherwise would have to perform. In addition, the 1919 statute permitted cities to authorize humane societies to spend tax revenues from the dog licensing tax on humane society purposes. The authorization for a non-government agency to defray its costs with tax revenues supports the subsidy theory for this tax exemption.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

After examining the Department of Revenue's property tax exemption database, the entities claiming this property tax exemption are humane societies, but there are other animal protection organizations receiving this property tax exemption as well. This tax preference has achieved its objective of providing an exemption to those quasi-governmental nonprofit organizations for their animal protection, shelter, control and education services. Since this exemption is targeted to only certain animal protection and shelter organizations, it achieves its purpose of limiting this benefit to organizations that are providing a number of animal welfare services that benefit local communities.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

According to the Department of Revenue's nonprofit exemption database, in property tax year 2006-07, there were 22 organizations and 35 parcels statewide that received this property tax

[31] Moses Lake-Grant Humane Society & SPCA v. State of Washington Department of Revenue, Docket No. 42999, April 20, 1993.

exemption. Nine organizations or 41 percent were actual humane societies throughout the state. The remaining 13 organizations were primarily animal protection and welfare and one pet adoption organization. Some examples of nonprofit organizations benefiting from this humane society property tax exemption are the following:

Peninsula Friends of Animals
Orcas Animal Protection Society
Wolf Haven
Dog Patch Group Inc
Various Humane Societies throughout the state

There were two organizations that received a partial property tax exemption. These 22 nonprofit organizations claiming the humane society property tax exemption are located in 17 counties statewide.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

After examining the Department of Revenue's property tax exemption database, the entities claiming this property tax exemption are humane society organizations that are required to meet the administrative rule definition of humane societies. There are other organizations which are qualifying for the humane society property tax exemption that are not called humane societies but have the same functions. Assuming the Legislature intended the activities of humane societies to be extended to other organizations which provide animal protection and welfare services, then there are no unintended beneficiaries. If the Legislature only intended actual humane societies to have a property tax exemption, then there are some unintended beneficiaries.

Revenue and Economic Impacts

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

Over the past 17 years, the property tax savings for humane societies has been fluctuating, based on various editions of the Department of Revenue's Tax Exemption studies from 1988 to 2004. A lot of the fluctuation in the property tax saving estimates could be due to changes in the sampled counties used to make projections by DOR over the years. In 1988, the property tax savings for humane societies was $94,000 and it grew to its peak in 1996 and 1997 at $322,000 each year. After 1997, the property tax savings declined for the next three years until 2000 when the taxpayer savings hit a low point of $69,000. Since 2000, the property tax saving estimate has risen. By 2005, the local and state property tax savings were $142,000.

In property tax year 2006-07, it is estimated that the humane societies had an annual property tax savings of approximately $170,000. This estimate was based on merging the Department of Revenue's 2007 nonprofit exempt property database with the counties' property tax roll data and estimating the remaining humane societies' real market value. This 2006-07 property tax savings estimate is higher than the DOR estimates for this tax preference in the 2004 Tax Exemption Report because in 2004 there were 20 humane societies instead of 22 organizations that are included in the more recent data. The projections for this property tax exemption are $173,000 in property tax year 2007-08 and rising slightly to $183,000 by 2009-10.

Table 10: Forecast of Local and State Property Tax Savings for Humane Societies

Year	Exempt Value ($ millions)	State Property Tax Savings	Local Property Tax Savings	Total Property Tax Savings
2006-07	$15.7	$34,000	$136,000	$170,000
2007-08	$16.3	$35,000	$138,000	$173,000
2008-09	$17.0	$35,000	$142,000	$177,000
2009-10	$17.7	$36,000	$147,000	$183,000

If this tax preference was continued and the exempt property value was not added to the tax roll, then humane societies would continue to not pay property taxes and other local taxpayers would pay slightly higher property taxes annually. There would be a shift in the tax burden in specific locations where the exempt properties are found statewide. Governments would not see a change in their overall property tax revenue collected due to this tax preference because of the shifting of tax liability among taxpayers unless the taxing districts were at their maximum tax rate limit. If taxing districts were at the maximum tax rate, then local governments might not be able to shift all the tax liability onto other taxpayers, and they would experience a small loss in property tax revenue from having humane societies exempt from property taxes.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

In examining the 2005 employment data for these humane societies and the Department of Revenue's data on which organizations are claiming this property tax exemption, it was found that 16 animal protection organizations had employees. Of these humane societies with employees, statewide there were a total of approximately 400 employees which represents .01 percent of the total statewide employment. The total wages of all humane societies statewide was $9.7 million or .01 percent of total wages statewide in 2005. The humane societies' economic impact on the state and regional economy is nearly zero. These humane societies are providing other valuable animal protection, shelter and education benefits for the local communities that are not easily identifiable in statewide and regional economic statistics of the economy.

Other States

Do other states have a similar tax preference?

From a brief CCH state review of other states, it was found that nine states, including Washington, have property tax exemptions for humane societies specified in their law.[32] In

[32] The states with humane society property tax exemptions were the following: AZ, AR, NJ, OH, OR, VA, VT, WI and WA.

addition, California and Nebraska have court ruling allowing certain property owned by humane societies to qualify for a property tax exemption. Through this research, it was found that California also excluded the property of a thrift store owned by a humane society for the property tax exemption. This tax treatment of thrift stores is the same as in Washington. Other states may provide a property tax exemption for nonprofit organizations running a humane society if it qualifies under different states' purposes and definition of charitable organizations.

NONPROFIT COLLECTIONS AND MUSEUMS – SUMMARY

Current Law

Under current law, all real and personal property of nonprofit collections and museums are exempt from property taxes. One main requirement for this tax exemption is that the property be used exclusively for the safekeeping, maintaining and exhibiting of the collections. Another criteria for nonprofit organizations claiming this property tax exemption is that they receive a substantial part of their support from the federal, state or local governments or from direct or indirect public contributions. There are other requirements specified in law that the nonprofit organization must meet in order to maintain the property's tax exempt status. In Appendix 3 is the current law statute, RCW 84.36.060(1)(a), which provides for the property tax exemption.

Findings and Recommendations

This review of Washington's museums, collections and historical societies' property tax exemption has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- This property tax exemption was enacted in 1915 and applied to "all art, scientific, or historical collections" of nonprofit associations that were maintained and exhibited "for the benefit of the general public."
- It was originally restricted to nonprofit organizations and the core purpose of the collections and museums had to be for the benefit of the general public. This restriction has remained intact since 1915.
- The public policy objective for this property tax exemption was created as a subsidy for nonprofit organizations that provide a social good to the public.
- This tax preference has achieved its objective of providing property tax relief to nonprofit museums, historical societies and collections in the past and present.
- This tax preference has required these organizations to receive a substantial portion of their revenue from government funding or public contributions and donations.
- In addition, this property tax exemption has the public policy objective of placing limits on the use of the exempt property for non-exempt purposes.

Beneficiaries

- In property tax year 2006-07, the entities benefiting from this property tax exemption are 145 nonprofit museums, historical societies and collections.
- There does not appear to be any unintended tax benefits.

Economic and Revenue Impacts

- In property tax year 2006-07, the nonprofit museums, historical societies and collections had an annual property tax savings of approximately $3.1 million.
- The future property tax savings for nonprofit museums, historical societies and collections over the next three years is between $3.1 and $3.4 million per year.

Other States

- The majority of states have either specific property tax exemptions for nonprofit museums or other nonprofit and charitable property tax exemptions that could apply to nonprofit museums.

Due to the fact that this tax preference was originally enacted to subsidize nonprofit museums, historical societies and collections for the social benefit they provide to local communities and the beneficiaries of the tax preference are those entities, this tax preference achieves its objectives. In addition, this tax preference provides some equity in taxation to nonprofit organizations that are running public museums like government entities which also receive a property tax exemption. This property tax exemption is a little more difficult to administer than a complete property tax exemption since there are the public policy objectives of limiting the use of the exempt property for non-exempt purposes and requiring the nonprofits to receive a substantial portion of their income from donations and contributions from the general public.

Recommendation

The Legislature should continue the property tax exemption for collections, museums and historical societies.

Legislation Required: None

Fiscal Impact: None

NONPROFIT COLLECTIONS AND MUSEUMS – REPORT DETAIL

Statutory History

The exemption for nonprofit collections and museums was enacted in 1915, but the organizations eligible for exemption may have been exempt under territorial law that exempted the property of "benevolent, charitable, literary, or scientific" institutions dating back to 1854. The 1915 exemption applied specifically to "all art, scientific, or historical collections" of nonprofit associations that were maintained and exhibited "for the benefit of the general public."

The language of this property tax exemption remained largely unchanged until 1973 when additional restrictions were added. The property tax exemption was extended to personal as well as real property of museums provided the property is used exclusively for safekeeping, maintaining and exhibiting such collections. The law specified that the organization must be operated exclusively for artistic, scientific, historical, literary or educational purposes and receive a substantial part of its support from government or public contributions.

In 1981, the property tax exemption was expanded to include organizations operated exclusively for musical, dance or dramatic purposes. In 1995, the law clarified the limits under which these organizations could use the exempt property for a non-exempt purpose. If the property is not being used for an exempt purpose, then the organization must submit a program to construct, remodel or enable the property to be used for an exempt purpose. In 2003, the law specified that, in order to retain the property tax exemption, the property has to be used by other organizations less than 25 days a year; not used for pecuniary gain or to promote business activities for more than seven of the 25 days a year; the property is used for artistic, scientific, or historic purposes for the production of musical dance, artistic, dramatic or literary works; and the amount of the rent or donations is reasonable and does not exceed maintenance and operation expenses.

Even with the amendments to this statute over the years since its enactment, the core purpose of the collections and museums must be for the benefit of the general public. As such, this exemption appears to have been created as a subsidy for organizations that provide a good to the public.

Public Policy Objectives

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?

According to the legal history on the property tax preference for collections and museums of nonprofit organizations, the original purpose was to benefit these organizations for the general public good the museums and collections provided to the local community. This purpose was consistent with the subsidy theory of exemptions that the state grants exemptions because the exempted organization lessens the burden on government or provides a public benefit. This exemption falls within the subsidy theory because of the original requirement in law that museums and collections must be for the benefit of the general public good. This tax preference was separated from the general charitable property tax exemption.

This property tax exemption was originally restricted to nonprofit organizations when it was enacted in 1915. This tax preference has had the public policy objective of limiting the property tax exemption to those entities which receive a substantial portion of their revenue from government funding or public contributions and donations. According to WAC 458-16-280, the nonprofit must receive a substantial part of its income from a government entity, or through direct or indirect contributions of money, real or personal property or services from the general public. This excludes admission fees as contributions from the general public. This property tax exemption has an additional objective of limiting the use of the exempt property for non-exempt purposes.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

According to the Department of Revenue's property tax exemption database, the entities claiming this property tax exemption are nonprofit museums, historical societies and collections. This tax preference has achieved its objective of providing property tax relief to nonprofit museums, historical societies and collections in the past and present. The administrative rule is consistent with the statute by limiting this property tax exemption to nonprofits which are receiving a substantial portion of their income from government entities or contributions and donations from the general public. This property tax exemption is targeting nonprofits that are receiving a substantial portion of their income from the general public or government entities. According to the National Center on Charitable Statistics database for Washington State nonprofits, in 2005 the arts, cultural and humanities nonprofit organizations in Washington received $262 million in contributions, gifts and grants so museums in Washington are receiving a portion of their revenue from public support.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

All entities benefiting from this property tax exemption are nonprofit museums and collections. Since the Department of Revenue has compiled Tax Exemption Reports, the number of beneficiaries of the property tax exemption for museums and collections has ranged from 69 in 1984 to 123 in 2004. From the most recent 2007 Department of Revenue (DOR) data on the museums and collections, there were 145 nonprofit museums and collections and 242 parcels qualifying for the property tax exemption. This represents an 18 percent increase in the number of museums and collections over the past four years. The museums, collections and historical societies are located all over the state with at least one museum or historical society in every county but three, Benton, Douglas and Mason. On the following page is a table of the top five counties with the largest number of museums and collections. King County has 19 museums and collections representing 13 percent of all museums statewide, and the top five counties together comprise 41 percent of all museums and historical societies statewide.

Of the 242 parcels receiving a property tax exemption in 2007, 95 percent of the parcels are completely exempt with 11 parcels having a partial property tax exemption.

Some examples of nonprofit collections, historical societies and museums receiving a property tax exemption from the most recent DOR data are the following:

Experience Music Project
Historical Societies
Tacoma Art Museum
Yakima Valley Rail and Steam Museum
Washington Public Affairs Network – TVW

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

There does not appear to be any unintended tax benefits to any entities other than nonprofit collections, museums and historical societies.

Revenue and Economic Impacts

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

According to the Department of Revenue's Tax Exemption Studies from 1988 to 2004, the property tax savings for collections, historical societies and museums has ranged from a low of $1.1 million in 1990 to $8.4 million in 1999. New estimates for this tax preference in each edition of a Tax Exemption Study could cause significant changes in the property tax savings estimates if there was a change in the sample of counties surveyed by the Department to forecast the tax savings estimates. For example between the 1998 and 2000 Tax Exemption Reports, the taxpayer saving estimates declined by approximately $4.9 million due to changes in the sampled counties used to forecast taxpayer savings. Overall, this tax preference has been growing since 1990 both in the value of the property tax savings as well as the number of museums, historical societies and collections qualifying annually for this exemption. According to the 2004 Tax Exemption Report, the overall taxpayer savings estimate was $2.6 million for calendar year 2005.

The annual projected property tax savings for this tax preference for collections, historical societies and museums, based on 2007 Department of Revenue exemption data and property tax year 2006-07 county tax roll data, is a little more than $3 million in state and local property tax savings. This is illustrated in Table 11. This projection is slightly higher than the Department of Revenue estimate.

Table 11: Forecast of Local and State Property Tax Savings for Nonprofit Museums, Historical Societies and Collections

Year	Exempt Value ($ millions)	State Property Tax Savings	Local Property Tax Savings	Total Property Tax Savings
2006-07	$296.16	$650,000	$2,490,000	$3,140,000
2007-08	$308.01	$670,000	$2,540,000	$3,210,000
2008-09	$320.33	$690,000	$2,620,000	$3,310,000
2009-10	$333.14	$710,000	$2,710,000	$3,420,000

If this tax preference is continued and the exempt property value is not added to the tax roll, then nonprofit museums and historical societies would not pay property taxes, and other local taxpayers would pay slightly higher property taxes annually. There will be a shift in property taxes in specific locations where the exempt museums and historical societies are found statewide. Governments will not see a change in their overall property tax revenue due to the exempt property because of the shifting of tax liability among taxpayers unless the taxing districts are at their maximum tax rate limit. In that case, local governments could see a small reduction in local property tax revenue because they are not be able to completing shift the tax liability of the exempt property onto other taxpayers.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

The 2005 employment data for all museums and historical sites statewide indicate that 120 museums and historical sites had employees. Of these museums and historical sites with employees, statewide there were a total of 1,569 employees which represents .05 percent of the total statewide employment. The total wages of all museums and historical sites statewide was $37.7 million or .03 percent of total wages statewide in 2005. The large majority of the museums and historical sites are run either by local governments or nonprofit organizations. Both types of organizations would be receiving a property tax exemption. After matching the Employment Department's employment database and Department of Revenue's nonprofit property tax exempt data for museums and historic sites, it was found that a little over 11 percent of the employment and more than 43 percent of the total wages in this sector were estimated to come from private companies.

From the 2004 IMPLAN dataset for Washington, the museum, historic sites, zoos and parks industry produced $123.97 million or .03 percent of total statewide production. This industry spent $77.35 million on goods and services in the state economy in 2004. The museum, historical sites, zoos and park industry's largest purchase was for real estate at 22 percent of all its purchases and other major purchases included services from performing arts companies and business support services at 12 percent and 10 percent of all purchases respectively.

Other States

Do other states have a similar tax preference?

JLARC staff used the CCH Tax Research network and database of other states' laws and administrative rules to conduct the survey of other states' similar tax preferences. After conducting this state survey on the different provisions for a property tax exemption for public museums, JLARC found that 27 states or 57 percent were providing this type of property tax exemption. Most all of these states with specific exemptions for museums were requiring that the museums be open to the public and restricting that the exemption be for public governmental or nonprofit organizations. Minnesota has provisions to provide a property tax exemption for property connected with agricultural history, and Louisiana has a property tax exemption for buildings of historic and architectural importance. Some states specify the museums that are exempt like Alabama and Utah.

VETERANS ORGANIZATIONS – SUMMARY

Current Law

Under current law, all real and personal property of an organization or society of veterans of any U.S. war are exempt from taxation. The organization must be recognized by the Department of Defense. The purpose of the organizations must be to preserve memories and associations incident to their veterans' war service and to recognize the efforts of their members to patriotic and community service to the state and nation. In Appendix 3 is the current law statute, RCW 84.36.030(4), which provides for the property tax exemption.

Findings and Recommendations

This review of Washington's war veteran organizations property tax exemption has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- This property tax exemption was enacted in 1929 and applied to all real and personal property of an organization or society of veterans recognized by the Department of Defense.
- The primary public policy objective of this tax preference was to provide a subsidy to veterans' organizations to recognize the service of their members to local community, state and nation.
- This tax preference has achieved its objective of providing property tax relief to veteran organizations in the past and present.
- In addition, this property tax exemption has the public policy objective of placing limits on the use of the exempt property for financial gain.

Beneficiaries

- In property tax year 2006-07, the entities benefiting from this property tax exemption are 159 local chapters of veterans' organizations.
- There does not appear to be any unintended tax benefits to any entities other than veterans' organizations in Washington State.

Economic and Revenue Impacts

- In property tax year 2006-07, the veterans' organizations had an annual property tax savings of approximately $570,000.

- The future property tax savings for nonprofit museums, historical societies and collections over the next three years is $580,000 in 2007-08 and increases to $620,000 by 2009-10.

Other States

- Forty-two states, including Washington and the District of Columbia, have specific property tax exemptions for property of war veterans' organizations. The other nine states had provisions providing a property tax exemption for charitable organizations which would likely include nonprofit war veteran organizations.

Since this tax preference was originally enacted to subsidize war veterans' organizations for the war service provided by its members and the fact that the beneficiaries of the tax preference are those veterans' organizations, this tax preference achieves its objectives. This property tax exemption is relatively easy to administer since it is a complete property tax exemption. The public policy objective of limiting the use of the exempt property for non-exempt purposes does add a little more difficulty in administering the tax preference.

Recommendation

The Legislature should continue the property tax exemption for war veteran organizations.

Legislation Required: None

Fiscal Impact: None

VETERANS ORGANIZATIONS – REPORT DETAIL

Statutory History

The property tax exemption for veterans' organizations first appeared in law in 1929. Although a few veterans associations date to the late 19th Century, the emergence of nationally chartered veterans' groups recognized by the War Department occurred in the ten years following World War I. This exemption follows the emergence of national veterans groups and appears to be an exemption for a type of charitable and benevolent groups which had not previously existed. Organizations to assist veterans began to appear following the Spanish American War and the Rebellion in the Philippines,[33] but these groups were few until World War I. These groups appeared as a new class of charitable or benevolent organizations.

In 1969, the Washington Legislature changed the organization recognizing the veterans' organizations from the United States War Department to the Defense Department. In 1984, the Legislature added a requirement that the exempt property must be used exclusively for the purposes for which the exemption is granted. In 1990, there was a use requirement placed on the exempt property of veterans' organizations. It specified that if the property is used for pecuniary gain or to promote business activities, except fundraising activities, these activities nullify the property tax exemption. In 1993, the law clarified which activities the veterans' organizations could conduct and still qualify for the property tax exemption. The organizations could collect rent or donations if the amount is reasonable and does not exceed maintenance and operation expenses. The organizations could have fund raising activities and use the exempt property for pecuniary gain for up to three days a year. In 2006, the Legislature clarified the law by stating that members of the community must derive a benefit from the rental or use of the exempt nonprofit property and the number of days per year that the exempt property could be operated for pecuniary gain increased from three to 15 days per year.

Public Policy Objectives

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?

[33] http://www1.va.gov/vso/index.cfm?template=view (Veterans' Administration directory of organizations including dates of organization showing the earliest recognized organization as the Navy Mutual Aid Association which formed in 1879. Other early veterans' associations included the American Red Cross (1881), Army and Navy Union (1886), Legion of Valor (1890) and Veteran's of Foreign Wars (1899).

The purpose language in this exemption has not been amended since its enactment in 1929. The requirement that exempt groups be organized for "…patriotic and community service to state and nation" goes beyond providing a benefit only for their members into the realm of imparting a benefit to the state and, as such, is subsidy language that continues to appear in the statute. The Legislature's public policy objective was to give veterans organizations a property tax exemption to subsidize them for the military service their members provided to our local community, state and the nation.

The Legislature has a public policy objective of limiting this property tax exemption to those veterans organizations recognized by the Department of Defense. The Legislature in recent years has clarified the amount of pecuniary use the veterans' organizations are allowed with the exempt property. The number of days allowed for pecuniary use of the veterans' property has increased recently.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

After examining the Department of Revenue's property tax exemption database, the entities claiming this property tax exemption are veterans' organizations. This tax preference has achieved its objective of providing property tax relief to these organizations for the service provided by their members to the local community, state and nation.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

There are 159 local chapters of war veterans' organizations all over Washington State that are receiving a property tax exemption. As of September 30, 2006, the U.S. Department of Veterans' Affairs reported 617,723 veterans living in Washington State. The following table indicates the number of local veterans' organizations by national veterans' organization in property tax year 2006-07 from the Department of Revenue data. The Other category contains other national veterans' organizations including veterans' building associations and committees.

Table 12: Washington State War Veterans' Organizations Receiving a Property Tax Exemption

Veterans' Organizations	Number of Local Chapters	% of Total Veteran Organizations
American Legion	82	51.5%
Veterans of Foreign Wars (VFW)	55	34.6%
Disabled American Veterans	7	4.4%
Others	15	9.5%
Total	159	100%

Source: Washington Department of Revenue Nonprofit Property Tax Database.

The 159 local chapters of veterans' organizations had 212 parcels statewide which received a property tax exemption in property tax year 2006-07. All these parcels were completely exempt except for three parcels which had partial tax exemptions. Most of these exempt parcels of property included a public meeting facility.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

There does not appear to be any unintended tax benefits to any entities.

Revenue and Economic Impacts

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

According to the Department of Revenue's Tax Exemption Studies from 1988 to 2004, the property tax savings for war veterans' organizations has ranged from a low of $273,000 in 1988 to $870,000 in 1999. New estimates for this tax preference in each edition of a Tax Exemption Study could cause significant changes in the property tax savings estimates given a change in the sample of counties surveyed by the Department. Overall, this tax preference has been growing since 1988 both in the value of the property tax savings as well as the number of parcels qualifying annually for this property tax exemption. According to the 2004 Tax Exemption Report, the value of this exemption was estimated at $500,000 in 2005.

The annual projected property tax savings for this tax preference for the property of war veterans' organizations is based on 2007 Department of Revenue exemption data and property tax year 2006-07 county tax roll data. Table 13 summarizes the projected state and local property tax savings. The projected total property tax savings is $570,000 in 2006-07 and increases to $620,000 by property tax year 2009-10.

Table 13: Forecast of Local and State Property Tax Savings For War Veterans' Organizations

Year	Exempt Value ($ millions)	State Property Tax Savings	Local Property Tax Savings	Total Property Tax Savings
2006-07	$51.37	$110,000	$460,000	$570,000
2007-08	$53.43	$110,000	$470,000	$580,000
2008-09	$55.56	$120,000	$480,000	$600,000
2009-10	$57.78	$120,000	$500,000	$620,000

If this tax preference is continued and the exempt property value is not added to the tax roll, then veterans' organizations will not pay property taxes and other local taxpayers will pay slightly higher property taxes annually. There will be a shift in property taxes onto residential and business property owners in specific locations where the veterans' organizations are found statewide. Governments will not see a change in their overall property tax revenue due to the exempt property because of the shifting of tax liability among taxpayers unless taxing districts are at their maximum property tax rate. In those cases, continuing the tax preference could lead to a small reduction in local government revenue due to the taxing districts' inability to fully shift the loss in tax revenue from the tax preference.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

The 2005 employment data for all civil and social clubs including war veteran organizations that could be easily identified was examined. JLARC found that there were 65 local veterans' organizations statewide with employees. Of these organizations, statewide there were a total of 413 employees and $5 million in total wages paid in 2005. These war veterans' organizations are providing a gathering place for sharing valuable and historical war service memories. The members of these organizations are recognized for the war service to their local communities, state and the nation. These types of benefits are not easily identifiable in statewide and regional economic statistics of the economy.

Other States

Do other states have a similar tax preference?

From the CCH 50 state survey, JLARC found that the District of Columbia and 41 states, including Washington, have specific property tax exemptions for property of war veterans' organizations. The other nine states had provisions providing a property tax exemption for charitable organizations which would likely include nonprofit war veterans organizations.

NONPROFIT YOUTH ORGANIZATIONS – SUMMARY

Current Law

Under current law, all real and personal property of a nonprofit organization that is engaged in character building of boys and girls under the age of 18 are exempt from taxation. If an organization's charter allows programs for youth up to the age of 21 years old, then those organizations qualify as well. The purposes of the organizations must be uses for the general public good. In Appendix 3 is the current law statute, RCW 84.36.030(3), which provides for the property tax exemption.

Findings and Recommendations

This review of Washington's youth organizations' property tax exemption has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- This property tax exemption was enacted in 1933 but was in essence in place from 1901 until 1915, when there was an explicit exemption for the YMCA. Language effectively exempting charitable youth organizations appears initially in an 1854 section stating that "benevolent, charitable, literary or scientific" institutions, churches, schools and public libraries were not to be part of the tax base.
- It was originally restricted to nonprofits organizations and the core purpose of the youth organizations had to be for character building of children and the purpose had to be for the general public which remained intact since 1933.
- The public policy objective for this property tax exemption was created as a subsidy for nonprofit youth organizations that provide services which are for the good of society.
- This tax preference has achieved its objective of providing property tax relief to nonprofit youth organizations in the past and present.

Beneficiaries

- In property tax year 2006-07, the entities benefiting from this property tax exemption are 115 youth organizations statewide.
- There does not appear to be any unintended tax benefits to any entities other than nonprofit organizations with character building programs targeted exclusively at youth.

Economic and Revenue Impacts

- In property tax year 2006-07, the nonprofit youth organizations had an annual property tax savings of approximately $1.9 million.
- The future property tax savings for nonprofit youth organizations over the next three years is between $2.0 and $2.1 million per year.

Other States

- Fourteen other states have property tax exemptions for nonprofit organizations that specifically have provisions exempting certain youth organizations. The most common youth organizations that are named in statute for a property tax exemption are Boys and Girl Scouts, Girls and Boys 4-H clubs, Camp Fire Girls and future farmers.

Due to the fact that this tax preference was originally enacted to subsidize nonprofit youth organizations for the social benefit they provide to local communities and the beneficiaries of the tax preference are those entities, this tax preference achieves its objectives. Given the fact that the youth programs are offered for free or small user fees makes the programs accessible to all youth in the local communities and meets the requirement that the organizations and programs are for the general public good. This property tax exemption is a relatively easy to administer as it is a complete property tax exemption.

Recommendation

The Legislature should continue the property tax exemption for nonprofit youth organizations.

Legislation Required: None

Fiscal Impact: None

NONPROFIT YOUTH ORGANIZATIONS – REPORT DETAIL

Statutory History

Youth organizations are generally charitable or benevolent institutions and have a long history of being property tax exempt. The exemption for youth organizations first appeared in 1933. However, from 1901 to 1915, there was an explicit exemption for the YMCA, and language effectively exempting charitable youth organizations appears initially in an 1854 section stating that "benevolent, charitable, literary or scientific" institutions, churches, schools and public libraries were not to be part of the tax base. In 1933, the law provided a specific exemption for property of nonprofit organizations engaged in character building in boys and girls under 21 years of age. The law stated that the property must be used for the general public good and properties devoted to the general public benefit:

> The following property, to the extent herein limited, shall be exempt from taxation:
>
> First. …; also the property of nonprofit organizations or associations engaged in character building in boys and girls under twenty-one years of age, to the extent such property is necessarily employed and devoted solely to the said objects: *Provided*, Such purposes are for the general public good and such properties are devoted to the general public benefit;

Since the 1933 law, there have only been minor modifications. In 1969, the property tax exemption was clarified to include the property **owned** by nonprofit organizations and associations engaged in character building in boys and girls under 21, instead of the property which was necessarily employed in youth organizations' functions. In 1971, the Legislature changed the tax exemption provisions to decrease the age of boys and girls from 21 to 18 years of age, unless the charter specified otherwise. Other changes made in 1971 were to allow nonprofit organizations to rent their exempt property to another nonprofit organization, church or school, provided that the other organization is engaged in character building of youth and the rental income is devoted to the operation of the property. In 1973, the Legislature clarified the law so the property tax exemption specifically included both real and personal property. In addition, the new law stated that buildings and improvements required for the maintenance and safeguarding of such exempt property owned by the nonprofit organization was included in the property tax exemption. In 1984, the requirements surrounding renting of the exempt property was deleted and replaced with the following language describing the real and personal property which is exempt:

> To be exempt under this section, the property must be used exclusively for the purposes for which exemption is granted, except as provided in RCW 84.36.805.

In 2006, the Legislature added a requirement that the members of the community must derive a benefit from the rental or use of the exempt property by the nonprofit community group. Some traditional "youth" organizations, like some chapters of the YMCA or YWCA, do not qualify for a property tax exemption under the youth organizations category because the law requires the organization to solely serve youth. Over time, the services provided by YMCAs have evolved to include programs for people of different ages.

Public Policy Objectives

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?

Since the enactment of this nonprofit youth organizations' tax preference in 1933, this property tax exemption has had the purpose of providing an exemption to these nonprofit organizations because they have programs targeted at youth that provide a "general public good." As such, it is the only exemption of those in this section of law to be based explicitly on a subsidy theory of exemptions since it has statutory language regarding purposes and uses that are for the general public good. A public policy objective of this tax preference is to provide a subsidy for those youth organizations which are assisting in educating and building character in individuals that will assist in developing a civil society. The property tax exemption for youth organizations is for nonprofit entities under the assumption that these entities will direct proceeds from their organization back into their work of character building for youth. The property tax exemption has been targeted to include those nonprofit organizations that serve youth under 18 or 21 years of age exclusively.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

According to the Department of Revenue's property tax exemption database, the entities claiming this property tax exemption are youth organizations. This tax preference has achieved its objective of providing property tax relief to these organizations for the character building services provided to local communities. Given the fact that most all of these youth organizations provide programs that are free or charge minimal fees to be members of the club, they provide public benefits to the local communities from their programs and social club membership for youth in those communities. It achieves the objective of proving a general public good.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

There are 115 youth organizations in cities and counties throughout the state that are receiving a property tax exemption in property tax year 2006-07. The majority of the beneficiaries were girl and boy scouts as well as boys and girls clubs. There were also a large number of youth camps, youth athletic associations and religious organizations with youth programs, like Youth for Christ. Other organizations included camp fire councils, 4-H clubs and youth leadership clubs.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

After examining the Department of Revenue's property tax exemption database, the entities claiming this property tax exemption are nonprofit organizations which have programs targeted exclusively at youth, typically of national organizations. Generally, this tax exemption does not appear to have any unintended tax benefits. It is unclear if the Legislature at the time of enactment intended local YMCAs to qualify for this Youth Organizations tax exemption. This tax preference generally does not apply to YMCAs unless they are serving youth only. Typically, YMCAs have programs targeted at adults as well as youth. Two YMCA camps did qualify for a property tax exemption under the youth category in property tax year 2006-07, but usually YMCAs throughout the state qualify for a property tax exemption under nonsectarian organizations.

Revenue and Economic Impacts

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

Over the past 17 years, the property tax savings for youth organizations has fluctuated from $1.7 million in 1988 to a peak in 1996 and 1997 of approximately $3.8 million in state and local tax savings, according to various editions of the Department of Revenue's Tax Exemption studies. New estimates for this tax preference in each edition of a Tax Exemption Study could cause significant changes in the property tax savings estimates given a change in the sample of counties surveyed by the Department and used to forecast the value of this exemption. Since 2000, the property tax savings has been growing to $1.4 million by 2005. Overall, the value of the taxpayer savings for this tax preference is fallen slightly than its value 17 years ago in 1988.

In property tax year 2006-07, the youth organizations had an annual property tax savings of approximately $1.93 million. This estimate was based on merging DOR's 2007 nonprofit exempt property database with the counties' property tax roll data and estimating the remaining youth organizations' real market value. These property tax savings estimates are higher than those reported in the 2004 Tax Exemption Report because the number of beneficiaries in 2004 was 97 versus 115 organizations in this dataset as well as growth in real market values over the past four years. The projections for this property tax exemption are $1.97 million in property tax year 2007-08 and rising slightly to $2.1 million by 2009-10.

Table 14: Forecast of Local and State Property Tax Savings for Youth Organizations

Year	Exempt Value ($ millions)	State Property Tax Savings	Local Property Tax Savings	Total Property Tax Savings
2006-07	$179.66	$370,000	$1,560,000	$1,930,000
2007-08	$186.84	$400,000	$1,570,000	$1,970,000
2008-09	$194.32	$420,000	$1,630,000	$2,050,000
2009-10	$202.09	$440,000	$1,690,000	$2,130,000

If this tax preference is continued and the exempt property value is not added to the tax roll, then youth organizations will not pay property taxes and other local taxpayers will pay slightly higher property taxes annually. There will be a shift in property taxes to residential and business property owners in specific locations where the property of youth organizations is found statewide. Governments will not see a change in their overall property tax revenue due to the exempt property because of the shifting of tax liability among taxpayers unless taxing districts are at their maximum property tax rate. In those cases, continuing the tax preference could lead to a small reduction in local government revenue due to the taxing districts' inability to fully shift the loss in tax revenue from the tax preference.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

JLARC staff searched the 2005 employment data to identify the youth organizations that were reported as claiming this property tax exemption. All youth organizations could not be found in the employment data as some organizations are run exclusively by volunteers. JLARC found using the employment data that there were 99 youth organizations with employees. Of these organizations, statewide there were 1,940 employees and $39 million in total wages paid in 2005. The youth organizations total employees represent .06 percent of all employees and .03 percent of total wages statewide. These youth organizations are providing character building programs which will benefit local communities and the state for years to come, and these types of benefits are not easily identifiable in statewide and regional economic statistics of the economy.

Other States

Do other states have a similar tax preference?

Washington's property tax exemption for youth organizations is broad based allowing organizations and associations engaged in character building of boys and girls under 18 years of age. Fourteen other states have property tax exemptions for nonprofit organizations that specifically have provisions exempting certain youth organizations. The most common youth organizations that are named in statute for a property tax exemption in other states are boys and girl scouts, girls and boys 4-H clubs, camp fire girls and future farmers. The following states have additional provisions related to their youth organization exemption:

Michigan

Real estate not exceeding 400 acres and personal property owned by a girl or boy scout organization, a camp fire organization, 4-H club or foundation or a YMCA or YWCA are exempt from taxation but the real estate is exempt only if at least half of the members are residents of Michigan. The county board of commissioners may waive the residency requirement if the land is occupied by the organization solely for the purposes for which it was established.

New Hampshire

The New Hampshire Supreme Court has recognized boy and girl scout programs and activities as "charitable in nature and purpose" since 1955.

New York and New Jersey

New Jersey exempts boy and girl scouts on a case law basis. Generally, New Jersey provides relief to associations and corporations organized exclusively for the "moral and mental improvement of men, women and children." New York also allows a tax exemption from municipalities' property tax for corporations or associations that are exclusively for the "moral or mental improvement of men, women or children."

Texas

Texas exempts real and tangible property owned and used exclusively by qualified youth development associations provided it is reasonably necessary for the operation of the association. The state law outlined five requirements that must be met by the organizations to qualify for the exemption: (1) must be organized and operated primarily for the purposes of promoting the threefold spiritual, mental and physical development of young men or women; (2) be operated in a way that does not result in the accrual of distributable profits and the realization of private gain beyond reasonable salaries; (3) operate in conjunction with a state or national organization with the same purpose as the association; (4) use its assets in performing the association's youth development functions; and (5) by charter, bylaw, or other regulation direct that when the association is dissolved, its assets are to be transferred to the state of Texas, the United States, or to a charitable educational, religious, or other similar organization that is qualified as a charitable organization under the Internal Revenue Code Sec. 501c.3.

Most other states have property tax exemption provisions for charitable organizations that may cover youth organizations and allow a property tax exemption. States vary in the standards that are required in order to qualify for the charitable use property tax exemption.

CONTRIBUTIONS AND DONATIONS – SUMMARY

Current Law

The fiscal impact of contributions and donations is estimated at over $10 million per biennium. Therefore this will be a full review rather than an expedited review.[34] Under current law, there is a deduction on the business and occupation tax for contributions and donations that a business receives as well as membership fees and dues received. Contributions and donations received by a business or organization can be deducted from the business and occupation tax under both Washington State and federal law.[35] Nonprofit organizations most likely are the entities receiving donations and contributions, but the deduction is not limited to nonprofit organizations. Membership dues and fees which are not for payment of goods or services can be deducted from the business and occupation tax also. In Appendix 3 is the current state law statute, RCW 82.04.4282, which provides for the business and occupation tax deductions.

Findings and Recommendations

This review of Washington's business and occupation deduction for donations and contributions received has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- This business and occupation tax deduction was enacted in 1935 and has remained the same since enactment. This preference has a tax base defining objective.
- The public policy objective for this business and occupation tax deduction was to be a deduction from the tax base because this revenue was not earned by performing any business activities.
- This preference provides similar tax treatment for nonprofits in terms of Washington's business and occupation tax deduction and the federal corporate tax exemption.
- This tax preference has achieved its objective of providing business and occupation tax relief to organizations which have received donations and contributions in the past and present.

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[34] EHB 1069 (2006) provided that an expedited review process could be done on any tax preference that had an estimated biennial fiscal impact of $10 million or less. Initially it was thought that contributions and donations had a fiscal impact under $10 million and it was placed on the expedited review list.

[35] 16 USC §501(c) exempts a variety of organizations from federal income tax. Contributions and donations to exempt organizations are not taxed.

Beneficiaries

- In 2006, generally the beneficiaries of this deduction were educational institutions, health organizations, professional, scientific and technical services and other social assistance nonprofit organizations like religious, fraternal, charitable and social clubs and associations. The tax deduction has never been restricted to nonprofits organizations.
- The exact number of beneficiaries of this tax preference is unknown as the available data from the Department of Revenue on businesses claiming this deduction appears incomplete.
- There does appear to be unintended tax benefits to businesses in the past due to some taxpayers incorrectly claiming this deduction in error. The Department of Revenue has indicated that they will be addressing the inaccurate deduction claims on accounts.

Economic and Revenue Impacts

- In 2006, the tax savings from the business and occupation tax deduction for donations and contributions received was $57 million. The Department of Revenue's prior taxpayer savings estimates based on the actual deduction amount claimed, was underestimating the value of donations and contributions received by nonprofit organizations statewide.
- The future business and occupation tax savings for donations and contributions received over the next three years is between $57 and $66 million per year.
- According to a report by the Evergreen State Society, they found in 2003 that there were 3,618 nonprofit employers with more than 234,700 employees and $5.7 billion in total wages. The nonprofit sector represents 8.8 percent of all employees and 5.5 percent of total wages in Washington.

Other States

- Since this deduction is allowed on federal corporate taxes, the majority of the states provide this deduction through their connection to federal law. This is a common deduction among states.

This tax preference has achieved the objective of providing organizations that receive donations and contributions with a deduction from the B&O tax due to this revenue not being generated from business activities. This tax preference has been underreported as a deduction based the Department's business and occupation tax deduction data. This deduction is probably most likely been utilized as an exemption from gross income instead by most nonprofit organizations or nonprofits did not have sufficient tax liability to be required to report this income. This deduction has also experienced reporting inaccuracies due to taxpayer error in understanding which deduction should be included on the tax form. This deduction adds uniformity to the tax system for nonprofit businesses' receiving donations and contributions as it is consistent with federal law in proving a similar tax exemption from gross income for this non-business income for federal tax purposes.

Recommendation

The Legislature should continue the business and occupation tax deduction for donations and contributions received by organizations.

Legislation Required: None

Fiscal Impact: None

CONTRIBUTIONS AND DONATIONS – REPORT DETAIL

Statutory History

The contributions and donations business and occupation tax deduction was enacted in 1935. The original language has essentially not changed in more than 70 years:

> In computing tax there may be deducted from the measure of tax the following items:
>
> (b) Amounts derived from bona fide ... contributions, donations … The provisions of this paragraph shall not be construed to exempt any person, association or society from tax liability upon selling tangible personal property or upon providing facilities or services for which a special charge is made to members or others: *Provided,* That dues which are for or graduated upon, the amount of service rendered by the recipient thereof are not permitted as a deduction hereunder.

Any businesses, organizations or institutions that receive donations or contributions can claim this non-business related income as a deduction. Businesses are required to separate out the donations and contributions from other types of revenue. Court decisions have determined whether payments from a federal program were contributions or donations. The Court found that contributions and donations must have a "gratuitous purpose."[36] It denied an exemption because the federal government (1) picked the projects toward which its funds were applied; (2) required regular progress reports; and (3) owned the intellectual property that resulted from the project.[37] Contributions or donations that are, in essence, payments for goods or services are not exempt. Revenue derived from other activities, such as selling meals or other property or renting its facilities for a fee must be separated from contributions and donations since the revenue of other activities does not qualify as a deduction for donations and contributions.[38]

This business and occupation tax deduction is reported by businesses on the same line on the excise tax form as membership dues and fees. Without careful examination of the deduction detail, it is unclear whether businesses are claiming a membership dues and fees or donations and contributions deduction. This became an issue in the analysis of whether these tax preferences are providing unintended tax benefits to entities other than those the Legislature intended.

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[36] Analytical Methods v. Department of Revenue, 84 Wn. App. 236 (1996 Div. II).

[37] *Id.* at 243.

[38] *See, e.g.,* Portland Golf Club v. Commissioner, 497 U.S. 154 (1990).

Federal Law Deduction

Federal law provides an exemption for nonprofit businesses that receive contributions and donations as it is considered exempt income. The reasoning for this exemption is because it is not directly connected with the production of gross income. Other types of income are also exempt from federal tax like dues, fees, charges or amounts paid by members of organizations for providing members with goods or services consistent with the purpose of the exempt organization.

In addition to the deduction for donations and contributions received, federal law also provides a deduction from federal income for contributions and gifts businesses or individuals make to charitable organizations.[39] This deduction is limited for corporations to ten percent of the taxpayer's taxable income. Since federal law allows for this type of deduction for corporations on their charitable contributions paid, this can cause confusion for some organizations that think Washington provides a similar deduction on the business and occupation tax. The only deduction on the Washington business and occupation tax for charitable contributions is for the donations and contributions received by organizations.

Public Policy Objectives

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?

This business and occupation tax deduction appears to be a deduction defining the tax base because it was enacted in the same year as the Revenue Act of 1935 that established the business and occupation tax. Generally, this deduction is claimed by nonprofit entities receiving contributions and donations. The purpose for this deduction also appears consistent with the base defining theory. A Washington Supreme Court case in 1897 justified exemptions from the property tax base as properties that provide a benefit to the public and they are relieving the state of expense. This same theory can be applied to the business and occupation tax deduction for contributions and donations. Most of the beneficiaries of this deduction are educational institutions, professional, scientific and technical services and other social assistance nonprofit organizations like religious, fraternal, charitable and social clubs and associations. There does not appear to be a significant discussion of the purpose of donations and contributions at the national level, nor is there Supreme Court case law that further addresses the purpose of the deduction.

What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives?

According to the Department of Revenue's business and occupation tax deduction database, there are entities claiming this business and occupation tax deduction that are conducting

[39] 26 USC §170.

educational, social assistance and other charitable services. This tax preference has achieved its objective of providing business and occupation tax relief to these organizations for their non-business related income.

To what extent will continuation of the tax preference contribute to these public policy objectives?

The public policy objectives of this tax preference are being fulfilled so continuation of this tax preference will contribute to fulfilling these public policy objectives.

If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment or recapture of the tax benefits?

The public policy objectives of this tax preference are being fulfilled so there is no need to modify the tax preference in statue. Due to the reporting inaccuracies in this deduction, there should be improvements made to educate taxpayers and change the labeling of this deduction on the tax form.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

Since this B&O tax deduction is just for organizations that have raised funds through contributions and donations received by the public, the typical beneficiaries of this tax preference are organizations that receive donations for their charitable and public service activities. Besides religious and charitable organizations conducting social assistance programs, there are also organizations that receive donations for their scientific and technical services as well as environmental programs. The exact number of beneficiaries of this tax preference is unknown.

Table 15 provides a breakdown of the Washington nonprofit organizations that report to the IRS and have claimed that they received donations, gifts and grants in 2005.[40] In 2005, 7,692 nonprofit organizations in Washington received public support in the form of contributions, donations, gifts and grants totaling $5.33 billion. The industry category that had the largest number of organizations with contributions and donations was education with 1,540 organizations representing 20 percent of all organizations reporting $604 million in public support. Recreation, sports and leisure had the second highest number of nonprofit organizations (997) at 13 percent of total organizations, receiving $150 million in public support.

[40] National Center for Charitable Statistics (NCCS).

Table 15: Number of Organizations and Amount of Contributions Received by Nonprofits in 2005

Industry Category	Number of Organizations	% Total	Gifts, Contributions and Grants	% Total
Arts, Culture, and Humanities	796	10.30%	262,029,025	4.90%
Education	1,540	20.00%	603,880,262	11.30%
Environmental Quality, Protection, and Beautification	199	2.60%	60,923,177	1.10%
Animal-Related	135	1.80%	53,615,305	1.00%
Health	398	5.20%	569,326,391	10.70%
Mental Health, Crisis Intervention	187	2.40%	207,910,113	3.90%
Diseases, Disorders, Medical Disciplines	106	1.40%	57,910,217	1.10%
Medical Research	43	0.60%	362,855,186	6.80%
Crime, Legal Related	139	1.80%	82,868,366	1.60%
Employment, Job Related	110	1.40%	118,516,507	2.20%
Food, Agriculture, and Nutrition	83	1.10%	98,387,272	1.80%
Housing, Shelter	272	3.50%	80,847,340	1.50%
Public Safety	36	0.50%	5,379,453	0.10%
Recreation, Sports, Leisure, Athletics	997	13.00%	149,888,618	2.80%
Youth Development	202	2.60%	77,950,424	1.50%
Human Services - Multipurpose and Other	893	11.60%	725,175,260	13.60%
International, Foreign Affairs, and National Security	120	1.60%	1,153,877,224	21.60%
Civil Rights, Social Action, Advocacy	29	0.40%	16,582,025	0.30%
Community Improvement, Capacity Building	310	4.00%	117,753,986	2.20%
Philanthropy, Voluntarism, and Grant making Foundations	322	4.20%	316,442,907	5.90%
Science and Technology Research Institutes, Services	35	0.50%	46,281,611	0.90%
Social Science Research Institutes, Services	12	0.20%	8,605,780	0.20%
Public, Society Benefit - Multipurpose and Other	50	0.70%	30,933,274	0.60%
Religion Related, Spiritual Development	369	4.80%	91,806,000	1.70%
Mutual/Membership Benefit Organizations, Other	12	0.20%	1,788,081	0.00%
Unknown	297	3.90%	29,502,003	0.60%
Total	7,692	100.00%	5,331,035,807	100.00%

The third largest category of organizations was in human services, multipurpose and other fields at 893 nonprofits or 11.6 percent of all organizations receiving $735 million in public support. The category of nonprofits receiving the largest amount of donations, gifts and grants was the

International, Foreign Affairs, and National Security category at more than $1.15 billion in public support. The second and third largest categories of nonprofits receiving public support was the human services, multipurpose and other fields and the health field respectively.

Since this tax preference is not limited to nonprofit organizations, there could be more than 7,692 organizations that could claim this deduction. On the other hand, some organizations may not have sufficient business and occupation tax liability to utilize this deduction. The number of beneficiaries of this tax preference is unclear at this time.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

The Legislature had originally intended this tax preference to be a deduction for donations and contributions received since this revenue was not derived from any business activity of the organization. In examining the Department of Revenue's database on businesses that claimed either membership dues and fees or a contributions and donations received B&O tax deduction, there certainly are organizations that typically solicit donations and receive contributions in the database on the claimants of this tax preference. Since this deduction is not reported by itself, it becomes more difficult to identify the beneficiaries. Initially in examining the Department of Revenue accounts on businesses which claimed this tax deduction in 2006, there were more than 1,300 accounts reporting a deduction for donations and contributions and membership dues and fees. The accounts had to be separated into the taxpayers who were receiving contributions and donations from those claiming membership dues and fees. This separation of the deduction into the two basic categories is based on the industry sectors and whether they typically receive donations versus those that have memberships and could claim dues and fees as a deduction.

During the course of this audit, JLARC staff determined a significant number of accounts with deduction amounts that were relatively small and not from industry sectors that typically receive donations or have a membership base to collect dues from. JLARC found 725 accounts or 56 percent of all the accounts claiming this tax deduction that were questionable deductions and have forwarded those accounts to the Department of Revenue for further investigation. According to discussions with the Department of Revenue staff, they believe taxpayers might have confused this business and occupation deduction for contributions and donations received with the federal deduction that is allowed for contributions and donations made. In addition, some organizations might have thought they could deduct membership dues and fees paid like it was a cost of doing business deduction that is also allowed on federal taxes. The Department indicated that they will further investigate these accounts and bill the taxpayer if necessary and find ways to correct the reporting problems for this deduction in the future.

At the time of this JLARC audit, this particular business and occupation tax deduction has taxpayer reporting errors which has lead to unintended benefits to entities that do not qualify for the deduction in the past. Given the data problems with the Department of Revenue's database for this deduction, the beneficiaries and tax savings estimates for this tax preference are being based on the Washington State statistics on charitable contributions from the National Center for Charitable Statistics.

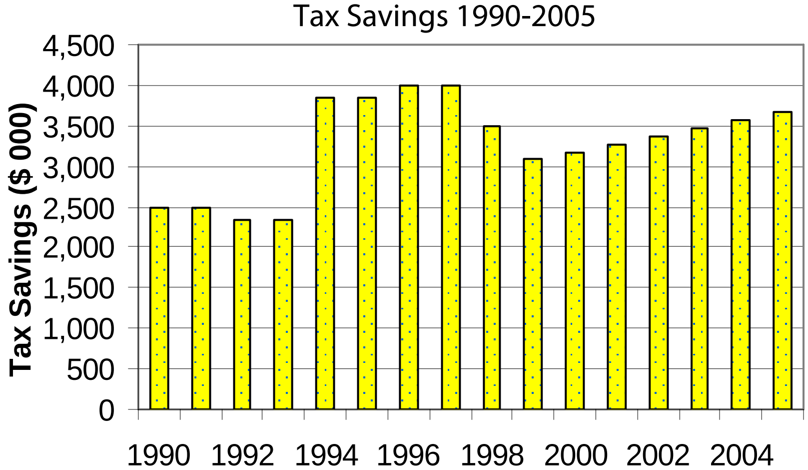
Revenue and Economic Impacts

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

In analyzing the past tax savings estimates, the Department of Revenue's previous Tax Exemption Reports were reviewed. In predicting the future taxpayer savings, this audit examined three sources of data: the Department of Revenue's business and occupation tax deductions reported for contributions and donations received, the National Center for Charitable Statistics donations and contributions and grants and the federal deduction total for charitable contributions on IRS income tax returns.

The estimates of the past tax savings for this tax preference have been hindered by the fact that the Department of Revenue has combined the reporting for this tax preference for contributions and donations with membership dues and fees. In addition, there could have been taxpayers claiming this deduction inaccurately which could lead to higher estimates for this deduction. The historical tax savings estimates are illustrated in Figure 3 and are based on various editions of the Department of Revenue's Tax Exemption Studies from 1990 to 2004. This deduction has only been reported separate from other tax preferences since 1990. Initially, the tax savings for contributions and donations deduction was approximately $2.5 million in 1990 and grew to a peak in 1996 and 1997 of $4 million annually. Since 1999, the taxpayer savings has been growing steadily to $3.5 million estimated for 2005 in the 2004 Tax Exemption Report.

Figure 3: Business and Occupation Tax Deduction for Contributions and Donations Tax Savings 1990-2005

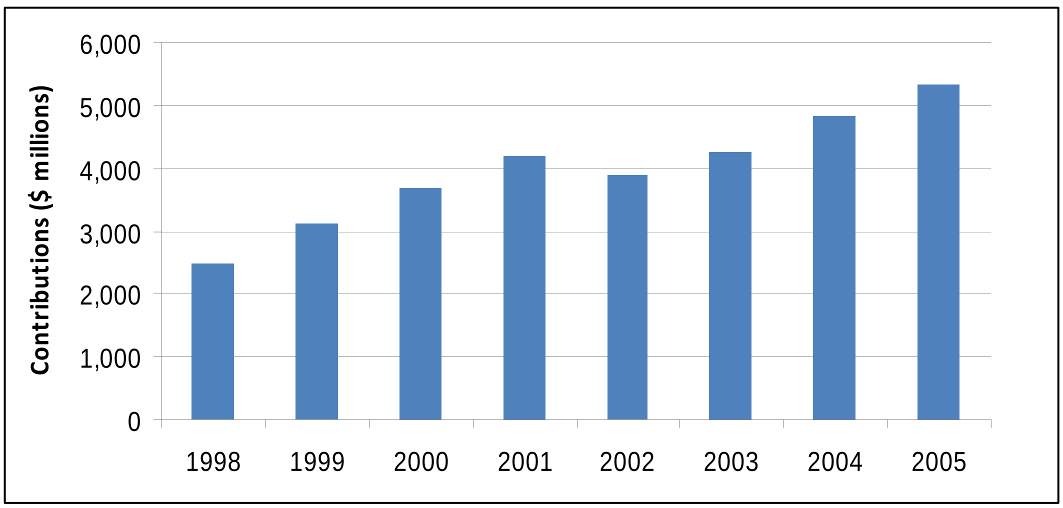


Source: Department of Revenue Tax Exemption Reports 1988 – 2004.

After examining various years of the Department of Revenue business and occupation tax data for the donations and contributions reported, including the most recent year 2006, the total amount of contributions and donations that were estimated to be reported as a deduction was only $134 million, which corresponded to taxpayer savings of $2 million, see Figure 3. This deduction total for contributions of $134 million is sizably lower than the total contributions and donations reported to the IRS reports for Washington nonprofit organizations. The total contributions, gifts and grants reported by all Washington nonprofits required to be registered was $5.3 billion in 2005. The difference between the total contributions estimates could be due to the fact that many nonprofits may not be reporting contributions and gifts to the Department of Revenue. Some taxpayers may be treating this deduction like an exemption versus reporting the contributions in total income and claiming a deduction for that type of revenue. The income is tax exempt regardless of how the taxpayers are reporting the income.

Figure 4 shows the total contributions, donations and grants reported by Washington nonprofit organizations to the IRS from 1998 through 2005. The total charitable donations grew from $2.5 to $5.3 billion in eight years. The number of organizations in Washington claiming to have received charitable donations grew over this eight year period from 4,371 to 7,692 nonprofit organizations in 2005. This data does include not only donations and contributions but also grants by the governments. This particular tax preference under review is just for the public contributions and donations and endowment funds received by nonprofits and the grants received by nonprofit organizations is placed under a separate tax preference which was enacted later in 1979.

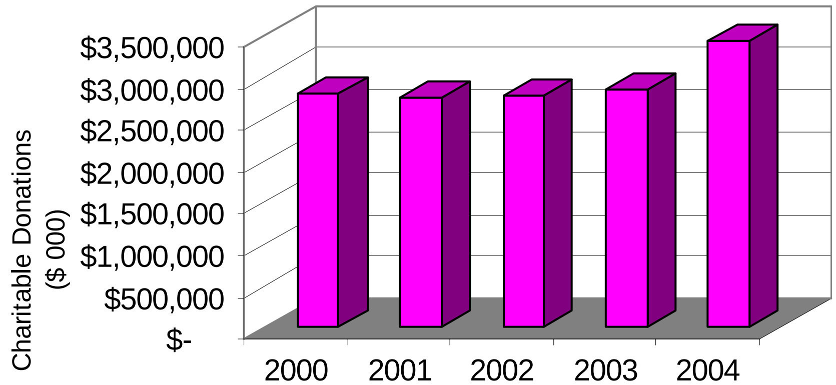
Figure 4: Total Contributions, Gifts and Grants to Washington Nonprofits 1998-2005



Source: National Center for Charitable Statistics 1998-2005.

In order to determine the amount of public charitable donations and contributions made, another IRS source was examined and that was the total amount of charitable contributions itemed by Washington residents and reported as a deduction on federal personal income tax returns. Figure 5 provides the total charitable donations of Washington residents that itemized their federal tax returns which reflects the majority of the total contributions made to charities in Washington. The total amount of itemized deductions for charitable contributions over the past five years has ranged from $2.5 billion to $3.4 billion by 2004. The growth in total contributions was not significant annually until 2004. There was a 21 percent increase in total itemized

Figure 5: 5-Year History of Itemized Charitable Donations by Washington Residents



Source: IRS Statistics of Income.

charitable donation deductions between 2003 and 2004. The average contribution per Washington itemizer has declined over the last five years from $3,543 to $3,268. This IRS data only reflects the contributions and donations made by those Washington residents that itemize their tax returns. In 2004, 31 percent of all Washington income tax returns itemized their returns. This data excludes the following donations and contributions made: (1) standard deduction filers; (2) non-residents who donate to a Washington charity; (3) corporate businesses that make charitable donations to Washington charities.

The projections of the tax savings from this tax preference will vary widely depending on what data is used for the amount of contributions and donations received by organizations in Washington. Due to the potential reporting inconsistencies with the Department of Revenue data and the incomplete data on total charitable contributions in the IRS income tax return information, the projections for this tax preference in this report are based on the amount of contributions, donations and grants reported by Washington nonprofits to the IRS with an adjustment made to exclude government grants to charities. The portion of total support which has been government grants for Washington public charities was 35 percent according to an examination of six years of data on Washington's public charities total support reported by National Center For Charitable Statistics. The projections for this tax deduction will be $57 million in 2006 and grow to $66 million by 2009. The estimated taxpayer savings reported in Table 16 is also the state government annual loss from this business and occupation tax deduction. Due to the fact that some of these nonprofit charitable organizations are small and **may have** tax liability less than the small business tax credit, eliminating this tax preference may not bring in all of the forecasted revenue for this tax preference.

Table 16: Forecast of Business and Occupation Tax Savings for Organizations Receiving Donations and Contributions

Year	Total Value of Contributions and Donations ($ millions)	Business and Occupation Tax Savings ($millions)
2006	$3,786	$56.80
2007	$3,976	$59.64
2008	$4,175	$62.62
2009	$4,383	$65.75

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?

Since the beneficiaries of this tax preference for public donations and contributions received by organizations in Washington are primarily charitable organizations, the most recent financial data from nonprofit organizations that are required to report to the IRS is summarized to examine their impact on the economy. There were nearly 7,700 nonprofit public charities in Washington that were required to report to the IRS in 2005. These organizations had $5.3 billion in grants and donations; total gross receipts of $28 billion; total revenue of $24.6 billion; total expenses of $22.8 billion; net income of $1.8 billion and total assets of $33.1 billion. Washington's nonprofits make up 2 percent of all nonprofit revenue and expenses in the U.S. and 1.7 percent of total nonprofit assets in the U.S.[41]

The number of nonprofit employers in Washington State, who are identified by Washington State Department of Employment Security as nonprofits, is sizably smaller than the total number of nonprofit firms reporting to the IRS. Several studies by the Evergreen State Society have quantified the number of nonprofit employers in different studies since 1993 with the most recent study completed in 2004.[42] In 2003, this study found that there were 3,618 nonprofit employers with more than 234,700 employees and $5.7 billion in total wages. The nonprofit sector represents 8.8 percent of all employees and 5.5 percent of total wages statewide.

If the tax preference were to be terminated, what would be the effect on the distribution of liability of state taxes?

Since this is a business and occupation tax deduction, an elimination of this tax preference would not have an effect on the distribution of liability of state taxes.

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[41] The Nonprofit Sector in Brief Facts and Figures from the Nonprofit Almanac 2007 data from National Center for Charitable Statistics at the Urban Institute.

[42] Nonprofits in Washington 2004 The Evergreen State Society.

Other States

Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

If states have a corporate income tax and their state law connects to the federal definition of taxable income, those states will also provide their businesses with a deduction for donations and contributions received and paid to charities unless the states have adopted laws to disconnect from that deduction. According to the CCH state survey, there are 37 states that connect to the federal definition of corporate taxable income and do not have other provisions to add back the contributions and donations received by an organization to its taxable income base. There are five states with a corporate income tax that connects to the federal gross income or other IRS provision and adopt their own business deductions and do not appear to have created specific provisions for excluding contributions and donations from the tax base. In general, this nonprofit organization deduction for donations and contributions received is common among states as a complete exemption. It is common for states to connect to the federal law that allows a complete deduction for nonprofit organizations receiving contributions and donations.

MEMBERSHIP DUES AND FEES – SUMMARY

Current Law

Under current law, there is a deduction on the business and occupation tax for bona fide initiation fees and membership dues that do not pay for goods and services. Certain membership dues and fees can be deducted from business taxes under both Washington State and federal law.[43] This applies to any business that has "social benefits" captured in the membership dues and fees. In Appendix 3 is the current state law statute, RCW 82.04.4282 (1)-(2), which provides for the business and occupation tax deductions.

Findings and Recommendations

This review of Washington's business and occupation tax deduction for membership dues and fees paid for the privilege of being a member of a club has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- This business and occupation tax deduction was enacted in 1935 and has remained the same since enactment.
- A public policy objective for this business and occupation tax deduction was to define the tax base, but other public policy objectives are relatively difficult to determine. It appears that another public policy objective stated in court rulings was to provide a tax deduction for the privilege of belonging to certain clubs.
- It is uncertain if the clubs, receiving this tax benefit are the ones that the Legislative intended to have targeted with this tax preference.
- This tax preference has only partially achieved its objective of providing business and occupation tax relief to clubs and organizations for societal benefits that their members are paying for. JLARC staff could not identify any evidence that because a club was older and more exclusive and charged higher membership fees that this fact meant the club was providing larger "social" benefits to its members as compared to other less exclusive clubs with lower membership dues and fees.
- As specified in administrative rule, in order to claim this tax preference, the taxpayer must first demonstrate that the club provides a gathering area for social activities. It is unclear if the "social" benefits of clubs are being correctly measured as defined in rule since "social" benefits are difficult to measure.

[43] 16 USC §501(c) exempts a variety of organizations from federal income tax. Contributions and donations to exempt organizations are not taxed.

Beneficiaries

- In 2006, most of the beneficiaries were in the following industry categories: golf and country clubs, athletic and other physical fitness clubs, civic and social organizations, professional associations, and camping and auto travel clubs. The exact number of beneficiaries is uncertain.
- This tax deduction has never been restricted to nonprofit organizations.
- Over time an inequity has developed among clubs in the "social" benefits they are providing. It is unclear if the valuation of "social" benefits is truly capturing all the "social" benefits clubs are providing to members.
- There does appear to be unintended tax benefits to some businesses in the past due to some taxpayers inaccurately claiming this deduction. The Department of Revenue has indicated that they will be addressing the inaccurate reporting on accounts.

Economic and Revenue Impacts

- In 2006, the tax savings from the business and occupation tax deduction for membership dues and fees received for the privilege of club membership was $2 million.
- The future business and occupation tax savings for membership dues and fees received over the next three years is between $2 million and $2.2 million per year.

Other States

- Since this deduction is allowed on federal corporate taxes, the majority of the states provide this deduction through their connection to federal law. This is a common deduction among states.

This tax preference has only partially achieved the objective of providing organizations with membership dues and fees with a deduction from the B&O tax due to the "social" benefits these organizations are providing to their members. This statute requires all types of clubs claiming this deduction to separate their membership dues and fees that pay for goods and services from the other social benefits of the club, and this adds administrative difficulty. This deduction has caused great inequity among clubs as some clubs are able to demonstrate a "social" privilege of being a member while other clubs cannot and thus are not able to claim this B&O tax deduction. This deduction causes significant inefficiency costs and difficulty in understanding this tax deduction among clubs. This deduction has experienced reporting inaccuracies due to taxpayer error. This deduction is inconsistent with federal law because at the federal level all membership dues and fees of certain nonprofit "social clubs" are exempt from federal tax.

Recommendation

To ease the administration and compliance of the membership dues and fees tax preference, the Legislature should clarify which clubs should qualify and provide a simple method to value this deduction.

Legislation Required:	Yes
Fiscal Impact:	Depends on the organizations that would be allowed the deduction under the proposed change.

MEMBERSHIP DUES AND FEES – REPORT DETAIL

Statutory History

This initiation fees and membership dues deduction from the business and occupation tax was enacted in 1935. The original language has essentially not changed in more than 70 years:

> In computing tax there may be deducted from the measure of tax the following items:
>
> (b) Amounts derived from bona fide ... Amounts derived from bona fide initiation fees, dues, … The provisions of this paragraph shall not be construed to exempt any person, association or society from tax liability upon selling tangible personal property or upon providing facilities or services for which a special charge is made to members or others: *Provided,* That dues which are for, or graduated upon, the amount of service rendered by the recipient thereof are not permitted as a deduction hereunder

This tax preference can potentially be claimed by any businesses with membership dues and fees regardless of ownership type. This deduction is not restricted to clubs that are open to all individuals regardless of age, sex, race, religion, color, ancestry, or national origin.

Federal Law Deduction

Federal law provides an exemption for nonprofit businesses for their membership dues and fees received by their members, provided these fees are used for exempt purposes under which the organization was formed. [44] These payments are classified under unrelated business taxable income as "exempt function income." The definition in federal law for "exempt function income" is as follows:

> The term "exempt function income" means the gross income from dues, fees, charges, or similar amounts paid by members or their dependents or guests goods, facilities or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid.[45]

The rationale for this exemption is that dues and fees are not directly connected with the production of gross income and the income was not derived from any business activity. All nonprofit organizations' membership dues and fees are classified as exempt income so they are

[44] IRS Publication 557 for Tax Exempt Organizations and IRS 990 Tax Form and Instructions.

[45] 26 USC §512(3)(B).

not trying to distinguish the amount of membership dues and fees above the cost of goods and services. Homeowner associations are also allowed a tax exemption for their membership dues received if dues are used for exempt functions. For-profit private corporations which assess membership dues and fees must report must include this income in gross receipts reported to the IRS as taxable income. Corporations also can claim a cost of goods and services sold deduction on their federal corporate income tax returns.

In addition to the membership dues received for certain organizations that are tax exempt under federal law, businesses can deduct certain membership dues that pertain to their occupation as a business expense. This can cause some confusion for taxpayers in Washington who think they can deduct membership dues paid as a cost of business which is not allowed on Washington's business and occupation tax. Only certain organizations that charge membership dues and fees can deduction a portion of their dues on the business and occupation tax.

The federal government has a separate category for nonprofit social clubs and places certain limits on them in order to qualify for the federal corporate tax exemption.[46] An organization may receive up to 35 percent of its gross receipts from sources outside of its membership without losing its tax-exempt status. No more than 15 percent of this amount may be derived from the use of the club's facilities or services by the general public or from other activities not furthering social or recreational purposes for members.[47]

Administration of Washington's Membership Dues and Fees Deduction

The difficulty in claiming and administering this tax preference is that not all membership dues and fees are tax deductible, and the entity must distinguish the deductible amounts (bona fide initiation fees and dues) from the taxable amounts (payment of goods and services rendered). According to WAC 458-20-183, this tax preference is not granted merely because the payment, required by members, is designated as "initiation fees" or "dues." This deduction is only allowed for those initiation fees and dues which are paid solely and exclusively for the express privilege of belonging as a member of a club, organization, or society. Under current law, only bona fide fees and dues can be deducted from the B&O tax. Not all organizations have bona fide dues and fees. The business ownership type is not a factor in determining whether the membership dues and fees qualify as a deduction. The organization must first have initiation fees or membership dues that are paid by members solely for the privilege of continuing membership in the club and not for payment of goods or services. The Department of Revenue has completed several Excise Tax Advisories (ETA) for this deduction to assist taxpayers in identifying which organizations can qualify and how to calculate this deduction. There are seven ETAs for different organizations including the following:

- Health/Fitness Services
- Camping Clubs
- Amusement, Recreation and Physical Fitness Services

[46] IRS section 501(c)(7).

[47] IRS informational sheet on Social Clubs.

- Pilates Specialty
- General Health and Physical Fitness
- Golf Clubs
- Building Associations

The first step for businesses considering the exemption is to demonstrate that their members are paying a fee or due for the "social" benefits of being a club member. The fees or dues paid by members cannot be graduated depending on the level of service or good that the club provides. Instructional fees for particular activities like swim or tennis lessons cannot qualify for a deduction.

According to WAC 458-20-183, once an organization can establish that it has a "social" benefit for members, the organization is required to separate the portion of the membership dues and initiation fees into taxable and deductible amounts. Deductible amounts can be calculated using two main methods: actual records of facilities usage or cost of production. The actual records method is allocating fee income based on records of the facilities usage. Actual usage reporting separates the due and fee income by the actual goods or service rendered or the average comparable charges for such good and service made by other comparable businesses. The second method of allocating fee income is to total all the costs of providing the goods and service to members. According to the administrative rule, the cost of production method is performed by multiplying gross income by a fraction of which the numerator is the direct and indirect costs associated with providing the goods and services and the denominator of which is the organization's total operating costs.

Currently, the Department of Revenue is revising their administrative rule for this deduction. They plan to separate out the one rule into three. One is for the health and physical fitness services. The second is for the amusement and recreation services. The third will cover all organizations claiming the dues and fees deduction.

Board of Tax Appeals and Court Cases

There have been numerous Board of Tax Appeals (BTA) cases and a few Supreme Court cases since this tax preference was enacted. This report will highlight two main Supreme Court cases.[48] In the Automobile Club v. Department of Revenue, this court case stated the following:

> The purpose of the [initiation fees and dues] deduction is to exempt from taxation only revenue exacted for the privilege of membership.

This case concluded that "it is quite likely that a portion of dues received by the Auto Club covers expenses incident to providing the privilege of membership and are thus deductible. The Auto Club has made no attempt to segregate these expenses. Absent such segregation, the Department may presume that the entire amount is taxable." This court ruling indicated that all organizations

[48] Automobile Club of Washington v. the Department of Revenue 27 Wn. App. 781 (1980) and the Group Health Cooperative of Puget Sound, Inc. v. Washington State Tax Commission 72 Wn.2d 422 (1967).

must separate out the taxable portion from the deductible portion of the dues and fees in order to have any portion of the dues and fees allowed as a deduction.

In the Group Health Cooperative of Puget Sound, Inc. v. Washington State Tax Commission case, it was determined that the monthly "membership fees" for Group Health did not qualify as a permissible deduction because the dues were graduated upon the amount of services rendered.

The BTA cases regarding membership dues and fees are varied as different types of clubs with membership dues and fees have brought questions before the board regarding whether they qualify for this deduction and how it is to be claimed.

Recent Proposed Legislation

Legislation has been proposed to expand the nonprofit organizations that can qualify for this deduction to include organizations which wholly or partially receive dues or donations in lieu of fees for services.[49] On the other hand, in recent years, there have been other bill proposals, like HB 2666 (2004) and HB 1529 (2005), to eliminate the initiation fees and dues B&O tax deduction for persons engaging in amusement and recreation services, physical fitness services or lodging and other services. In 2007, HB 2397 was introduced that placed a deduction limit on the amount of initiation fees claimed to $1,000 per membership and a limit of $200 per member per month on the dues that could be claimed by social clubs.

Public Policy Objectives

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?

This business and occupation tax deduction is allowed only if the dues and fees are not in return for any good or services. There does not appear to be a significant discussion of the purpose of dues and fees exemptions at the national level, nor is there U.S. Supreme Court case law. In the court decision on Automobile Club of Washington v. the Department of Revenue, the court quotes WAC 458-20-114 which states:

> The purpose of the dues deduction is to exempt from taxation only revenue exacted for the privilege of membership.

According to the Department's administrative rule, this tax preference is not granted merely because the payment, required by members, is designated as "initiation fees" or "dues." This deduction is only allowed for those initiation fees and dues which are paid solely and exclusively for the express privilege of belonging as a member of a club, organization, or society. Since this deduction was enacted in 1935 in the same year as the business and occupation tax, it appears to have a tax base defining policy objective. Tax base defining theory states that at the time legislatures are developing a tax, they will define the elements that will be subject to the tax and

[49] HB1913 (1997) and HB1884 (1993).

the elements excluded. In 1935 when this tax preference was enacted, the number of clubs that probably existed in the category of clubs with membership dues and fees must have been minimal compared to the wide range of "social" clubs now.

Another public policy objective of the deduction, when enacted, could have been to provide a tax deduction for the societal benefits that certain clubs provide. The Legislative intent on this purpose is not very clear.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

After examining the Department of Revenue's business and occupation tax deduction database, there are clubs and associations claiming this deduction that have identified a portion of their fees that represents the value of the privilege of being a member of that club. Since one of the objectives of this deduction is to define the business and occupation tax base and provide tax relief to certain social clubs, then this base defining objective is partially fulfilled. Since the Legislative intent on which clubs are to be receiving this tax deduction is not clear, there is uncertainty about whether the clubs claiming the deduction are the clubs that the Legislature intended to target with this tax preference.

Since this tax preference is partially based on the premise that the clubs are being provided a tax deduction based on their "social" benefit, then the clubs with the highest membership fees and "social" benefits will be the organizations receiving the largest benefits from this tax preference.

It is uncertain if the primary objective of this tax preference will continue to be fulfilled in the future as clubs and associations expand and the interests that clubs represent change as well. The "social" aspects of clubs are ever evolving, and over time this tax preference has become more difficult to have a standard method of calculating the "social" benefits of a club. It is uncertain how effective this deduction will be in the future or even has been in the past at capturing the true "social" benefits of all clubs equitably.

It is unclear if these organizations that claim this deduction are actually the clubs providing additional "social" benefit its members. In order to further examine this objective, the 2006 membership dues and fees deduction data from the Department of Revenue was analyzed based on the year that the organization had reported to state agencies that they established their business. This data reveals that the 28 clubs or associations that are the oldest in the state comprised the largest portion (42 percent) of the total membership dues deduction. This result illustrates that the older clubs in the state are the ones with the highest membership dues and perceived "social" benefit as individuals are willing to pay a higher membership fee. As Table 17 reveals, the average deduction amount per club or association varies widely from $1.98 million per club for the oldest clubs in the state to $250,675 for the clubs that began in 2000 or later. This data reveals that the oldest clubs in the state are receiving the biggest tax deduction but it is still unclear if they are providing the largest "social" benefits through their clubs.

Table 17: 2006 Membership Dues and Fees Deduction Summary By Year of Establishment

Year of Establishment	Total No.	Deduction Sum	% Of Total Deduction	Average Deduction
Before 1970s	28	55,528,703	42 %	1,983,168
1970s	25	12,510,275	9.4%	500,411
1980s	54	33,638,058	25.4%	622,927
1990s	46	14,376,638	10.9%	312,536
Since 2000	65	16,293,875	12.3%	250,675
TOTAL=	218	132,347,549	100%	607,099

Source: Department of Revenue business and occupation tax deduction database.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

This tax preference benefits a variety of clubs, associations and organizations. It is not clear exactly how many clubs are claiming this B&O tax deduction because businesses report this deduction with the contributions and donations deduction. There have been reporting errors with this deduction. There were a total of 218 taxpayers who were estimated to have claimed a deduction for membership dues and fees as of the time of this report. The Department of Revenue was still investigating numerous accounts to determine if the reported deductions were accurate. The largest share of those taxpayers was in the civic, professional, religious and other similar industry classification with 49 percent of the total taxpayers. The amusement, gambling and recreation industries had the next largest share of all industries at 29 percent of all taxpayers.

The total number of taxpayers claiming this membership dues and fees deduction on the Washington excise tax return is significantly less than the total number of non 501(c)(3) nonprofit organizations in Washington registered with the IRS. The National Center on Charitable Statistics database reveals that there are 2,558 civil leagues, social welfare and other clubs that reported to the IRS in 2005 (see Table 20). Of those clubs that potentially could be assessing membership dues and fees, 33 percent of the total organizations were business leagues; 19 percent were social clubs; 30 percent were civic leagues; 5.5 percent were domestic fraternal societies and the remaining clubs were 12.5 percent. It is unclear if all these organizations which assess membership dues and initiation fees can meet the "social benefits" tests required to qualify for this deduction. The discrepancy between the large number of nonprofit organizations (2,558) reporting to the IRS and the small number of taxpayers claiming this deduction, 218, makes it difficult to be certain on the number of beneficiaries of this tax preference.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

One objective of this tax preference was to provide a deduction for clubs and organizations in the state that have membership dues and fees that pay for the privilege of belonging to the club. Having to separate that "social" benefit of a club or organization from the dues and fees paid for goods and services is difficult and inconsistent among club types. This JLARC report could not find any evidence that because a club was older and more exclusive or charged higher membership fees that this fact meant this club was providing larger "social" benefits to members than other less exclusive clubs with lower membership dues and fees.

Initially, in examining the Department of Revenue accounts on businesses which claimed this tax deduction in 2006, there were more than 1,300 accounts reporting a deduction for donations and contributions and membership dues and fees. JLARC staff decided whether the taxpayers were claiming contributions and donations received or membership dues and fees received. JLARC based this separation of the deduction on the industry sectors and whether they typically receive donations versus those that typically have memberships and could claim dues and fees as a deduction. During the course of this analysis, JLARC staff determined a significant number of accounts with deduction amounts that were relatively small and not from industry sectors that typically receive contributions or have a membership base to collect dues from. JLARC found 725 accounts or 56 percent of all the accounts claiming this tax deduction that were questionable deductions and have forwarded those accounts to the Department of Revenue for further investigation. According to discussions with the Department of Revenue staff, they believe taxpayers might have confused this business and occupation deduction for membership dues and fess and contributions and donations received with the federal deduction. Some businesses might have thought they could deduct membership dues and fees paid like a cost of doing business deduction that is also allowed on federal taxes. The Department indicated that they will further investigate these accounts and bill the taxpayer if necessary and find ways to correct the reporting problems for this deduction in the future.

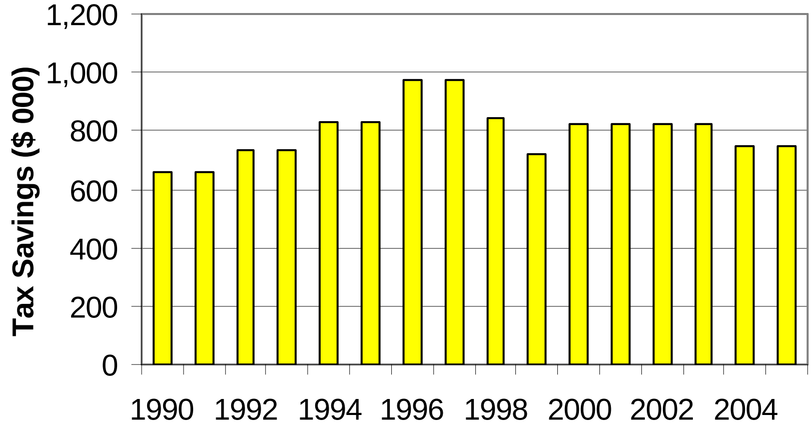
At the time of this JLARC audit, this particular business and occupation tax deduction has taxpayer reporting errors which has led to unintended benefits to entities that do not qualify for the deduction.

Revenue and Economic Impacts

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

Since 1990, the tax savings for this business and occupation tax deduction has ranged from $659,000 in 1990 to $977,000 in 1996 and 1997. In 2004, the business tax deduction savings were nearly $800,000. The estimates in Figure 6 are taken from the Department of Revenue's Tax Exemption Reports from 1990-2004.

Figure 6: Membership Dues and Fees B&O Tax Savings: 1990-2005



Source: Department of Revenue Tax Exemption Reports 1988 – 2004.

The forecast of the tax savings for this tax preference is $1.98 million in 2006. The estimated amount of the "social" benefit of these clubs and organizations is $132 million. This 2007 estimate is higher than the 2004 Tax Exemption Report estimate for 2006. This is due to this estimate having an industry sector and/or account level distinction made regarding whether the deduction would likely qualify for membership dues or fees or not. The business and occupation tax savings forecast is between $2 million and $2.2 million.

Table 18: Forecast of Business and Occupation Tax Savings for Organizations Receiving Membership Dues and Fees

Year	**Total Value of Contributions and Donations ($ millions)**	**Business and Occupation Tax Savings ($)**
2006	$132.3	$1,980,000
2007	$137.6	$2,060,000
2008	$143.2	$2,150,000
2009	$148.9	$2,230,000

Source: Department of Revenue Tax Exemption Reports 1988 – 2004.

The estimated taxpayer savings reported in Table 18 is also the state government annual loss from this business and occupation tax deduction.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

Table 19, on page 112, shows information on the assets and revenue of non-501(c)(3) nonprofits in Washington. The information comes from data provided by the National Center for Charitable Statistics (NCCS). The NCCS combines information from two IRS files: The Business Master File and the Return Transaction File (RTF). The RTF contains information taken from the annual returns filed by nonprofits. This table only has information on nonprofits required to file annual returns with the IRS (nonprofits with gross revenue over $25,000). This table underestimates the number of organizations by removing the smaller organizations. The clubs highlighted in this table are ones that might typically claim membership dues and fees as a deduction on their business and occupation tax return. This information reveals that there are 2,500 clubs that typically assess membership dues and fees each year. The business leagues and chambers of commerce make up the largest share at 33 percent of all organizations. The second largest category of organizations that assess membership dues and fees are civic leagues, social welfare organizations and local associations of employee organizations at 851 organizations. Social and recreation clubs are the third largest at 494 organizations.

The total amount of revenue generated by those clubs was $5.4 billion in the most recent year and, the total assets equaled $3.68 billion. Of the $5.4 billion in total revenue, $3 billion was from voluntary employee beneficiary associations comprising the largest share of total revenue. [50] The voluntary employee beneficiary associations also had the largest share of total assets at $1.5 billion of the $3.6 billion in total assets.

It is unlikely that the impact from the beneficiaries will be this large since not all these nonprofit organizations may be claiming membership dues and fees as a deduction. In addition, there may be other businesses that are not nonprofit that assess membership dues and fees that are claiming this deduction. The economic impact from the beneficiaries of this tax preference is difficult to assess with any degree of confidence.

[50] Voluntary employees beneficiary associations are associations filing IRS form 501(c)(9) and providing for payment of life, sickness, accident, or other benefits to members.

Table 19: Non-501(c)(3) Organizations in Washington with Potential Club Memberships

Club Category	Number of Organizations and % of Total Organizations		Total Revenue and % of Total Revenue		Assets and % of Total Assets	
Civic leagues, social welfare organizations, and local associations of employees	781	30.53%	1,665,376,552	30.83%	1,042,968,818	28.30%
Business leagues, chambers of commerce, real estate boards, etc.	851	33.27%	404,962,155	7.50%	369,573,981	10.03%
Social and recreational clubs which provide pleasure, recreation, and social activities	494	19.31%	196,047,361	3.63%	396,557,733	10.76%
Fraternal beneficiary societies and associations	159	6.22%	37,411,170	0.69%	186,740,954	5.07%
Voluntary employees' beneficiary associations	132	5.16%	3,075,507,438	56.94%	1,578,200,777	42.83%
Domestic fraternal societies and associations - lodges devoting their net earnings to charitable causes	141	5.51%	21,804,602	0.40%	110,799,437	3.01%
Total	2,558	100.00%	5,401,109,278	100.00%	3,684,841,700	100.00%

Other States

Do other states have a similar tax preference?

In general, this deduction for membership dues and fees is common among states as a complete exemption for nonprofit organizations only. One reason for this is because states typically connect to the federal law that allows a complete deduction for membership dues and fees received and certain dues and fees paid by businesses. If states have a corporate income tax and their state law connects to the federal definition of taxable income, those states will also provide their nonprofit businesses with an exemption for membership dues and fees received and certain dues paid unless the states have adopted laws to disconnect from that exemption. According to the CCH state survey, there are 37 states that connect to the federal definition of corporate taxable income and do not have other provisions to add back the membership dues and fees to a club or organization's taxable income base. There are five states with a corporate income tax that connect to the federal gross income or other IRS provision and adopt their own business deductions and do not appear to have created specific provisions for excluding membership fees and dues from the tax base. Through the course of this audit, JLARC found no other state that requires clubs to divide membership dues and fees received into taxable and deductible portions of the fees and dues like Washington.

Two states, which impose their own type of business tax (New Hampshire and Texas) do not appear to have provisions to exempt membership dues and fees received from taxable income for businesses. New Hampshire, which imposes a business profits tax and a business enterprise tax, does not base that tax on federal taxable income. The JLARC CCH state survey did not uncover that this state had specific provisions for excluding membership dues and fees from the gross receipts of businesses. Texas also with its franchise tax on corporations does not appear to have provisions for deducting membership dues and fees received as income.

The federal government has a requirement for being an exempt nonprofit "social club" under IRS 501(c)(7) that a club will not discriminate against any person based on race, color or religion in order to qualify for tax exempt status. Three states (California, Colorado and Kentucky) have also enacted provisions to restrict membership dues and fees deductions to clubs and associations which cannot discriminate on the basis of age, sex, race, religion, color, ancestry, or national origin.

California

California has an anti-discrimination provision for membership dues and fees deduction with an exception being made for those organizations of a local chapter of a American national fraternal organization that operates in at least 20 states, has at least 175 local units and has been in active continuous existence for at least 20 years.

Colorado

Colorado has adopted provisions that a club that is licensed to sell alcoholic beverages and that has a policy of restricting membership to the club on the basis of sex, race, religion, color or ancestry or national origin, must have this deduction income added back their federal taxable income.

Kentucky

Kentucky has provisions that state that taxpayers may not deduct amounts paid to any club or establishment that has been determined by the courts or a state agency not to afford equal membership or privileges because of race, color, religion, national origin or sex.

HORSE RACING – SUMMARY

Current Law

Under current law, persons who conduct horse racing events that are licensed by the State Horse Racing Commission are exempt from the business and occupation tax. In Appendix 3 is the current law statute, RCW 82.04.350, which provides for the business and occupation tax exemption. This business and occupation tax exemption is for the income received for conducting race meets or pari-mutuel wagering. This exemption does not extend to other sources of income derived at racetracks such as sales of food or souvenirs, rental income from the use of the facilities and parking charges.

Findings and Recommendations

This review of Washington's business and occupation tax exemption for businesses conducting horse races has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- This business and occupation tax exemption was enacted in 1933 at the same time as the temporary business activities tax and the gross receipts pari-mutuel tax.
- The public policy objective for this business and occupation tax exemption was to exclude the gross receipts from the B&O tax for businesses conducting horse race meets who were licensed with the Washington State Horse Racing Commission.
- This tax preference has achieved its objective of providing business and occupation tax relief to these racetrack owners in the past.
- While the legislative intent is unclear, an objective for this tax preference might have been to avoid double taxation from both business and occupation as well as pari-mutuel taxes.

Beneficiaries

- In calendar year 2006, the entities benefiting from this business and occupation tax exemption were one class 1 racetrack and four smaller nonprofit race tracks.
- It is uncertain if the Legislature intended to provide this B&O tax relief to avoid double taxation for these businesses because they also had to pay the pari-mutuel tax which was also based on gross receipts. If that was the public policy objective, then there are unintended beneficiaries with this tax exemption as nonprofit race tracks do not pay the pari-mutuel tax and also do not have to pay the business and occupation tax.

Economic and Revenue Impacts

- In calendar year 2006, the horse racing businesses had a business and occupation tax savings of approximately $2 million.
- The future business and occupation tax savings for horse racing businesses over the next three years is between $2.1 and $2.24 million per year.

Other States

- The JLARC CCH survey of other states revealed that 37 other states have pari-mutuel taxes.

Due to the fact that this tax preference was originally enacted to provide a business and occupation tax exemption for businesses that were licensed with the Horse Racing Commission and were conducting horse race meets and the beneficiaries of the tax preference are those race track owners, this tax preference achieves those objectives. This business and occupation tax exemption is relatively easy to administer as it is a complete business and occupation tax exemption. This tax preference is not tied to the entities actually paying the pari-mutuel tax in order to qualify for this exemption. As a result, certain racetracks are avoiding double taxation with this exemption while others are not subject to either the pari-mutuel or business and occupation tax on their horse racing wagering receipts.

Recommendation

If the Legislature had a public policy objective to avoid double taxation for all horse racing, then this business and occupation tax exemption should be adjusted to tie qualifying for this exemption to actually paying the pari-mutuel tax. If the Legislature had a public policy objective to avoid double taxation only for businesses operating class 1 horse racing meets, then the Legislature should continue the business and occupation tax exemption.

Legislation Required: Yes, if the exemption is tied to paying the pari-mutuel tax.

Fiscal Impact: Approximately $10,000 annually in additional business and occupation tax from nonprofit race tracks which are exempt under current law.

HORSE RACING – REPORT DETAIL

Statutory History

This exemption to the business and occupation tax was enacted in 1933. Since this exemption was enacted at the same time as the new temporary business and occupation tax and the pari-mutuel tax, it appears to be a base defining exemption for the business and occupation tax. The original language, 74 years ago, was identical to the current language for this tax preference.

Background – Pari-Mutuel Tax

The background for this tax preference will cover the pari-mutuel tax, distributions of this tax and the business and occupation tax.

The first pari-mutuel tax rate on gross receipts from horse racing meets was 5 percent. Since that time, the tax rate has been lowered to its current rate of between 1.3 and 1.8 percent depending on the amount of gross receipts. If gross receipts are in excess of $50 million, then the pari-mutuel tax rate is 1.3 percent; otherwise, it is 1.8 percent. The law for the pari-mutuel tax is outlined in RCW 67.16. Currently, there is only one racetrack, Emerald Downs, which is paying the 1.3 percent pari-mutuel tax.

Originally in 1933, all horse racing tracks were paying the pari-mutuel tax on gross receipts from racing meets. In 1979, "nonprofit" tracks, as defined by the Washington Horse Racing Commission, were allowed an exemption from the pari-mutuel tax. The requirements for the nonprofit race tracks are that they can not exceed ten days a year of events and the average daily handle of these race tracks can not exceed $120,000. [51] Currently, there are four nonprofit race tracks in Washington, Sun Downs, Walla Walla, Waitsburg and Dayton. For the past four years, the only nonprofit race track that has operated ten race days per year has been Sun Downs. The other three nonprofit tracks combined have had ten or less races days each year since 2003.

Figure 7 shows the history of collections for the pari-mutuel tax. When horse racing was first legalized and taxed in Washington, the amount of wagering was small, just $1.48 million. Initially there was one class A[52] (Longacres) and two class B[53] racetracks (Playfair and Yakima Meadows) in Washington. Horse racing increased in popularity from 1933 and wagering grew significantly. In 1979, there was the distinction made for small "nonprofit" racetracks and the exemption from the pari-mutuel tax began. For years, there were five smaller nonprofit tracks. Wagering Income hit a high point in 1991 at $243 million. By 1993, the Longacres race track had closed and by

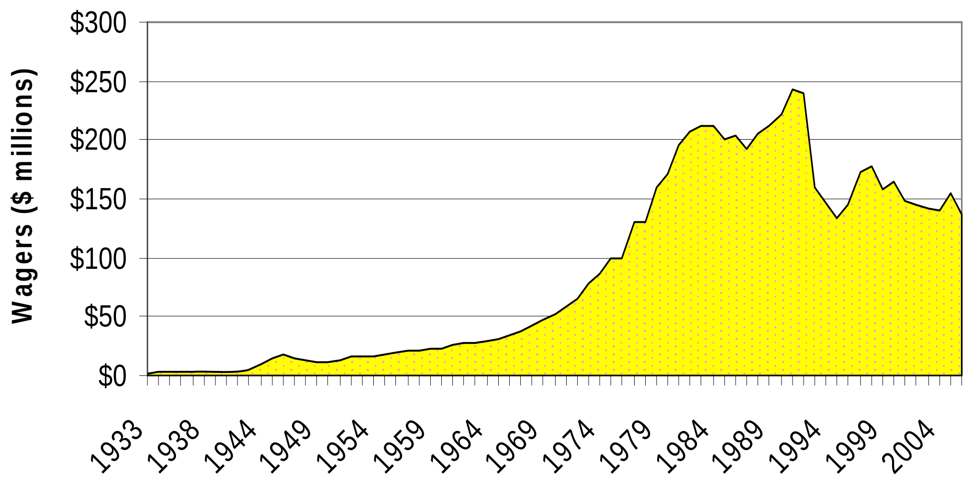
[51] Handle – total amount of money bet over a specified period of time.

[52] Class A racetrack has gross receipts of all in-state pari-mutuel machines that exceed $50 million dollars in the previous year as outlined in RCW 67.16.105.

[53] Class B racetrack has gross receipts of all in-state pari-mutuel machines that are $50 million or less in the previous calendar year as outlined in RCW 67.16.105.

1996, Emerald Downs had opened for horse racing and wagering increased again until Playfair closed in 1998, lowering total wagering statewide. By 2001, there was only one class A racetrack, Emerald Downs, and no class B and four nonprofit racetracks. The total annual wagering has been a little under $150 million since 2001.

Figure 7: History of Pari-mutuel Wagering Since Enactment in 1933



Source: Washington State Horse Racing Commission – Annual Reports and other historical data.

In the last four years, pari-mutuel wagering by nonprofit racetracks has been on average $707,958. This is significantly less than the approximately $150 million in wagering at the class 1 racetrack in the state.

Table 20: Nonprofit Racetrack Wagers

Year	Pari-mutuel wagering
2003	773,680
2004	680,016
2005	718,728
2006	659,407
4 -Year Average	**707,958**

Source: Washington State Horse Racing Commission – Annual Reports.

Distributions of Pari-mutuel and Additional Dedicated Taxes

Under current law, all of the tax revenue from the pari-mutuel tax is distributed to the Washington State Horse Racing Commission. Between 1941 and 1998, the pari-mutuel tax had also been funding the Fair Fund and the State Trade Fair Fund. With the enactment of E2SSB 6562 in 1998, the pari-mutuel tax was no longer distributed to the fair accounts.[54]

[54] JLARC Report 99-12, *Impact of Full Card Simulcasting and Reduction in the Parimutuel Tax on Horse Racing Industry*, December 1999.

In addition to the 1.3 percent pari-mutuel tax on gross receipts, there is also a 1 percent tax on gross receipts from all pari-mutuel machines at each race with the exception of the nonprofit races.[55] These funds are distributed to the Commission and deposited into the Washington Bred Owners' Bonus Fund Account. In addition to the 1.3 percent pari-mutuel tax and the 1 percent tax on gross receipts for the Washington Bred Owners' Bonus Fund Account, there is an additional .1 percent tax of daily gross receipts of in-state pari-mutuel machines for payment to the nonprofit race meets. In addition to the tax revenue of the .1 percent tax paid by all racetracks except the nonprofit tracks, the Washington Horse Racing Commission provides additional funds as necessary so the total amount deposited into the nonprofit racetrack purse fund has a total revenue amount equal to $300,000 each year. These funds must be used for purses at nonprofit tracks that have operated for five consecutive years immediately preceding the year of payment.

Business and Occupation Tax

Up until 1933, Washington's main sources of tax revenue were the property tax, motor vehicle fuel tax, inheritance taxes and insurance premiums tax. Then, the Washington Legislature enacted the "Tax on Business Activities" in 1933 on a temporary basis.[56] Two years later, the Revenue Act of 1935 included the business and occupation tax (B&O) as a replacement for the "Tax on Business Activities." The initial tax rate was .25 percent of gross receipts for all business activities, except services which were taxed at .5 percent. Subsequent tax rate increases were enacted in 1951, 1955, 1959, 1976, 1982 and 1983. Over the years, the Legislature has developed a number of specialized tax rates created for particular types of businesses.[57]

The business and occupation tax is imposed on gross receipts and for the most part revenues are deposited in the State General Fund. There are two exceptions. The B&O tax imposed on public and nonprofit hospitals under RCW 82.04.260(10) is deposited in the health services and the B&O tax on contests of chance and pari-mutuel wagering is deposited into the problem gambling account. Under current law, for most companies, the business and occupation tax rates range from .13 percent for pari-mutuel wagering to 1.5 percent for service and other activities, hospitals and gambling contests of chance (less than $50,000 per year). Gambling contests of chance, worth $50,000 or more each year, pay 1.63 percent tax rate. There is a higher B&O tax rate of 3.3 percent for a small number of companies that dispose of low-level radioactive wastes. Those covered businesses not otherwise subject to a specific tax rate pay the B&O tax at the rate of 1.5 percent. A business may have more than one B&O tax rate, depending on the types of activities conducted. The B&O tax does not permit deductions for the costs of doing business, such as payments for raw materials and wages of employees. The pari-mutuel tax rate of 1.3 percent of wagering income is in the range of other B&O tax rates but not as high as the 1.63 percent for gambling contests of chance.

[55] RCW 67.16.102.

[56] Fifth Biennial Report of the Washington Tax Commission, Sept. 30, 1934.

[57] 2005 Tax Reference Manual, Washington Department of Revenue.

The 2005 Legislature enacted ESHB 1031 which created a new B&O tax on a portion of the pari-mutuel wagering income and the new revenue was directed toward gambling treatment programs. A new business and occupation tax was placed on both the operation of contests of chance and pari-mutuel wagering. The new tax rate on horse racing pari-mutuel wagering was .13 percent of a business's gross income beginning July 1, 2006. For this new B&O tax, the tax base is not the same as the gross receipts of pari-mutuel wagering on which the pari-mutuel tax, collected by the Washington Horse Racing Commission, is based. The tax base for the new tax is "gross income of the business" which is defined as the gross receipts from pari-mutuel wagering less the amounts paid to players for winning wagers, or taxes imposed or other distributions required by the Horse Racing Commission under RCW 67.16. In examining prior years' pari-mutuel tax data from the Washington Horse Racing Commission, the deduction amount for winning wages alone is roughly on average 80 percent of the gross pari-mutuel wagering income. This new business and occupation tax is the first business and occupation tax on a portion of the pari-mutuel wagering income since the enactment of the business and occupation tax.

Public Policy Objectives

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?

Tax base defining theory states that at the time legislatures are developing a tax, they will define the elements that will be subject to the tax and the elements excluded. The public policy objective for this exemption was to exclude the gross receipts from horse racing events from the tax base of the business and occupation tax, consistent with tax base defining theory. The key criteria necessary to qualify for this exemption is being licensed by the State Horse Racing Commission and in the business of conducting race meets. The Legislature has only required businesses which operate racetracks to be licensed with the State Horse Racing Commission in order to qualify for the business and occupation tax exemption. The Legislature has never required the owners of racetracks to actually pay another tax, like the pari-mutuel tax, in order to have their gross receipts exempt from the business and occupation tax. The public policy objective of this tax preference appears to be a tax base defining exemption. It is unclear if the Legislature would have considered placing a new business and occupation tax based on the gross receipts that the pari-mutuel tax collected by State Horse Racing Commission as imposing double taxation on that income. From the original statutory language, it is unclear if the Legislature had that particular public policy objective that gross receipts exempt from the business and occupation tax would always pay some tax on those wagering gross receipts to the state.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

For 46 years, between 1933 and 1979, all racetracks in Washington paid the pari-mutuel tax. This business and occupation tax exemption achieved the public policy objectives of providing an exemption from the business and occupation tax due to the entities being licensed with the State Horse Racing Commission and that the wagering gross receipts from these racetracks would not be double taxed by both the pari-mutuel and B&O tax. In more recent years, this tax preference has achieved the objective of providing an exemption to businesses licensed with the State Horse Racing Commission. If the Legislature also had a public policy objective that the businesses licensed with the State Horse Racing Commission would always be paying the pari-mutuel tax, then that public policy objective has not been fulfilled since 1979 when the nonprofit racetracks became exempt from the pari-mutuel tax and also exempt from the B&O tax.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

Since 2001, there has only been one racetrack in Washington subject to the pari-mutuel tax and that is the Emerald Downs racetrack. There have been four other smaller nonprofit racetracks that have also been provided a business and occupation tax exemption for their wagering gross receipts which currently do not pay the pari-mutuel taxes. All five race tracks are currently benefiting from the business and occupation tax exemption.

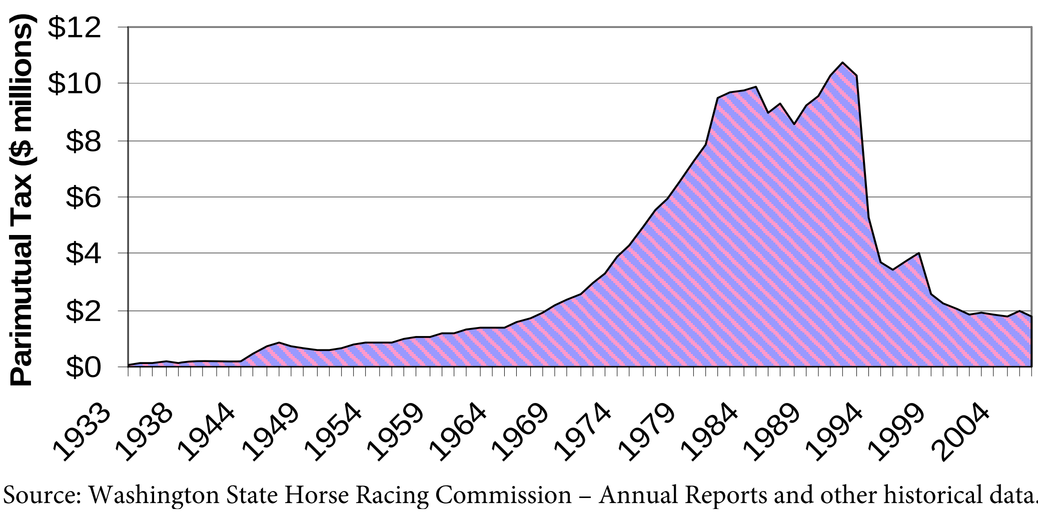
To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

If the Legislature enacted this tax exemption from the business and occupation tax because these businesses were licensed with the State Horse Racing Commission, then the tax preference is not providing unintended tax benefits. If the Legislature assumed that those businesses licensed with the State Horse Racing Commission would also be paying a pari-mutuel tax and the reason for the tax exemption from the B&O tax was to avoid double taxation, then the tax exemption has unintended B&O tax benefits going to businesses operating nonprofit racetracks.

Revenue and Economic Impacts

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

Figure 8: History of Parimutuel Tax Collections Since Enactment in 1933



Source: Washington State Horse Racing Commission – Annual Reports and other historical data.

Initially in 1933, the pari-mutuel tax was small, and wagering was not yet widely accepted and popular. Horse racing steadily grew in popularity until it hit its peak in 1992, when the pari-mutuel tax rose above $10 million, the last year of Longacres, see figure 8. In 1993, the Longacres race track closed. By 1996, Emerald Downs had opened for horse racing, and wagering increased again until Playfair closed in 1999, lowering total wagering statewide. Legislation enacted in 1998 reduced the pari-mutuel tax rate by 50 percent which lead to further reductions in the pari-mutuel tax revenues. By 2001, there was only one class A racetrack, Emerald Downs, no class B tracks and four nonprofit racetracks. The total annual wagering has been a little under $150 million and the pari-mutuel tax approximately $2 million since 2001.The forecast for the state business and occupation tax exemption for businesses conducting horse racing is expected to be a little more than $2 million over the next three fiscal years. This is assuming a B&O tax rate of 1.5 percent since this would be a miscellaneous business activity which currently does not fit into one of the specified activities with a particular tax rate. If the tax preference were terminated, the B&O tax being assessed on horse racing businesses' gross receipts would increase state government revenue by the estimated amounts in Table 21.

Table 21: Forecast of Business and Occupation Tax Savings to Horse Racing Businesses

Year	**Exempt Wagering Value ($ millions)**	**B&O Tax Savings (Assuming 1.5% B&O tax rate) ($millions)**
2006	$136.72	$2.04
2007	$143.69	$2.16
2008	$146.56	$2.20
2009	$149.49	$2.24

Source: Washington State Horse Racing Commission – Annual Reports and other historical data.

The estimated taxpayer savings reported in Table 21 is also the state government annual loss from this business and occupation tax exemption.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

At the national level, the American Horse Council commissioned a comprehensive study of the economic impact of the horse industry completed in 2006. This study found that the total U.S. horse industry, including recreation and racing purposes contributed $39 billion of direct revenue and $102 billion of direct, indirect and induced spending to the U.S. economy. The racing industry alone generated $10.7 billion in direct revenue and $26 billion of direct, indirect and induced spending to the U.S. economy. There are 1.4 million full-time equivalent (FTE) jobs produced from all aspects of the horse industry with 38 percent or 530,451 FTE jobs due to racing industry impact. This study estimated that the entire U.S. has 9.2 million horses of which 844,531, or 9 percent of all horses, were for racing purposes. This study reported that Washington was 11th in terms of the total number of horses with 249,964 horses, which represented 2.7 percent of all horses in U.S.

There have been various state level economic impact studies of the horse industry. Through the course of this audit, JLARC staff was not aware of any recent economic impact study of the horse industry for Washington State. The last study that JLARC found on Washington's horse racing and breeding industry was in 1990.[58]

There have been other more recent state studies on the horse industry. In 2003, Pennsylvania completed an equine industry study. They found that in 2001, the entire industry had a direct impact of $642.9 million in revenue and $330.5 million in value added. Including in the secondary effects, the equine industry had an impact of $1.124 billion in revenues and $615.1 million in value added. From the study, it was reported that the Pennsylvania horse racing industry indicated that their industry generated $197 million in direct output and $100.6 million in value added. Accounting for multiplier effects, the racing industry added $147.1 million in output and $87 million in value added.[59] The Pennsylvania equine industry was comprised of 215,693 horses of which 26,365, or 12 percent, were horses for the racehorse industry.

Due to the small number of beneficiaries of this horse racing business and occupation tax preference, the total number of employees and their impact on the state and regional economy can not be discussed for disclosure requirements. The disclosure laws state that all Employment Department data cannot be disclosed in groups with fewer than three firms.

Other States

Do other states have a similar tax preference?

In performing a CCH review of other states to determine if they had a pari-mutuel tax on horse racing wagering, we found that 37 states, including Washington, do have that type of tax.[60] There may be other states that also have this type of tax.[61] Given the time constraints on this report, JLARC has not had sufficient time to complete a full 50 state survey or determine which of these 37 states with a pari-mutuel tax also exempt wagering gross receipts from other business taxes. This highlights a few examples of other state laws pertaining to the overall tax treatment of pari-mutuel wagering:

- California does not exempt promoters of horse racing from paying any other fee otherwise required by the state.
- Indiana law pre-empted local government from assessing a tax or fee except for real or personal property taxes.

[58] JLARC Report 99-12 Impact of Full Card Simulcasting and Reduction in the Parimutuel Tax on the Horse Racing Industry, December 1999 cited report titled *The Economic Contribution of the Thoroughbred Horseracing and Breeding Industry to the State of Washington*, Killingsworth Associates, Inc. 1990.

[59] Penn State University, *Pennsylvania Horse Power Pennsylvania Equine Economic Impact Study*, May 2003.

[60] The 12 states with a pari-mutuel tax were the following: AZ, CO, KY, MI, MN, ND, NE, NM, NY, OR, SD and WA.

[61] This research could not identify a pari-mutuel tax in the following 14 states: AK, GA, DC, HI, ME, MS, MO, NC, SC, TN, UT, VT, WI, WY.

- Iowa law is similar to Washington's because it states that no other excise tax shall be levied, assessed or collected from the licensee on horse racing.
- Kentucky and West Virginia laws both state that the pari-mutuel license tax, admission tax and state taxes and contributions on pari-mutuel systems shall be in lieu of all other license, excise, special or franchise taxes.
- New Mexico law exempts pari-mutuel income from other state and local receipts tax.

BOXING AND WRESTLING MATCHES – SUMMARY

Current Law

Under current law, persons who conduct boxing contests and sparring or wrestling matches and exhibitions that are licensed by the Department of Licensing are exempt from the business and occupation tax. In Appendix 3 is the current law statute, RCW 82.04.340, which provides for the business and occupation tax exemption.

Findings and Recommendations

This review of Washington's boxing, wrestling and martial arts promoters' business and occupation tax exemption has evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following findings were determined through this audit:

Legal History and Public Policy Objectives

- This business and occupation tax exemption was enacted in 1935 at the same time as the business and occupation tax and the boxing and wrestling tax. There was an objective to define the business and occupation tax base in enacting this tax preference.
- The public policy objective for this business and occupation tax exemption was to exclude these gross receipts from the B&O tax for businesses conducting boxing, wrestling and martial arts events in Washington.
- This tax preference may have been enacted to avoid double taxation since sporting event promoters are also subject to the gross receipts boxing and wrestling tax.
- This tax preference has achieved its objective of defining the business and occupation tax base by providing business and occupation tax relief to these sporting event promoters.

Beneficiaries

- In 2006, there were six promoters of boxing events, eight promoters of wrestling matches and martial arts events who were licensed by DOL to conduct sporting events.
- There does not appear to be any unintended tax benefits to any entities as the sporting event promoters are also paying the gross receipts boxing and wrestling tax so this tax preference also achieves the objective of eliminating double taxation on these promoters' gross receipts.

Economic and Revenue Impacts

- In 2006, the business and occupation tax savings for sporting event promoters was $18,000.
- The future business and occupation tax savings for sporting event promoters over the next three years is between $19,000 and $21,000 per year.

Other States

- Thirty-three states, including Washington, had a boxing and wrestling gross receipts tax. Most tax rates were between 3 and 5 percent.

Due to the fact that this tax preference was originally enacted to provide a business and occupation tax exemption for businesses that were licensed by the Department of Licensing and conducting boxing, wrestling and martial arts events and the beneficiaries of the tax preference are those promoters, this tax preference achieves its objectives. This business and occupation tax exemption is provided to all business entities equally and all businesses receiving this B&O tax exemption also pay the gross receipts boxing and wrestling tax so it eliminates double taxation for these businesses.

Recommendation

The Legislature should continue the business and occupation tax exemption for promoters of boxing, wrestling and martial arts matches.

Legislation Required: None

Fiscal Impact: None

BOXING AND WRESTLING MATCHES – REPORT DETAIL

Statutory History

This language originally was enacted in 1935. In the 1935 chapter of law which specifies the gross receipts that are to be subject to the business and occupation tax, it states the following exemption. It is nearly identical language to today except for the licensing agency being the state athletic board.

> This chapter shall not apply to any person in respect to the business of conducting boxing contests and sparring or wrestling matches for the conduct of which a license must be secured from the state athletic board.

Boxing and Wrestling Tax

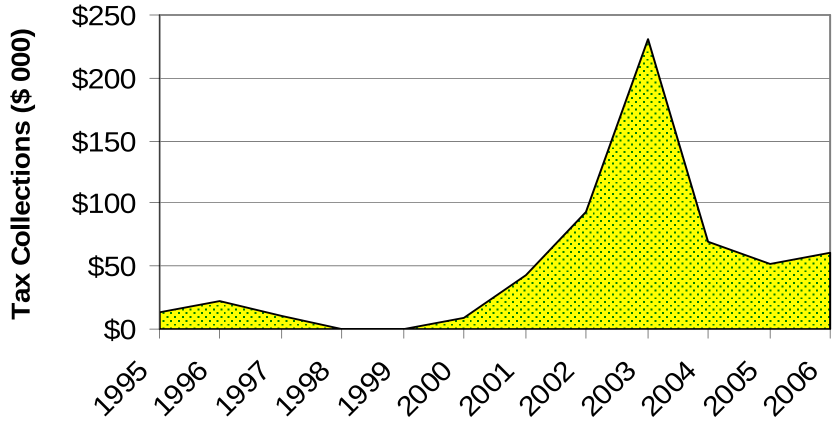
The Department of Licensing (DOL) regulates boxing, martial arts, kickboxing and wrestling events. Boxers, promoters, inspectors, physicians and others involved with the events must obtain a license from DOL. Federal law requires boxing events, including events on tribal lands, to be supervised by a regulatory entity. Since 1933, a gross receipts boxing and wrestling tax has been assessed on promoters of these events. After an event, a promoter must file a report with DOL and pay the boxing and wrestling tax. Since enactment, the boxing and wrestling gross receipts tax has been 5 percent tax of gross receipts of these boxing, wrestling and marital arts matches.[62]

This tax applies to most all boxing, wrestling and martial arts events with a few exceptions. There is an exemption from the tax on complementary event tickets, up to 10 percent of the number of tickets sold and not to exceed 1,000 tickets. Matches that are held by public or private schools, colleges, and universities in which students participate are exempt from this gross receipts tax. Amateur events, promoted by nonprofit charitable organizations for charitable purposes are also exempt from the boxing and wrestling gross receipts tax. In addition, closed circuit telecasts of such matches or exhibitions viewed within the state must pay the gross receipts boxing and wrestling tax. Figure 9 provides the history of this tax since 1995.

[62] RCW 67.08.055.

This tax has been quite volatile until recently. The tax collections can change significantly depending on the number and size of sporting events in the state. In 2003, there was a big WWE wrestling event in Seattle that increased tax collections to more than $200,000. Since 2002, the tax collections have typically been a little more than $50,000.

Figure 9: Total Boxing and Wrestling Tax Collections Since 1995



Source: Licensing Department Tax Collections.

Between February 2005 and February 2007, 45 out of 46 of the boxing events have occurred at tribal casinos throughout the state. The wrestling matches have occurred in other non-casino venues throughout the state. All martial arts events for this same time period were held in the Tacoma Dome. Table 22 summarizes the following events that have been assessed the boxing and wrestling tax between February 2005 and February 2007. There were a total of 117 sporting events. 56.5 percent of the sporting events were wrestling matches, 39.5 percent were boxing matches and 4 percent were martial arts events. The total amount of tax based on the gross receipts from all of these sporting events was $142,410 for the two-year period.

Table 22: Sporting Events Subject to the Boxing and Wrestling Gross Receipts Tax between Feb. 2005 and Feb. 2007

Type of Event	Number of events	Boxing and Wrestling Tax paid
Boxing	46	$68,850.3
Wrestling	66	$59,368.6
Martial Arts	5	$14,190.8
TOTAL =	**117**	**$142,409.7**

The boxing and wrestling tax collections for 2006 are given in Table 23 on the following page. In 2006, tax collections were $60,646 and for the first two months in 2007, tax collections totaled $30,347. Wrestling matches made up the largest share of total tax collections with boxing matches not far behind.

Table 23: Boxing and Wrestling Tax Collections – Calendar Year 2006

Type of Sport	Tax Collections 2006
Boxing	$27,805.01
Wrestling	$28,508.96
Marital Arts	$4,332.02
Total	$60,645.99

In 2007, HB 1961 was introduced by the Department of Licensing to change numerous provisions in the boxing and wrestling tax. One important change pertaining to the boxing and wrestling tax was to replace the boxing and wrestling gross receipts tax with a fee. The Department had gotten legal advice that federal requirements restrict the state from imposing a "tax" on federal tribal land. Since most all of the boxing and wrestling matches are on tribal land. They wanted to replace the language for the gross receipts tax with a fee. This legislation was not passed.

The proceeds of this boxing and wrestling tax are deposited into the state general fund.

Business and Occupation Tax

Up until 1933, Washington's main sources of tax revenue were the property tax, motor vehicle fuel tax, inheritance taxes and insurance premiums tax. Then the Washington Legislature enacted the "Tax on Business Activities" in 1933 on a temporary basis.[63] Two years later, the Revenue Act of 1935 included the business and occupation tax (B&O) as a replacement for the "Tax on Business Activities". The initial tax rate was .25 percent of gross receipts for all business activities, except services which were taxed at .5 percent. Subsequent tax rate increases were enacted in 1951, 1955, 1959, 1976, 1982 and 1983. Over the years, there has developed a number of specialized tax rates created for particular types of businesses.[64]

The business and occupation tax is imposed on gross receipts and for the most part revenues are deposited in the State General Fund. There are two exceptions. The B&O tax imposed on public and nonprofit hospitals under RCW 82.04.260(10) is deposited in the health services and the B&O tax on contests of chance and pari-mutuel wagering is deposited into the problem gambling account.

Under current law, for most companies, the business and occupation tax rates range from .13 for pari-mutuel wagering to 1.5 percent for service and other activities, hospitals and gambling contests of chance (less than $50,000 per year). Gambling contests of chance, worth $50,000 or more each year, pay 1.63 percent tax rate. There is a higher B&O tax rate of 3.3 percent for a small number of companies that dispose of low-level radioactive wastes. Those covered businesses not otherwise subject to a specific tax rate pay the B&O tax at the rate of 1.5 percent. A business may have more than one B&O tax rate, depending on the types of activities conducted.

[63] Fifth Biennial Report of the Washington Tax Commission, Sept. 30, 1934.
[64] 2005 Tax Reference Manual, Washington Department of Revenue.

The B&O tax does not permit deductions for the costs of doing business, such as payments for raw materials and wages of employees. The tax rates for the gross receipts B&O tax are all much lower than 5 percent which is the tax rate for the boxing and wrestling gross receipt tax.

Public Policy Objectives

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?

Tax base defining theory states that at the time legislatures are developing a tax, they will define the elements that will be subject to the tax and the elements excluded. The public purpose of this tax exemption was to exclude the gross receipts of promoters of boxing and wrestling matches from the business and occupation tax base when it was enacted in 1935. This tax preference was a base defining tax preference. Since the boxing and wrestling tax is also based on the gross receipts from these types of matches, the tax exemption from the state business and occupation tax avoids double taxing the same gross receipts for these businesses. It is unclear if the Legislature made avoiding double taxation an objective when enacting this tax preference. The criteria for this B&O tax exemption is that those businesses be licensed by the Department of Licensing and their business activities be conducting boxing and wrestling matches in the state.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

After examining the Department of Licensing's data on the businesses paying the boxing and wrestling tax, the businesses with the ability to claim this business and occupation tax exemption are promoters of sporting events. This tax preference has achieved its objective of providing business and occupation tax relief to the entities paying the boxing and wrestling tax. This tax preference has also achieved the objective of avoiding double taxation and redundancy of taxing the same gross receipts.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

Between 2005 and 2007, there were six promoters of boxing events and eight promoters of wrestling and martial arts events who were licensed by DOL to conduct sporting events.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

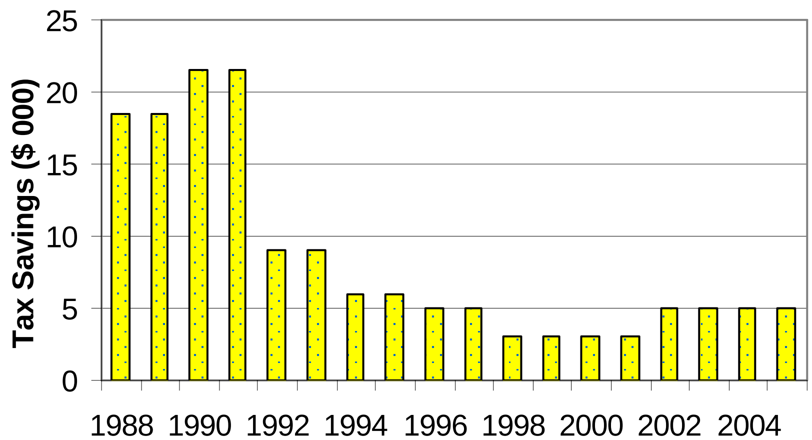
After examining the Department of Licensing's boxing and wrestling tax data, the businesses with the ability to claim this business and occupation tax exemption are the entities that the Legislature intended. This tax preference has achieved its objective of providing business and occupation tax relief for businesses conducting boxing and wrestling matches who are already subject to a gross receipts tax.

Revenue and Economic Impacts

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

The 2004 DOR Tax Exemption Study placed the value of this Business and Occupation (B&O) tax exemption at $5,000. Figure 10 shows the history of this tax exemption, based on the Department of Revenue's Tax Exemption Reports since 1988. After examining the Department of Licensing's recent data on boxing and wrestling match tax collections, it was found that the estimated B&O tax of the gross receipts from these sporting events multiplied by 1.5 percent tax rate has exceeded $5,000 since 2001.

Figure 10: Boxing and Wrestling Promoters Business and Occupation State Tax Savings: 1988-2005



Source: Department of Revenue Tax Exemption Reports 1988 – 2004.

The forecast for this tax preference is between $19,000 and $21,000 over the next three years. This forecast is based on the gross receipts from these sporting events in 2006, the most recent full year of data and a business and occupation tax rate of 1.5 percent. Since this tax preference is a Business and Occupation tax exemption, if the preference was continued, the B&O tax loss from exempting boxing, wrestling and martial arts gross receipts would decrease state government revenue by the estimated amount in Table 24.

Table 24: Forecast of Business and Occupation Tax Savings to Promoters of Sporting Events

Year	Exempt Gross Receipts Value ($ millions)	B&O Tax Savings (Assuming 1.5% B&O tax rate)
2006	$1.21	$18,000
2007	$1.27	$19,000
2008	$1.34	$20,000
2009	$1.40	$21,000

Source: Department of Licensing Annual Tax Collection data for boxing and wrestling matches.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

Since this tax preference has only applied to approximately 14 promoters statewide the impact on the economy from this tax preference is nearly 0. In analyzing the industry sectors of promotion of performing arts, sports and similar events with and without their own facilities, the 2005 Employment Department data indicates that there were 131 firms with 1,928 employees and $36.4 million in total wages. The promotion of performing arts, sports and similar events with and without their own facilities industry sectors only represent .07 percent of all employees statewide and .03 percent of total wages. The boxing and wrestling promoters benefiting from this tax preference are only a small fraction of these sporting promotion industry sectors. That is the reason why the impact of the beneficiaries on the regional and state economy is nearly 0 given the large scale of the Washington State economy.

Other States

Do other states have a similar tax preference?

From the JLARC CCH state law research, 33 states were identified as having a boxing and wrestling gross receipts tax. Most of these states' tax rates were between 3 and 5 percent with a few states having a sliding scale depending on gross receipts. Due to the time constraints on this study, we were not able to determine whether all these states with a boxing and wrestling tax had provisions to exclude promoters of these sporting events from paying other business taxes on gross receipts from these events. In a brief examination of three of these other states with boxing and wrestling matches, it was found that Alabama, North Carolina and Tennessee each did not exempt promoters of boxing and other sporting events from other business taxes. Alabama called the boxing and wrestling tax a "privilege tax" to conduct these matches in their state.

REFUNDED FUEL TAX FOR NONHIGHWAY USE – SUMMARY

This review will look at fuel tax refunds for nonhighway or off road use of gasoline and diesel fuels. The fiscal impact of these refunds is estimated at over $10 million per biennium. Therefore this will be a full review rather than an expedited review.[65]

Current Law

The motor vehicle fuel taxes are laid out in two separate chapters of state law. Chapter 82.36 RCW pertains to motor vehicle fuel, which is basically gasoline, and Chapter 82.38 RCW pertains to special fuel, which are all combustible gasses and liquids that can propel a motor vehicle except gasoline (primarily diesel).[66]

There are two sections of law that pertain specifically to personal refunds for nonhighway use of fuel that are subject to this review:

- RCW 82.36.280 (motor vehicle fuel/gasoline), and
- RCW 82.38.180 (special fuel/diesel).

These sections essentially provide that any person who pays fuel taxes, either directly or to the vendor from whom it was purchased, may file a claim with the Department of Licensing for a refund of the tax if the fuel was NOT used in conjunction with any motor vehicle licensed to be operated on the public highways.

In addition to the two personal refund statutes found in the motor vehicle fuel and special fuel chapters, there are three more "refund" programs for the benefit of classes of recreational users of fuel used for nonhighway purposes.[67] These programs have to do with boating facilities, off-road vehicle facilities and trails, and snowmobile facilities. These programs are included in this review and discussed below..

- Chapter 79A.25 RCW has several sections concerning the refund of taxes paid on marine fuel. The essentials of the program are:

[65] EHB 1069 (2006) provided that an expedited review process could be done on any tax preference that had an estimated biennial fiscal impact of $10 million or less. Initially it was thought that refunded fuel for nonhighway use had a fiscal impact under $10 million and it was placed on the expedited review list.
[66] This report will use motor vehicle fuel and gasoline interchangeably, as well as special fuel and diesel. It will also refer to the motor vehicle fuel tax and the special fuel tax as "fuel taxes."
[67] While state law refers to these as "refunds" in line with a state constitutional provision, they are accomplished by transfers of funds by the State Treasurer from the Motor Vehicle Fund to another state account.

  - The Department of Licensing determines the amount of fuel tax revenues collected on marine fuel. These funds are transferred into the Marine Fuel Tax Refund Account. Individuals can apply for a personal refund from this account.
  - After time has expired for claiming personal refunds, the Treasurer transfers to the Recreation Resource Account a portion of the moneys in the Refund Account (21 cents per gallon) and the remainder to the Motor Vehicle Fund.
  - The Recreation Resource Account is administered by the Interagency Committee for Outdoor Recreation (now Recreation and Conservation Funding Board) for the benefit of watercraft recreation.
  - In addition, an amount equal to one cent per gallon from each marine use refund claim is deposited into the Coastal Protection Fund administered by the Department of Ecology for the restoration of natural resources.

- Chapter 46.09 RCW has several sections concerning the refund of taxes paid on fuel used for off-road vehicles. The essentials of this program are:
  - One percent of motor vehicle fuel taxes, prorated to a rate of 21 cents per gallon is "refunded" to the:
    - Off Road Vehicle and Nonhighway Vehicle Account administered by the Department of Natural Resources, the Department of Fish and Wildlife, and the Parks and Recreation Commission for the development and maintenance of nonhighway roads and recreation facilities; and
    - Nonhighway and Off-Road Vehicle Activities Program (NOVA) Account administered by the Interagency Committee for Outdoor Recreation (now Recreation and Conservation Funding Board) for development and management of ORV, non-motorized, and nonhighway road recreation facilities.
  - Fuel taxes paid on fuel for nonhighway vehicles are not refundable to individuals.

- Chapter 46.10 RCW has several sections concerning the refund of taxes paid on fuel used in snowmobiles. The essentials of this program are:
  - The Department of Licensing determines the amount of moneys paid as tax on snowmobile fuel – estimated from the number of registered snowmobiles, 135 gallons as the average yearly fuel usage per snowmobile and a fuel tax rate of 21 cents per gallon;
  - Snowmobile fuel tax monies are "refunded" to the Snowmobile Account administered by the State Parks and Recreation Commission for snowmobile purposes; and

  - Users of motor vehicle fuel in snowmobiles are not entitled to a refund.

There are several other sections of law that provide refunds or exemptions for specifically identified fuel uses. Those exemptions are **not** subject to this review. RCW 82.36.305 (dealer refunds for marine use of gasoline); RCW 82.38.080 (exemption for farming, logging, power take-off units, refrigeration units, and heating purposes); and RCW 82.38.020(23) (exemption for dyed special fuel, which are designated for non-highway use and enforced with a highway inspection program).

Findings and Recommendations

This review of Washington's motor vehicle fuel tax refunds for nonhighway or off road use of motor vehicle fuel evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following were determined through this audit:

Legal History and Public Policy Objectives

- Washington State first imposed the motor vehicle fuel tax in 1921 on the sale of liquid fuel for use in internal combustion engines. In 1923, the tax was changed to be a tax on fuel used to operate motor vehicles upon the public highways. Tax refunds were provided for the nonhighway use of fuel, except in motor vehicles operated or intended to be operated upon the public highways.

- The 18th Amendment to the State's Constitution provides that all excise taxes collected on the sale of motor vehicle fuel were to be placed in a dedicated account to be used exclusively for highway purposes. The term "highway purposes" includes refunds authorized by law.

- In addition to refunds authorized for individuals who use fuel off-road, there are three "refund" programs for the benefit of recreational users of fuel off-road – marine fuel used by boaters (1964); fuel used by off-road vehicles (1971); and fuel used in snowmobiles (1971).

- Taxes refunded to the recreational programs are calculated using lower than actual motor vehicle fuel tax rates. In 1990, when the motor vehicle fuel tax was raised to 23 cents per gallon, the refunds were limited to 18 cents per gallon. In 2003, the refund rate was increased by one cent per gallon per biennium, ending at 23 cents per gallon after July 1, 2011. The motor vehicle fuel tax is currently 36 cents per gallon.

- The public objective of providing tax refunds to nonhighway users of motor vehicle fuel is one of equity. If the fuel is used on the public highways, the fuel is collected to support the public highway system; if the fuel is not used on the public highways, the tax may be refunded.

- There have been two court decisions that clearly articulate the concept of equity in the motor vehicle fuel taxes. In 1939, the State Supreme Court found that there was a long established general policy that the burden of gasoline taxes should be borne exclusively by those who use the roads for motor vehicle traffic. In 2005, the Court of Appeals, Division Three, found that the framers of the 18th Amendment intended to (1) ensure that gasoline taxes paid by drivers using public highways would be used to construct and maintain those public highways, and (2) return the share of those taxes paid by drivers who expended fuel driving on roadways other than public highways.

- There is some evidence that the public policy objective of equity is only partially being fulfilled. First, not all off-road users of fuel claim a refund. Second, by statute, only a portion of the fuel taxes collected on fuel used for off-road recreational purposes are refunded to the three recreational programs.

Beneficiaries

- There are two sets of beneficiaries of the tax refunds:
    - Direct tax refunds may be claimed by the private businesses and individuals that use fuel off-road – the primary industries include agriculture, logging and construction. In 2006, the Department of Licensing made 4,967 refunds to off-road users of fuel.
    - Recreational users of fuel off-road, specifically watercraft, off-road vehicles, and snowmobiles, are also indirect beneficiaries as their tax dollars are "refunded" to special programs to develop facilities for recreation.

Economic and Revenue Impacts

- Total refunds, both direct refunds to individual users and transfers to the recreational accounts, came to $20.3 million in 2006.
- Fuel used in Washington, if not taxed by the motor vehicle fuel tax, is then taxed by the retail sales or use tax.
- Gross refunds to private businesses and individual off-road users of fuel amounted to $9.0 million in 2006. Of this amount $4.9 million was collected in use tax, and the net refund amount was $4.1 million.
- Refunds to the three recreational programs amounted to $11.3 million in 2006. This amount was computed at a fuel tax rate of 20 cents per gallon when the actual fuel tax was 34 cents per gallon. At the full rate, the amount refunded would have been $19.2 million.
- There are competing uses of fuel tax revenues. The various short-term and long-term economic impacts can be described as follows:
    - Short- and long-term impacts of lower costs in the agricultural, logging, and construction industries;
    - Short-term impacts of recreational facilities construction and maintenance;

  - Long-term impacts of additional recreational facilities;
  - Short-term impacts of highway construction and maintenance; and
  - Long-term impacts of an improved highway system.
- The trade-offs between spending in the various sectors are probably offsetting within the amount of tax revenues being discussed.

Other States

- Thirty-three states either exempt or refund fuel taxes for the private and commercial general nonhighway use of gasoline. Forty-eight states exempt or refund fuel taxes for the agricultural use of gasoline.

Recommendation

In an effort to maintain equity in the treatment of fuel taxes, the Legislature should review its policy of restricting the amount of fuel taxes that may be refunded to programs for off-road recreational users of motor vehicle fuel.

Legislation Required:	Yes, to amend RCW 79A.25.070; RCW 46.09.170; and RCW 46.10.170.
Fiscal Impact:	If the transfers to the special recreational accounts in the 2007-09 biennium were at the full motor vehicle fuel tax rate, then there would be a biennial $18.5 million reduction in the Motor Vehicle Fund and a biennial $18.5 million increase to the special recreation accounts.

REFUNDED FUEL TAX FOR NONHIGHWAY USE – REPORT DETAIL

Statutory History

Motor Vehicle Fuel Tax and Refunds for Nonhighway Use

Washington State first imposed the motor vehicle fuel tax in 1921. The tax was one cent per gallon imposed on the **sale** of liquid fuel – gasoline and other fuel for use in internal combustion engines. The tax was not imposed on liquid fuel sold for export. Revenues were credited to the Motor Vehicle Fund. The Motor Vehicle Fund was a fund dedicated to, among other things, "paving and general road construction of the state primary highways."

In 1923 the tax was raised to two cents per gallon and the tax base was more narrowly drawn. The tax was now on sales of liquid fuel to everyone who **used** liquid fuel for the purpose of operating motor vehicles **upon the public highways**. Tax receipts were still credited to the Motor Vehicle Fund. Several **refunds** were now **provided for nonhighway use of fuel**:

> … any liquid fuel used for the purpose of operating or propelling stationary gas engines, farm tractors or motor boats, or who shall purchase and use any such fuel for cleaning or dyeing or other commercial use of the same, **except in motor vehicles operated or intended to be operated** upon the public highways of the state, and who shall have paid any tax on such liquid fuel … either directly by the collection of such tax by the vendor from such consumer, or indirectly by adding the amount of such tax to the price of such liquid fuel and paid by the consumer, shall be reimbursed and repaid the amount of such tax paid by him …

The 1923 changes clarified that, if fuel was used in vehicles operated upon the public highways, it was subject to the fuel tax and the tax receipts were dedicated to the Motor Vehicle Fund. If the fuel was used for some other purpose, the consumer could apply for a tax refund if the taxes had previously been paid.

In 1944 the voters passed the 18th Amendment to the State Constitution. This constitutional provision states, in part, that:

> … all excise taxes collected … on the sale, distribution or use of motor vehicle fuel … shall be … placed in a special fund to be used exclusively for highway purposes, such highway purposes shall be construed to include the following: … (d) Refunds authorized by law for taxes paid on motor vehicle fuels …

The 18th Amendment constitutionally dedicated motor vehicle fuel tax receipts to highway purposes and prevented the Legislature from using the tax receipts for other purposes. It still allowed the Legislature to provide for tax refunds.

Special Programs for Recreational Off-Road Users

Marine use: In 1964 Initiative Measure No. 215 was passed by the voters. The essential parts of the initiative were:

- The Department of Licensing was to determine the amount or proportion of monies paid as motor vehicle fuel tax which was on marine fuel;
- The Marine Fuel Tax Refund Account was created and it was to receive the amount determined to be tax on marine fuel;
- Refunds of tax on marine fuel were to be paid from Marine Fuel Tax Refund Account;
- The Outdoor Recreation Account was created;
- On the expiration of the time limit for claiming refunds of tax on marine fuel, such monies in Marine Fuel Tax Refund Account not required for payment of refunds were to be transferred to Outdoor Recreation Account for the benefit of watercraft recreation; and
- The Interagency Committee for Outdoor Recreation was created.

The amount of money that could be transferred to the Marine Fuel Tax Refund Account was limited to the greater of (1) 2 percent of all moneys paid as motor vehicle fuel tax, or (2) an amount necessary to meet all the approved refunds of tax paid on marine fuel.[68]

In 1971, the Coastal Protection Fund was created and, among other monies, it was to receive one cent per gallon from each marine use refund claimed under RCW 82.36.330.

In 1990, the transfer of funds from the Marine Fuel Tax Refund Account to the Outdoor Recreation Account was limited to an amount equal to the proportion of the moneys in the account representing the motor vehicle fuel tax rate in effect on January 1, 1990 (18 cents) with the remainder transferred to the Motor Vehicle Fund. Later in 1990, the motor vehicle fuel tax was raised from 18 cents by four cents on April 1, 1990 and by one cent on April 1, 1991.

In 2003, the motor vehicle fuel tax rate at which transfers were made to the Outdoor Recreation Account from the refund account was increased from 18 cents to 19 cents from 2003-2005; 20 cents from 2005-07; 21 cents from 2007-09; 22 cents from 2009-11; and 23 cents after July 1, 2011. (The motor vehicle fuel tax will be 36 cents on July 1, 2007 and increase to 37.5 cents on July 1, 2008.)

Snowmobiles: In 1971, the Legislature passed the “Snowmobile Act” which essentially had the State Treasurer “refund” from the Motor Vehicle Fund to the Snowmobile Account amounts which had been determined to be fuel tax on snowmobile fuel. Fuel used for snowmobiles was to

[68] The Department of Licensing is still required to conduct a study to determine the amount of gasoline that is used by watercraft. There most recent survey was conducted in 2004 and in 2005 they reduced the transfer rate from 0.97 to 0.9 percent on July 1, 2005.

be considered a nonhighway use of fuel, but individuals were not entitled to a refund. The Department of Licensing was to determine the amount of monies paid as motor vehicle fuel tax that was tax collected on snowmobile fuel. The Snowmobile Fund is managed by the State Parks and Recreation Commission and is for the administration, acquisition, development, operation and maintenance of snowmobile facilities and programs.

In 1990, while the gas tax was being raised from 18 cents to 23 cents per gallon, the revenue distributed to the Snowmobile Account was to be calculated using the current level (18 cents).

In 1994, the formula for determining the amount of fuel used by snowmobiles was placed in law at 135 gallons annually per the number of registered snowmobiles.

In 2003, the motor vehicle fuel tax rate at which transfers are made to the Snowmobile Account was increased from 18 cents to 19 cents from 2003-2005; 20 cents from 2005-07; 21 cents from 2007-09; 22 cents from 2009-11; and 23 cents after July 1, 2011. (The motor vehicle fuel tax will be 36 cents on July 1, 2007 and increase to 37.5 cents on July 1, 2008.)

All-Terrain Vehicles: Also in 1971, the Legislature passed a new program for state recreation trails utilizing motor vehicle fuel refunds. Motor vehicle fuel used for all-terrain vehicles on other than public highways was to be considered a nonhighway use of fuel (known as ATV fuel), and individuals were not entitled to a refund. The Department of Licensing was to determine the amount of fuel tax which was derived from taxes on ATV fuel. The State Treasurer was to transfer from the Motor Vehicle fund to the Outdoor Recreation Account the amount that was determined to be a tax on ATV fuel. The money could be used for ATV trail-related expenses.

Over the years, where the money has been deposited and the uses of the money have changed. Today, the money is split between the ORV and Nonhighway Vehicle Account and the Nonhighway and Off-Road Vehicle Activities Program Account. The funds may now be used for the development and maintenance of ORV, non-motorized, and nonhighway road recreation facilities, the maintenance of nonhighway roads, and for education and law enforcement programs.

In 1972, the “refund” was limited to $1 million for the 1971-73 Biennium. In 1974 the “refund” of the tax on fuel used for ATV’s could not exceed one percent of all fuel taxes for the balance of the 1973-75 Biennium. In 1975, the 1 percent limit was made permanent. (For the 1975-77 Biennium, the 1 percent limit would allow a transfer of $3.3 million, instead of a possible $14 million.)

In 1990, while the gas tax was being raised from 18 cents to 23 cents per gallon, the revenue distributed to the off-road vehicle accounts was to be calculated using the current level (18 cents).

In 2003, the motor vehicle fuel tax rate at which transfers are made to the off-road vehicle accounts was increased from 18 cents to 19 cents from 2003-2005; 20 cents from 2005-07; 21 cents from 2007-09; 22 cents from 2009-11; and 23 cents after July 1, 2011. (The motor vehicle fuel tax will be 36 cents on July 1, 2007 and increase to 37.5 cents on July 1, 2008.)

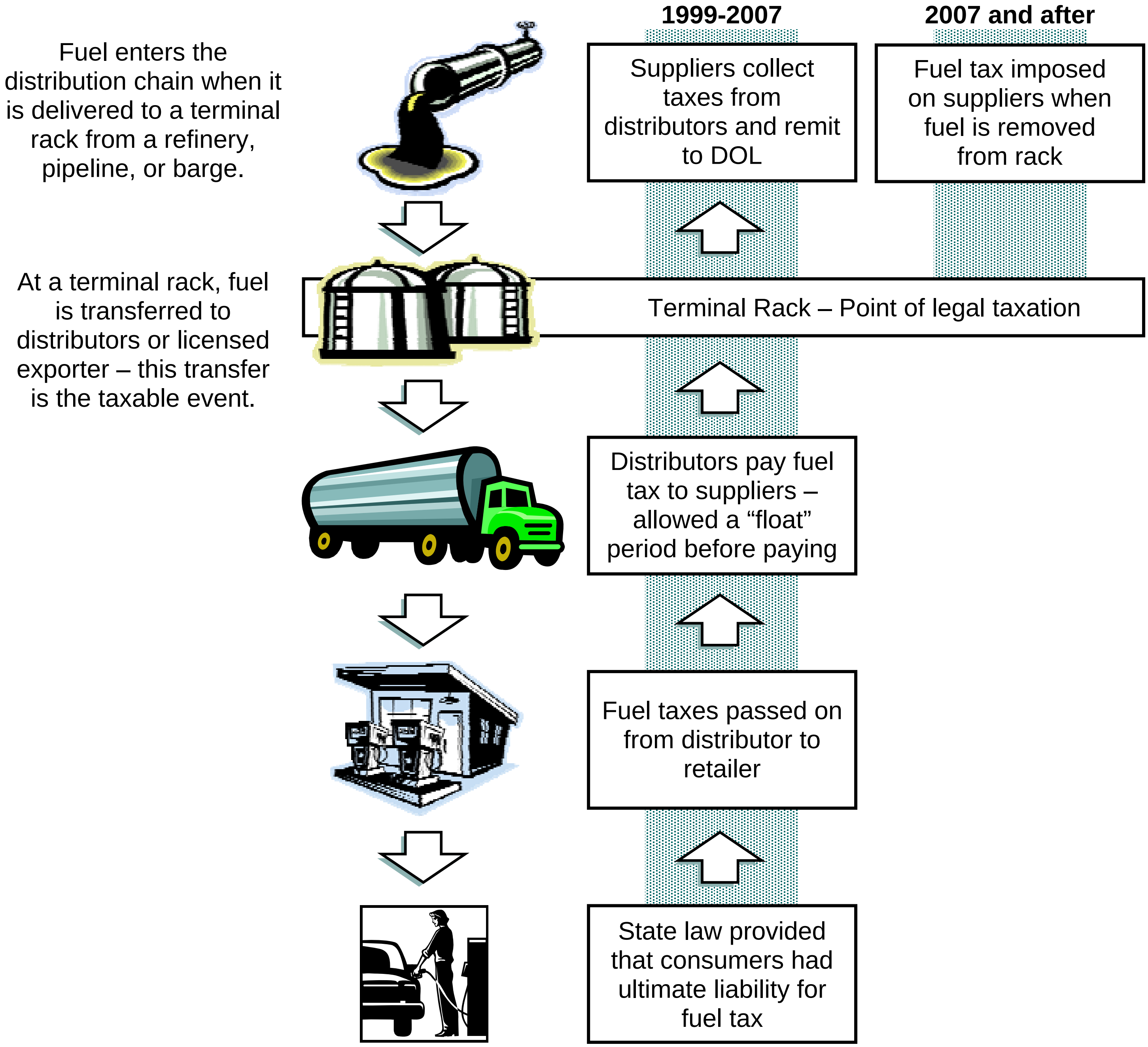
Other Relevant Background

Tax Incidence

The fuel tax system is based on a four-tiered distribution chain. Fuel enters the distribution chain when it is delivered to a "terminal rack" from a refinery, pipeline or barge. At the terminal rack, fuel is transferred from the supplier to distributors or licensed exporters. The vast majority of fuel taxes are imposed when fuel is removed from a terminal rack.[69] The supplier is responsible for submitting fuel taxes to the Department of Licensing. The distributors distribute the fuel to retailers (gas stations) and bulk fuel users. The retailers sell the fuel to the end users or consumers.

[69] There are several other instances that can trigger the imposition of the tax, such as, importing fuel into the state outside of the bulk-transfer terminal system.

Figure 11: Gasoline and Diesel Fuel Tax Collection System



Under prior law (adopted in 1998), while the supplier was responsible for remitting fuel taxes to the state, the distributors paid the fuel tax to the suppliers. The distributors were allowed a "float" period before paying fuel taxes to the supplier. Fuel taxes could be passed on from the distributor to the retailer. Fuel taxes could then be passed from the retailer to the consumer. Prior to change in 2007, state law placed the statutory incidence of the tax on the end user of the fuel (RCW 82.36.407 and RCW 82.38.285).

A 2005 federal district court decision concluded that the legal incidence of the tax in Washington actually fell on the retailer.[70] The upshot of this decision was that fuel distributed to retailers on Indian reservations could not be subjected to state fuel taxes.

Due to the court decision and the potential loss of fuel tax revenues on fuel delivered to and sold on tribal lands, the Legislature passed SB 5272 (2007). The law now imposes the motor vehicle fuel and special fuel taxes directly on suppliers, rather than distributors. This bill repealed the statutory language that declared the fuel taxes were imposed on the end user. The intent now is that the tax is imposed at the time and place of the first taxable event and upon the first taxable person within this state.

Fuel Tax Refund Process

A person is eligible for a fuel tax refund if they paid $20 or more in fuel taxes (minimum 56 gallons at a tax rate of 36 cents per gallon) and the fuel was used for a nonhighway purpose (e.g., boats, lawnmowers, backhoes and bulldozers, tractors and combines, nonhighway logging equipment, power take-off units or refrigeration units, etc). Users of fuel used in off-road vehicles or snowmobiles are not allowed a refund.

The process for obtaining a refund begins by completing a "Fuel Tax Refund Permit Account Application." The Department of Licensing then sets up a refund permit account for the person and sends them a Claim for Refunds of Fuel Tax form. The individual then returns the completed form along with the fuel invoices to the Department. The fuel invoices need to be dated within 13 months of the postmark date of the refund claim. If approved, a refund check is sent by the Department to the person. If applicable, the sales and use tax and the coastal protection tax are deducted from the refund.

The general record keeping requirements for the claimants include:

- All fuel receipts showing the number of gallons received and taxes paid;
- Gallons of fuel used in each piece of equipment (for refundable and nonrefundable usage);
- Other uses, gains, and losses of fuel;
- Physical inventory of fuel; and

[70] "Squaxin Island Tribe, et al v. Fred Stephens," U.S. District Court for the Western District of Washington, 400 F. supp. 2d, November 22, 2005.

- On-highway and off-highway mileage records for each licensed vehicle.

The records are to be kept by the claimants for each refund claim filed with the Department. All refund claims and associated records are subject to audit and must be kept for five years from the date of the refund claim.

Dyed Diesel

In an effort to lessen fuel tax evasion, in 1993 the federal government began requiring that diesel fuel, on which federal tax was not paid, be dyed to differentiate it from taxed fuel.

In 1998, also in an effort to lessen fuel tax evasion, the Washington Legislature changed the point of fuel taxation from the fuel distributor to the terminal rack. This reduced the number of tax collectors from approximately 30,000 fuel tax accounts to 100.

Changing the point of taxation required that something be done about diesel – specifically about the purchase of clear diesel used for nontaxable purposes. Licensed dual users could buy clear diesel for taxable or nontaxable purposes without any tax payment. These users then remitted taxes on fuel used on-highway after the fuel was used. Some 27,000 persons held special fuel user licenses that allowed them to purchase diesel in bulk storage with the fuel tax applied and subsequently pay fuel tax on any of the fuel used on-road. Of this number, nearly 21,000 farmers, loggers and contractors, who certified that they had no diesel-powered vehicles licensed for on-road use, had special licenses that exempted them from submitting tax reports to the Department of Licensing.

The 1998 legislation created a dyed diesel program. The owner of the fuel at the time of removal from the rack is required to collect fuel taxes on clear diesel and remit it to the Department of Licensing. Dyed diesel can be purchased tax exempt. A person cannot operate a vehicle on a public road with dyed fuel in the vehicle's fuel tank (unless authorized by federal IRS code). The special fuel user licensing and reporting requirements have been deleted. Special fuel users are not permitted to purchase clear diesel fuel into bulk storage without payment of the special fuel tax.

Use Tax

The complementary tax to the retail sales tax is the use tax. This tax applies to the use of tangible personal property in this state for which the retail sales tax has not been collected. Fuel that is subject to the fuel taxes is exempt from the retail sales/use taxes (RCW 82.08.0255(1b) and RCW 82.12.0256(3) – scheduled for review in 2009). However, if the fuel has been consumed in Washington and if the fuel tax has been refunded because the fuel was used off-road, then the use tax applies. For individuals seeking a fuel tax refund, the use tax is deducted from the amount of refund. No use tax calculation is made for the refunds of marine fuel tax, snowmobile fuel tax, or ATV fuel that are made into the special recreational accounts.

The gas tax is 36 cents per gallon (as of July 1, 2007) and the use tax is 8.2 percent of the purchase price less state and federal fuel taxes. Over the past several years the average net refund has fallen as the price increases in gasoline have more than offset the rising fuel tax.

Table 25: Net Fuel Tax Refund per Gallon

	Average Gasoline Price[71]	Fuel Tax	Use Tax	Net Refund
2003	$1.68	28 cents	10 cents	18 cents
2004	$1.99	28 cents	13 cents	15 cents
2005	$2.41	31 cents	16 cents	15 cents
2006	$2.75	34 cents	18 cents	16 cents

Public Policy Objectives

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?

The public policy objective for the refunds of fuel tax paid on fuel not used on the public highways appears to be one of equity. There are two notions of equity discussed in public finance literature.[72] One is the "ability to pay principle" and the other is the "benefits received principle." The ability to pay principle requires that burdens on taxpayers be related to their ability to pay. The benefits received principle states that the burden on taxpayers should be related to the benefits they receive. These principles cannot identify one tax policy as more equitable than another, but they do aid in clarifying and supporting value judgments about equity. For example, the gas tax could be considered inequitable under the ability to pay principle as it is regressive. However, under the benefits received principle the gas tax is equitable because the people who pay the tax (drivers) are the same taxpayers who receive the benefits.

From the beginning of the fuel tax in 1921, together with the 1923 and ensuing exemptions/refunds and the 18th Amendment to the state's Constitution, it appears that: Fuel used in motor vehicles on public highways is to be taxed by the motor vehicle or special fuel taxes;

- Fuel not used on public highways is not to be taxed by the motor vehicle or special fuel taxes; and
- Fuel tax revenues are dedicated for highway purposes.

[71] Energy Information Administration, retail gasoline prices for Washington State, all grades, includes state and federal taxes.

[72] For example, see "Public Finance and the American Economy, Second Edition," Neil Bruce, Addison-Wesley Longman, Inc., 2001 or "Understanding the Tax Reform Debate: Background, Criteria, & Questions," U.S. Government Accountability Office, September, 2005.

The State Supreme Court in 1939 carefully laid the legislative history of this exemption and its rationale.[73] The initial act in 1921 was on the sale of liquid fuel. In 1923, this was revised to be a tax on the use of liquid fuel for the purpose of operating motor vehicles upon the public highways. Refunds were allowed for the use of fuel except in motor vehicles operated or intended to be operated upon the public highways of the state. The Court found that the connection of this tax with the state highway program was further emphasized by the fact that the next legislation on the subject was found in an act relating to public highways (with the short title "Highways") in 1929. With regards to a 1933 amendment, the Court wrote:

> … it becomes manifest that the Legislature of 1933 continued to adhere to the just and reasonable policy which governed its predecessors, to wit: That the burden of special taxes created and imposed to raise funds for the construction and upkeep of the costly and highly specialized highways suitable for motor vehicle traffic ought to be borne by those who use the highways for that traffic.

In 1935, a change had been made in the test of who was eligible for a refund. The major question before the court in 1939 was:

> Did the Legislature, by the 1935 amendment, intend to extend the scope of the act and tax the use of gasoline in vehicles not actually operating on the highways; or did it, as the appellant contends, intend to more adequately insure that no refund should be made of taxes paid with respect to gasoline which had, in fact, been used on the highways?

The Court answered the question thusly:

> In enacting the 1935 amendment, the Legislature did not intend to abandon the long-established general policy that the burden of gasoline taxes should be borne exclusively by those who use roads for motor vehicle traffic. No intention appears to limit the right to a refund of tax payments with respect to gasoline not used in propelling motor vehicles upon the highways of the state. The 1935 amendment was enacted to insure that no refunds should be made of taxes paid with respect to gasoline *actually* used on the public highways. [emphasis in original]

In a 2005 decision regarding the off-road vehicle program, the Washington Court of Appeals, Division Three, found that the intent of the 18th Amendment was to ensure that fuel taxes paid by drivers using the public highways would be used to construct and maintain the public highways upon which they drove.[74] It was also the intent to return the share of those taxes paid by drivers who expended fuel driving on roadways other than public highways. The refund is paradoxically a "highway purpose" for taxes levied on nonhighway driving. The inference is that the sum should be returned to those people who used the gasoline for nonhighway purposes.

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[73] "Mason-Walsh-Atkinson-Kier Company v. Otto Case," Supreme Court of Washington, Department One, 2 Wn.2d 33; 97 P.2d 165; December 21, 1939.

[74] "Northwest Motorcycle Association v. The Interagency Committee for Outdoor Recreation," Court of Appeals, Division Three, 127 Wn. App. 408; 110 P.3d 1196, May 5, 2005; petition for review denied.

However, direct refunds to those who purchased gasoline for nonhighway road trips was not practical due to the number of recipients and the difficulty in providing proof of the nonhighway use.[75] Consequently the Legislature directed that 1 percent of total gasoline taxes be refunded to a program that would benefit the nonhighway travelers who purchased the gasoline. The Court found the 1 percent withdrawal acceptable.

Washington courts have clearly seen that there is a public policy that the burden of fuel taxes should be borne by those who use the public highways. This is in alignment with the public finance literature.

What evidence exists to show that the tax preference has contributed to the achievement of any of these public policy objectives?

The evidence that the public policy objective of equity is being achieved, to some extent, is that (a) refunds are being granted to individuals who are using fuel off-road and (b) refunds are being transferred to the special recreational accounts in lieu of being refunded to individuals. However, the public policy objective of equity is not sacrosanct, and the Legislature has purposely modified it over the years.

In 2006, there were nearly 5,000 refund claims made for 29 million gallons of fuel used off-road.[76] The fuel taxes on this fuel came to $9.0 million. The net amount refunded was $4.1 million with $4.9 million retained for use tax and $11,000 retained for coastal protection.

Also in 2006, the marine fuel program received $4.9 million; the off-road vehicle programs received $5.4 million; and the snowmobile program received $931,000.

To what extent will continuation of the tax preference contribute to these public policy objectives?

Fuel taxes are collected at the top of the fuel distribution scheme. The end use of the fuel is not necessarily known when the tax is collected. To maintain the equity of having those who use the highways pay for the highways and those who do not use the highways not pay for them, then some form of tax refund or tax diversion program will need to be maintained. Continuation of the refund program and the diversion to the recreational accounts will maintain the public policy objective.

If the public policy objectives are not being fulfilled, what is the feasibility of modifying the tax preference for adjustment or recapture of the tax benefits?

[75] An IAC-sponsored survey involving 7,252 vehicle owners found that they used over 25 million gallons of gasoline in 2002 to travel on nonhighway roads – including back roads and off-road trails.

[76] Overall, some 6,409 refund claims were processed for 70 million gallons of fuel and $22 million in fuel taxes. Besides off-road usage, claims were made for tribal reservations, transit, other governmental refunds, and exported fuel, to name several of the larger categories.

There is some evidence that the public policy objective is only being partially fulfilled. First, not all off-road users claim a refund. Second, only a portion of the fuel taxes collected on off-road recreational use are transferred to the recreational accounts. In the first case, there does not seem to be a clear way to expand the refund program and avoid the issue of tax evasion. In the second case, it would be a matter of amending current state law.

(1) The Federal Highway Administration estimates nonhighway use of gasoline by state and type of user.[77] Total nonhighway use of gasoline in Washington in 2005 was 98 million gallons. Of this amount, private and commercial nonhighway use was estimated at 96 million gallons. Agricultural consumption was estimated at 23 million gallons; construction at 14 million gallons; and industrial and commercial use at 16 million gallons.

In 2005, there were 531 refund claims to the Department of Licensing for 1.6 million gallons of gasoline used off-road. Agriculture filed 399 claims for 800,000 gallons; construction filed 105 claims for 560,000 gallons; and logging filed 17 claims for 54,000 gallons. The amount of nonhighway refunds provided to industrial users of gasoline appears to be only a very small percentage of the total gasoline used.

The refund program is voluntary, and not everyone who uses gasoline off-road is required to claim a refund. The mere step of needing to file a claim and the keeping of the necessary records may discourage many people. Also, the requirement that use tax be collected lessens the fiscal incentive – especially as the price of fuel increases. The program does offer a relief valve for those who do want to claim their fuel taxes.

There does not seem to be a clear way to expand the refund program so that it is utilized to a greater extent while at the same time protecting against tax evasion. On the diesel side, access to tax-exempt dyed diesel is available and reduces the need for refunds. Prior to 1999 dual users – who used fuel both on and off-highways – could be licensed to purchase fuel in bulk without initially paying tax and remit the tax on the portion of fuel used on highways. This license was ended in an effort to simplify the tax collections and reduce tax evasion.

(2) On the recreational side there are several statutory restrictions on the amount of gasoline taxes that can be refunded. Off-road vehicle users and snowmobile users are prohibited by law from directly seeking a refund. There are restrictions in statute on the total amount that can be transferred to the recreational accounts (although in the case of marine use of fuel, the statutory restriction of two percent of total fuel used is in excess of the 0.9 percent actual marine use of fuel). Finally, there is a fuel tax rate limit at which the transfers are calculated. Currently, a fuel tax rate of 21 cents per gallon is used in determining the refund amount while the actual fuel tax rate is 36 cents per gallon.

Adjusting the rate at which the fuel tax calculation is made for the transfers to the recreational accounts is a matter of changing state law.

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[77] Federal Highway Administration, Office of Highway Policy Information, "Highway Statistics." No estimates are made for nonhighway use of diesel.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

The fuel tax refunds provided for off-road use of fuel directly benefit the commercial and individual users of motor fuel off-road. The larger commercial sectors include agriculture, construction, logging and commercial fishing. In 2006, private businesses and individuals made 4,967 refund claims.

Indirectly, boaters, off-road vehicle and motorcycle users, horseback riders, hikers, mountain bikers, and snowmobile users are beneficiaries of fuel tax "refunds." Estimated fuel taxes on fuel used off-road by these groups are transferred to dedicated accounts to develop facilities for these groups.

To what extent is the tax preference providing unintended benefits to entities other than those the Legislature intended?

There are no apparent unintended beneficiaries.

Revenue and Economic Impacts

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?

Of the 3.4 billion gallons of gross fuel consumed in Washington annually, 3.2 to 3.3 billion gallons are used on highways and 160 million gallons are used off highways.[78] Between 4 to 5 percent of taxable fuel sales are subject to refunds.

Table 26: Washington Fuel Consumption

Millions of Gallons			
Fiscal Year	**Gross Fuel Sales**	**Nonhighway Use**	**Highway Use**
2004	3,411	144	3,266
2005	3,402	164	3,237
2006	3,441	160	3,282

Source: Washington Department of Transportation, March 2007 revenue forecast; gross sales exclude tax-exempt sales.

In 2007, the fuel taxes are expected to raise nearly $1.2 billion. Total nonhighway refunds and transfers to the recreational accounts reduce this amount by $35 million.

[78] Source: "Transportation Revenue Forecast Council March 2007 Forecasts," Washington Department of Transportation. Fuel includes taxed gasoline, alcohol, and diesel; exempt fuel such fuel exported or dyed diesel is excluded. Off-highway use includes nonhighway refunds, refunds for exported fuel, nonhighway transfers, and tribal reservation refunds.

Table 27: State Motor Vehicle Fuel Tax Revenues

Millions of Dollars				
	FY 2007	**FY 2008**	**FY 2009**	**FY 2010**
Gross Fuel Tax	$1,151.9	$1,278.3	$1,375.3	$1,421.5
Nonhighway Refunds	(23.9)	(34.6)	(37.8)	(39.9)
Marine Transfer	(4.9)	(5.3)	(5.5)	(5.8)
ORV Transfer	(5.4)	(5.8)	(6.0)	(6.4)
Snowmobile Transfer	(0.9)	(1.0)	(1.0)	(1.1)
Subtotal Refunds/Transfers	(35.1)	(46.7)	(50.3)	(53.2)
Other Transfers/Refunds	(7.5)	(5.9)	(6.1)	(6.5)
Administration	(6.2)	(6.3)	(6.4)	(6.6)
Net Fuel Taxes	$1,103.1	$1,219.4	$1,312.3	$1,355.4

Source: Washington Department of Transportation, March 2007 revenue forecast.

The forecast for "nonhighway refunds" is broader than the scope of this review. It includes not only the refunds provided for off-road use of fuel but, also, refunds for exported fuel and refunds for transit and other governmental use. This broad category of nonhighway refunds is nearly $24 million in 2007. The recreational accounts received $11 million in 2007.

Table 28: Off-Road Motor Vehicle Fuel Tax Refunds

	2003	**2004**	**2005**	**2006**
Refunds				
Number of Claims	4,611	5,094	4,835	4,967
Gallons (mil.)	26.6	28.0	28.2	28.9
Total Refunds ($ mil.)	$6.4	$7.7	$8.3	$9.0
Use Tax ($ mil.)	$2.2	$3.0	$3.9	$4.9
Coastal Protection ($ mil.)	$0.012	$0.012	$0.012	$0.011
Net Refund ($ mil.)	$4.1	$4.6	$4.1	$4.1
Transfers				
Marine Program ($ mil.)	$5.0	$5.1	$5.0	$4.9
ORV Program ($ mil.)	$5.0	$5.1	$5.1	$5.4
Snowmobile Program ($ mil.)	$0.9	$0.8	$0.9	$0.9
Total Recreational ($ mil.)	$11.0	$11.0	$11.0	$11.3

Sources: Department of Licensing and Office of the State Treasurer.

Direct refunds of fuel taxes to users of off-road fuel were $9.0 million in 2006. Use tax collections reduced this amount by $4.9 million. Coastal protection funds received another $11,000. Net refunds directly paid to off-road users were $4.1 million.

Additionally, transfers to the three recreational programs totaled $11.3 million.

Overall, the Motor Vehicle Fund was reduced by $20.3 million in 2006; the general fund gained $4.9; and the taxpayers were either directly or indirectly refunded $15.4 million.

Economic Impacts

There are several competing types of economic impacts involved with the motor vehicle fuel taxes and tax refunds for off-road use of fuel. The following section offers a description of these impacts. The types of economic impacts include:

(1) The economic impact of the private commercial industries that claim refunds (e.g., agriculture, logging, and construction) and what they do with the refunds (increased wages, spending or lower prices to customers). For example, if the refunds are spent on personal consumption, there are about ten jobs generated in the Washington economy for every $1 million of personal consumption expenditures.[79]

(2) The economic impacts associated with constructing and maintaining recreational facilities. For every $1 million of construction activity, about 14 to 17 jobs are created in the Washington economy.[80]

(3) The economic impact of the recreational users of the facilities developed with the fuel tax refunds to the special recreational accounts. This goes beyond the spending by these users on equipment and travel. It is the total value to the recreationist of doing the activity. This can be considered a longer-term impact and is not easily measured.

(4) The economic benefits associated with constructing and maintaining the public highways. The jobs multiplier associated with highway construction and maintenance is 15 jobs per $1 million of expenditures.[81]

(5) The economic benefits to the overall economy of improved efficiency of the highways. This, too, can be considered a longer-term impact that is not easily measured.

In the end it is likely that the amount of refunds/tax collections would stay and be spent in the state's economy to the same degree. The trade-offs between refunds, transfers to other governmental programs, or returning the taxes to taxpayers are offsetting – especially within the dollar amounts being discussed.

[79] Household spending multipliers derived from 2004 IMPLAN Input-Output Model for Washington State.

[80] General construction multipliers derived from 2004 IMPLAN Input-Output Model for Washington State.

[81] Highway construction and maintenance multipliers derived from 2004 IMPLAN Input-Output Model for Washington State.

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?

If the tax refund program for off-road use of fuel were terminated, the impact on the agriculture, logging and construction industries would be minimal. Already, the refund is reduced by the collection of the use tax. More damaging to these industries are the price increases of fuel – which has the double impact of (a) directly increasing costs within the industries and (b) reducing the amount of the refund as the use tax takes a larger bite. These industries had gross sales of $38 billion in 2004; value added (wages, profit, taxes) of $19 billion; and purchased $679 million in petroleum products.[82] These industries received net fuel tax refunds of $3.1 million in 2004.

The impact on the recreational side if the fuel tax refunds were terminated would mean a loss of funds to the recreational programs. The fuel tax revenues are now going to the development and operation of recreational facilities for boaters, off-road vehicle users, horseback riders, hikers, and snowmobile users. Loss of these funds would mean fewer and less maintained facilities – which would have some impact on recreational activity. However, if the recreational activity and spending did not occur at these facilities or in these activities, it would likely occur on something else.

Combined, the overall higher taxes would net to virtually no economic impact. While the businesses currently receiving refunds, the recreational programs, and the general fund would lose $20 million per year, the Motor Vehicle Fund would gain $20 million per year. The money is not leaving the economy.

If the tax preference were to be terminated, what would be the effect on the distribution of liability for payment of state taxes?

The fuel taxes are 36 cents per gallon (FY 2008) and are expected to raise a net of $1.226 billion – some $34 million per penny of tax. If $20 million were not refunded to the off-road users, then the fuel tax could be lowered by 0.6 cents to 35.4 cents.

Other States

Do other states have a similar tax preference and what potential public policy benefits might be gained by incorporating a corresponding provision in Washington?

Thirty-three states either refund or exempt private and commercial general nonhighway use of gasoline from fuel taxes.[83] Seventeen states tax the general nonhighway use (except agriculture

[82] Data taken from the 2004 IMPLAN Input-Output Model for Washington State.

[83] Source: "Highway Taxes and Fees: How They Are Collected and Distributed, 2001," Office of Highway Policy Administration, Federal Highway Administration, 2001.

and aviation use) of gasoline. Of these 17 states, two states, Nevada and Vermont, tax agricultural use of gasoline.

LOST OR DESTROYED FUEL – SUMMARY

Current Law

The motor vehicle fuel taxes are laid out in two separate chapters of state law. Chapter 82.36 RCW pertains to motor vehicle fuel, which is basically gasoline, and Chapter 82.38 RCW pertains to special fuel, which is all combustible gasses and liquids that can propel a motor vehicle except gasoline (primarily diesel).[84]

There are two sections of law that deal specifically with refunds of fuel tax for lost or destroyed fuel: RCW 82.36.370 (motor vehicle fuel/gasoline) and RCW 82.38.180 (4-6)(special fuel/diesel). In both cases a licensee may apply for a tax refund or credit in the event that fuel for which taxes have previously been paid has been lost or destroyed (1) through fire, lightning, flood, wind storm, or explosion or (2) leakage or other casualty except evaporation, shrinkage or unknown causes and the amount is 500 gallons or more. In addition, if taxed diesel fuel is inadvertently mixed with tax-free dyed diesel fuel, the licensee may apply for a tax refund. Positive proof needs to be provided to the Department of Licensing to substantiate the loss.

The Legislature amended these sections in 2007, and now only licensees (licensed fuel suppliers, importers, exporters, blenders, distributors) may apply for the refund or credit. Previously any owner of the lost or destroyed fuel could have applied for a refund or credit.

Findings and Recommendations

This review of Washington's motor vehicle fuel tax refunds for lost or destroyed fuel evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following findings were determined through this audit:

Legal History and Public Policy Objectives

- Washington State first imposed the motor vehicle fuel tax in 1921 on the sale of liquid fuel for use in internal combustion engines. In 1923, the tax was changed to be a tax on fuel used to operate motor vehicles upon the public highways. Tax refunds were provided for the nonhighway use of fuel, except in motor vehicles operated or intended to be operated upon the public highways. In 1933, the Legislature provided a specific refund or credit for taxes paid on motor vehicle fuel which was lost or destroyed.
- The public policy objective of providing tax refunds for lost or destroyed fuel is one of equity – fuel used in motor vehicles operated on the public highways is subject to the motor fuel taxes; fuel that is not used on the public highways is not subject to the tax.

[84] This report will use motor vehicle fuel and gasoline interchangeably, as well as special fuel and diesel. It will also refer to the motor vehicle fuel tax and the special fuel tax as "fuel taxes."

Beneficiaries

- This refund is seldom used. The beneficiaries of the lost or destroyed fuel refund appear to be a few fuel distributors. Examples of refund claims include distributors mixing gasoline with diesel when delivering fuel to a customer and converting taxable clear diesel to tax-exempt dyed diesel.

Economic and Revenue Impacts

- Very few refund claims are made for lost or destroyed fuel. The amount of refunds granted for lost or destroyed fuel in one year may be in the hundreds or low thousands of dollars.

Other States

- At least 11 other states provide for refunds or credits for losses of fuel by destruction or losses beyond the control of the distributor.

Recommendation

The refund of fuel taxes for lost or destroyed fuel should be continued.

Legislation Required: None

Fiscal Impact: None

LOST OR DESTROYED FUEL – REPORT DETAIL

Statutory History

Washington State first imposed the motor vehicle fuel tax in 1921. Revenues were credited to the Motor Vehicle Fund. The Motor Vehicle fund was a fund dedicated to, among other things, "paving and general road construction of the state primary highways." In 1923, the tax base was more narrowly drawn. The tax was now on sales of liquid fuel to everyone who used liquid fuel for the purpose of operating motor vehicles upon the public highways. The Legislature provided several refunds for the nonhighway use of fuel. The 1923 changes clarified that if fuel was used in vehicles operated upon the public highways it was subject to the fuel tax, and the tax receipts were dedicated to the Motor Vehicle Fund. If the fuel was used for some other purpose, the consumer could apply for a tax refund if the taxes had previously been paid.

In 1933, the Legislature provided a specific refund or credit for the tax paid or accrued on all motor vehicle fuel which, after shipment or receipt, was lost or destroyed by fire, lightning, flood, wind storm or explosion. The loss or destruction had to be proved to the complete satisfaction of the administering department, now the Department of Licensing.

In 1944, the voters passed the 18th Amendment to the State Constitution. This constitutional provision states that "… all excise taxes collected … on the sale, distribution or use of motor vehicle fuel … shall be … placed in a special fund to be used exclusively for highway purposes." One of the specified "highway purposes" includes "refunds authorized by law for taxes paid on motor vehicle fuels." The 18th Amendment constitutionally dedicated motor vehicle fuel tax receipts to highway purposes and prevented the Legislature from using the tax receipts for other purposes. It still allowed the Legislature to provide for tax refunds.

A 1965 restriction required that the amount of fuel involved in the loss or destruction needed to be in excess of 500 gallons. Also, leakage or other casualty, except evaporation, shrinkage or unknown cause, became additional means for loss or destruction of fuel. In 1967, the Legislature clarified this to mean that the 500 gallons or more restriction applied only to the leakage or other casualty losses and not to losses due to fire, lightning, etc. Refunds for losses due to inadvertently mixing taxed special fuel with dyed diesel fuel became available in 1998.

In 2007, the Legislature amended these statutes again to restrict the refund or credit to licensees only. Licensees consist of persons holding a motor vehicle fuel or special fuel supplier, importer exporter, blender, distributor, or international fuel tax agreement license.

Other Relevant Background

Tax Incidence: The fuel tax system is based on a four-tiered distribution chain. Fuel enters the distribution chain when it is delivered to a "terminal rack" from a refinery, pipeline or barge. At the terminal rack, fuel is transferred from the supplier to distributors or licensed exporters. The vast majority of fuel taxes are imposed when fuel is removed from a terminal rack.[85] The supplier is responsible for submitting fuel taxes to the Department of Licensing. The distributors distribute the fuel to retailers (gas stations) and bulk fuel users. The retailers sell the fuel to the end users or consumers.

Under prior law (adopted in 1998), while the supplier was responsible for remitting fuel taxes to the state, the distributors paid the fuel tax to the suppliers. The distributors were allowed a "float" period before paying fuel taxes to the supplier. Fuel taxes could be passed on from the distributor to the retailer. Fuel taxes could then be passed from the retailer to the consumer. Prior to change in 2007, state law placed the statutory incidence of the tax on the end user of the fuel (RCW 82.36.407 and RCW 82.38.285).

In 2007, the Legislature changed the statutory incidence of the tax. The law now imposes the motor vehicle fuel and special fuel taxes directly on suppliers, rather than distributors. This bill repealed the statutory language that declared the fuel taxes were imposed on the end user. The intent now is that the tax is imposed at the time and place of the first taxable event and upon the first taxable person within this state.

Handling Losses: The exemption for lost and destroyed fuel is not to be confused with the gas tax exemption for handling losses (RCW 82.36.029). The handling losses exemption is scheduled for review in 2008.

Public Policy Objectives

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?

The public policy objective for the refunds of fuel tax paid on lost or destroyed fuel appears to be one of equity. There are two notions of equity discussed in public finance literature.[86] One is the "ability to pay principle" and the other is the "benefits received principle." The ability to pay principle requires that burdens on taxpayers be related their ability to pay. The benefits received principle states that the burden on taxpayers should be related to the benefits they receive. These principles cannot identify one tax policy as more equitable than another, but they do aid in clarifying and supporting value judgments about equity. For example, the gas tax could be

[85] There are several other instances that can trigger the imposition of the tax, such as, importing fuel into the state outside of the bulk-transfer terminal system.

[86] For example, see "Public Finance and the American Economy, Second Edition," Neil Bruce, Addison-Wesley Longman, Inc., 2001 or "Understanding the Tax Reform Debate: Background, Criteria, & Questions," U.S. Government Accountability Office, September 2005.

considered inequitable under the ability to pay principle as it is regressive. However, under the benefits received principle the gas tax is equitable because the people who pay the tax (drivers) are the same taxpayers who receive the benefits.

From the beginning of the fuel tax in 1921, together with the 1923 and ensuing exemptions/refunds and the 18th Amendment to the State's Constitution, it appears that:

- Fuel used in motor vehicles on public highways is to be taxed by the motor vehicle or special fuel taxes;
- Fuel not used on public highways is not to be taxed by the motor vehicle or special fuel taxes; and
- Fuel tax revenues are dedicated for highway purposes.

Because the tax is imposed at the top of the distribution chain, before the end use of the fuel is known, the only way to "exempt" the fuel from taxation is to provide a refund or credit to the end user. Lost or destroyed fuel is not used on Washington's highways. To provide equity under the benefits received principle, it is necessary to refund any fuel taxes that were previously paid on the lost or destroyed fuel.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

There are anecdotes of taxpayers who have paid the fuel tax and have been granted a refund due to the fuel subsequently being destroyed or rendered unusable for the purpose for which it was taxed. Since the refund is seldom used, there are not any statistics maintained on the use of the lost/destroyed fuel refund. The tax refund appears to offer a safety valve for the few occasions when mistakes are made or circumstances require a change in the end use of the fuel.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

The beneficiaries of the lost or destroyed fuel refund are fuel distributors. The legal incidence of the tax is the removal of fuel at the terminal rack. Under the pre-2007 law, the fuel tax was collected by the supplier from the distributor who in turn collected the tax from the retailers. With the new law, the tax is on the supplier, but it is likely that the tax will be passed on to the distributor. If the fuel is either rendered unusable or the product is changed from one that can be used on the public highways to one that is prohibited from being used on the public highways, the cost of the fuel tax cannot be billed to the retailer. Since the tax was either directly paid by the distributor or included in the price of the fuel when obtained from the supplier, the only recourse for the distributor is to seek a refund from the Department of Licensing.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

There are no unintended tax benefits being provided.

Revenue and Economic Impacts

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

This refund is seldom used. No detailed statistics are maintained by the Department of Licensing on this refund as it is lumped together with other miscellaneous refunds. A few examples are provided below. Individuals who claim lost fuel through leakage need to prove they have reported the leak to the Department of Ecology, which discourages some from pursuing the refund. Under the 2007 revised law, individuals are no longer allowed to claim a refund.

From the evidence provided by the Department of Licensing, the amount of refunds granted for lost or destroyed fuel in one year may be in the hundreds or low thousands of dollars. For practical purposes past forecasts of the tax savings to taxpayers have been 0.

Examples:

In January 2007, a customer ordered 3,100 gallons of winterized dyed diesel from a distributor.[87] At the terminal rack there was no additive available to winterize the dyed diesel so the distributor picked up non-dyed diesel that was already winterized. The distributor then re-branded the diesel to dyed diesel and sold it to the customer without tax. The distributor then sought a refund of the taxes paid to the supplier ($1,054).

In September 2006, a customer ordered 9,800 gallons of clear diesel fuel. The distributor picked up 9,800 gallons of diesel fuel from a terminal rack. The driver then delivered 6,500 of the clear diesel into the customer's dyed diesel tank before realizing the error. The 6,500 gallons was re-branded and sold to the customer as tax-free dyed diesel. The distributor then sought a refund of the taxes paid on the 6,500 gallons to the supplier ($2,210).

In October 2005, a distributor delivered 1,163 gallons of unleaded gasoline into a customer's diesel tank. The diesel tank was then later pumped out by the distributor and subsequently sold in March 2006 to a refiner. The customer then invoiced the distributor for 5,757 gallons of diesel and 1,163 gallons of unleaded gasoline. The distributor then sought a refund of the taxes paid on the unleaded gasoline and the diesel.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

There were 83 "petroleum merchant wholesalers" reported by the Employment Security Department in 2005. These firms employed 1,254 people and paid wages of $51 million in 2005.

[87] Dyed diesel fuel is sold tax free and cannot be used on public roads – it can only be used off road.

The level of employment has remained fairly constant from 2000 to 2005. Average wages paid per employee has increased slightly from $37,000 per year in 2000 to $41,000 in 2005 (not adjusted for inflation). The average firm size is 15 employees. These firms are located all around the state.

Other States

Do other states have a similar tax preference?

At least 11 states provide for refunds or credits for losses by destruction or losses beyond the control of the distributor. Not all states responded to a survey by the federal Office of Highway Policy Information.[88] The question concerned state gasoline loss and expense allowances. Twenty states provided no comments. Many states reported provisions regarding allowances for loss due to evaporation or handling losses and allowances for collection expenses.

[88] Published in "Highway Taxes and Fees, How they Are Collected and distributed, 2001," Office of Highway Policy Information, Highway Funding and Motor Fuels Division, Federal Highway Administration, June 2001.

SALES TAX DEFERRAL; HISTORIC AUTO MUSEUMS – SUMMARY

Current Law

State law provides for a retail sales and use tax deferral for the preparation and construction of a historic automobile museum (RCW 82.32.580). The museum must be used to exhibit a collection of at least 500 vehicles. To receive the deferral, the governing board of the organization must be a nonprofit organization and must apply to the Department of Revenue.

Taxes must be repaid beginning in the fifth year after the museum is operationally complete. Ten percent of the tax liability is due each year for ten years. If the Department finds the project to be ineligible during the deferral period or if the project is not operational after five years from when the deferral was issued, the deferred taxes must be immediately paid with interest.

This retail sales and use tax deferral was passed as part of an omnibus revenue bill in 2005. This section of the bill took effect on July 1, 2007. Applications must be received by the Department by December 31, 2008.

The impetus for the deferral was that in August 2002, the City of Tacoma provided for the use of nine acres of land adjacent to the Tacoma Dome for the purposes of constructing a historic car museum. The City made the agreement with a nonprofit organization. The organization was seeking to begin construction of a museum in 2007 and to begin museum operations in 2008. Construction of the museum would be subject to the retail sales and use taxes. The Department of Revenue assumes that this will be the only museum that will qualify for this deferral.

Findings and Recommendations

This review of Washington's retail sales and use tax deferral on the construction of a historic automobile museum evaluated the legal history, public policy objectives, economic and revenue impacts and other states' similar tax preferences. The following findings were determined through this audit:

Legal History and Public Policy Objectives

- The sales tax deferral for the construction of a historic automobile museum was enacted in 2005, took effect on July 1, 2007, and applications need to be received by December 31, 2008.
- The public policy objective of the retail sales and use tax deferral for historic auto museums is to encourage the construction of the Harold E. LeMay Museum in Tacoma.

- The Harold E. LeMay Museum has applied to the Department of Revenue for a sales and use tax deferral (March 26, 2007). The deferral application has been approved by the Department (April 19, 2007).

Beneficiaries

- The direct beneficiary of the retail sales tax deferral is the Harold E. LeMay Museum, a nonprofit organization. The organization has applied for and been approved for the deferral.

Economic and Revenue Impacts

- Fundraising for the museum is still ongoing, and the museum has not yet commenced construction. Construction may begin in 2007 and last for two years. The amount of deferred taxes may be $8.8 million during this period. Repayments of $880,000 per year may begin in 2014 (five years after project completion) and last for ten years.
- From the state's perspective, the deferral is an interest-free loan.
- The entire museum campus is expected to cost $118 million. The construction of new structures is expected to cost $99.5 million.
- According to an economic impact analysis commissioned by the museum, visitor attendance to the museum is expected to stabilize at over 400,000 per year with 38 percent expected to be overnight visitors to the area. Expenditures by visitors to the museum are expected to support approximately 700 direct and indirect jobs.

Other States

- No other states appear to use retail sales tax deferral programs. Some 26 states (out of 45 states with a sales tax) provide sales tax exemptions to some nonprofit organizations.

Recommendation

The retail sales and use tax deferral for historic auto museums should be continued.

Legislation Required: None

Fiscal Impact: None

SALES TAX DEFERRAL; HISTORIC AUTO MUSEUMS – REPORT DETAIL

Museum History

Harold and Nancy LeMay amassed the largest privately owned collection of automobiles, motorcycles, trucks, other vehicles and related memorabilia in the world. At its peak, the LeMay Collection numbered in excess of 3,000 vehicles and thousands of artifacts. Currently the collection contains 1,900 vehicles. In 1998, Harold and Nancy LeMay formed a nonprofit, charitable organization, The Harold E. LeMay Museum. The LeMays provided $10 million for capital facilities and $5 million for operations. Design concepts for the future home of the museum were approved by the Board of Directors in November 2003. The organization expects groundbreaking to occur late in 2007 with the museum opening in 2009. The cost of the entire museum campus – including construction of a Pavilion, Collector Car Center, Administration and Education Center, Show Field and Retail Concourse – is projected to be $118 million. The organization's plans call for the museum to be built in two phases with the contents of Phase 1 and Phase 2 still being discussed.

The City of Tacoma is a partner with the museum and has provided a nine acre building site next to the Tacoma Dome, valued at nearly $17.5 million. The City has three conditions which need to be met before the museum can take title to the property: (1) the museum design work needs to be completed; (2) the museum needs to have title to 600 vehicles; and (3) the museum needs to have commitments for 75 percent of the Phase 1 cost of construction.

Other Public Commitments to the LeMay Museum

Federal Government: The Federal Government has provided a $1 million design grant to the museum.

State Capital Budget: The 2005-07 Capital Budget appropriated $1 million to the Department of Community, Trade, and Economic Development (CTED) for the LeMay Museum. This is a general pass-through grant with no restrictions on the use of the money other than it needs to spent on items appropriate for the use of bond proceeds – design, engineering or construction. These funds have not been spent and were reappropriated in the 2007-09 Capital Budget. CTED will not release the funds until the museum gains control of the building site.

State Transportation Budget: The 2006 supplemental Transportation Budget provided $2 million from the Multimodal Transportation Account to the Department of Transportation for the LeMay Museum – a historic preservation project. This money was to assist in the design phase for the construction of a museum for the storage and display of historic automobiles. Over $600,000 of these funds was spent in the 2005-07 Biennium and the remainder was reappropriated in the 2007-09 Biennium. Expenditures from the Multimodal Transportation Account may only be used for transportation purposes.

Other Retail Sales and Use Tax Deferral Programs

Washington has several other retail sales and use tax deferral programs for capital investments. Sales tax deferral programs have been selectively used in the past for major projects of a public or quasi-public nature. The projects are virtually identified in the legislation providing the deferral. These include:

Public Facilities

Baseball Stadium Deferral (RCW 36.100.090) – Safeco Field

Football Stadium Deferral (RCW 36.102.070) – Qwest Field

2nd Narrows Bridge (RCW 47.46.060)

Quasi-Public Facilities

Horse Racing Track Deferral (RCW 82.66.040) - Emerald Downs

Public Policy Objectives

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?

The public policy purpose for providing a retail sales and use tax deferral for a historic automobile museum was to encourage the construction of such a facility. This intent is clear from the very specific criteria contained in RCW 82.32.580. A governing body of a nonprofit organization, corporation or association may apply for a deferral of taxes on an "eligible project." An "eligible project" means a project that is used primarily for a "historic automobile museum." A "historic automobile museum" means a facility owned and operated by a nonprofit organization, corporation or association that is used to maintain and exhibit to the public a collection of at least 500 motor vehicles.

Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

The Harold E. LeMay Museum has applied for and been issued a sales and use tax deferral certificate. This in itself does not mean achievement of the public policy objective. The Harold E. LeMay Museum is still in the process of raising funds for the construction of the facility. The organization's plans are to break ground in late 2007 or possibly early 2008 with the facility opening in late 2009 or early 2010.

Beneficiaries

Who are the entities whose state tax liabilities are directly affected by the tax preference?

The only entity who is expected to be directly affected by the historic automobile sales and use tax deferral is the Harold E. LeMay Museum.

To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

There are not expected to be any unintended tax benefits to any other entities. The definitions were written such that there is only one known historic automobile museum that has plans to construct a museum for the purpose of exhibiting at least 500 motor vehicles. The application for the sales and use tax deferral also needs to be made prior to December 31, 2008. This further restricts the potential for other entities to receive this tax preference. No one else has applied for this deferral as of November 2, 2007.

Revenue and Economic Impacts

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

The expected revenue impact would be a reduction in state and local retail sales and use tax during the construction phase. Construction of new structures is estimated to cost $99.5 million. If the full amount is subject to sales tax, then the amount of deferred taxes would equal $8.8 million during 2007-09. These monies would be repaid during a ten-year period, possibly from 2014 through 2023. Each payment will be 10 percent of the deferred tax. This impact will occur only if construction takes place. If the museum is not constructed, there will be no sales tax deferred.

Interest-Free Loan

A retail sales and use tax deferral is essentially an interest-free loan from the state and local government to the entity receiving the deferral. Rather than paying the sales and use tax at the time of purchase, the entity is provided a grace period until construction is completed and then pays the tax over a period of years. No interest is charged. In the case of the historic automobile museum, payments begin in the fifth year after the project is operationally completed and payments are 10 percent of the deferred amount per year for ten years.

The present value of an interest-free loan depends on the amount of sales and use taxes deferred and the interest rate at which the borrower would otherwise borrow money or the interest rates at which the lender either borrows money or, alternatively, earns on investments.

The estimated amount of deferred state and local sales tax is $8.8 million on construction costs of $99.5 million. The LeMay Museum deals in cash – they have not needed to or plan to borrow money. They intend to rely on gifts and donations from individuals, corporations and foundations.

The state, on the other hand, both borrows and invests money. The forecasted interest rate at which the state will borrow money (25 year bonds) is between 4.9 to 5.1 percent.[89] Short-term investment earnings (average portfolio life of two years) are forecasted to be 4.9 percent.[90] An example of long-term investment earnings are the assumptions adopted by the Pension Funding Council. They use 8.0 percent (real) for the average annual rate of return to earned by the State Investment Board on retirement system funds and 3.5 percent for inflation – making the nominal rate of return 11.8 percent.[91] Over the last five years, the average annual rate of return for the State Investment Board has been 12.93 percent.[92]

For illustrative purposes, assume that $8.8 million were loaned over the next two years and repayments were started in 2014 (the fifth year after completion) and continued through 2023. At 0 percent interest, the net present value is 0 – the $8.8 million in repayments equals the loan of $8.8 million. At an alternative 5 percent interest rate, the net present value is negative $2.0 million. It costs the lender $2.0 million in either lost earnings or increased borrowing costs. At an interest rate of 11.8 percent, lost earnings to the lender would be $3.4 million. The cost to the state and local government of deferring the retail sales tax on the construction of the museum is between $2.0 and $3.4 million.

What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

The Harold E. LeMay Museum commissioned an economic and fiscal impact statement by Economics Research Associates (ERA).[93] This analysis looked at the overall gross impact of the proposal as opposed to its net impact on the local area or state. An increase in expenditures at a new facility such as the museum does not necessarily mean a net increase in expenditures in the area or state. The spending related to the museum may have occurred anyway at other places in the state if the museum did not exist. Net positive state impacts occur when new activity takes place within Washington that otherwise would not have occurred.

With that caveat, ERA estimated that the one-time construction impact would be 835 jobs directly related to construction of the museum and another 649 jobs indirectly related to construction. For the ongoing impact of the museum, ERA anticipated that attendance would stabilize at 414,000 per year, 38 percent of which would be overnight visitors to the area. Total annual visitor expenditures in the area (on and off-site) were estimated at $41.5 million. These expenditures are estimated to support 338 jobs directly and another 365 jobs indirectly. Overall average wages associated with these jobs is $25,000 per year.

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[89] Office of the State Treasurer, debt model forecast, May 2007.

[90] Office of the State Treasurer, revenue forecast, June 2007.

[91] Office of the State Actuary, current rates were prescribed by the Legislature in 2001.

[92] State Investment Board, April 2007 Monthly Report.

[93] "Economic and Fiscal Impact Analysis of the Harold E. LeMay Museum," Economics Research Associates, December 2004.

Other States

Do other states have a similar tax preference?

Forty-five states and the District of Columbia have a retail sales tax. Washington appears to be the only state that offers retail sales and use tax deferrals. Other states either tax or exempt the activity.

With regards to sales to nonprofit organizations (or purchases by nonprofit organizations), 26 states exempt some organizations from the retail sales tax sales. The general category for exemption is sales to charitable, religious, or educational organizations.

APPENDIX 1 – SCOPE AND OBJECTIVES

2007 EXPEDITED TAX PREFERENCE PERFORMANCE REVIEWS

SCOPE AND OBJECTIVES
MARCH 2007

STATE OF WASHINGTON
JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE

STUDY TEAM

Gary Benson
LIZBETH MARTIN-MAHAR

LEGISLATIVE AUDITOR

RUTA FANNING

Copies of Final reports and Digests are available on the JLARC website at:

http://jlarc.leg.wa.gov

Joint Legislative Audit & Review Committee
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(360) 786-5171
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MANDATE

Engrossed House Bill 1069 (2006) established the Citizen Commission for Performance Measurement of Tax Preferences and directed it to develop a schedule for periodic review of the state's tax preferences. The bill also directed the Joint Legislative Audit and Review Committee (JLARC) to conduct the periodic reviews.

BACKGROUND

Tax preferences are exemptions, exclusions, or deductions from the base of a state tax; a credit against a state tax; a deferral of a state tax; or a preferential state tax rate. The state has more than 500 tax preferences.

Recognizing the need to assess the effectiveness of these tax preferences in meeting their intended objectives, and an orderly process to do so, the Legislature established the Citizen Commission for Performance Measurement of Tax Preferences. The role of the commission is to develop a schedule for the performance review of all tax preferences at least once every ten years. The ten year schedule is to be revised annually.

Omitted from review are several categories of tax preferences identified by statute (e.g., tax preferences required by constitutional law). Any tax preference that the commission determines is a critical part of the structure of the tax system may also be omitted. The commission may recommend an expedited review process for any tax preference that has an estimated biennial fiscal impact of $10 million or less.

JLARC is to review tax preferences according to the schedule developed by the commission, and consistent with guidelines set forth in statute. For each tax preference JLARC is to provide recommendations to (1) continue, (2) modify, (3) add an expiration date and conduct another review prior to the expiration date, or (4) terminate the preference. JLARC may also recommend accountability standards for future reviews of tax preferences.

EXPEDITED STUDY SCOPE

This tax preference performance review will include the tax preferences identified by the Citizen Commission to be reviewed prior to August 30, 2007. These tax preferences were recommended by the Citizen Commission as being subject to an expedited review process:

Brief Description	RCW Citation	Year Enacted
1. Nonprofit libraries	84.36.040(1b)	1854
2. Fire companies	84.36.060(1c)	1890
3. Growing crops	84.40.030(3)	1890
4. Nursing homes	84.36.040(1d)	1891
5. Orphanages	84.36.040(1c)	1891
6. Humane societies	84.36.060(1d)	1915
7. Collections and museums	84.36.060(1a)	1915
8. Refunded fuel tax for nonhighway use	82.36.280; 82.38.180(1)	1923

EXPEDITED STUDY SCOPE (CONT'D.)

Brief Description	RCW Citation	Year Enacted
9. Lost or destroyed fuel	82.36.370; 82.38.180(4)-(6)	1923
10. Veterans organizations	84.36.030(4)	1929
11. Youth organizations	84.36.030(3)	1933
12. Contributions and donations	82.04.4282	1935
13. Membership dues and fees	82.04.4282	1935
14. Horse Racing	82.04.350	1935
15. Boxing and wrestling matches	82.04.340	1935
16. Sales tax deferral; historic auto museums	82.32.580	2005

EXPEDITED STUDY OBJECTIVES

In response to the legislative directive, the study will answer, for each tax preference, the following questions:

Public Policy Objectives:

1. What are the public policy objectives that provide a justification for the tax preference? Is there any documentation on the purpose or intent of the tax preference?
2. Is there any readily available evidence related to the achievement of any of these public policy objectives (in the past, present or future)?

Beneficiaries:

3. Who are the entities whose state tax liabilities are directly affected by the tax preference?
4. To what extent is the tax preference providing unintended tax benefits to entities other than those the Legislature intended?

Revenue and Economic Impacts:

5. What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?
6. What impact do the beneficiaries of the tax preference have on the economy at a state and regional level?

Other States:

7. Do other states have a similar tax preference?

TIMEFRAME FOR THE STUDY

A preliminary audit report will be presented at the July 2007 JLARC meeting and at the August 2007 meeting of the commission. A final report will be presented to JLARC in November 2007.

JLARC STAFF CONTACT FOR THE STUDY

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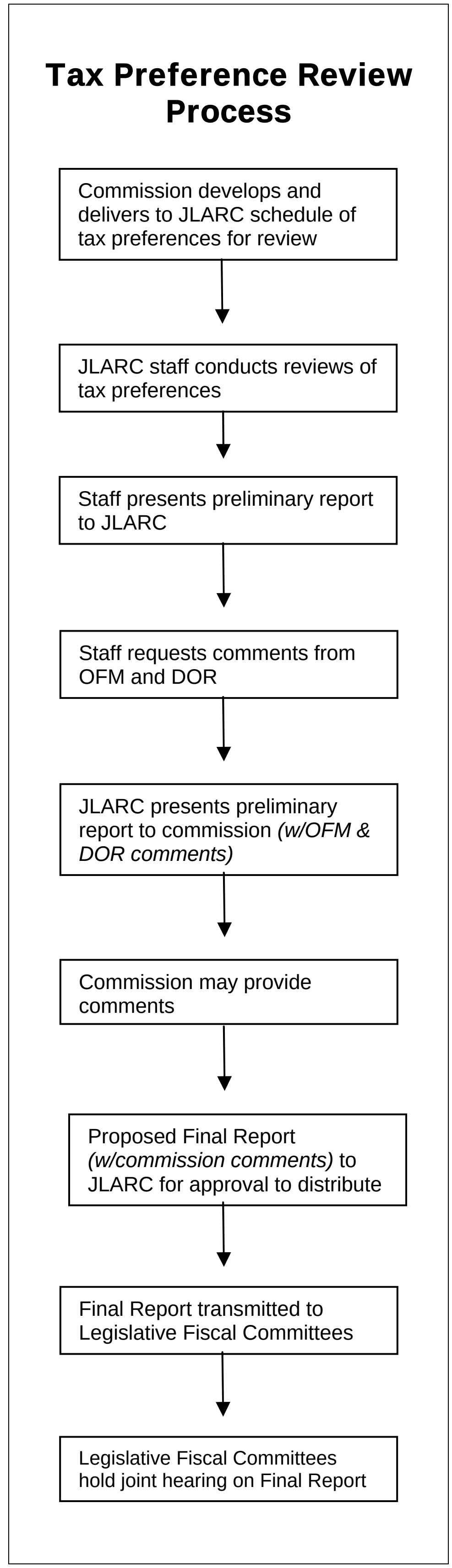

APPENDIX 2 – TAX PREFERENCE COMMISSION AND AGENCY RESPONSES

- Citizen Commission for Performance Measurement of Tax Preferences
- Office of Financial Management, Department of Revenue, and Department of Licensing
- Department of Licensing

State of Washington

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Citizen Commission for Performance Measurement of Tax Preferences

November 14, 2007

To: Joint Legislative Audit and Review Committee

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

Subject: 2007 Tax Preference Reviews

Thank you for the opportunity to comment on the 2007 Tax Preference Review Preliminary Reports. The Commission endorses the recommendations in the report. Our comments are as follows:

JLARC RECOMMENDATION	COMMISSION POSITION AND ADOPTED COMMENTS	EXPLANATION OF COMMISSION COMMENTS
Nonprofit Hospitals		
Recommendation 1: If the Legislature intended to provide a nonprofit hospital property tax exemption under the assumption that these organizations were providing more charity or low-income care than other hospitals, then the Legislature should modify the property tax exemption to be dependent on meeting a threshold of charity or low-income care.	Endorses with the following additional comments: The Legislature should determine whether the nonprofit hospital property tax exemption is intended to be available to hospitals that provide more charity or low-income care than other hospitals, and if necessary, amend the exemption to ensure that it carries out its intended purpose.	The Commission intends their comments to be more directive than JLARC staff by stating the Legislature should definitively clarify their intent.
Recommendation 2: If the Legislature wants additional information on community service activities performed by hospitals, then it should require hospitals to report an annual community services inventory.	Endorses with the following additional comments: The Legislature should determine whether it should require information on community service activities performed by nonprofit hospitals, and if so, it should amend the exemption to require nonprofit hospitals to report an annual community service inventory.	
Recommendation 3: The Legislature should clarify which specific services provided by nonprofit hospitals qualify for a property tax exemption.	Endorses	

JLARC RECOMMENDATION	COMMISSION POSITION AND ADOPTED COMMENTS	EXPLANATION OF COMMISSION COMMENTS
Nonprofit Nonsectarian Organizations Recommendation: If the Legislature intended all nonprofit nonsectarian organizations to meet a gift giving test to qualify for the property tax exemption, then the Legislature should enact a gift giving criterion into law.	Endorses with the following additional comments: The Legislature should determine whether it intends nonprofit nonsectarian organizations to meet a gift giving test to qualify for the property tax exemption, and if so, it should enact a gift giving criterion into law.	
Nonprofit Nursing Homes Recommendation 1: If the Legislature intended to provide the nonprofit nursing home property tax exemption under the assumption that these organizations were providing more charity or low-income care than other nursing homes, then the Legislature should modify the property tax exemption to be dependent on meeting a threshold of charity or low-income care. Recommendation 2: If the Legislature wants information on community service activities performed by nursing homes, then it should require nursing homes to report an annual community service inventory.	Endorses with the following additional comments: The Legislature should determine whether the nonprofit nursing home property tax exemption is intended to be available to nursing homes that provide more charity or low-income care than other nursing homes, and if necessary, amend the exemption to ensure that it carries out its intended purpose. Endorses with the following additional comments: The Legislature should determine whether it should require information on community service activities performed by nursing homes, and if so, it should amend the exemption to require nursing homes to report an annual community service inventory.	The Commission intends their comments to be more directive than JLARC staff by stating the Legislature should definitively clarify their intent.
Nonprofit Orphanages Recommendation: If the Legislature is concerned with providing uniform and equitable tax treatment to all nonprofit organizations providing similar housing and care for children, the Legislature should terminate the orphanage property tax exemption and allow the orphanages to qualify for the nonsectarian property tax exemption like other similar nonprofit organizations.	Endorses with the following additional comments: The Commission recommends that nonprofit orphanages continue to qualify for tax exempt status.	The Commission intends to ensure that nonprofit orphanages continue to qualify for tax exempt status.

JLARC RECOMMENDATION	COMMISSION POSITION AND ADOPTED COMMENTS	EXPLANATION OF COMMISSION COMMENTS
Membership Dues and Fees Recommendation: The Legislature should clarify which clubs should qualify for the tax preference and provide a simple method to value this deduction.	Endorses	
Horse Racing Recommendation: If the Legislature had a public policy objective to avoid double taxation for all horse racing, then this business and occupation tax exemption should be adjusted to tie qualifying for this exemption to actually paying the pari-mutuel tax. If the Legislature had a public policy objective to avoid double taxation only for businesses operating class 1 horse racing meets, then the Legislature should continue the business and occupation tax exemption.	Endorses	The Commission agrees the Legislature should clarify the purpose of this preference.
Refunded Fuel Tax for Nonhighway Use Recommendation: In an effort to maintain equity in the treatment of fuel taxes, the Legislature should review its policy of restricting the amount of fuel taxes that may be refunded to programs for off-road recreational users of motor vehicle fuel.	Endorses	
Churches, Parsonages, and Convents Recommendation: The property tax exemption for churches, parsonages, and convents should be continued.	Endorses	
Cemeteries Recommendation: The property tax exemption for all privately owned cemeteries should be continued.	Endorses	
Household Goods Recommendation: The property tax exemption for household goods, furnishings, and personal effects should be continued.	Endorses	The Commission determined that this is a critical part of the structure of the tax system. The Commission stated that this preference should no longer be subject to review.

JLARC RECOMMENDATION	COMMISSION POSITION AND ADOPTED COMMENTS	EXPLANATION OF COMMISSION COMMENTS
Refund of Fuel Tax for Exported Fuel Recommendation: The motor vehicle fuel tax refunds for exported fuel should be continued.	Endorses	
Nonprofit Libraries Recommendation: The property tax exemption for nonprofit libraries should continue.	Endorses	
Fire Companies Recommendation: The property tax exemption for fire companies should continue.	Endorses	
Growing Crops Recommendation: The Legislature should continue to exclude the value of growing crops from the farmland value.	Endorses	
Humane Societies Recommendation: The property tax exemption for humane societies should continue.	Endorses	
Collections and Museums Recommendation: The property tax exemption for collections, museums, and historical societies should continue.	Endorses	
Veterans Organizations Recommendation: The property tax exemption for war veteran organizations should continue.	Endorses	
Nonprofit Youth Organizations Recommendation: The property tax exemption for nonprofit youth organizations should continue.	Endorses	
Contributions and Donations Recommendation: The business and occupation tax deduction for donations and contributions should continue.	Endorses	
Boxing and Wrestling Matches Recommendation: The business and occupation tax exemption for promoters of boxing, wrestling and martial arts matches should continue.	Endorses	

JLARC RECOMMENDATION	COMMISSION POSITION AND ADOPTED COMMENTS	EXPLANATION OF COMMISSION COMMENTS
Lost or Destroyed Fuel Recommendation: The refund of fuel taxes for lost or destroyed fuel should be continued.	Endorses	
Historic Auto Museums Recommendation: The retail sales and use tax deferral for historic auto museums should continue.	Endorses	

c: Commission Members
Ruta Fanning
Keenan Konopaski
Gary Benson
Lizbeth Martin-Mahar
Cindy Evans

STATE OF WASHINGTON

August 13, 2007

TO: Ruta Fanning, Legislative Auditor
Joint Legislative Audit and Review Committee

FROM: Victor A. Moore, Director
Office of Financial Management

V.A.M.

Cindi Holmstrom, Director
Department of Revenue

Cindi Holmstrom

Liz Luce, Director
Department of Licensing

Liz Luce

SUBJECT: JLARC PRELIMINARY REPORTS ON 2007 TAX PREFERENCE PERFORMANCE REVIEW

Thank you for the opportunity to review and comment on the Joint Legislative Audit and Review Committee's (JLARC) preliminary reports on 2007 Tax Preference Performance Reviews.

We appreciate the efforts of JLARC and the Citizens Commission for Performance Measurement of Tax Preferences (Commission) to identify current tax preference legislation for further review by the Legislature. Informed discussion about the original intent and assumptions underlying current tax preferences – and legislative debate about their continuing effectiveness and relevance – can help state government maintain a fair and equitable tax system.

We believe your work could improve the fairness of current tax preferences and add to our capacity to evaluate their impact on an ongoing basis. In examining these issues further, it may help to look at the administrative burdens borne by both taxpayers and state agencies that result from administering a particular tax preference. It also may be useful to look at what possible new burdens could come along with a proposed reform. In addition, it is possible that there could be pressures on state expenditures if changes are made to a specific exemption (such as a change to tax exemptions now provided to non-profit hospitals and non-profit nursing homes that results in pressure to replace the exemption with a budget item).

Again, we appreciate your effort to continuously review and analyze the state's structure of tax liabilities and exemptions. Please continue to consult with the Office of Financial Management, Department of Revenue, and other agencies that would be affected by possible changes to tax preference legislation.

STATE OF WASHINGTON
DEPARTMENT OF LICENSING
PO Box 9020 • Olympia, Washington 98507-9020

August 16, 2007

Ruta Fanning, Legislative Auditor
Joint Legislative Audit and Review Committee
Post Office Box 40910
Olympia, Washington 98501-2323

Dear Ruta,

The Department has reviewed the draft report regarding tax preference performance reviews conducted by JLARC. The tax preferences reviewed included off highway fuel tax refunds, refunds of exported fuel and refunds of fuel reported lost or destroyed. From a tax collection perspective the Department of Licensing does not have any concerns regarding the administration of the proposals included in the report.

Together with OFM and DOL, we are offering additional perspectives concerning the tax preference reviews in a separate communication.

Thank you,

Sharon L Whitehead for
Liz Luce
Director

AH:kj

cc:

APPENDIX 3 – CURRENT LAW

Nonprofit Day Care Centers, Libraries, Orphanages, Homes for the Sick or Infirm, Hospitals and Outpatient Dialysis Facilities

RCW 84.36.040(1)

(1) The real and personal property used by nonprofit (a) day care centers as defined pursuant to RCW 74.15.020 (b) free public libraries; (c) orphanages and orphan asylums; (d) homes for the sick or infirm; (e) hospitals for the sick; and (f) outpatient dialysis facilities, which are used for the purposes of such organizations shall be exempt from taxation: PROVIDED, That the benefit of the exemption inures to the user.

(3) To be exempt under this section, the property must be used exclusively for the purposes for which exemption is granted, except as provided in RCW 84.36.805.

Museums and Collections, Performing Arts, Fire Companies and Humane Societies

RCW 84.36.060(1)(c)

(1) The following property shall be exempt from taxation:

(a) All art, scientific, or historical collections of associations maintaining and exhibiting such collections for the benefit of the general public and not for-profit, together with all real and personal property of such associations used exclusively for the safekeeping, maintaining and exhibiting of such collections;

(b) All the real and personal property owned by or leased to associations engaged in the production and performance of musical, dance, artistic, dramatic, or literary works for the benefit of the general public and not for profit, which real and personal property is used exclusively for this production or performance;

(c) All fire engines and other implements used for the extinguishment of fire, and the buildings used exclusively for their safekeeping, and for meetings of fire companies, as long as the property belongs to any city or town or to a fire company; and

(d) All property owned by humane societies in this state in actual use by the societies.

(2) To receive an exemption under subsection (1)(a) or (b) of this section:

(a) An organization must be organized and operated exclusively for artistic, scientific, historical, literary, musical, dance, dramatic, or educational purposes and receive a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its purpose or function) from the United States or any state or any political subdivision thereof or from direct or indirect contributions from the general public.

(b) If the property is not currently being used for an exempt purpose but will be used for an exempt purpose within a reasonable period of time, the nonprofit organization, association, or corporation claiming the exemption must submit proof that a reasonably specific and active program is being carried out to construct, remodel, or otherwise enable the property to be used for an exempt purpose. The property does not qualify for an exemption during this interim period if the property is used by, loaned to, or rented to a for-profit organization or business enterprise. Proof of a specific and active program to build or remodel the property so it may be used for an exempt purpose may include, but is not limited to:

(i) Affirmative action by the board of directors, trustees, or governing body of the nonprofit organization, association, or corporation toward an active program of construction or remodeling;

(ii) Itemized reasons for the proposed construction or remodeling;

(iii) Clearly established plans for financing the construction or remodeling; or

(iv) Building permits.

(3) The use of property exempt under subsection (1)(a) or (b) of this section by entities not eligible for a property tax exemption under this chapter, except as provided in this section, nullifies the exemption otherwise available for the property for the assessment year. The exemption is not nullified if:

(a) The property is used by entities not eligible for a property tax exemption under this chapter for periods of not more than twenty-five days in the calendar year;

(b) The property is not used for pecuniary gain or to promote business activities for more than seven of the twenty-five days in the calendar year;

(c) The property is used for artistic, scientific, or historic purposes, for the production and performance of musical, dance, artistic, dramatic, or literary works, or for community gatherings or assembly, or meetings; and

(d) The amount of any rent or donations is reasonable and does not exceed maintenance and operation expenses created by the user.

Growing Crops

RCW 84.40.030(3)

All property shall be valued at one hundred percent of its true and fair value in money and assessed on the same basis unless specifically provided otherwise by law.

Taxable leasehold estates shall be valued at such price as they would bring at a fair, voluntary sale for cash without any deductions for any indebtedness owed including rentals to be paid.

The true and fair value of real property for taxation purposes (including property upon which there is a coal or other mine, or stone or other quarry) shall be based upon the following criteria:

(1) …

(3) In valuing any tract or parcel of real property, the true and fair value of the land, exclusive of structures thereon shall be determined; also the true and fair value of structures thereon, but the valuation shall not exceed the true and fair value of the total property as it exists. In valuing agricultural land, growing crops shall be excluded.

War Veterans and Youth Organizations

RCW 84.36.030 (3) and (4)

(3) Property, including buildings and improvements required for the maintenance and safeguarding of such property, owned by nonprofit organizations or associations engaged in character building of boys and girls under eighteen years of age, and used for such purposes and uses, provided such purposes and uses are for the general public good: PROVIDED, That if existing charters provide that organizations or associations, which would otherwise qualify under the provisions of this paragraph, serve boys and girls up to the age of twenty-one years, then such organizations or associations shall be deemed qualified pursuant to this section.

(4)(a) Property owned by all organizations and societies of veterans of any war of the United States, recognized as such by the department of defense, which shall have national charters, and which shall have for their general purposes and objects the preservation of the memories and associations incident to their war service and the consecration of the efforts of their members to mutual helpfulness and to patriotic and community service to state and nation. To be exempt such property must be used in such manner as may be reasonably necessary to carry out the purposes and objects of such societies.

(b) The use of the property for pecuniary gain or for business activities, except as provided in this subsection (4), nullifies the exemption otherwise available for the property for the assessment year. The exemption is not nullified by:

(i) The collection of rent or donations if the amount is reasonable and does not exceed maintenance and operation expenses.

(ii) Fund-raising activities conducted by a nonprofit organization.

(iii) The use of the property for pecuniary gain for periods of not more than fifteen days in a year.

(c) An inadvertent use of the property in a manner inconsistent with the purpose for which exemption is granted, if the inadvertent use is not part of a pattern of use. A pattern of use is presumed when an inadvertent use is repeated in the same assessment year or in two or more successive assessment years.

…

(7) To be exempt under this section, the property must be used exclusively for the purposes for which exemption is granted, except as provided in RCW 84.36.805.

(8) For the purposes of this section, "general public good" means members of the community derive a benefit from the rental or use of the property by the nonprofit community group or organization.

Initiation Fees, Membership Dues , Contributions and Donations

RCW 82.04.4282

In computing tax there may be deducted from the measure of tax amounts derived from bona fide (1) initiation fees, (2) dues, (3) contributions, (4) donations, (5) tuition fees, (6) charges made by the nonprofit trade or professional organization for attending or occupying space at a trade show, convention, or educational seminar sponsored by the nonprofit trade or professional organization , which trade show, convention, or educational seminar is not open to the general public, (7) charges made for operation of privately operated kindergartens, and (8) endowment funds. This section shall not be construed to exempt any person, association, or society from tax liability upon selling tangible personal property or upon providing facilities or services for which a special charge is made to members or others. If dues are in exchange for any significant amount of goods or services rendered by the recipient thereof to members without any additional charge to the member, or if the dues are graduated upon the amount of goods or services rendered, the value of such goods or services shall not be considered as a deduction under this section.

Horse Racing

RCW 82.04.350

Except as provided in RCW 82.04.286(1), this chapter shall not apply to any person in respect to the business of conducting race meets for the conduct of which a license must be secured from the horse racing commission.

Boxing and Wrestling Matches

RCW 82.04.340

This chapter shall not apply to any person in respect to the business of conducting boxing contests and sparring or wrestling matches for the conduct of which a license must be secured from the department of licensing.

Refunded Fuel Tax for Nonhighway Use

RCW 82.36.280

Any person who uses any motor vehicle fuel for the purpose of operating any internal combustion engine not used on or in conjunction with any motor vehicle licensed to be operated over and along any of the public highways, and as the motive power thereof, upon which motor vehicle fuel excise tax has been paid, shall be entitled to and shall receive a refund of the amount of the motor vehicle fuel excise tax paid on each gallon of motor vehicle fuel so used, whether such motor vehicle excise tax has been paid either directly to the vendor from whom the motor vehicle fuel was purchased or indirectly by adding the amount of such excise tax to the price of such fuel. No refund shall be made for motor vehicle fuel consumed by any motor vehicle as herein defined that is required to be registered and licensed as provided in chapter 46.16 RCW; and is operated over and along any public highway except that a refund shall be allowed for motor vehicle fuel consumed:

(1) In a motor vehicle owned by the United States that is operated off the public highways for official use;

(2) By auxiliary equipment not used for motive power, provided such consumption is accurately measured by a metering device that has been specifically approved by the department or is established by either of the following formulae:

(a) For fuel used in pumping fuel or heating oils by a power take-off unit on a delivery truck, refund shall be allowed claimant for tax paid on fuel purchased at the rate of three-fourths of one gallon for each one thousand gallons of fuel delivered: PROVIDED, That claimant when presenting his or her claim to the department in accordance with the provisions of this chapter, shall provide to said claim, invoices of fuel oil delivered, or such other appropriate information as may be required by the department to substantiate his or her claim; or

(b) For fuel used in operating a power take-off unit on a cement mixer truck or load compactor on a garbage truck, claimant shall be allowed a refund of twenty-five percent of the tax paid on all fuel used in such a truck; and

(c) The department is authorized to establish by rule additional formulae for determining fuel usage when operating other types of equipment by means of power take-off units when direct measurement of the fuel used is not feasible. The department is also authorized to adopt rules regarding the usage of on board computers for the production of records required by this chapter.

RCW 82.38.180 as amended by SB 5272 (2007)

Any person who has purchased special fuel on which tax has been paid ((a special fuel tax either directly or to the vendor from whom it was purchased)) may file a claim with the department for a refund of the tax ((so paid and shall be reimbursed and repaid the amount of))for:

(1)((Any)) Taxes previously paid on special fuel used for purposes other than for the propulsion of motor vehicles upon the public highways in this state.

(2)((Any)) Taxes previously paid on special fuel exported for use outside of this state. Special fuel carried from this state in the fuel tank of a motor vehicle is deemed to be exported from this state. Special fuel distributed to a federally recognized Indian tribal reservation located within the state of Washington is not considered exported outside this state.

(3)((Any)) Tax, penalty, or interest erroneously or illegally collected or paid.

(4)((Any)) Taxes previously paid on all special fuel which is lost or destroyed, while ((applicant)) the licensee shall be the owner thereof, through fire, lightning, flood, wind storm, or explosion.

(5)((Any)) Taxes previously paid on all special fuel of five 2 hundred gallons or more which is lost or destroyed while ((applicant)) the licensee shall be the owner thereof, through leakage or other casualty except evaporation, shrinkage, or unknown causes.

(6)((Any)) Taxes previously paid on special fuel that is inadvertently mixed with dyed special fuel.

Recovery for such loss or destruction under either subsection (4), (5), or (6) of this section must be susceptible to positive proof thereby enabling the department to conduct such investigation and require such information as ((they)) it may deem necessary. In the event that the department is not satisfied that the fuel was lost, destroyed, or contaminated as claimed because information or proof as required hereunder is not sufficient to substantiate the accuracy of the claim, ((they)) it may deem such as sufficient cause to deny all right relating to the refund or credit for the excise tax paid on special fuel alleged to be lost or destroyed. No refund or claim for credit shall be approved by the department unless the gallons of special fuel claimed as nontaxable satisfy the conditions specifically set forth in this section and the nontaxable event or use occurred during the period covered by the refund claim. Refunds or claims for credit ((by sellers or users of special fuel)) shall not be allowed for anticipated nontaxable use or events.

RCW 79A.25.030

From time to time, but at least once each four years, the director of licensing shall determine the amount or proportion of moneys paid to him or her as motor vehicle fuel tax which is tax on marine fuel. The director shall make or authorize the making of studies, surveys, or investigations to assist him or her in making such determination, and shall hold one or more public hearings on the findings of such studies, surveys, or investigations prior to making his or her determination. The studies, surveys, or investigations conducted pursuant to this section shall encompass a period of twelve consecutive months each time. The final determination by the director shall be implemented as of the next biennium after the period from which the study data were collected. The director may delegate his or her duties and authority under this section to one or more persons of the department of licensing if he or she finds such delegation necessary and proper to the efficient performance of these duties. Costs of carrying out the provisions of this section shall be paid from the marine fuel tax refund account created in RCW 79A.25.040, upon legislative appropriation.

RCW 79A.25.040

There is created the marine fuel tax refund account in the state treasury. The director of licensing shall request the state treasurer to refund monthly from the motor vehicle fund amounts which have been determined to be tax on marine fuel. The state treasurer shall refund such amounts and place them in the marine fuel tax refund account to be held for those entitled thereto pursuant to chapter 82.36 RCW and RCW 79A.25.050, except that he or she shall not refund and place in the marine fuel tax refund account for any period for which a determination has been made pursuant to RCW 79A.25.030 more than the greater of the following amounts: (1) An amount equal to two percent of all moneys paid to him or her as motor vehicle fuel tax for such period, (2) an amount necessary to meet all approved claims for refund of tax on marine fuel for such period.

RCW 79A25.070

Upon expiration of the time limited by RCW 82.36.330 for claiming of refunds of tax on marine fuel, the state of Washington shall succeed to the right to such refunds. The director of licensing, after taking into account past and anticipated claims for refunds from and deposits to the marine fuel tax refund account and the costs of carrying out the provisions of RCW 79A.25.030, shall request the state treasurer to transfer monthly from the marine fuel tax refund account an amount equal to the proportion of the moneys in the account representing a motor vehicle fuel tax rate of: (1) Nineteen cents per gallon of motor vehicle fuel from July 1, 2003, through June 30, 2005; (2) twenty cents per gallon of motor vehicle fuel from July 1, 2005, through June 30, 2007; (3) twenty-one cents per gallon of motor vehicle fuel from July 1, 2007, through June 30, 2009; (4) twenty-two cents per gallon of motor vehicle fuel from July 1, 2009, through June 30, 2011; and (5) twenty-three cents per gallon of motor vehicle fuel beginning July 1, 2011, and thereafter, to the recreation resource account and the remainder to the motor vehicle fund.

RCW 79A.25.080

Moneys transferred to the recreation resource account from the marine fuel tax refund account may be used when appropriated by the Legislature, as well as any federal or other funds now or hereafter available, to pay the necessary administrative and coordinative costs of the interagency committee for outdoor recreation established by RCW 79A.25.110. All moneys so transferred, except those appropriated as aforesaid, shall be divided into two equal shares and shall be used to benefit watercraft recreation in this state as follows:

(1) One share as grants to state agencies for (a) acquisition of title to, or any interests or rights in, marine recreation land, (b) capital improvement and renovation of marine recreation land, including periodic dredging in accordance with subsection (3) of this section, if needed, to maintain or make the facility more useful, or (c) matching funds in any case where federal or other funds are made available on a matching basis for purposes described in (a) or (b) of this subsection;

(2) One share as grants to public bodies to help finance (a) acquisition of title to, or any interests or rights in, marine recreation land, or (b) capital improvement and renovation of marine recreation land, including periodic dredging in accordance with subsection (3) of this section, if needed, to maintain or make the facility more useful. A public body is authorized to use a grant, together with its own contribution, as matching funds in any case where federal or other funds are made available for purposes described in (a) or (b) of this subsection. The committee may prescribe further terms and conditions for the making of grants in order to carry out the purposes of this chapter.

(3) For the purposes of this section "periodic dredging" is limited to dredging of materials that have been deposited in a channel due to unforeseen events. This dredging should extend the expected usefulness of the facility for at least five years.

RCW 79A.25.200

The recreation resource account is created in the state treasury. Moneys in this account are subject to legislative appropriation. The committee shall administer the account in accordance with this chapter and chapter 79A.35 RCW and shall hold it separate and apart from all other money, funds, and accounts of the committee. Moneys received from the marine fuel tax refund account under RCW 79A.25.070 shall be deposited into the account. Grants, gifts, or other financial assistance, proceeds received from public bodies as administrative cost contributions, and moneys made available to the state of Washington by the federal government for outdoor recreation may be deposited into the account.

RCW 90.48.390

The coastal protection fund is established to be used by the department as a revolving fund for carrying out the purposes of restoration of natural resources under this chapter and chapter 90.56 RCW. To this fund there shall be credited penalties, fees, damages, charges received pursuant to the provisions of this chapter and chapter 90.56 RCW, compensation for damages received under this chapter and chapter 90.56 RCW, and an amount equivalent to one cent per gallon from each marine use refund claim under RCW 82.36.330.

Moneys in the fund not needed currently to meet the obligations of the department in the exercise of its powers, duties, and functions under RCW 90.48.142, 90.48.366, 90.48.367, and 90.48.368 shall be deposited with the state treasurer to the credit of the fund.

RCW 46.09.150

Motor vehicle fuel excise taxes paid on fuel used and purchased for providing the motive power for nonhighway vehicles shall not be refundable in accordance with the provisions of RCW 82.36.280 as it now exists or is hereafter amended.

RCW 46.09.170

(1) From time to time, but at least once each year, the state treasurer shall refund from the motor vehicle fund one percent of the motor vehicle fuel tax revenues collected under chapter 82.36 RCW, based on a tax rate of: (a) Nineteen cents per gallon of motor vehicle fuel from July 1, 2003, through June 30, 2005; (b) twenty cents per gallon of motor vehicle fuel from July 1, 2005, through June 30, 2007; (c) twenty-one cents per gallon of motor vehicle fuel from July 1, 2007, through June 30, 2009; (d) twenty-two cents per gallon of motor vehicle fuel from July 1, 2009, through June 30, 2011; and (e) twenty-three cents per gallon of motor vehicle fuel beginning July 1, 2011, and thereafter, less proper deductions for refunds and costs of collection as provided in RCW 46.68.090.

(2) The treasurer shall place these funds in the general fund as follows:

(a) Thirty-six percent shall be credited to the ORV and nonhighway vehicle account and administered by the department of natural resources solely for acquisition, planning, development, maintenance, and management of ORV, nonmotorized, and nonhighway road recreation facilities, and information programs and maintenance of nonhighway roads;

(b) Three and one-half percent shall be credited to the ORV and nonhighway vehicle account and administered by the department of fish and wildlife solely for the acquisition, planning, development, maintenance, and management of ORV, nonmotorized, and nonhighway road recreation facilities and the maintenance of nonhighway roads;

(c) Two percent shall be credited to the ORV and nonhighway vehicle account and administered by the parks and recreation commission solely for the acquisition, planning, development, maintenance, and management of ORV, nonmotorized, and nonhighway road recreation facilities; and

(d) Fifty-eight and one-half percent shall be credited to the nonhighway and off-road vehicle activities program account to be administered by the committee for planning, acquisition, development, maintenance, and management of ORV, nonmotorized, and nonhighway road recreation facilities and for education, information, and law enforcement programs. The funds under this subsection shall be expended in accordance with the following limitations:

(i) Not more than thirty percent may be expended for education, information, and law enforcement programs under this chapter;

(ii) Not less than seventy percent may be expended for ORV, nonmotorized, and nonhighway road recreation facilities. Except as provided in (d)(iii) of this subsection, of this amount:

(A) Not less than thirty percent, together with the funds the committee receives under RCW 46.09.110, may be expended for ORV recreation facilities;

(B) Not less than thirty percent may be expended for nonmotorized recreation facilities. Funds expended under this subsection (2)(d)(ii)(B) shall be known as Ira Spring outdoor recreation facilities funds; and

(C) Not less than thirty percent may be expended for nonhighway road recreation facilities;

(iii) The committee may waive the minimum percentage cited in (d)(ii) of this subsection due to insufficient requests for funds or projects that score low in the committee's project evaluation. Funds remaining after such a waiver must be allocated in accordance with committee policy.

(3) On a yearly basis an agency may not, except as provided in RCW 46.09.110, expend more than ten percent of the funds it receives under this chapter for general administration expenses incurred in carrying out this chapter.

(4) During the 2003-05 fiscal biennium, the Legislature may appropriate such amounts as reflect the excess fund balance in the NOVA account to the interagency committee for outdoor recreation, the department of natural resources, the department of fish and wildlife, and the state parks and recreation commission. This appropriation is not required to follow the specific distribution specified in subsection (2) of this section.

RCW 46.10.075

There is created a snowmobile account within the state treasury. Snowmobile registration fees, monetary civil penalties from snowmobile dealers, and snowmobile fuel tax moneys collected under this chapter and in excess of the amounts fixed for the administration of the registration and fuel tax provisions of this chapter shall be deposited in the snowmobile account and shall be appropriated only to the state parks and recreation commission for the administration and coordination of this chapter.

RCW 46.10.150

From time to time, but at least once each biennium, the director shall request the state treasurer to refund from the motor vehicle fund amounts which have been determined to be a tax on snowmobile fuel, and the treasurer shall refund such amounts determined under RCW 46.10.170, and place them in the snowmobile account in the general fund.

RCW 46.10.160

Motor vehicle fuel used and purchased for providing the motive power for snowmobiles shall be considered a nonhighway use of fuel, but persons so purchasing and using motor vehicle fuel shall not be entitled to a refund of the motor vehicle fuel excise tax paid in accordance with the provisions of RCW 82.36.280 as it now exists or is hereafter amended.

RCW 46.10.170

From time to time, but at least once each four years, the department shall determine the amount of moneys paid to it as motor vehicle fuel tax that is tax on snowmobile fuel. Such determination shall use one hundred thirty-five gallons as the average yearly fuel usage per snowmobile, the number of registered snowmobiles during the calendar year under determination, and a fuel tax rate of: (1) Nineteen cents per gallon of motor vehicle fuel from July 1, 2003, through June 30, 2005; (2) twenty cents per gallon of motor vehicle fuel from July 1, 2005, through June 30, 2007; (3) twenty-one cents per gallon of motor vehicle fuel from July 1, 2007, through June 30, 2009; (4) twenty-two cents per gallon of motor vehicle fuel from July 1, 2009, through June 30, 2011; and (5) twenty-three cents per gallon of motor vehicle fuel beginning July 1, 2011, and thereafter.

Lost or Destroyed Fuel

***RCW 82.36.370* as amended by SB 5272 (2007)**

(1) A refund shall be made in the manner provided in this chapter or a credit given to a licensee allowing for the excise tax paid or accrued on all motor vehicle fuel which is lost or destroyed, while ((applicant shall be the owner thereof)) the licensee was the owner, through fire, lightning, flood, wind storm, or explosion.

(2) A refund shall be made in the manner provided in this chapter or a credit given allowing for the excise tax paid or accrued on all motor vehicle fuel of five hundred gallons or more which is lost or destroyed, while ((applicant shall be)) the licensee was the owner thereof, through leakage or other casualty except evaporation, shrinkage or unknown causes: PROVIDED, That the director shall be notified in writing as to the full circumstances surrounding such loss or destruction and the amount of the loss or destruction within thirty days from the day of discovery of such loss or destruction.

(3) Recovery for such loss or destruction under either subsection (1) or (2) must be susceptible to positive proof thereby enabling the director to conduct such investigation and require such information as the director may deem necessary.

In the event that the director is not satisfied that the fuel was lost or destroyed as claimed, wherefore required information or proof as required hereunder is not sufficient to substantiate the accuracy of the claim, the director may deem as sufficient cause the denial of all right relating to the refund or credit for the excise tax on motor vehicle fuel alleged to be lost or destroyed.

RCW 82.38.180 as amended by SB 5272 (2007)

Any person who has purchased special fuel on which tax has been paid ((a special fuel tax either directly or to the vendor from whom it was purchased)) may file a claim with the department for a refund of the tax ((so paid and shall be reimbursed and repaid the amount of)) for:

(1)((Any)) Taxes previously paid on special fuel used for purposes other than for the propulsion of motor vehicles upon the public highways in this state.

(2)((Any)) Taxes previously paid on special fuel exported for use outside of this state. Special fuel carried from this state in the fuel tank of a motor vehicle is deemed to be exported from this state. Special fuel distributed to a federally recognized Indian tribal reservation located within the state of Washington is not considered exported outside this state.

(3)((Any)) Tax, penalty, or interest erroneously or illegally collected or paid.

(4)((Any)) Taxes previously paid on all special fuel which is lost or destroyed, while ((applicant)) the licensee shall be the owner thereof, through fire, lightning, flood, wind storm, or explosion.

(5)((Any)) Taxes previously paid on all special fuel of five 2 hundred gallons or more which is lost or destroyed while ((applicant)) the licensee shall be the owner thereof, through leakage or other casualty except evaporation, shrinkage, or unknown causes.

(6)((Any)) Taxes previously paid on special fuel that is inadvertently mixed with dyed special fuel.

Recovery for such loss or destruction under either subsection (4), (5), or (6) of this section must be susceptible to positive proof thereby enabling the department to conduct such investigation and require such information as ((they)) it may deem necessary. In the event that the department is not satisfied that the fuel was lost, destroyed, or contaminated as claimed because information or proof as required hereunder is not sufficient to substantiate the accuracy of the claim, ((they)) it may deem such as sufficient cause to deny all right relating to the refund or credit for the excise tax paid on special fuel alleged to be lost or destroyed. No refund or claim for credit shall be approved by the department unless the gallons of special fuel claimed as nontaxable satisfy the conditions specifically set forth in this section and the nontaxable event or use occurred during the period covered by the refund claim. Refunds or claims for credit ((by sellers or users of special fuel)) shall not be allowed for anticipated nontaxable use or events.

Sales Tax Deferral; Historic Auto Museums

RCW 82.32.580

(1) The governing board of a nonprofit organization, corporation, or association may apply for deferral of taxes on an eligible project. Application shall be made to the department in a form and manner prescribed by the department. The application shall contain information regarding

the location of the project, estimated or actual costs of the project, time schedules for completion and operation of the project, and other information required by the department. The department shall rule on the application within sixty days. All applications for the tax deferral under this section must be received no later than December 31, 2008.

(2) The department shall issue a sales and use tax deferral certificate for state and local sales and use taxes due under chapters 82.08, 82.12, and 82.14 RCW on each eligible project.

(3) The nonprofit organization, corporation, or association shall begin paying the deferred taxes in the fifth year after the date certified by the department as the date on which the eligible project is operationally complete. The first payment is due on December 31st of the fifth calendar year after such certified date, with subsequent annual payments due on December 31st of the following nine years. Each payment shall equal ten percent of the deferred tax.

(4) The department may authorize an accelerated repayment schedule upon request of the nonprofit organization, corporation, or association.

(5) Except as provided in subsection (6) of this section, interest shall not be charged on any taxes deferred under this section for the period of deferral. The debt for deferred taxes is not extinguished by insolvency or other failure of the nonprofit organization, corporation, or association.

(6) If the project is not operationally complete within five calendar years from issuance of the tax deferral or if at any time the department finds that the project is not eligible for tax deferral under this section, the amount of deferred taxes outstanding for the project shall be immediately due and payable. If deferred taxes must be repaid under this subsection, the department shall assess interest, but not penalties, on amounts due under this subsection. Interest shall be assessed at the rate provided for delinquent taxes under this chapter, retroactively to the date of deferral, and shall accrue until the deferred taxes due are repaid.

(7) Applications and any other information received by the department of revenue under this section are not confidential under RCW 82.32.330. This chapter applies to the administration of this section.

(8) This section applies to taxable eligible project activity that occurs on or after July 1, 2007.

(9) The following definitions apply to this section:

(a) "Eligible project" means a project that is used primarily for a historic automobile museum.

(b) "Historic automobile museum" means a facility owned and operated by a nonprofit organization, corporation, or association that is used to maintain and exhibit to the public a collection of at least five hundred motor vehicles.

(c) "Nonprofit organization, corporation, or association" means an organization, corporation, or association exempt from tax under section 501(c)(3), (4), or (10) of the federal internal revenue code (26 U.S.C. Sec. 501(c)(3), (4), or (10)).

(d) "Project" means the construction of new structures, the acquisition and installation of fixtures that are permanently affixed to and become a physical part of those structures, and site preparation. For purposes of this subsection, structures do not include parking facilities used for motor vehicles that are not on display or part of the museum collection.

(e) "Site preparation" includes soil testing, site clearing and grading, demolition, or any other related activities that are initiated before construction. Site preparation does not include landscaping services or landscaping materials.

APPENDIX 4 – PROPERTY TAX ESTIMATION PROCEDURE

The following procedure was used for the following property tax exemptions for 2007: churches, cemeteries, nonsectarian organizations, youth organizations, nonprofit nursing homes, humane societies, nonprofit museums and collections, war veterans, and orphanages. JLARC collected the value for all the exempt parcels for fire companies, nonprofit libraries and hospitals from the counties that quantified assessed values for exempt properties.

The Department of Revenue (DOR) requires certain taxpayers, in particular nonprofits organizations, to file an application for a property tax exemption, which does not include information on the value of the property. DOR reviews and approves the property tax exemption for these taxpayers and then transfers the identified exempt parcel numbers to the county assessors. For exempt property in Washington, the county assessors are required by law to place a value on the county tax rolls, with only certain exemptions.[94] DOR does not require the county assessors to report the value of the exempt value to them annually.

In order to estimate the assessed value of property tax preferences for nonprofits, the procedure by DOR in the past and JLARC in 2007 has been to get a sample of county tax roll data and match that data with DOR's nonprofit property exempt database. DOR gave JLARC 14 counties to include in this year's sample of counties to estimate the value of the tax exemptions for the 2007 tax preference reviews.[95] The exempt parcels in these 14 counties represent 60 percent of all exempt parcels in DOR nonprofit database. JLARC summarized the real market value per exempt parcel by different types of exemptions for the sampled counties. Then, we divided the sampled counties into rural and urban counties. Rural counties had a population of less than 100/sq. mile and urban counties had a population greater than 100/sq. mile. We calculated the average value per exempt parcel for rural and urban counties for each type of property tax exemption. We compared the average value per exempt parcel to the average value of all parcels in the sampled counties. We computed a ratio of the average exempt value to the countywide value per parcel for each tax exemption type in rural and urban counties. For the remaining counties, not included in the sample, we calculated the countywide average real market value per parcel by multiplied either the urban or rural ratio of average value per exempt parcel to countywide average real market value per parcel for each tax preference. This procedure resulted in each county having an average value for each exempt parcel. This average value was multiplied by the total number of exempt parcels in each county for every type of tax preference. JLARC multiplied the average local property tax rate for each county by the total exempt property by county for each tax preference to get the estimates for the taxpayer savings. JLARC calculated the state taxpayer savings estimates from a spreadsheet model from DOR which estimates the amount of state taxes loss due to the tax rate limit. This model also estimated that on average statewide the amount of local property taxes loss to local governments was 20 percent of the total value of the tax preference.

[94] RCW 84.40.175

[95] The counties included in the 2007 tax preference review study were the following: Asotin, Clark, Cowlitz, Ferry, Grant, Grays Harbor, King, Okanogan, Pierce, Spokane, Thurston, Walla Walla, Whitman and Yakima

The remaining 80 percent of the value of the tax preference is a shift in local property tax rates onto other taxpayers. This percentage breakdown in the value of the tax preference indicates that for each tax preference there is some local government loss but the majority of the exemption is paid for by other non-exempt taxpayers. The amount of this tax loss to local governments is likely to be felt by junior districts that are at their maximum tax rate limits. These local government losses vary widely in each county throughout the state.

For nonprofit libraries and fire companies, all counties' values for each exempt parcel were obtained to estimate the exempt value and taxpayer savings for these tax preferences. For nonprofit hospitals, JLARC attempted to obtain each exempt parcel's county value, but three small counties indicated that they do not place a value on exempt value. Due to this data limitation on certain county tax rolls, JLARC used the Department of Health data for hospitals. One statistic submitted to the Department of Health by all hospitals is the value of their real and personal property. This was used to make the estimates for the property tax exemption for nonprofit hospitals because the county total value reported was significantly less and may not have included the personal property of hospitals which is also exempt under this tax preference.