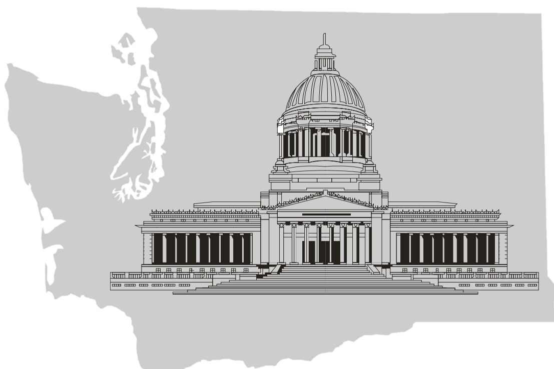
State of Washington
Joint Legislative Audit & Review Committee (JLARC)



2010 Expedited Tax Preference Performance Reviews

Report 11-5

January 5, 2011

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Joint Legislative Audit and Review Committee

1300 Quince St SE

PO Box 40910

Olympia, WA 98504

(360) 786-5171

(360) 786-5180 Fax

www.jlarc.leg.wa.gov

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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Committee Approval

Subsequent to the January 5, 2011 meeting, this report was approved for distribution by the Joint Legislative Audit and Review Committee.

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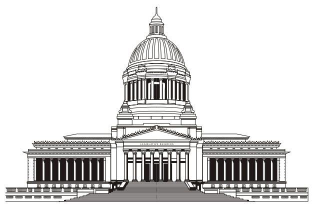

STATE OF WASHINGTON
JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE

STUDY TEAM
Mary Welsh
Dana Lynn
Stacia Hollar
Peter Heineccius

PROJECT SUPERVISOR
Keenan Konopaski

LEGISLATIVE AUDITOR
Keenan Konopaski

Copies of Final Reports and Digests are available on the JLARC website at:
www.jlarc.leg.wa.gov
or contact
Joint Legislative Audit & Review Committee
1300 Quince St SE
Olympia, WA 98504-0910
(360) 786-5171
(360) 786-5180 FAX

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 nearly 590 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 the 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.

The Commission has identified three categories of review, based on each tax preference's estimated biennial fiscal impact:

1. Full reviews (over $10 million)
2. Expedited reviews (between $2 million and $10 million)
3. Expedited light reviews ($2 million or less)

However, at their discretion, the Commission may elect to subject a tax preference with a fiscal impact of $2 million or less to the expedited review process.

In October 2009, the Commission adopted its fourth ten-year schedule for the tax preference reviews. The schedule for 2010 includes a total of 58 tax preferences under the business and occupation tax, public utility tax, sales tax, use tax, property tax, motor vehicle fuel tax, special fuel tax, litter tax, real estate excise tax, leasehold excise tax, and the insurance premiums tax. Of these 58 tax preferences, the law allowed 10 tax preferences to have an expedited review process, which are included in this report.

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 of the 10 tax preferences scheduled by the Commission for expedited review. Ten full tax preference reviews are included in a separate report. A third report contains information on the remaining 38 preferences with a biennial fiscal impact of less than $2 million.

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 four questions for each tax preference:

- **Public Policy Objectives:**
  1) What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?
  2) Is there any readily available evidence related to the achievement of any of these public policy objectives?
- **Beneficiaries:**
  3) Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?
- **Revenue and Economic Impacts:**
  4) What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

Methodology

JLARC staff analyzed the following evidence in conducting these expedited reviews: 1) legal and public policy history of the tax preferences; 2) beneficiaries of the tax preferences; 3) government data pertaining to the utilization of these tax preferences and other relevant data; and 4) revenue impacts of the 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, and Board of Tax Appeals decisions relevant to each tax preference. Staff interviewed the agencies that administer the tax preferences (primarily the Department of Revenue, the Department of Transportation, and the Department of Agriculture). These parties provided data on the value and usage of the tax preference and the beneficiaries. JLARC staff also obtained data from other state and federal agencies to which the beneficiaries are required to report. In a few cases, beneficiaries and other agencies provided additional information.

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

Summary of the Results from JLARC's Reviews

The table beginning on page 5 provides a summary of the recommendations from JLARC's analysis of the tax preferences scheduled for expedited review in 2010. JLARC provides analysis of tax preferences scheduled for full review and expedited light review in 2010 in additional volumes. Of the ten tax preferences included in this volume, this report recommends that the Legislature continue five tax preferences as they are. The expedited report raises issues for the Legislature's consideration for one of the current tax preferences, and recommends that the Legislature allow four tax preferences to expire.

Organization of This Report

This report includes ten separate chapters. Each chapter consists of a review of one or more related tax preferences. Each chapter begins with a summary of the findings and recommendations from JLARC's analysis of the individual tax preferences. Then, each chapter provides additional detail, including additional information supporting the answers to the questions outlined in the approach. The current appendices provide the Scope and Objectives and the text of current law for each preference.

2010 Expedited Reviews

Year Enacted	# of Claimants ($ amount)	JLARC Recommendation	Comments by Citizen Commission for Performance Measurement of Tax Preferences	Related Legislation as of 2010
JLARC recommendation: Legislature should continue the tax preference				
Poultry Used to Produce Poultry and Poultry Products / RCW 82.08.0267; RCW 82.12.0262				
1961	733 $222,000	Continue	Endorses without comment	Unknown until after 2011 session
Farm Machinery Sold to Nonresidents / RCW 82.08.0268				
1961	Unknown $4.6 million	Continue	Endorses without comment	Unknown until after 2011 session
Vehicles Acquired Out-of-State While in the Armed Services / RCW 82.12.0266				
1963	Unknown $2.4 million	Continue	Endorses without comment	Unknown until after 2011 session
Labor and Services for Mining/Sorting/Crushing Sand/Gravel/Rock for Public Road Purposes / RCW 82.08.0275; RCW 82.12.0269				
1965	Unknown $2 million	Continue	Endorses without comment	Unknown until after 2011 session
Conservation and Open Space Lands / RCW 84.36.260; RCW 84.34.220				
1967	58 $1.7 million	Continue	Endorses without comment	Unknown until after 2011 session

2010 Expedited Reviews

Year Enacted	# of Claimants ($ amount)	JLARC Recommendation	Comments by Citizen Commission for Performance Measurement of Tax Preferences	Related Legislation as of 2010
JLARC recommendation: Legislature should re-examine or clarify the intent of the tax preference				
Bailed Tangible Personal Property Consumed in R & D, Experimental, and Testing / RCW 82.12.0265.				
1961	Unknown $4.7 million	Because of the ambiguity of current law, the Legislature should review and clarify the purpose of the preference providing a use tax exemption for bailed tangible personal property consumed in research, development, experimental, and testing activities.	Endorses with comment: The Commission endorses the recommendation that the Legislature should review and clarify the purpose of the preference and further recommends that the Legislature consider whether the interpretation of the existing statute by the Department of Revenue results in fairness or competitive impacts. Rationale: The Commission noted that the Department of Revenue issued an advisory in 2005 explaining that labels provided ("bailed") to salmon labeling companies qualify for this preference. The rationale of this advisory ruling appears to be a technical interpretation of the statue and may not be what the Legislature intended when it established a preference for a use tax exemption for tangible property that is bailed to a person and used in research, development, experimental, and testing activities when the bailed property is entirely consumed during the research, development, experimental, and testing activities, and the party that bails the property was not subject to sales tax or use tax when the party initially purchased or acquired the property.	Unknown until after 2011 session

2010 Expedited Reviews				
Year Enacted	**# of Claimants ($ amount)**	**JLARC Recommendation**	**Comments by Citizen Commission for Performance Measurement of Tax Preferences**	**Related Legislation as of 2010**
JLARC recommendation: Legislature should allow the tax preference to expire				
Fruit and Vegetable Manufacturers / 82.04.4266; 82.04.260(1)(d)				
2005	109 $5 million	Recommendation 1		
		Because the public policy objective of creating and retaining quality jobs is not being fully achieved, and the B&O tax exemption was intended to be temporary, the Legislature should allow the B&O tax exemption for fresh fruit and vegetable processors to expire on July 1, 2012.	Endorses with comment: The Commission endorses the recommendation, but acknowledges that the Department of Agriculture provided correspondence to the Commission indicating they disagreed with the JLARC recommendation.	Unknown until after 2011 session
		Recommendation 2		
		To achieve the public policy objective of providing consistent tax treatment to fresh food processors, the Legislature should continue the preferential tax rate of 0.138 percent that becomes effective on July 1, 2012.	Same as Recommendation 1	Unknown until after 2011 session
Seafood Products Manufacturers / 82.04.4269; 82.04.260(1)(b)				
2006	22 $3.3 million	Recommendation 1		
		Because the implied public policy objective of creating and retaining quality jobs is not being fully achieved, and the B&O tax exemption was intended to be temporary, the Legislature should allow the B&O tax exemption for seafood processors to expire on July 1, 2012.	Endorses with comment: The Commission endorses the recommendation, but acknowledges that the Department of Agriculture provided correspondence to the Commission indicating they disagreed with the JLARC recommendation.	Unknown until after 2011 session
		Recommendation 2		
		To achieve the public policy objective of providing consistent tax treatment to fresh food processors, the Legislature should continue the preferential tax rate of 0.138 percent that becomes effective on July 1, 2012.	Same as Recommendation 1	Unknown until after 2011 session

2010 Expedited Reviews

Year Enacted	# of Claimants ($ amount)	JLARC Recommendation	Comments by Citizen Commission for Performance Measurement of Tax Preferences	Related Legislation as of 2010
Dairy Products Manufacturers / 82.04.4268; 82.04.260(1)(c)				
2006	11 $1.5 million	Recommendation 1		
		Although the implied policy objective of creating and retaining quality jobs is being partially achieved, the Legislature should allow the B&O tax exemption for dairy processors to expire on July 1, 2012, because the B&O tax exemption was intended to be temporary.	Endorses with comment: The Commission endorses the recommendation, but acknowledges that the Department of Agriculture provided correspondence to the Commission indicating they disagreed with the JLARC recommendation.	Unknown until after 2011 session
		Recommendation 2		
		To achieve the public policy objective of providing consistent tax treatment to fresh food processors, the Legislature should continue the preferential tax rate of 0.138 percent that becomes effective on July 1, 2012.	Same as Recommendation 1	Unknown until after 2011 session
Fresh Food Processors / 82.74 RCW				
2005	6 $1.1 million	Because the amount of investment in plant and equipment and the number of new jobs are less than expected by the public policy objective, the Legislature should allow the fresh food processors deferral to expire on July 1, 2012.	Endorses with comment: The Commission endorses, but acknowledges that the Department of Agriculture provided correspondence to the Commission indicating they disagreed with the JLARC recommendation and recommended that the deferral be continued.	Unknown until after 2011 session

POULTRY USED TO PRODUCE POULTRY AND POULTRY PRODUCTS RETAIL SALES AND USE TAX EXEMPTIONS – SUMMARY

Current Law

Sales and use of poultry used to produce for sale other poultry (e.g., chicks) or poultry products (e.g., eggs) are exempt from retail sales tax and use tax. Although "poultry" is not defined in state statute for tax purposes, the term refers to domestic fowl that are valued for their meat and eggs, such as chickens, turkeys, geese, and ducks.

See page A3-1 in Appendix 3 for the current statutes, RCW 82.08.0267 and RCW 82.12.0262.

Legal History and Public Policy Objectives

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. No exemptions were provided for purchases or use of poultry used in production.

1961 The Legislature added retail sales and use tax exemptions for the sale and use of baby chicks and turkey poults for use in the production for sale of poultry and poultry products.

1980 The Legislature slightly reworded the retail sales and use tax exemptions to apply to "poultry for use in the production of poultry or poultry products for sale."

The Legislature provided no clear public policy statement. However, the Legislature has provided tax exemptions for the purchase or use of a variety of ingredients and component parts that are used in the production of agricultural commodities for sale. The implied public policy objective for this preference is to extend to the poultry industry this ingredient and component tax treatment, where the poultry purchased or used provides a mechanism for producing poultry or poultry products for sale.

Beneficiaries

The beneficiaries are poultry layer operations in Washington that produce eggs for sale. There are seven large commercial layer operations and numerous smaller egg producers currently operating in Washington.

Revenue Impacts

JLARC estimates the taxpayer savings for 2009 at $222,000.

Recommendation

Because the preference for poultry used to produce poultry and poultry products for sale is achieving the objective of excluding agricultural ingredients and component parts from the tax base, the Legislature should continue this preference.

Legislation Required:	No.
Fiscal Impact:	None.

POULTRY USED TO PRODUCE POULTRY AND POULTRY PRODUCTS RETAIL SALES AND USE TAX EXEMPTIONS – REPORT DETAIL

Current Law

Sales and use of poultry used to produce for sale other poultry (e.g., chicks) or poultry products (e.g., eggs) are exempt from retail sales tax and use tax. Although "poultry" is not defined in state statute for tax purposes, the term refers to domestic fowl that are valued for their meat and eggs, such as chickens, turkeys, geese, and ducks.

See page A3-1 in Appendix 3 for the current statutes, RCW 82.08.0267 and RCW 82.12.0262.

Legal History

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Other Relevant Background

The Poultry Industry in Washington

When this preference was adopted in 1961, Washington's poultry industry consisted for the most part of both turkey and chicken producers. Currently, the state's poultry industry is composed mainly of chickens, split between broilers (meat production) and layers (hens producing eggs). This preference applies to purchases or use of "layers"—poultry used to produce eggs. Poultry purchased for the purpose of producing for sale broilers and fryers is considered a wholesale purchase and is not discussed in this review.

There are two classifications for poultry layer operations: "commercial," meaning the operation maintains over 75,000 birds; and "non-commercial," meaning the operation has fewer than 75,000 birds. There are currently no large hatcheries that produce layers in the state. The last large layer hatchery in Washington closed in 2008. Most commercial poultry operations in Washington obtain chicks from out-of-state, most commonly from California.

A "chick" is a very young (baby) chicken ranging in age from newborn to several weeks old. Female domestic chickens up to one year in age are called "pullets." "Hens" are adult female domestic chickens.

Tax Exemptions for Ingredients and Component Parts used in Agricultural Production

State statute provides several sales and use tax exemptions to farmers/agricultural producers for their purchases or use of goods that are used as ingredients or component parts in the production of agricultural products for sale. For example, exemptions are provided for feed and seed (covered in the 2009 JLARC tax preference review); fertilizer, sprays, and chemical sprays (covered in the 2010 JLARC tax preference review); and breeding livestock, cattle, and milk cows (also covered in the 2010 JLARC tax preference review). Sales tax is generally defined as a tax on the final consumer of goods. In the case of ingredients or component parts used in agricultural production, the farmer/agricultural producer uses the goods to produce a new product for sale, rather than being the final consumer of the goods.

Public Policy Objectives

What are the public policy objectives that provide justification for the tax preference? Is the purpose or intent of the tax preference clear?

The Legislature provided no clear public policy statement. However, the Legislature has provided tax exemptions for the purchase or use of a variety of ingredients and component parts that are used to produce agricultural commodities for sale. The implied public policy objective for this preference is to extend to the poultry industry this ingredient and component tax treatment, where the poultry purchased or used provides a mechanism for producing poultry or poultry products that will be sold.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

Exempting sales or use of poultry used to produce poultry and poultry products from sales tax and use tax is a matter of definition. Certain farmers purchase or acquire poultry to produce poultry and/or poultry products that they will sell. Those sales fit within the production concept of an ingredient or component part used to create a new product for sale.

Beneficiaries

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

The beneficiaries are poultry layer producers both large and small.

The major beneficiaries are the seven commercial poultry layer producers currently operating in Washington: Briarwood Farms, Dynes Broadview Farms, National Food Corporations, Oakdell Farms, Stiebrs Farms, Wilcox Family Farms, and Willamette Egg Farms. Most are family owned.

These egg producers sell to chain retail grocers in the Northwest and also ship eggs to Alaska. They also own the majority of the state's layer hens. In 2002, the percentage of layers owned by commercial producers was 78 percent. In 2007, almost 99 percent of the layers in Washington were owned by commercial producers. The change reflects a movement toward consolidation and the closure of smaller facilities.

Smaller operations with fewer than 75,000 birds that produce eggs for sale benefit from the preference, as well. Although very small layer operations (one to 99 hens) account for a tiny percentage of the total layers in Washington, the 2007 USDA Census of Agriculture reflected the number of such operations has increased, from 403 operations in 2002 to 726 of these small operations in 2007.

Revenue 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 preference historically provided sales and use tax exemptions to hatcheries and egg producers on the poultry they purchased to produce poultry or poultry products for sale. Since there are no longer any large layer hatcheries in the state, the preference is now used predominately by commercial layer operations for purchases of chicks or pullets used to produce eggs for sale.

The "Top Forty Agricultural Commodities for Washington, 2006 – 2008," ranks eggs 14th in total market value of all Washington agricultural production in 2008. As Exhibit 1 reflects, the value of eggs produced in Washington increased dramatically from 2006 to 2008.

Exhibit 1 – Egg Production Value Increased Significantly between 2006 and 2008

Value of Production			Change 2006 to 2008
2006	2007	2008	
$56.7 million	$105.4 million	$136.4 million	241%

Source: October 5, 2009, USDA National Agricultural Statistics Service, Press Release.

The increase in the value of egg production is likely attributable to a reduction in the number of layers and to increased production and input costs, such as layer feed and flock replacement. A summary of prices paid by farmers in Washington, Oregon, and California for various commodity inputs reflects a sharp increase in layer feed costs, which more than doubled from 2004 to 2008. (See Exhibit 2.)

Exhibit 2 – Prices Paid by Farmers - Laying Feed

Year	$ per Ton
2004	239
2005	204
2006	238
2007	253
2008	499

Source: *2008 Washington Annual Agriculture Bulletin*, Prices Paid by Farmers, Pacific Region 2004-2008, page 15.

JLARC's estimate of taxpayer savings from this preference is based on how frequently the large layer operations buy chicks to replace their older laying hens. Commercial laying operations find it most cost effective to replace layers after two years in production. About every two years, hatcheries make significant genetic improvements to the breeds that justify replacing older, lower producing hens with genetically improved chicks.

Baby chicks currently cost about 65 cents for a day-old chick; an 18-week old pullet costs about $9. As there are no hatcheries in Washington that produce these genetically improved chicks on a large scale basis for commercial producers, Washington's commercial egg producers purchase their replacement chicks from out-of-state hatcheries that deliver the chicks to them. Purchases of replacement chicks by Washington commercial laying operations in 2009 are estimated at $2.5 million, amounting to an estimated state and local sales/use tax amount of $222 thousand in 2009. (See Exhibit 3.)

Exhibit 3 – Estimated Taxpayer Savings – Poultry Used to Produce Poultry or Poultry Products for Sale ($ in Thousands)

Year	Poultry Purchases	State Sales/ Use Tax	Local Sales/ Use Tax	Total Sales/ Use Tax
2008	$2,837	$184	$68	$252
2009	$2,500	$162	$60	$222
2010	$2,450	$159	$58	$217
2011	$2,521	$164	$60	$224
2012	$2,577	$167	$61	$229
2013	$2,620	$170	$62	$233

Source: JLARC estimate for 2009 based on replacement chick expenditures information and industry practice. 2010 – 2013 estimates based on USDA expenditure growth estimates.

Recommendation

Because the preference for poultry used to produce poultry and poultry products for sale is achieving the objective of excluding agricultural ingredients and component parts from the tax base, the Legislature should continue this preference.

Legislation Required: No.

Fiscal Impact: None.

FARM MACHINERY SOLD TO NONRESIDENTS RETAIL SALES TAX EXEMPTION – SUMMARY

Current Law

Nonresidents may purchase and take delivery in Washington of machinery, implements, and parts for use in farming, as well as repair labor and services on such goods, without paying Washington sales tax, so long as they immediately take the machinery, implements, or parts outside the state.

See page A3-1 in Appendix 3 for the current statute, RCW 82.08.0268.

Legal History and Public Policy Objectives

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. The act provided for certain sales tax exemptions, but none for sales of farming machinery or implements to nonresidents.

1961 The Legislature provided a retail sales tax exemption to nonresidents that purchased machinery and implements for use outside of Washington in conducting a farming activity, so long as the machinery and implements are taken immediately outside the state by the nonresident buyer.

1998 The Legislature extended the exemption to include purchases of parts for farm machinery and implements, and for repair labor and services performed in Washington on machinery, implements, and parts for use outside of Washington in a farming activity.

The Legislature provided no clear public policy statement when it enacted the exemption in 1961. However, the implied public policy objective is to encourage nonresidents to purchase farm machinery, implements, parts, and repair services in Washington.

Beneficiaries

The beneficiaries are nonresident farmers that purchase and take delivery of farm machinery, implements, and parts in Washington and who bring such items into Washington for repair.

Revenue Impacts

The Department of Revenue estimated the taxpayer savings for this preference at $4.6 million for 2009.

Recommendation

Because it is likely achieving the public policy intent of encouraging nonresidents to purchase farm machinery and repair services in Washington, the Legislature should continue the retail sales tax exemption for farm machinery, implements, parts and repairs purchased by nonresidents.

Legislation Required: No.

Fiscal Impact: None.

FARM MACHINERY SOLD TO NONRESIDENTS RETAIL SALES TAX EXEMPTION – REPORT DETAIL

Current Law

Nonresidents may purchase and take delivery in Washington of machinery, implements, and parts for use in farming, as well as repair labor and services on such goods, without paying Washington sales tax, so long as they immediately take the machinery or implements outside the state.

Nonresident buyers must provide photo identification from their home state and an appropriate exemption certificate issued by the Department of Revenue (currently, the Farmers' Certificate for Wholesale Purchases and Sales Tax Exemptions) to the Washington machinery and implement dealer or repair facility.

See page A3-1 in Appendix 3 for the current statute, RCW 82.08.0268.

Legal History

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. The act provided for certain sales tax exemptions, but none for sales of farm machinery or implements to nonresidents.

1961 The Legislature provided a retail sales tax exemption to nonresidents that purchased machinery and implements for use outside of Washington in conducting a farming activity, so long as the machinery and implements are taken immediately outside the state by the nonresident buyer.

1998 The Legislature extended the sales tax exemption to include purchases of parts for farm machinery and implements, and for repair labor and services performed in Washington on machinery, implements, and parts for use outside of Washington in a farming activity.

Public Policy Objectives

What are the public policy objectives that provide justification for the tax preference? Is the purpose or intent of the tax preference clear?

Although no intent was specified when initially adopted, the implied public policy objective was to encourage nonresidents to purchase farm machinery and implements from Washington dealers by removing the barrier imposed on such sales by Washington's sales tax.

Before the preference was enacted, Washington farm machinery and implement dealers, especially those located near the Idaho and Oregon borders, suffered a competitive disadvantage because Washington imposed sales tax on purchases of farm equipment. In 1961, neither Oregon nor Idaho imposed a sales tax. Currently, Oregon still has no sales tax while Idaho (which imposed a sales tax in 1965) provides a "production sales tax exemption for any tangible personal property primarily and directly used or consumed in a farming operation," effectively exempting all farm machinery and equipment.

When the Legislature extended the sales tax exemption to parts and repair labor and services in 1998, the public policy justification stated by stakeholders in legislative hearings was that extending the exemption to parts and repair labor and services would enable Washington farm machinery and implement dealers to retain their out-of-state customers, and would have a positive impact on retail activity, especially along the Idaho border.

What readily available evidence exists to show the preference has contributed to achieving the public policy objectives?

Insufficient data

The preference is likely achieving its public policy objective of retaining nonresident customers at farm machinery businesses. However, due to a lack of reporting, JLARC could not quantify how many exempt sales are occurring. There is no prescribed method for Washington machinery and implement dealers and repair facilities to report the sales tax exemption provided by this preference when they file their Department of Revenue excise tax returns.

An indicator that the preference may be achieving its objective is that farm machinery businesses reported interstate sales deductions totaling over $80 million in 2007 and nearly $106 million in 2008. While this information reflects sales are being made to nonresidents, there is no way to determine if the sales reported as interstate sales deductions were exempt due to this preference (with delivery taking place in Washington), or if the goods sold were shipped directly to the nonresident buyer outside the state. This preference only covers situations where the nonresident buyer takes delivery of the goods in Washington or has repair labor and services performed here.

JLARC's review of excise tax return data from 2007 and 2008 reflected that retailers may be reporting sales exempted under this preference under one of three general deduction classifications. However, there is no way to identify the sales tax exemptions attributable to this preference from other types of tax exempt sales reported under the same general deduction classifications.

An industry representative reported that dealers are unsure where to report tax exempt sales to nonresident farmers when completing their excise tax returns. Some dealers said they received conflicting advice from the Department of Revenue. JLARC questioned several Department of Revenue staff and found they were also uncertain how the preference should be reported on the tax return. Neither the administrative rule (Washington Administrative Code 458-20-239) nor any Department of Revenue publication provides direction to farm machinery retailers or repair facilities on how to report the preference when deducting it from their retail sales.

Because there is no clear direction provided for Washington dealers and repair facilities to accurately report sales qualifying for this preference, there is no accessible data for JLARC to analyze. Paper exemption certificates are kept on file by each farm machinery and implement dealer and repair facility for audit purposes, but this data is not reported or submitted to the Department of Revenue.

Beneficiaries

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

The beneficiaries are nonresident farmers, especially those from neighboring states and Canada, that purchase and take delivery of farm machinery, implements, and parts in Washington and who bring such items into Washington for repair. The preference exempts them from sales tax on purchases that would otherwise be subject to sales tax when delivery is made in Washington. However, the specific number of out-of-state beneficiaries is unknown.

If the preference were removed, buyers from Idaho would be the most severely impacted, as they would have to pay sales tax on all farm machinery, implements, and parts purchased or repaired in Washington. Nonresident buyers from Oregon and some Canadaian provinces might continue to be exempt from paying sales tax under another sales tax exemption – RCW 82.08.0273 exempts purchases by residents of states and Canadian provinces without a sales tax or with a sales tax of less than 3 percent.

Revenue 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 estimated taxpayer savings reflected in Exhibit 4 of $4.6 million for 2009 are those published by the Department of Revenue in its *2008 Tax Exemption Study*. The Department's estimated taxpayer savings are likely overstated, as they include all sales reported under the interstate/foreign sale retail sales tax deduction, and probably include many sales not covered by this preference. In addition, machinery and implement dealers and repair facilities may be reporting amounts attributable to this preference in some other manner. JLARC did not identify another method to estimate the taxpayer savings. (See Exhibit 4)

Exhibit 4 – Department of Revenue Estimated Taxpayer Savings ($ in Millions)

Tax Type	2008	2009	2010	2011
State Sales Tax	$3.3	$3.5	$ 3.7	$3.9
Local Sales Tax	$1.0	$1.1	$1.1	$1.2
Total	$4.4	$4.6	$4.8	$5.1

Source: Department of Revenue 2008 Tax Preference Study for 2008 - 2011. JLARC unable to determine estimates for 2012 and 2013.

Recommendation

Because it is likely achieving the public policy intent of encouraging nonresidents to purchase farm machinery and repair services in Washington, the Legislature should continue the retail sales tax exemption for farm machinery, implements, parts and repairs purchased by nonresidents.

Legislation Required: No.

Fiscal Impact: None.

BAILED TANGIBLE PERSONAL PROPERTY CONSUMED IN R & D, EXPERIMENTAL, AND TESTING USE TAX EXEMPTION – SUMMARY

Current Law

This preference provides a use tax exemption for tangible personal property that is bailed to a person and used in research, development, experimental, and testing activities when:

- The bailed property is entirely consumed during the research, development, experimental, and testing activities, and
- The party that bails the property was not subject to sales tax or use tax when the party initially purchased or acquired the property.

"Bailment" is defined as "granting to another the temporary right of possession to and use of tangible personal property for a stated purpose without consideration to the grantor."

See page A3-2 in Appendix 3 for the current statute, RCW 82.12.0265.

Legal History and Public Policy Objectives

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. At the time the use tax was enacted, bailed tangible personal property was not subject to use tax.

1955 The Legislature amended the statute that imposed use tax (RCW 82.12.020) twice with regard to bailed tangible personal property. The first bill enacted provided that tangible personal property acquired by bailment was subject to use tax. Later, a second bill enacted reversed the first bill and made bailed tangible personal property not subject to use tax.

1959 The Legislature added bailed goods back into the definition of tangible personal property subject to use tax.

1961 The Legislature added a specific use tax exemption for bailed tangible personal property that was not subject to sales tax or use tax when first acquired by the party that bailed the property, and that is entirely consumed in research, development, experimental, and testing activities.

2005 The Department of Revenue issued an advisory explaining that labels provided ("bailed") to salmon labeling companies qualify for this preference.

The Legislature did not specify its intent when it enacted the preference in 1961. The public policy objective is unclear, particularly given its current application.

Beneficiaries

It is difficult to determine the number or types of businesses benefiting from this preference. Known beneficiaries include companies that contract with the federal government to perform certain types of research and development (R&D) activities and salmon labelers. Other beneficiaries could exist, but there is no reporting mechanism to identify them.

Revenue Impacts

The Department of Revenue estimates taxpayer savings at $4.7 million for 2009.

Recommendation

Because of the ambiguity of current law, the Legislature should review and clarify the purpose of the preference providing a use tax exemption for bailed tangible personal property consumed in research, development, experimental, and testing activities.

Legislation Required:	Yes.
Fiscal Impact:	A change in revenue is possible depending on the clarification.

BAILED TANGIBLE PERSONAL PROPERTY CONSUMED IN R & D, EXPERIMENTAL, AND TESTING USE TAX EXEMPTION – REPORT DETAIL

Current Law

This preference provides a use tax exemption for tangible personal property that is bailed to a person and used in research, development, experimental, and testing activities when:

- The bailed property is entirely consumed during the research, development, experimental, and testing activities, and
- The party that bails the property was not subject to sales tax or use tax when the party initially purchased or acquired the property.

"Bailment" is defined as "granting to another the temporary right of possession to and use of tangible personal property for a stated purpose without consideration to the grantor."

According to the Department of Revenue, this preference typically applies when tangible personal property is provided by the federal government (which is not subject to Washington retail sales or use taxes) to federal contractors working in Washington. However, nothing in the statute limits the preference's application to federal government contractors.

See page A3-2 in Appendix 3 for the current statute, RCW 82.12.0265.

Legal History

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. At the time the use tax was enacted, bailed tangible personal property was not subject to use tax.

1955 The Legislature amended the statute that imposed use tax (RCW 82.12.020) twice with regard to bailed tangible personal property. The first bill enacted provided that tangible personal property acquired by bailment was subject to use tax. Later, a second bill enacted reversed the first bill and made bailed tangible personal property not subject to use tax.

1959 The Legislature added bailed goods back into the definition of tangible personal property subject to use tax.

1961 The Legislature added a specific use tax exemption for bailed tangible personal property that was not subject to sales tax or use tax when first acquired by the party that bailed the property, and that is entirely consumed in research, development, experimental, and testing activities.

2005 The Department of Revenue issued an advisory explaining that labels provided ("bailed") to salmon labeling companies qualify for this preference.

Other Relevant Background

The Department of Revenue reports that the preference is most widely used by federal contractors working on projects at the Hanford Nuclear Reservation. The Department considers all purchases of tangible personal property by federal government contractors at the Hanford facility to be the property of the federal government at the time of purchase, so federal contractors do not pay sales or use taxes on these goods at time of purchase. If tangible goods are assigned for use in research, development, experimental and testing activities, the Department considers the goods covered under this preference, and no use tax is paid. Goods assigned to other uses are put on an amortized bailment schedule and federal contractor pays use tax on a monthly basis.

The preference applies to "any article of tangible personal property which is entirely consumed in the course of research, development, experimental and testing activities conducted by the user." There is no explanation in statute or administrative rule for the term "entirely consumed," and the preference applies to "any article." The Department of Revenue reports that it allows the exemption for virtually any tangible personal property, including: computers, software programs, instruments, microscopes, lab suits, Geiger counters, gloves, tables, desks, chairs, file cabinets, and containers. Use tax is only paid if tangible goods are still useful or have a value when removed from or transferred out of research and development use. Otherwise, the Department considers the tangible goods "entirely consumed" and covered in full by the preference.

Public Policy Objectives

What are the public policy objectives that provide justification for the tax preference? Is the purpose or intent of the tax preference clear?

The Legislature did not specify its intent when it enacted the preference in 1961. The public policy objective is unclear, particularly given its current application.

A 1982 Department of Revenue report stated the preference's legislative intent was to lower costs on federal government contracts to federal contractors in Washington. Because the federal government was the primary party not subject to sales and use taxes and was also a major research and development contractor, the Department concluded that the preference would primarily apply to federal government contractors.

JLARC confirmed that during the 1950s and early 1960s Cold War era, much federal government research and development work was being conducted in the state. Aerospace industry research and development for the military, as well as nuclear research and plutonium production at the Hanford Reservation were significant to Washington's economy. In addition, a 1961 letter from the Tax Commission stated certain businesses had lobbied the legislative committees in 1961 for passage of the preference, seeking relief from some of the use tax burdens on their federal government contracts.

However, the law does not restrict the preference or make any reference to federal contractors. In 2005, a Department of Revenue Advisory indicated that labelers of canned salmon also qualify for use tax exemption under this preference. In addition, the purpose for the requirement that qualifying tangible personal property be "entirely consumed" is not clear, resulting in questions regarding this requirement's intent and application.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

The Tax Commission marketed the newly enacted use tax exemption for tangible personal property acquired through bailment as an incentive to a federal government contractor inquiring about Washington State business tax obligations in 1964.

A 1982 Department of Revenue report stated that this preference reduced federal contractors' tax burdens and improved Washington's competiveness with other states competing for similar federal work, especially Texas and California, which at the time did not tax bailed property.

In 2007, Washington ranked 16th nationally in federal government scientific and engineering research and development (R&D) expenditures. In 2006, Washington was ranked ninth in total federal R&D obligations—placing third in Department of Commerce and sixth in Department of Defense R&D spending.[1] Total federal government R&D spending in Washington for 2007 was over $1.584 trillion. Thus, it appears Washington has maintained a strong foothold in securing federal research and development contracts. However, it is not possible to determine the extent to which this particular preference has contributed to securing these contracts.

Beneficiaries

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

Since the use tax exemption provided by this preference does not require beneficiaries to report, file, deduct, or otherwise document their use of the preference, it is difficult to determine the number or types of businesses benefiting from this preference. The beneficiaries include companies that contract with the federal government to perform research, development, experimental, and testing activities in the state. Many research and development federal contractors operate in Washington, especially in the Tri-Cities and Puget Sound regions.

Salmon labelers operating in Washington also benefit from this preference. Unlabeled cans of salmon are shipped to them from Alaska. Packers provide "bailed" labels along with the cans of salmon. The labelers test every can of salmon for quality control and apply the labels to the cans. The cans are then delivered back to the packers for sale. Since the labels are "consumed" in the testing process, the Department of Revenue determined that salmon labelers' use of the labels qualifies for the preference.

It is unknown whether there are other beneficiaries.

[1] National Science Foundation State R&D Statistics, 2006 – 2008.

Revenue 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 Department of Revenue estimates the taxpayer savings for this preference at $4.7 million for 2009. The Department based its estimates on information derived from some large federal contractors doing research and development work in Washington. Given the ambiguity of the beneficiaries, JLARC did not identify another method to estimate the taxpayer savings. (See Exhibit 5.)

Exhibit 5 – Department of Revenue Estimated Taxpayer Savings for Bailed Tangible Personal Property Consumed in Research, Development, Experimental, and Testing Activities ($ in Millions)

	2008	2009	2010	2011
State Use Tax	$3.3	$3.6	$3.9	$4.3
Local Use Tax	$1.0	$1.1	$1.2	$1.2
Total Use Tax	$4.3	$4.7	$5.1	$5.4

Source: Estimates for 2008-2011, Department of Revenue "Tax Exemptions 2008." JLARC is unable to determine estimates for 2012 and 2013.

Recommendation

Because of the ambiguity of current law, the Legislature should review and clarify the purpose of the preference providing a use tax exemption for bailed tangible personal property consumed in research, development, experimental, and testing activities.

Legislation Required: Yes.

Fiscal Impact: A change in revenue could be possible depending on the clarification.

VEHICLES ACQUIRED OUT-OF-STATE WHILE IN THE ARMED SERVICES USE TAX EXEMPTION – SUMMARY

Current Law

Washington residents who are members of the armed services and stationed outside of Washington pursuant to military orders are exempt from use tax for motor vehicles or trailers they acquired and used while stationed outside the state. The exemption does not apply to the use of vehicles or trailers acquired less than 30 days before the discharge or release from active duty of any person from the armed forces, nor does it apply to armed service members called to active duty for training purposes for periods of less than six months.

See page A3-2 in Appendix 3 for the current statute, RCW 82.12.0266.

Legal History and Public Policy Objectives

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure, including the retail sales tax and the companion use tax. The act provided some use tax exemptions, but none for vehicles or trailers purchased by resident armed service members while stationed outside the state.

1961 A bill was introduced to provide a use tax exemption to resident armed service members for bring vehicles acquired while stationed outside the state into Washington. The bill did not pass.

1963 The Legislature passed two separate bills in 1963 related to this preference. First, the Legislature enacted a use tax exemption for motor vehicles and trailers acquired by Washington residents while serving in the armed forces and stationed outside of Washington pursuant to orders. The Legislature limited the exemption for Washington residents discharged or released from active duty, noting the exemption did not apply to motor vehicles or trailers acquired less than six months before discharge.

Then, in a second bill, the Legislature amended the provisions of the first bill to change the qualifying time period for the exemption from six months to 30 days prior to discharge or release from active duty.

1965 The Legislature altered the part of the exemption dealing with discharged service members so that it no longer applied only to Washington residents. Instead of being limited to Washington residents, "any person" was now allowed a use tax exemption for vehicles purchased 30 days or more prior to the person being released or discharged from active duty. In effect, this provided any former armed service member moving to Washington a use tax exemption on vehicles and trailers, so long as they were purchased at least 30 days prior to discharge.

The Legislature also clarified that the use tax exemption did not apply to members of the armed services called to active duty for training purposes for periods of less than six months.

1967 The Legislature passed a law providing a credit against use tax owed on tangible goods (including vehicles and trailers) for sales tax or use tax paid to another state at the time of purchase.

Although no intent was specified in the law, the implied public policy objective was to ease the tax burden for resident armed service members returning to Washington for motor vehicles and trailers they purchased while on active duty stationed out of state.

Beneficiaries

The beneficiaries are: 1) Washington resident armed service members who are stationed outside the state pursuant to military orders; 2) recently discharged or released armed service members; and 3) armed service members called to active duty for training purposes for periods of six months or more.

The 2000 U.S. Census noted 47,877 Washington residents were members of the armed services and 670,628 were armed service veterans. However, we are unsure how many of these armed service members and veterans received the benefit of the tax preference.

Revenue Impacts

JLARC estimates taxpayer savings of nearly $2.4 million in 2009. This figure includes state, local, and the additional motor vehicle use taxes.

Recommendation

Because the preference is meeting the public policy objective of easing the tax burden for resident armed service members returning to Washington, the Legislature should continue the use tax exemption for motor vehicles and trailers purchased by resident armed service members while stationed on active duty outside the state.

Legislation Required: No.

Fiscal Impact: None.

Vehicles Acquired Out-of-State While in the Armed Services Use Tax Exemption – Report Detail

Current Law

Washington residents who are members of the armed services and stationed outside of Washington pursuant to military orders are exempt from use tax for motor vehicles or trailers they acquired and used while stationed outside the state. The exemption does not apply to the use of vehicles or trailers acquired less than 30 days before the discharge or release from active duty of any person from the armed forces, nor does it apply to armed service members called to active duty for training purposes for periods of less than six months.

Qualifying motor vehicles include passenger cars, sport utility vehicles, pickup trucks, recreational vehicles, and motorcycles. This preference does not apply to farm tractors or vehicles, off-road vehicles, all terrain vehicles, or snowmobiles.

See page A3-2 in Appendix 3 for the current statute, RCW 82.12.0266.

Legal History

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure, including the retail sales tax and the companion use tax. The act provided some exemptions, but did not provide a specific use tax exemption for vehicles or trailers purchased by resident armed service members while stationed outside the state.

1958-1961 Washington legislators and Governor Rossellini received several letters from Washington resident armed service members. The service members complained that they had to pay Washington use tax on vehicles they had purchased while stationed outside the state when they brought the vehicles back into Washington. In their complaints, the service members sometimes noted they had paid sales tax in the state where the vehicle was purchased.

1961 A bill was introduced to provide a use tax exemption to resident armed service members for vehicles acquired while stationed outside the state of Washington. The bill did not pass.

1963 The Legislature passed two separate bills in 1963 related to this preference. First, the Legislature enacted a use tax exemption for motor vehicles and trailers acquired by Washington residents while serving in the armed forces and stationed outside of Washington pursuant to orders. The Legislature limited the exemption for Washington residents discharged or released from active duty, noting the exemption did not apply to motor vehicles or trailers acquired less than six months before discharge.

Then, in a second bill, the Legislature amended the provisions of the first bill to change the qualifying time period for the exemption from six months to 30 days prior to discharge or release from active duty.

1965 The Legislature altered the part of the exemption dealing with discharged service members so that it no longer applied only to Washington residents. Instead of being limited to Washington residents, "any person" was now allowed a use tax exemption for vehicles purchased 30 days or more prior to the person being released or discharged from active duty. In effect, this provided any former armed service member moving to Washington a use tax exemption on vehicles and trailers, so long as they were purchased at least 30 days prior to discharge.

The Legislature also clarified that the use tax exemption did not apply to members of the armed services called to active duty for training purposes for periods of less than six months.

1967 The Legislature passed a law providing a credit against use tax owed for sales tax or use tax paid to another state on purchases of tangible personal property.

Public Policy Objectives

What are the public policy objectives that provide justification for the tax preference? Is the purpose or intent of the tax preference clear?

Although no intent was specified in the law, the implied public policy objective was initially to ease the tax burden for resident armed service members returning to Washington and to "eliminate an admitted injustice."[2] In the late 1950s and early 1960s, the Governor and the Tax Commission were responding to letters written by Washington resident service members who were surprised to learn that they owed use tax on vehicles they had acquired while on active duty stationed outside the state. In some cases, they had purchased the vehicles months or years before returning to Washington. Many had also paid sales tax on the vehicle when purchased in another state and felt they were being taxed twice on the same purchase. In the early 1960s, Washington statute did not allow for a credit against use tax owed in Washington for sales tax paid to another state.

When enacted in 1963, the exemption applied only to Washington resident active duty armed service members (without a qualifying time frame) and Washington residents who had been recently discharged or released from active duty and had purchased a vehicle at least 30 days prior to discharge or release from active duty. The inclusion of a specific timeframe for recently discharged or released persons may have been to avoid tax evasion. Governor Rossellini addressed the concern about tax evasion in a February 12, 1963, letter to a resident service member.

> *We recognize that a serviceman has little, if any, choice as to where and when he moves and the State Tax Commission is now recommending to the legislature that servicemen be exempt on cars purchased longer than 30 days prior to entrance into the state. To remove the tax entirely in all instances would encourage evasion of the tax in too many instances.* [Emphasis added.]

[2] April 1961 letter from Governor Rossellini to a resident armed service member.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

Since first implemented in 1963, the law has provided resident active duty service members a use tax exemption on vehicles and trailers they bring with them when they return to Washington. Thus, the public policy objective to ease the tax burden for resident armed service members returning to Washington is being met. It should be noted, however, that Washington now provides a separate credit for sales tax paid outside the state. This would ensure that any person who purchased a motor vehicle or trailer in another state would receive credit for any sales/use tax paid and would not pay sales/use tax twice on the same vehicle. This other preference is available regardless of the preference for armed service member.

Beneficiaries

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

The beneficiaries are: 1) Washington resident armed service members who are stationed outside the state pursuant to military orders; 2) recently discharged or released armed service members; and 3) armed service members called to active duty for training purposes for periods of six months or more. (See Exhibit 6.)

Exhibit 6 – Beneficiaries of Use Tax Exemption Tax Preference

Status of Armed Service Member	Qualifying Time Period for Vehicle/Trailer Use Tax Exemption
Washington Resident, Active Duty Armed Services	None
Former Armed Service Member (Resident or Nonresident)	Purchase must be 30 days or more prior to discharge or release from active duty
Armed Service Member on Active Duty for Training Purposes	Training period outside the state must be six months or more

Source: JLARC analysis of RCW 82.12.0266.

The most recent published U.S. Census noted that 47,877 Washington residents were active duty members of the armed services and that 670,628 Washington residents were armed service veterans. Washington's active duty armed service members amount to nearly 3.5 percent of the total U.S. armed services number. The total number of armed services personnel nationwide has remained static, increasing only one percent from 2000 to 2008.

Revenue 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?

Washington resident armed service members that are stationed outside of Washington pursuant to military orders, retired armed services members moving to Washington, and armed service members on active duty outside the state for training purposes for six months or more are exempt from paying Washington state and local use tax (combined rates vary from seven to nine and one-half percent, depending on the location). In addition, they are exempted from the three-tenths of one percent motor vehicle use tax that applies to all vehicles subject to sales or use tax in Washington.

JLARC estimates the taxpayer savings from this preference to be $2.4 million in 2009. The estimation is based on the average yearly expenditure for new and used cars, average vehicle age, number of vehicles per household, average period of military service and the number of resident armed service members. (See Exhibit 7.)

Exhibit 7 – Estimated Taxpayer Savings - Use Tax Exemption for Vehicles Acquired While Stationed Out of State by Armed Service Members ($ in Thousands)

	2007	2008	2009	2010	2011	2012	2013
State use tax	$2,404	$2,149	$1,696	$1,933	$2,366	$2,681	$2,849
Local use tax	$881	$788	$621	$708	$867	$982	$1,044
Motor vehicle use tax	$111	$99	$78	$89	$109	$124	$132
Total tax	$3,396	$3,036	$2,395	$2,730	$3,342	$3,787	$4,025

Sources: JLARC estimate using: 2007 Statistical Abstract, Table 2014; R. L. Polk & Co, March 2009; Bureau of Labor Statistics Table 8.3; Congressional Budget Office; 2000 U.S. Census; U.S. Economic Forecast Summary, Table A1.1. Does not include trailers or motor vehicles not defined as automobiles.

Recommendation

Because the preference is meeting the public policy objective of easing the tax burden for resident armed service members returning to Washington, the Legislature should continue the use tax exemption for motor vehicles and trailers purchased by resident armed service members while stationed on active duty outside the state.

Legislation Required: No.

Fiscal Impact: None.

Labor and Services for Mining/Sorting/Crushing Sand/Gravel/Rock for Public Road Purposes Retail Sales and Use Tax Exemptions – Summary

Current Law

Counties and cities that own or lease pits or quarries are provided a retail sales tax and a use tax exemption for labor and services performed to mine, sort, crush, screen, wash, haul, and stockpile sand, gravel, or rock from the pits/quarries under certain circumstances. The exemptions apply when: 1) the gravel, rock, or sand is stockpiled at the pit/quarry for the city or county to place on its own roads; or 2) the gravel, rock, or sand is sold by the county/city to another county/city at actual cost to be placed by that city or county on its roads.

See page A3-2 and A3-3 in Appendix 3 for the current statutes, RCW 82.08.0275 and RCW 82.12.0269.

Legal History and Public Policy Objectives

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. The taxability of construction activities was not addressed in the Revenue Act of 1935. At that time, labor and services performed to construct, repair, etc., real property were not considered retail activities.

1941 The Legislature imposed retail sales tax on construction activities performed to real property. Labor and services performed as part of construction work, including road construction, were now subject to retail sales tax.

1946 At the State Highway Department's request, the Tax Commission allowed a use tax exemption unsupported by statute for sand, gravel, or rock taken from pits or quarries owned by or leased to the state for use in state highway contracts.

1946-1958 The Tax Commission extended the use tax exemption policy to sand, rock, and gravel taken from a pit owned by or leased to a contractor if the state had offered its facility, but the contractor did not use the state-owned facility. The Tax Commission acknowledged that it had inconsistently extended the exemption to counties and cities as well.[3]

1958 The Tax Commission re-examined the use tax exemption policy and concluded it was not supported in statute. The Commission notified the Highway Department that it would

[3] June 5, 1959, letter from James Stanford, Tax Commission, to Washington State Association of County Commissioners.

revoke the exemption effective May 1, 1959. The Commission noted the delay was intended to provide the Highway Department an opportunity to secure a statutory use tax exemption during the 1959 Legislative Session.[4] If no law passed, the Tax Commission indicated it would begin assessing use tax on the processed materials.

1959 A bill providing a use tax exemption to the State Highway Department did not pass. The Tax Commission noted this was due, in part, to opposition from the cities and counties.[5]

1961 A bill providing a use tax exemption to the State Highway Department was introduced but did not get a committee hearing.

1965 The Legislature passed sales and use tax exemptions limited to labor and services performed in processing sand, gravel, or rock from pits owned or leased by cities or counties when the materials are applied to county and city roads by the local governments themselves or sold to another city or county at cost for the same use. The law did not include the state in the exemption.

The implied public policy objective was to reduce labor and other service costs incurred by cities and counties on materials processed from pits or quarries they owned or leased when the materials were applied to their roads by the cities or counties themselves, or when sold to another city or county at cost for like use.

Beneficiaries

The beneficiaries of the sales and use tax exemptions are Washington cities and counties that produce and use materials processed from their own or a leased rock, sand, or gravel pits/quarries for maintenance and repair work they perform on roads they own. The Department of Ecology lists 135 active or inactive sand or gravel pit or quarry permits that are held by cities and counties. Cities and counties that buy such materials at cost from other cities or counties that own or lease pits or quarries also benefit, if they place the materials on roads they own.

Revenue Impacts

Estimated taxpayer savings realized by counties and cities from the preference were just over $2 million in 2009.

Recommendation

Because the preference is meeting the implied public policy objective of lowering the costs for maintaining and preserving roads by Washington county and city governments, the Legislature should continue the preference.

Legislation Required: No.

Fiscal Impact: None.

[4] September 25, 1958, letter from James Stanford, Chief of Tax Interpretation, Tax Commission, to W. H. Butts, Chief Accountant, Dept of Highways.

[5] August 24, 1960, letter from W. Schumacher, Tax Commission Chief, to Governor Rossellini.

LABOR AND SERVICES FOR MINING/SORTING/ CRUSHING SAND/GRAVEL/ROCK FOR PUBLIC ROAD PURPOSES RETAIL SALES AND USE TAX EXEMPTIONS – REPORT DETAIL

Current Law

Counties and cities that own or lease pits or quarries are provided a retail sales tax and a use tax exemption for labor and services performed to mine, sort, crush, screen, wash, haul, and stockpile sand, gravel, or rock from the pits/quarries under certain circumstances. The exemptions apply when: 1) the gravel, rock, or sand is stockpiled at the pit/quarry for the city or county to place on its own roads; or 2) the gravel, rock, or sand is sold by the county/city to another county/city at actual cost to be placed by that city or county on its roads.

The exemption does not apply when the gravel, rock, or sand is put to any use other than a county or city placing the materials on its roads, or when the materials are sold to anyone other than another city or county at cost for use on its roads. If sand, gravel, or rock is used by a private road contractor performing road construction for a city or county, the contractor owes sales or use tax on the value of the materials, including the processing labor and services component.

See page A3-2 and A3-3 in Appendix 3 for the current statutes, RCW 82.08.0275 and RCW 82.12.0269.

Not part of this review: RCW 82.04.415 also provides a business and occupation (B&O) tax exemption for similar activities. The B&O tax exemption is discussed separately in the 2010 JLARC report on Expedited Light Tax Preferences.

Legal History

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. The taxability of construction activities was not addressed in the Revenue Act of 1935. At that time, labor and services performed to construct, repair, etc., real property were not considered retail activities.

1941 The Legislature imposed retail sales tax on construction activities performed to real property. Labor and services performed as part of construction work, including road construction, were now subject to retail sales tax.

1946 At the State Highway Department's request, the Tax Commission allowed a use tax exemption for sand, gravel, or rock taken from pits or quarries owned by or leased to the state for use in state highway contracts. The use tax exemption was not meant to apply to materials processed and taken from pits owned or leased by counties or cities.[6]

Correspondence from the Tax Commission indicates that they did not formally adopt this policy into any rule or publication. It was a "tacit understanding" between the Department of Highways and the Tax Commission.

1946-1958 The Tax Commission extended the use tax exemption policy to sand, rock, and gravel taken from a pit owned by or leased to a contractor if the state had offered its facility to the contractor but, for its own reasons, the contractor did not use the state-owned facility.

The Tax Commission acknowledged that it had also at times, but not consistently, extended the exemption to counties and cities producing such materials from their own pits in "the interest of equity." In a letter dated September 25, 1958, James Stanford of the Tax Commission stated:

> . . . because the extension . . . to cover counties and cities was not called to the attention of some of our staff personnel, there was some lack of uniformity in the application of the exemption at the audit level and it is now apparent that some counties were required to pay the tax while others were not.

1958 The Tax Commission re-examined the use tax exemption policy extended to the State Highway Department. The state was experiencing a budget crisis, and the Tax Commission was trying to secure the maximum revenue from existing taxes to avoid the need for passing new taxes or increasing existing ones. Furthermore, counties and cities were "demanding" they receive the same use tax exemption for sand, rock, and gravel as had been extended to the state. The Commission concluded "clearly, there are no statutory grounds for the exemptions. . . While there may be reasons of public policy to justify exemption, at least insofar as state highway contractors are concerned, this is a matter for legislative determination." [7]

On September 25, 1958, the Tax Commission notified the Highway Department it would revoke the exemption granted by administrative interpretation. However, the revocation would not be effective until May 1, 1959, (after the legislative session) in order to provide the Highway Department an opportunity to secure a statutory use tax exemption. If no law passed, the Tax Commission indicated it would begin assessing use tax on processed materials taken from pits owned or leased to the state, counties, and municipalities, as well as to materials taken from privately owned pits where a state, county, or municipal pit was offered.

1959 The Tax Commission helped draft legislation which was introduced in the Senate but did not pass. Cities and counties raised opposition to the bill and wanted to be included. The Tax Commission Chief noted in a letter to Governor Rossellini that because of the estimated

[6] August 24, 1960, letter from William Schumacher, Tax Commission Chief, to Governor Rossellini.

[7] September 25, 1958, letter from James Stanford, Chief of Tax Interpretation, Tax Commission, to W. H. Butts, Chief Accountant, Dept of Highways.

revenue loss "the Senate Ways and Means Committee was unwilling to go along with the broader exemption and the legislation finally died in the committee."

After failing to secure a statutory tax exemption, the Department of Highways wrote to the Tax Commission and asked that it reconsider its ruling to begin assessing use tax after May 1, 1959. The Tax Commission rejected the request, explaining the Commission had "exceeded its authority" by providing the use tax exemption and noting that such an exemption must be specifically provided in statute. The Commission also noted the 1959 Legislature had considered granting the use tax exemption, but "the exemption was finally lost through the intervention of counties and cities."

1960 In a memo to Governor Rossellini, the Tax Commission noted that counties and cities were "aggressively seeking the same benefit *(that had been)* afforded state contracts. If we held the exemption, we felt we would have to let them in on it, with a further revenue loss." The Commission recommended to "stall the matter for the short time left before the 1961 Legislature, then give the road groups every cooperation in securing the statutory exemption, (but possibly limited to the State Highway Department)."

1961 A Senate bill providing a use tax exemption to the State Highway Department was introduced but did not get a committee hearing.

1965 During the 1965 extra session, the Legislature provided sales tax and use tax exemptions limited to labor and services performed in processing sand, gravel, or rock from city or county owned or leased pits when applied to county and city roads by the local governments themselves or sold to another city or county at cost for the same use. The law did not include the state in the exemption.

The state faced severe budget problems in 1965. As noted in a veto message by Governor Evans, the exemptions were part of a bill with a "hodge-podge of increased taxes designed to balance the state budget during the next biennium."

Public Policy Objectives

What are the public policy objectives that provide justification for the tax preference? Is the purpose or intent of the tax preference clear?

Although no intent was specified in the law, the implied public policy intent was to reduce the cost of services for maintaining and preserving city and county roads. The Legislature made a deliberate decision to provide these limited exemptions to cities and counties. JLARC could not determine why the exemptions were not provided to the state of Washington.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

Washington cities and counties spent over $500 million in both 2008 and 2009 for maintenance and preservation of city and county roads. We are unable, however, to determine how much of this investment is directly attributable to the preference.

JLARC assumes these preferences apply primarily to maintenance and preservation work, which is most likely conducted by the local government itself. New road construction is more likely hired out to private contractors who are not impacted by this preference. According to Washington State Department of Transportation data, road maintenance and preservation expenditures by cities and counties have generally been about one-half of the amounts cities and counties spent on new road construction. (See Exhibit 8.)

Assuming road maintenance and preservation work is performed by the county or city itself, this preference relieves cities and counties from paying sales or use tax on the labor and services attributable to processing the materials taken from pits or quarries they own or lease when the cities or counties place the materials on their own roads, or when they sell the materials at cost to another local government for like use.

Exhibit 8 – City and County Road Construction and Maintenance/Preservation Expenditures ($ in Millions)

State FY	Construction	Maintenance & Preservation
2005	$739.7	$416.9
2006	$785.2	$386.3
2007	$891.8	$491.1
2008	$937.4	$509.8
2009	$934.7	$508.4

Source: Washington State Department of Transportation (WSDOT).

Beneficiaries

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

The beneficiaries of the sales and use tax exemptions are Washington cities and counties that produce and use materials processed from their own or a leased rock, sand, or gravel pit or quarry for maintenance and repair work they perform on roads they own. Cities and counties that buy such materials at cost from other cities or counties that own or lease pits or quarries also benefit, if they place the materials on roads they own.

The State Department of Ecology's Water Quality Permit Division issues Sand and Gravel Permits to all private and public entities that own or lease gravel or sand pits or quarries. The current list of active and inactive permits notes 135 out of 941 facilities were owned or leased by counties or cities, mostly county public works departments. Other pits may be owned or leased by cities or counties, but the facilities are not clearly identifiable as publicly owned or operated.

Revenue 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 preference provides sales and use tax exemptions to counties and cities for the labor and services involved in processing rock, sand, and gravel taken from their pits and applied to their roads. It also provides sales and use tax exemptions to cities and counties that purchase such materials at cost for use on their roads from cities or counties that own or lease pits/quarries. By limiting the preferences to only counties and cities and specifying that counties or cities must place the materials on their roads themselves, the Legislature narrowed and limited the preference's impact on state revenues, while assisting counties and cities to maintain and repair their roads.

Cities and counties benefit from the preference by not paying sales tax or use tax on charges and costs incurred in processing or handling activities involved in readying the materials for use. Exhibit 9 shows that cities and counties realized an estimated $2 million in sales and use tax savings in 2008 and 2009. These estimated taxpayer savings may be overstated, since they are based on the total cost of all maintenance and repair work for cities and counties, including work performed by hired contractors. These savings to local governments would potentially allow them to perform maintenance and preservation work more economically.

Exhibit 9 – Estimated Taxpayer Savings ($ in Thousands)

Year	State Sales/ Use Tax	Local Sales/ Use Tax	Total Taxpayer Savings
2008	$1,512	$554	$2,066
2009	$1,508	$553	$2,060
2010	$1,512	$554	$2,066
2011	$1,543	$565	$2,108
2012	$1,572	$576	$2,148

Source: JLARC estimate based on WSDOT data and forecasting methodology.

Recommendation

Because the preference is meeting the implied public policy objective of lowering the costs for maintaining and preserving roads by Washington county and city governments, the Legislature should continue the preference.

Legislation Required: No.

Fiscal Impact: None.

CONSERVATION AND OPEN SPACE LANDS PROPERTY TAX EXEMPTION – SUMMARY

Current Law

This tax preference provides an exemption from property tax for qualifying property held for conservation purposes by eligible nonprofit organizations. The preference applies to all interests in real property, including outright ownership ("fee simple") and lesser interests such as easements or the right to develop the property in the future.

To qualify, the property must be used exclusively for conservation of ecological systems, natural resources or open spaces, including park land. To be eligible, the nonprofit organization must have as its primary purpose either scientific research or conservation of land for the public.

The tax preference applies if the property is either:

1) Open to the public, not used for the monetary benefit of any person or company, and used primarily for research, public education, or the preservation of nature or the works of ancient human beings; or
2) Subject to a written option contract that gives a government entity the right to buy the property for the lesser of either the original purchase price (plus interest) or its appraised value.

See page A3-3 and A3-4 in Appendix 3 for the current statute, RCW 84.36.260 and RCW 84.34.220.

Legal History and Public Policy Objectives

This section provides the legal history for two statutes related to the property tax exemption for nonprofit land conservation organizations. RCW 84.36.260 provides the property tax exemption. RCW 84.34.220 allows certain nonprofit organizations and others to purchase future development rights, which could then qualify for the exemption.

1889 Upon achieving statehood, Washington adopted a constitution which required that "all property in the state shall be taxed in proportion to its value." The Constitution exempted all publicly owned property from taxation.

1930 Voters approved the 14th Amendment to the Constitution which gave powers to the Legislature to classify property for tax purposes and to grant property tax exemptions.

1967 The Legislature enacted a property tax exemption (RCW 84.36.260) for nonprofit conservation organizations. To qualify, the nonprofit had to conserve natural resources for public education and recreation. The exemption applied to both real and personal property. All property owned by a qualified nonprofit was eligible if it was used solely for education or recreation, or if a government entity had an option contract to buy the property.

1971 In separate statutes, the Legislature enacted the conservation futures program which allowed local governments to purchase "conservation futures" from private landowners (RCW 84.34.220). Conservation futures are the rights to future development on privately owned agricultural, timber, or open space land. In effect, the landowner retains ownership and use of the land, but needs the permission of the owner of the conservation future to develop or build on the land.

1973 The Legislature expanded the property tax exemption to also apply to nonprofit organizations that conducted scientific research. However, the Legislature restricted eligible property to real property, rather than all real and personal property. Real property was eligible if it was publicly accessible and used primarily for research, education, or preservation, or if a government entity had an option contract.

1975 The Legislature expanded the conservation futures program to include purchases by nonprofit conservancy organizations. In the same act, the Legislature expanded the property tax exemption to cover conservation futures owned by such organizations. Additionally, the Legislature expanded this property tax exemption to include other lesser property interests similar to conservation futures. While these other interests function similarly to conservation futures, they are not limited to agricultural, timber, or open space land.

1979 The Legislature added conservation of open space, including park lands, to the list of uses of real property that are eligible for the exemption.

The implied public policy objective is to conserve ecological systems, natural resources, and open space, including park land, for the purpose of conducting scientific research and conserving natural resources for the public.

Beneficiaries

The beneficiaries are the 58 nonprofit land conservation organizations that own property in Washington and that have received approval for this exemption for an estimated 40,000 acres of land. It is not known how much property is conserved under lesser rights such as easements or conservation futures.

Revenue Impacts

Nonprofit conservation organizations saved a total of $1.7 million from the conservation and open space lands property tax exemption in Calendar Year 2008.

Recommendation

Because the tax preference is fulfilling its public policy objective of conserving ecological systems, natural resources, open space, and park land, the Legislature should continue the tax preference.

Legislation Required:	No.
Fiscal Impact:	None.

CONSERVATION AND OPEN SPACE LANDS PROPERTY TAX EXEMPTION – REPORT DETAIL

Current Law

This tax preference provides an exemption from property tax for qualifying property held for conservation purposes by eligible nonprofit organizations. The preference applies to all interests in real property, including outright ownership ("fee simple") and lesser interests such as easements or the right to develop the property in the future.

To qualify, the property must be used exclusively for conservation of ecological systems, natural resources or open spaces, including park land. To be eligible, the nonprofit organization must have as its primary purpose either scientific research or conservation of land for the public.

The tax preference applies if the property is either:

1) Open to the public, not used for the monetary benefit of any person or company, and used primarily for research, public education, or the preservation of nature or the works of ancient human beings; or
2) Subject to a written option contract that gives a government entity the right to buy the property for the lesser of either the original purchase price (plus interest) or its appraised value.

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Legal History

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1979 The Legislature added conservation of open space, including park lands, to the list of uses of real property that are eligible for the exemption.

Other Relevant Background

Real property ownership includes what is often described as a "bundle of rights." These rights include the right to enter and use the property, the right to a view, water rights, and the right to develop or build on the property in the future. An owner may choose to sell some of these rights while retaining ownership to the land itself. For example, an owner could enter into a lease with another person, thereby transferring the owner's right to use the property to that person while still retaining ownership to the land itself.

In order to conserve existing ecosystems or other natural resources, private landowners may donate or sell their property rights to nonprofit conservation organizations or others such as local governments. The owners may choose to transfer all of their rights ("fee simple") or only some of their rights, such as an easement or the right to develop the land in the future. For example, if a landowner sold development rights to a nonprofit organization, the landowner would continue to own and use the property, but would need the permission of the nonprofit to build, improve, or subdivide the land.

The value of real property for tax purposes depends on how it is assessed. In general, real property is assessed at its "highest and best" use, which includes the development potential of the property. However, agricultural, timber, and open space lands may be assessed at "current use," which does not include future development potential. In 2009, the "current use" assessment applied to over 11 million acres of land in Washington. In either case, the tax is assessed against the owner of the real property. County assessors generally do not separately assess the owners of lesser property interests, such as the owners of easements and future development rights, for collecting property taxes.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

The implied public policy objective is to conserve ecological systems, natural resources, and open space, including park land for the purpose of conducting scientific research and conserving natural resources for the public.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

Nonprofit conservation organizations are purchasing conservation and open space lands and making use of the property tax exemption. In 2009, the exemption applied to 1,071 parcels containing approximately 40,000 acres of land owned in fee simple. The number of parcels receiving the exemption has more than doubled in ten years. The Department of Revenue's 2000 Exemption Study listed 423 parcels receiving the exemption.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

The beneficiaries are the 58 nonprofit land conservation organizations that own property in Washington and that have received approval for this exemption from the Department of Revenue. It is not known how much property is conserved under lesser rights such as conservation futures.

These nonprofits are organized as land trusts and foundations with property located throughout the state. The largest of these is the Nature Conservancy, which owns 20 percent of all parcels exempt under the tax preference.

Based on available county records, Grant and Okanogan Counties contain the most acreage exempt under this tax preference. Kitsap and San Juan Counties rank highest in the state in terms of dollars of exempt value. (See Exhibit 10.) However, not all county assessors update the assessed value of exempt property or maintain the number of acres per parcel.

Exhibit 10 – Top 5 Counties Ranked in Order of Exempt Acres and Value of Exempt Property

County Ranked by Number of Acres	Number of Acres
Grant	6,689
Okanogan	6,292
Grays Harbor	1,800
Thurston	1,672
Whatcom	1,622
Other Counties	21,925
Total All Counties	40,000

County Ranked by Value of Property	Value of Exempt Property
Kitsap	$27,970,280
San Juan	19,598,620
Clark	16,827,250
Skagit	13,468,856
King	12,017,300
Other Counties	87,517,694
Total All Counties	$177,400,000

Source: JLARC Analysis of DOR Exempt Property File and county assessors' records.

Revenue 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?

Nonprofit conservation organizations saved a total of $1.7 million from the conservation and open space lands property tax exemption in Calendar Year 2008. The estimate for taxpayer savings may be low. County assessors may not have updated the value of property that is exempt from the property tax.

Exhibit 11 – Savings from the Conservation & Open Space Lands Property Tax Exemption

Calendar Year	State Levy	Local Levy	Total
2008	$320,000	$1,349,000	$1,669,000
2009	$323,000	$1,394,000	$1,717,000
2010	$324,000	$1,484,000	$1,808,000
2011	$328,000	$1,531,000	$1,859,000
2012	$330,000	$1,584,000	$1,914,000
2013	$333,000	$1,662,000	$1,995,000

Source: JLARC analysis based on the DOR Exempt Property File and county assessors' records.

To date, conservation organizations have applied for the exemption on lands they own in fee simple. Since owners of lesser rights are not typically taxed on the value of those rights, there have not been any applications to date to exempt conservation easements or futures.

Recommendation

Because the tax preference is fulfilling its public policy objective of conserving ecological systems, natural resources, open space, and park land, the Legislature should continue the tax preference.

Legislation Required: No.

Fiscal Impact: None.

FRUIT AND VEGETABLE MANUFACTURERS B&O TAX EXEMPTION AND PREFERENTIAL RATE – SUMMARY

Current Law

This review includes two tax preferences for manufacturers of fresh fruit and vegetable products:

1) A business and occupation (B&O) tax exemption for manufacturing of fresh fruit and vegetable products and for wholesaling these products to purchasers that transport them out of state in the ordinary course of business. The B&O tax exemption became effective July 1, 2005, and is set to expire on July 1, 2012.
2) A preferential B&O tax rate of 0.138 percent for the same fruit and vegetable manufacturing and wholesaling activities that goes into effect when the B&O exemption (above) expires on July 1, 2012.

Manufacturers are eligible for the tax preferences if they manufacture fresh fruits and vegetables by "canning, preserving, freezing, processing, or dehydrating." Ordinarily, fruit and vegetable manufacturers that wholesale their products to instate purchasers owe the wholesaling B&O tax at the rate of 0.484 percent. Fruit and vegetable manufacturers are eligible for the tax preferences if they make wholesale sales that are delivered instate to purchasers that then transport the products out of state.

Beneficiaries of the B&O tax exemption must file an annual survey with the Department of Revenue (DOR) by April 30 each year based on the previous year's activity. The survey is not required for beneficiaries of the preferential rate. The survey provides information on the number of employees; wages by wage bands; and medical, dental, and retirement benefits. The names of beneficiaries and the amount of tax exemption taken may be disclosed.

If the beneficiary fails to file a survey for a previous year, DOR may assess taxes and interest on the amount of exemption taken for the year.

See page A3-4 and A3-5 in Appendix 3 for the current statutes, RCW 82.04.4266 and 82.04.260(1)(d).

Legal History and Public Policy Objectives

The Legislature has provided preferential B&O tax rates to manufacturers of several fresh food products over the years. Manufacturers of flour received the first preferential B&O rate in 1949, followed by seafood processors in 1959, fresh fruit and vegetable products manufacturers in 1965, processors of dried peas and perishable meat products in 1967, and dairy product manufacturers in 2001. (The tax preferences for seafood and dairy products manufacturers are reviewed in separate sections of the report. JLARC reviewed the preference for manufacturers of flour in 2009, and is scheduled to review the other preferences in future years.)

Pre-1954 B&O tax law classified canning and packing of fresh fruits and vegetables as a manufacturing activity. Processors that prepared and froze fresh fruits and vegetables owed tax as wholesalers.

1954 The State Tax Commission amended a rule to define canning, preparing, and freezing fresh fruits and vegetables as a manufacturing process, which was subject to the manufacturing B&O tax rate of 0.3 percent at the time.

1957 The State Supreme Court confirmed that the Tax Commission had the authority to change the manufacturing definition by rule and did not require legislation.[8]

1959 The general manufacturing B&O tax rate was raised to 0.44 percent.

1965 The Legislature provided fruit and vegetable manufacturers a preferential B&O tax rate of 0.3 percent. To receive the new rate, a business had to process fresh fruits and vegetables by "canning, preserving, freezing or dehydrating."

1993 Due to a revenue shortfall, the Legislature enacted surtaxes across the board on all B&O rates. The surtax boosted the preferential rate for fruit and vegetable manufacturers to 0.351 percent and the general manufacturing rate to 0.515 percent.

1994 The Legislature partially rolled back the 1993 surtax on B&O rates, reducing the rate for fruit and vegetable manufacturers to 0.345 percent and the general manufacturing rate to 0.506 percent effective January 1, 1995.

1996 The Legislature expanded the tax preference by giving the lower B&O tax rate to manufacturers of fruit and vegetable products for selling at wholesale to purchasers that transport the products out of state. The Legislature added "processing" fresh fruits and vegetables to the list of eligible activities of "canning, preserving, freezing or dehydrating."

1997 The 1993 B&O surtax expired, lowering the fruit and vegetable manufacturing rate to 0.33 percent on July 1, 1997. The general manufacturing rate became 0.484 percent.

1998 The Legislature reduced the preferential fruit and vegetable manufacturing B&O tax rate to 0.138 percent. The general manufacturing rate remained at 0.484 percent.

2005 The Washington Supreme Court granted a preferential B&O tax rate for processing of perishable meat to a manufacturer of chili con carne.[9] DOR interpreted this decision to mean that manufacturers of fresh fruits and vegetables might be granted the preferential tax rate even though the end product contained a small portion of fruits and vegetables.

2005 The Legislature changed the preferential B&O tax rate to an exemption effective July 1, 2005.

2006 The Legislature set an expiration date of July 1, 2012, for the B&O tax exemption for fruit and vegetable manufacturers. At that time, the industry will pay a preferential tax rate of 0.138 percent. In the same bill, the Legislature extended the B&O tax exemption to

[8] Stokely-Van Camp, Inc. v. Washington, 50 Wn.2d 492 (1957).

[9] Agrilink Foods, Inc. v. Department of Revenue, 153 Wn.2d 392 (2005).

manufacturers of dairy and seafood products, with the same expiration date and the same future preferential B&O tax rate.

2007 DOR determined that wineries qualify for the exemption as fruit and vegetable manufacturers. Wineries that filed claims were entitled to refunds of taxes paid back to 2003.

2010 In response to the 2004 Supreme Court case, the Legislature approved DOR request legislation to require that fruit and vegetable processors receive the exemption (and the lower rate on July 1, 2012) only if fruit, vegetable, and water comprise at least 50 percent of the ingredients in the end product (2ESSB 6143). This legislation was passed to avoid an unintended consequence of extending the tax preference to manufacturers that only include a small amount of fruits and vegetables in their product.

The implied public policy objectives of the fruit and vegetable processors' B&O tax preferences are:

1) To create and retain quality jobs;
2) To provide temporary relief through an exemption; and
3) To provide tax treatment consistent with other fresh food processors.

Beneficiaries

The beneficiaries of the tax preference are the manufacturers of fresh fruit and vegetable products that claim the B&O exemption. Wineries began taking the exemption in 2007 under a new interpretation by the DOR. Altogether, 109 firms benefited from the tax preference in 2008.

Revenue Impacts

Beneficiaries of the B&O tax exemption saved $5 million in Calendar Year 2008. On July 1, 2012, the tax exemption expires and is replaced by the preferential B&O tax rate. Beneficiaries are estimated to save $4.5 million in Calendar Year 2013, a full year under the preferential rate.

Recommendations

Recommendation 1

Because the public policy objective of creating and retaining quality jobs is not being fully achieved, and the B&O tax exemption was intended to be temporary, the Legislature should allow the B&O tax exemption for fresh fruit and vegetable processors to expire on July 1, 2012.

Recommendation 2

To achieve the public policy objective of providing consistent tax treatment to fresh food processors, the Legislature should continue the preferential tax rate of 0.138 percent that becomes effective on July 1, 2012.

Legislation Required: No.

Fiscal Impact: None. No change from status quo.

FRUIT AND VEGETABLE MANUFACTURERS B&O TAX EXEMPTION AND PREFERENTIAL RATE – REPORT DETAIL

Current Law

This review includes two tax preferences for manufacturers of fresh fruit and vegetable products:

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Manufacturers are eligible for the tax preferences if they manufacture fresh fruits and vegetables by "canning, preserving, freezing, processing, or dehydrating." Ordinarily, fruit and vegetable manufacturers that wholesale their products to instate purchasers owe the wholesaling B&O tax at the rate of 0.484 percent. Fruit and vegetable manufacturers are eligible for the tax preferences if they make wholesale sales that are delivered instate to purchasers that then transport the products out of state.

Beneficiaries of the B&O tax exemption must file an annual survey with the Department of Revenue (DOR) by April 30 each year based on the previous year's activity. The survey is not required for beneficiaries of the preferential rate. The survey provides information on the number of employees; wages by wage bands; and medical, dental, and retirement benefits. The names of beneficiaries and the amount of tax exemption taken may be disclosed.

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2010 In response to the 2004 Supreme Court case, the Legislature approved DOR request legislation to require that fruit and vegetable processors receive the exemption (and the lower rate on July 1, 2012) only if fruit, vegetable, and water comprise at least 50 percent of the ingredients in the end product (2ESSB 6143). This legislation was passed to avoid an unintended consequence of extending the tax preference to manufacturers that only include a small amount of fruits and vegetables in their product.

The history of rate changes for fruit and vegetable processing and for general manufacturing is shown in Exhibit 12.

Exhibit 12 – B&O Tax Rate History for Fruit & Vegetable Processing

Year	Action	Fruit & Vegetable Processors Rate	General Manufacturing & Wholesaling Rates
1935	Treated like farming activity	Exempt	0.25%
1954	Ruled to be manufacturing activity	0.30%	0.30%
1965	Granted preferential rate	0.30%	0.44%
1993	Surtax enacted	0.351%	0.515%
1995	Surtax partially rolled back	0.345%	0.506%
1997	Surtax expires	0.33%	0.484%
1998	Preferential rate reduced further	0.138%	0.484%
2005	Exempted from B&O	Exempt	0.484%
2012	Preferential rate to be reenacted	0.138%	0.484%

Source: JLARC analysis of state statutes.

Other Relevant Background

Washington has been a leader among the states in growing fresh fruits and vegetables. In 2007, Washington growers produced 92 percent of the nation's red raspberries and 57 percent of the nation's apples. Washington also ranks high among the states in growing plums, carrots, asparagus, potatoes, and corn. Yet Washington is responsible for only 5 percent of the value of U.S. manufactured fruit and vegetable products.

Fruit and vegetable growing and processing has been an essential part of the Washington economy for a century. In the 1910s, apple growers began to sell their blemished fruit to Puget Sound processing plants rather than dump the fruit in rivers and ravines. Irrigation projects begun in the

1930s stimulated increased fruit growing in Central Washington, and processors found it economical to build plants closer to the orchards east of the Cascades.

In recent years, consolidation in the grocery industry has resulted in higher quality standards and has put pressure on manufacturing costs. As well, increasing competition from overseas manufacturers and high energy prices has weakened the fruit and vegetable manufacturing industry.

A number of processing plant closures in the years leading up to the 2005 enactment of the tax exemption resulted in loss of jobs in rural areas. The Ocean Spray bottling plant closed in Grays Harbor (1997); AgriFrozen Foods closed plants in Walla Walla and Grandview (2001); and J. R. Simplot Company closed a plant in Quincy (2004). In the year the Legislature enacted the tax preference (2005), Seneca closed its asparagus plant in Dayton, with a loss of 1,000 seasonal jobs.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

The implied public policy objectives of the fruit and vegetable processors' B&O tax preferences are:

1) To create and retain quality jobs;
2) To provide temporary relief through an exemption; and
3) To provide tax treatment consistent with other fresh food processors.

To create and retain quality jobs

Although not specifically stated, the public policy objective to create and retain quality jobs can be implied from the type and purpose of information the Legislature required in statute.

Type of Information

The Legislature required beneficiaries of the exemption to report in an annual survey on the number of full-time, part-time, and temporary employees; the number of employees by wage bands; and medical, dental, and retirement benefits offered to employees. The Legislature permitted DOR to ask additional survey questions "necessary to measure the results of the exemption program." This indicates that the Legislature was interested in factors beyond just the number of jobs created.

Purpose of Information

The Legislature wanted to be able to compare the performance of various tax incentives. The statutory language states the purpose of the annual survey is to assist the Legislature in evaluating how a tax incentive is used in order "to make policy choices regarding the best use of limited state resources." This language is the same for all tax incentives requiring beneficiaries to file annual surveys.

In the 2005 legislation, the Legislature directed DOR to study the effect of the fruit and vegetable manufacturing exemption on job creation, job retention, company growth, and other factors. In 2010, the Legislature removed the study language when it repealed duplicate studies for tax preferences that were also being reviewed by JLARC (SHB 3066). However, it can be inferred that the original purpose of this exemption is to create new employment opportunities and to retain existing employment.

To provide temporary relief through an exemption

The Legislature intended the tax exemption as temporary tax relief. The Legislature initially established the exemption in 2005 without an expiration date. Then in 2006, the Legislature took deliberate action to add an expiration date. In 2006, the Governor stated that "the 2005 tax breaks for the fruits and vegetable processors were enacted to help an industry that was in obvious trouble and in need of temporary aid to help turn around the industry's misfortunes."[12]

In 2010, the Legislature amended the law dealing with fresh food processors. However, it left intact the provision that allows the exemption to expire, and to be replaced by a preferential tax rate on July 1, 2012 (2ESSB 6143). This indicates that the Legislature still intends the exemption to be temporary and the preferential tax rate to replace the exemption when it expires.

To provide tax treatment consistent with other fresh food processors

An implied public policy objective is to treat fresh fruit and vegetable processors consistently with other fresh food processors. This is reflected in parallel legislative actions for fruits, vegetables, dairy, and seafood processors. Beginning July 1, 2012, fresh food processors, including fruit and vegetable processors, will pay the same preferential B&O tax rate of 0.138 percent.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

To date, the B&O tax exemption for fruit and vegetable processors does not appear to be fully achieving the objective of creating and retaining quality jobs. When the exemption expires on July 1, 2012, the public policy objective of providing temporary tax relief to fresh fruit and vegetable processors will have been achieved. The exemption will be replaced by the preferential B&O tax rate of 0.138 percent, achieving the objective for consistent tax treatment with other fresh food processors.

Not fully achieving objective of quality jobs

The public policy objective of creating and retaining quality jobs is not being fully achieved. JLARC measured achievement of this objective by comparing beneficiaries of the fresh fruit and vegetable processors' B&O tax exemption to beneficiaries of the five other B&O tax incentives for which surveys are available. JLARC compared incentive programs in six ways:

1) The percentage of beneficiaries reporting new jobs in the year they claimed an incentive;
2) The amount of incentive claimed for each new job created (cost per job);
3) The percentage of employees by wage bands earning $30,000 or more;
4) The percentage of part-time and temporary employees working for beneficiaries;
5) The percentage of employees receiving health and retirement benefits; and
6) Trends in fruit and vegetable processing employment to determine if jobs are being retained.

[12] Veto message for sections 14 and 15 of EHB 3159, 2006.

Not all beneficiaries of these B&O tax incentives created new jobs in the year they claimed the incentive. In 2008, 33 out of 104 fruit and vegetable processers reported new jobs. (See Exhibit 13.)

Exhibit 13 – 33 out of 104 Fruit & Vegetable Processors Created Jobs in 2008

Incentive Program	Number of Firms Creating Jobs	Total Number of Firms	Percent of Firms Creating Jobs
High Technology	249	485	51%
Timber & Wood Products	32	258	12%
Customized Training	3	7	43%
Dairy Processors	5	11	45%
Seafood Processors	3	16	19%
Fruit & Vegetable Processors	33	104	32%

Source: DOR Annual Surveys, 2008; 2 years are shown for customized training due to disclosure issues.

The amount of incentive claimed per each new job created is $10,821 for fruit and vegetable processors. This cost per job is low in relation to some other incentive programs. (See Exhibit 14.)

Exhibit 14 – Cost per Job is Lower for Fruit & Vegetable Processers Than some Other Tax Incentive Programs in 2008

Incentive Program	Dollars of Tax Incentive Taken	Number of New Jobs	Cost per Job
High Technology	$22,192,077	3,991	$5,561
Timber & Wood Products	$14,034,043	149	$94,207
Customized Training	$52,993	6	$9,110
Dairy Processors	$1,633,703	137	$11,914
Seafood Processors	$3,290,786	51	$64,530
Fruit & Vegetable Processors	$5,004,981	463	$10,821

Source: DOR Annual Surveys, 2008; 2 years are shown for customized training due to disclosure issues.

The Legislature required beneficiaries to report the number of employment positions by three wage bands: 1) less than $30,000, 2) $30,000 to $60,000, and 3) $60,000 or greater. Fruit and vegetable processors paid 37 percent of their employees $30,000 or more a year, comparing less favorably to other incentive programs. (See Exhibit 15.)

Exhibit 15 – Fruit & Vegetable Processors Paid Lower Wages Than Beneficiaries of Other Tax Incentives in 2008

Tax Incentive Program	Total Employment	Number Earning $30,000 or More	Percent Earning $30,000 or More
High Technology	102,075	97,392	95%
Timber & Wood Products	19,965	17,201	86%
Customized Training	1,377	713	52%
Dairy Processors	1,561	1,346	86%
Seafood Processors	2,714	1,519	56%
Fruit & Vegetable Processors	12,559	4,644	37%

Source: DOR Annual Surveys, 2008.

Fruit and vegetable processors employed fewer full-time employees (78 percent of all employees) than most beneficiaries other incentive programs. (See Exhibit 16.)

Exhibit 16 – Fruit & Vegetable Processors Employed Fewer Full-Time Workers Than Beneficiaries of Most Other Tax Incentives in 2008

Tax Incentive Program	Percent Full-Time	Percent Part-Time	Percent Temporary
High Technology	83%	2%	15%
Timber & Wood Products	98%	2%	0%
Customized Training	95%	3%	2%
Dairy Processors	95%	3%	2%
Seafood Processors	55%	6%	39%
Fruit & Vegetable Processors	78%	15%	8%

Source: DOR Annual Surveys, 2008.

The Legislature required beneficiaries of tax incentive programs to report the number of employees receiving medical, dental, and retirement benefits. Fruit and vegetable processors provided benefit coverage to a lower percentage of employees than most of the beneficiaries of other tax incentive programs. (See Exhibit 17.)

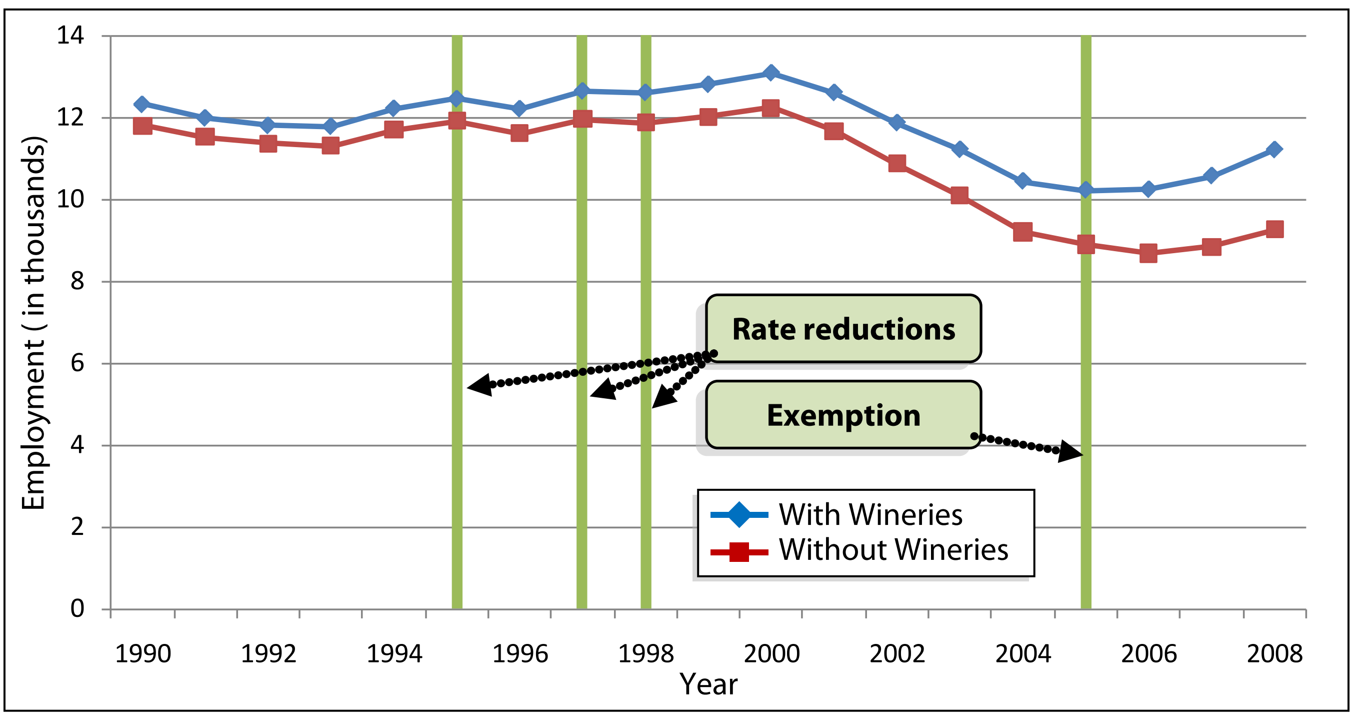
Exhibit 17 – Fruit & Vegetable Processors Provided Less Benefit Coverage Than Most Beneficiaries of Other Tax Incentives in 2008

Tax Incentive Program	Medical	Dental	Retirement
High Technology	81%	80%	71%
Timber & Wood Products	82%	79%	79%
Customized Training	77%	76%	55%
Dairy Processors	88%	79%	81%
Seafood Processors	61%	61%	33%
Fruit & Vegetable Processors	56%	54%	51%

Source: DOR Annual Surveys, 2008; 2 years are shown for customized training due to disclosure issues.

There is no available data to determine if the beneficiaries of the fruit and vegetable processors' exemption have retained existing jobs. For the industry as a whole, employment declined beginning in 2000, but has recovered somewhat since 2005. (See Exhibit 18.)

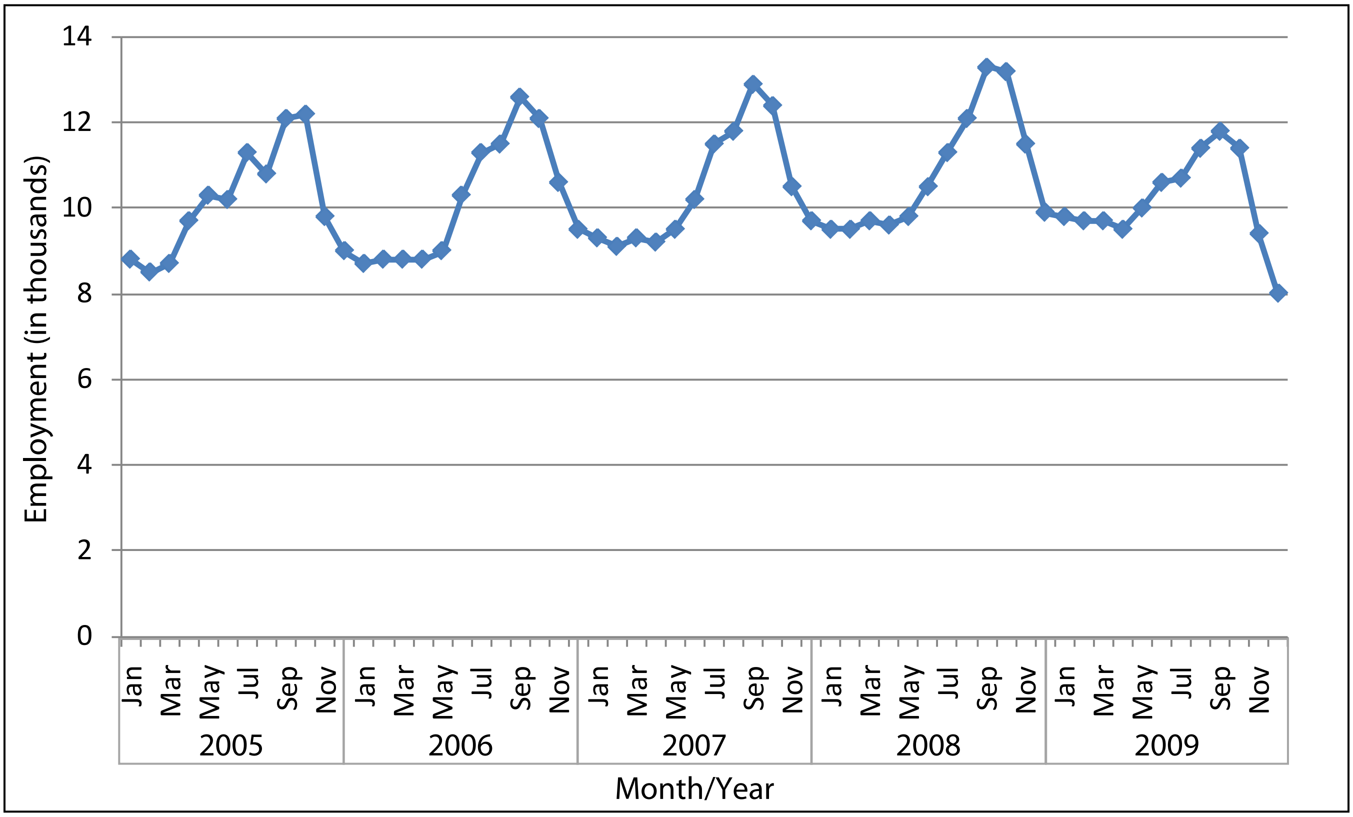
Exhibit 18 – Fruit & Vegetable Processing Employment – With and Without Wineries (in Thousands)



Source: Quarterly Census of Employment and Wages, U.S. Bureau of Labor Statistics.

Employment in the industry is highly seasonal, peaking in the fall harvest season. (See Exhibit 19.)

Exhibit 19 – Fruit & Vegetable Processing is Highly Seasonal—Without Wineries



Source: Quarterly Census of Employment and Wages, ESD.

Fruit and vegetable processors received temporary relief through the exemption

The Legislature's actions indicate the exemption was intended to be temporary. When this exemption expires in 2012, beneficiaries will have received seven years of exemption from the B&O tax, and will have saved an estimated $35.4 million.

Tax treatment consistent with other fresh food processors

Fresh food processors have not always received the same tax treatment. The Legislature granted preferential tax rates to food processors one sector at a time over a period of years beginning in 1949. However, on July 1, 2012, several fresh food processors will pay the same preferential B&O tax rate of 0.138 percent. Fresh food processors receiving this preferential rate are manufacturers of flour and oil, processors of dried peas, processors of meat, manufacturers of dairy products, manufacturers of fruits and vegetables products, and manufacturers of seafood products.

Wholesalers of fresh food products do not all benefit from the preferential rate, however. Wholesalers of seafood, dairy, and fruit and vegetable products receive the lower 0.138 percent rate only if they sell to purchasers that transport the goods out of state. Other wholesalers that deliver their products instate pay the general wholesaling rate of 0.484 percent.

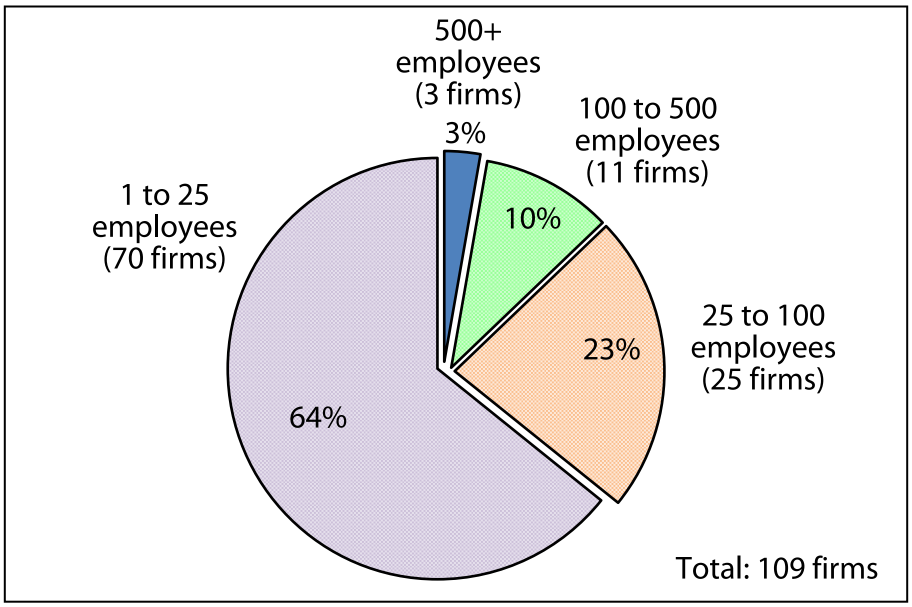
Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

The beneficiaries of the tax preference are the 109 fresh fruit and vegetable manufacturers that claimed the B&O exemption. Wineries began taking the exemption in 2007 under a new interpretation by DOR.

Three firms are responsible for over half of the employment. Most firms benefiting from the tax exemption are small, having fewer than 25 employees. (See Exhibit 20.) DOR maintains a list of all beneficiaries on its website.

Exhibit 20 – Most Beneficiaries are Small Firms With Fewer Than 25 Employees



Source: DOR Annual Surveys.

Revenue Impact

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

Beneficiaries of the B&O tax exemption saved $5 million in Calendar Year 2008. On July 1, 2012, the tax exemption will expire and be replaced by the preferential B&O tax rate. Beneficiaries are estimated to save $4.5 million in Calendar Year 2013, a full year under the preferential rate.

The tax savings due to the exemption are calculated based on the general manufacturing and wholesaling rate of 0.484 percent. The tax savings due to the preferential tax rate are based on the difference between the general 0.484 percent rate and the preferential 0.138 percent rate.

Exhibit 21 – Taxpayer Savings from Fruit and Vegetable Tax Preferences

Calendar Year	Tax Treatment	B&O Exemption	Preferential Rate
2008	Exemption in effect	$5,000,000	Not Applicable
2009	Exemption in effect	$4,800,000	Not Applicable
2010	Exemption in effect	$5,000,000	Not Applicable
2011	Exemption in effect	$5,500,000	Not Applicable
2012	Preferential rate at 0.138% begins July 1, 2012	$3,400,000	$1,700,000
2013	Tax at preferential rate	Not Applicable	$4,500,000

Source: DOR Annual Descriptive Statistics and Economic and Revenue Forecast Council February 2010 B&O Forecast.

Recommendations

Recommendation 1

Because the implied public policy objective of creating and retaining quality jobs is not being fully achieved, and the B&O tax exemption was intended to be temporary, the Legislature should allow the B&O tax exemption for fresh fruit and vegetable processors to expire on July 1, 2012.

Recommendation 2

To achieve the public policy objective of providing consistent tax treatment to fresh food processors, the Legislature should continue the preferential tax rate of 0.138 percent that becomes effective on July 1, 2012.

Legislation Required: No.

Fiscal Impact: None. No change from status quo.

SEAFOOD PRODUCTS MANUFACTURERS B&O TAX EXEMPTION AND PREFERENTIAL RATE – SUMMARY

Current Law

This review includes two tax preferences for the seafood processing industry:

1) A business and occupation (B&O) tax exemption for seafood products manufacturing and for selling seafood products at wholesale to purchasers that transport them out of state in the ordinary course of business. The B&O tax exemption became effective July 1, 2006, and is set to expire on July 1, 2012.
2) A preferential B&O tax rate of 0.138 percent for the same seafood products manufacturing and wholesaling activities that goes into effect when the B&O exemption (above) expires on July 1, 2012.

To qualify for the two tax preferences, seafood, including fish and shellfish, must remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing process. Ordinarily, seafood products wholesalers that sell their products to instate purchasers owe the wholesaling B&O tax at the rate of 0.484 percent. Seafood products wholesalers are eligible for the tax preferences if they make wholesale sales that are delivered instate to purchasers that then transport the products out of state.

Neither of the preferences applies to:

- Cutting, grading, or ice glazing seafood which has been cooked, frozen, or canned outside this state; or
- Inspecting, testing, labeling, and storing canned salmon owned by another business.

Beneficiaries of the tax exemption must file a survey with the Department of Revenue (DOR) by April 30 each year based on the previous year's activity. The survey is not required for beneficiaries of the preferential rate. The survey provides information on the number of employees; wages by wage bands; and medical, dental, and retirement benefits. The names of beneficiaries and the amount of tax exemption taken may be disclosed.

If the beneficiary fails to file a survey for a previous year, the Department may assess taxes and interest on the amount of exemption taken for the year.

See page A3-8 in Appendix 3 for the current statutes, RCW 82.04.4269 and 82.04.260(1)(b).

Legal History and Public Policy Objectives

The Legislature has provided preferential B&O tax rates to manufacturers of several fresh food products over the years. Manufacturers of flour received the first preferential B&O rate in 1949, followed by seafood processors in 1959, fresh fruit and vegetable products manufacturers in 1965, processors of dried peas and perishable meat products in 1967, and dairy product manufacturers in 2001. (The tax preferences for dairy and fruit and vegetable products manufacturers are reviewed in separate sections of the report. JLARC reviewed the preference for manufacturers of flour in 2009, and is scheduled to review the other preferences in future years.)

Pre-1959 Seafood products manufacturers paid the general manufacturing B&O tax rate.

1959 The Legislature enacted a preferential B&O tax rate of 0.125 percent for the manufacturing of seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing process. The general manufacturing B&O tax rate at the time was 0.44 percent.

1993 Due to a revenue shortfall, the Legislature enacted temporary surtaxes that applied across the board to all B&O tax rates. The surtax boosted the preferential rate for manufacturers of seafood products to 0.146 percent and the general manufacturing rate to 0.515 percent.

1994 The Legislature partially rolled back the 1993 surtax on B&O tax rates, reducing the rate for seafood processors to 0.144 percent and the general manufacturing rate to 0.506 percent effective January 1, 1995.

1997 The 1993 B&O surtax expired, lowering the B&O tax rate for seafood processors to 0.138 percent on July 1, 1997. The general manufacturing rate became 0.484 percent.

2005 The Legislature changed the preferential B&O tax rate for manufacturers and certain wholesalers of fresh fruits and vegetables products to an exemption effective July 1, 2005. The preferential rate for seafood processors remained at 0.138 percent.

2006 The Legislature provided a B&O tax exemption in place of the preferential rate for seafood processors. Additionally, the exemption applied to wholesalers that sold seafood products to purchasers that transported the goods out of state. The exemption became effective on July 1, 2006, and is set to expire on July 1, 2012.

At that time, seafood manufacturers will pay a preferential B&O tax rate of 0.138 percent, the same rate provided to other fresh food processors. Due to an omission in the legislation, seafood wholesalers did not receive the preferential rate, but would instead pay tax at the general wholesaling rate of 0.484 percent.

2007 In a technical corrections bill, the Legislature amended the 2006 statute to grant the same preferential B&O rate to the wholesalers that sold seafood products to purchasers that transported the goods out of state. This preferential rate applies when the exemption expires on July 1, 2012. The Legislature had provided the same tax treatment to dairy, fruit, and vegetable wholesalers previously.

The implied public policy objectives of the seafood processors' B&O tax preferences are:

4) To create and retain quality jobs;
5) To provide temporary relief through an exemption; and
6) To provide tax treatment consistent with other fresh food processors.

Beneficiaries

The beneficiaries of the tax preference are the 22 seafood processors that claimed the exemption in 2007 and 2008, the two years for which data is available. Of those, one firm received 31 percent of the total exemption amount.

Revenue Impacts

Beneficiaries of the B&O tax exemption saved $3.3 million in Calendar Year 2008. On July 1, 2012, the tax exemption expires and is replaced by the preferential B&O tax rate. Beneficiaries are estimated to save $3.0 million in Calendar Year 2013, a full year under the preferential rate.

Recommendations

Recommendation 1

Because the implied public policy objective of creating and retaining quality jobs is not being fully achieved, and the B&O tax exemption was intended to be temporary, the Legislature should allow the B&O tax exemption for seafood processors to expire on July 1, 2012.

Recommendation 2

To achieve the public policy objective of providing consistent tax treatment to fresh food processors, the Legislature should continue the preferential tax rate of 0.138 percent that becomes effective on July 1, 2012.

Legislation Required:	No.
Fiscal Impact:	None. No change from status quo.

SEAFOOD PRODUCTS MANUFACTURERS B&O TAX EXEMPTION AND PREFERENTIAL RATE – REPORT DETAIL

Current Law

This review includes two tax preferences for the seafood processing industry:

1) A business and occupation (B&O) tax exemption for seafood products manufacturing and for selling seafood products at wholesale to purchasers that transport them out of state in the ordinary course of business. The B&O tax exemption became effective July 1, 2006, and is set to expire on July 1, 2012.
2) A preferential B&O tax rate of 0.138 percent for the same seafood products manufacturing and wholesaling activities that goes into effect when the B&O exemption (above) expires on July 1, 2012.

To qualify for the two tax preferences, seafood, including fish and shellfish, must remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing process. Ordinarily, seafood products wholesalers that sell their products to instate purchasers owe the wholesaling B&O tax at the rate of 0.484 percent. Seafood products wholesalers are eligible for the tax preferences if they make wholesale sales that are delivered instate to purchasers that then transport the products out of state.

Neither of the preferences applies to:

- Cutting, grading, or ice glazing seafood which has been cooked, frozen, or canned outside this state; or
- Inspecting, testing, labeling, and storing canned salmon owned by another business.

Beneficiaries of the tax exemption must file a survey with the Department of Revenue (DOR) by April 30 each year based on the previous year's activity. The survey is not required for beneficiaries of the preferential rate. The survey provides information on the number of employees; wages by wage bands; and medical, dental, and retirement benefits. The names of beneficiaries and the amount of tax exemption taken may be disclosed.

If the beneficiary fails to file a survey for a previous year, the Department may assess taxes and interest on the amount of exemption taken for the year.

See page A3-8 in Appendix 3 for the current statutes, RCW 82.04.4269 and 82.04.260(1)(b).

Legal History

The Legislature has provided preferential B&O tax rates to manufacturers of several fresh food products over the years. Manufacturers of wheat into flour received the first preferential B&O rate in 1949, followed by seafood processors in 1959, fresh fruit and vegetable products manufacturers in 1965, and processors of dried peas and perishable meat products in 1967. Dairy products manufacturers received a preferential B&O tax rate in 2001. (The tax preferences for dairy and fruit and vegetable products manufacturers are reviewed in separate sections of the report. JLARC reviewed the preference for manufacturers of flour in 2009, and is scheduled to review the other preferences in future years.)

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure, including the B&O tax. The B&O tax applied to the gross income or value of products as a measure of the privilege of engaging in business in Washington. The general manufacturing B&O tax rate that applied to seafood processing was 0.25 percent.

1959 The Legislature enacted a preferential B&O tax rate of 0.125 percent for the manufacturing of seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing process. The general manufacturing B&O tax rate at the time was 0.44 percent.

1993 Due to a revenue shortfall, the Legislature enacted temporary surtaxes that applied across the board to all B&O tax rates. The surtax boosted the preferential rate for manufacturers of seafood products to 0.146 and the general manufacturing rate to 0.515 percent.

1994 The Legislature partially rolled back the 1993 surtax on B&O tax rates, reducing the rate for seafood processors to 0.144 percent and the general manufacturing rate to 0.506 percent effective January 1, 1995.

1997 The 1993 B&O surtax expired, lowering the B&O tax rate for seafood processors to 0.138 percent on July 1, 1997. The general manufacturing rate became 0.484 percent.

2005 The Legislature changed the preferential B&O tax rate for manufacturers and certain wholesalers of fresh fruits and vegetables products to an exemption effective July 1, 2005. The preferential rate for seafood processors remained at 0.138 percent.

2006 The Legislature provided a B&O tax exemption in place of the preferential rate for seafood processors. Additionally, the exemption applied to wholesalers that sold seafood products to purchasers that transported the goods out of state. The exemption became effective on July 1, 2006, and is set to expire on July 1, 2012.

At that time, seafood manufacturers will pay a preferential B&O tax rate of 0.138 percent, the same rate provided to other fresh food processors. Due to an omission in the legislation, seafood wholesalers did not receive the preferential rate, but would instead pay tax at the general wholesaling rate of 0.484 percent.

2007 In a technical corrections bill, the Legislature amended the 2006 statute to grant the same preferential B&O rate to the wholesalers that sold seafood products to purchasers that transported the goods out of state. This preferential rate applies when the exemption expires on July 1, 2012. The Legislature had provided the same tax treatment to dairy, fruit, and vegetable wholesalers previously.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

The implied public policy objectives of the seafood processors' B&O tax preferences are:

1) To create and retain quality jobs;
2) To provide temporary relief through an exemption; and
3) To provide tax treatment consistent with other fresh food processors.

To create and retain quality jobs

Although not specifically stated, the public policy objective to create and retain quality jobs can be implied from the type and purpose of information the Legislature required in statute.

Type of Information

The Legislature required beneficiaries of the exemption to report in an annual survey on the number of full-time, part-time, and temporary employees; the number of employees by wage bands; and medical, dental, and retirement benefits offered to employees. The Legislature permitted DOR to ask additional survey questions "necessary to measure the results of the exemption program." This indicates that the Legislature was interested in factors beyond just the number of jobs created.

Purpose of Information

The Legislature wanted to be able to compare the performance of various tax incentives. The statutory language states the purpose of the annual survey is to assist the Legislature in evaluating how a tax incentive is used in order "to make policy choices regarding the best use of limited state resources." This language is the same for all tax incentives requiring beneficiaries to file annual surveys.

In the 2006 legislation, the Legislature directed DOR to study the effect of the seafood products manufacturing exemption on job creation, job retention, company growth, and other factors. In 2010, the Legislature removed the study language when it repealed duplicate studies for tax preferences that were also being reviewed by JLARC (SHB 3066). However, it can be inferred that the original purpose of this exemption is to create new employment opportunities and to retain existing employment.

To provide temporary relief through an exemption

The Legislature established the B&O tax exemption for seafood processors as a temporary exemption in 2006. In 2010, the Legislature amended the law dealing with fresh food processors, but left intact the provision that allows the exemption to expire, to be replaced by a preferential tax rate on July 1, 2012 (2ESSB 6143). This indicates that the Legislature still intends the exemption to be temporary and the preferential tax rate to replace the exemption when it expires.

To provide tax treatment consistent with other fresh food processors

An implied public policy objective is to treat seafood processors consistently with other fresh food processors. This is reflected in parallel legislative actions for fruits, vegetables, dairy, and seafood processors. Beginning July 1, 2012, fresh food processors including seafood processors will pay the same preferential B&O tax rate of 0.138 percent.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

To date, the B&O tax exemption for seafood processors does not appear to be fully achieving the objective of creating and retaining quality jobs. When the exemption expires on July 1, 2012, the public policy objective of providing temporary tax relief to seafood processors will have been achieved. The exemption will be replaced by the preferential B&O tax rate of 0.138, achieving the objective for consistent tax treatment with other fresh food processors.

Not fully achieving objective of quality jobs

The public policy objective of creating and retaining quality jobs is not being fully achieved. JLARC measured achievement of this objective by comparing the seafood processors' B&O tax exemption to five other B&O tax incentives that require annual surveys. JLARC compared incentive programs in six ways:

1) The percentage of beneficiaries reporting new jobs in the year they claimed an incentive;
2) The amount of incentive claimed for each new job created (cost per job);
3) The percentage of employees earning $30,000 a year or more;
4) The percentage of part-time and temporary employees working for beneficiaries;
5) The percentage of employees receiving health and retirement benefits; and
6) Trends in seafood processing employment to determine if jobs are being retained.

Not all beneficiaries of these B&O tax incentives created new jobs in the year they claimed the incentive. Of the 16 seafood processors that claimed the exemption in 2008, three reported creating jobs. (See Exhibit 22.)

Exhibit 22 – 3 out of 16 Seafood Processors Created Jobs in 2008

Incentive Program	Number of Firms Creating Jobs	Total Number of Firms	Percent of Firms Creating Jobs
High Technology	249	485	51%
Timber & Wood Products	32	258	12%
Customized Training	3	7	43%
Fruit & Vegetable Processors	33	104	32%
Dairy Processors	5	11	45%
Seafood Processors	3	16	19%

Source: DOR Annual Surveys, 2008; 2 years are shown for customized training due to disclosure issues.

The amount of incentive claimed per each new job created is $64,530 for seafood processors. This cost per job is high in relation to most of the other incentive programs. (See Exhibit 23.)

Exhibit 23 – Cost per Job is Higher for Seafood Processers Than Most Other Tax Incentive Programs in 2008

Incentive Program	Dollars of Tax Incentive Taken	Number of New Jobs	Cost per Job
High Technology	$22,192,077	3,991	$5,561
Timber & Wood Products	$14,034,043	149	$94,207
Customized Training	$52,993	6	$9,110
Fruit & Vegetable Processors	$5,004,981	463	$10,821
Dairy Processors	$1,633,703	137	$11,914
Seafood Processors	$3,290,786	51	$64,530

Source: DOR Annual Surveys, 2008; 2 years are shown for customized training due to disclosure issues.

Beneficiaries report the number of employees by three wage bands: 1) less than $30,000, 2) $30,000 to $60,000, and 3) $60,000 or greater. Seafood processors paid 56 percent of their employees $30,000 or more a year, comparing less favorably to some other incentive programs. (See Exhibit 24.)

Exhibit 24 – Seafood Processors had Fewer High Wage Employees Than Beneficiaries of Some Other Tax Incentives in 2008

Tax Incentive Program	Total Employment	Number Earning $30,000 or More	Percent Earning $30,000 or More
High Technology	102,075	97,392	95%
Timber & Wood Products	19,965	17,201	86%
Customized Training	1,377	713	52%
Fruit & Vegetable Processors	12,559	4,644	37%
Dairy Processors	1,561	1,346	86%
Seafood Processors	2,714	1,519	56%

Source: DOR Annual Surveys, 2008.

Seafood processors employed fewer full-time employees (55 percent of all employees) than beneficiaries of the other five incentive programs. (See Exhibit 25.)

Exhibit 25 – Seafood Processors Employed Fewer Full-Time Workers Than Beneficiaries of Other Tax Incentives in 2008

Tax Incentive Program	Percent Full-Time	Percent Part-Time	Percent Temporary
High Technology	83%	2%	15%
Timber & Wood Products	98%	2%	0%
Customized Training	95%	3%	2%
Fruit & Vegetable Processors	78%	15%	8%
Dairy Processors	95%	3%	2%
Seafood Processors	55%	6%	39%

Source: DOR Annual Surveys, 2008.

Beneficiaries must report the number of employees receiving medical, dental, and retirement benefits. Seafood processors provided coverage to a lower percentage of employees than beneficiaries of other tax incentive programs. (See Exhibit 26.)

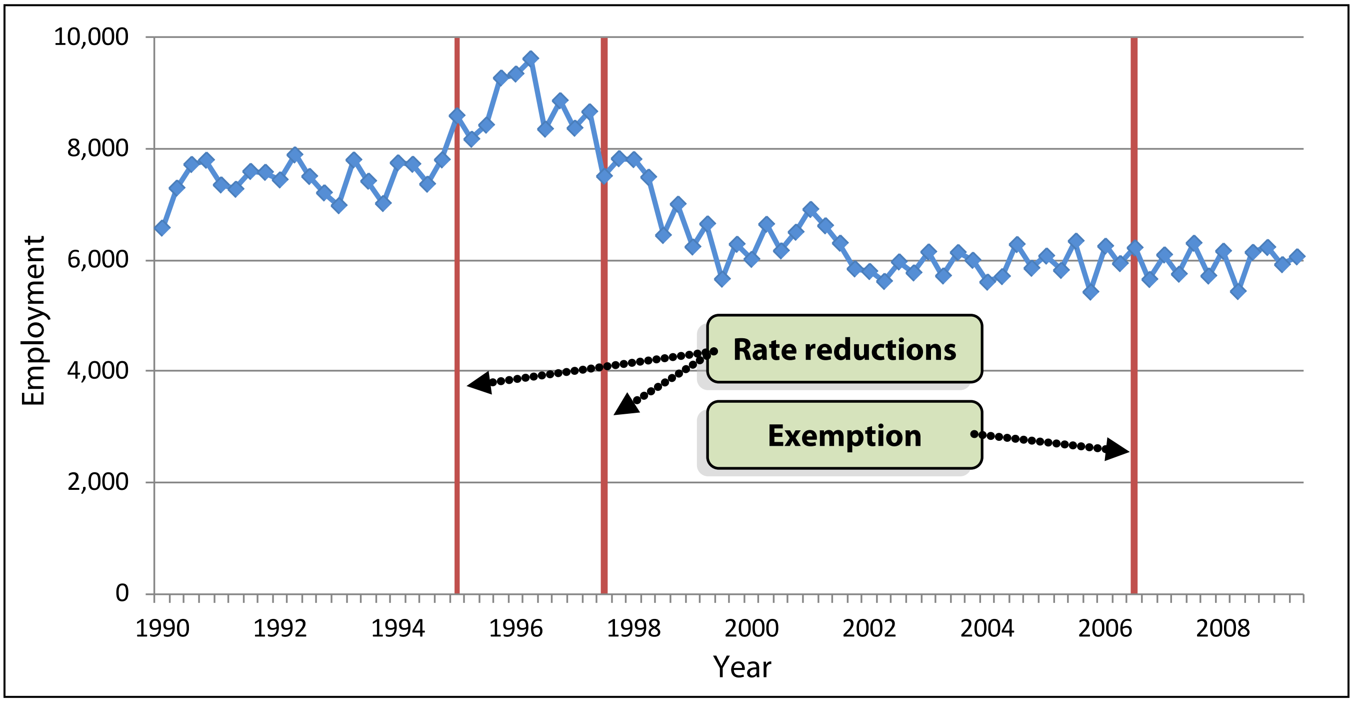
Exhibit 26 – Seafood Processors Provided Less Benefit Coverage Than Beneficiaries of Other Tax Incentives in 2008

Tax Incentive Program	Medical	Dental	Retirement
High Technology	81%	80%	71%
Timber & Wood Products	82%	79%	79%
Customized Training	77%	76%	55%
Fruit & Vegetable Processors	56%	54%	51%
Dairy Processors	88%	79%	81%
Seafood Processors	61%	61%	33%

Source: DOR Annual Surveys, 2008.

There is no available data to determine if the beneficiaries of the seafood processing exemption have retained existing jobs. For the industry as a whole, employment has remained stable since 2000. (See Exhibit 27.)

Exhibit 27 – Washington Seafood Processing Jobs Have Remained Stable Since 2000



Source: Quarterly Census of Employment and Wages, ESD.

Seafood processors received temporary relief through the exemption

The Legislature's actions indicate the exemption was intended to be temporary. When this exemption expires in 2012, beneficiaries will have received six years of exemption from the B&O tax, and will have saved an estimated $17.1 million. To date, 22 seafood processors have benefited from the B&O tax exemption.

Tax treatment consistent with other fresh food processors

Fresh food processors have not always received the same tax treatment. The Legislature granted preferential tax rates to food processors one sector at a time over a period of years beginning in 1949. However, on July 1, 2012, several fresh food processors will pay the same preferential B&O tax rate of 0.138 percent. Fresh food processors receiving this preferential rate are manufacturers of flour and oil, processors of dried peas, processors of meat, manufacturers of dairy products, manufacturers of fruits and vegetables products, and manufacturers of seafood products.

Wholesalers of fresh food products do not all benefit from the preferential rate, however. Only wholesalers of seafood, dairy, and fruit and vegetable products receive the lower 0.138 percent rate if they sell to purchasers that transport the goods out of state. Other wholesalers that deliver their products instate pay the general wholesaling rate of 0.484 percent.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

The beneficiaries of the tax preference are the 22 seafood processors that claimed the exemption in 2007 and 2008, the two years for which data is available. Of those, one firm received 31 percent of the total exemption amount. (See Exhibit 28).

Exhibit 28 – Beneficiaries of the Exemption for Seafood Manufacturers

Business Name	Taxpayer Savings	Percent of Total
Signature Seafoods Inc	$1,468,440	31%
Goose Point Oysters Inc	$824,236	17%
McGee Paul D	$680,485	14%
Orca Bay Seafoods Inc	$428,166	9%
Trident Seafoods Corp	$369,962	8%
Ocean Gold Seafoods Inc	$344,465	7%
Alyeska Seafoods Inc	$133,895	3%
Redbow Industries LLC	$120,650	3%
Odyssey Enterprises Inc	$91,033	2%
Ocean Harvest Seafoods LLC	$73,801	2%
Best Fish LLC	$69,743	1%
Seafreeze Ltd	$69,637	1%
Jessies Ilwaco Fish Co Inc	$51,936	1%
Pacific Seafood Group	$33,726	1%
Schulte Theodore E	$18,600	less than 1%
Wiegardt Bros Inc	$11,528	less than 1%
Nisbet Oyster Co Inc	$7,651	less than 1%
Harders Donovan c & Debra D	$6,844	less than 1%
Norris Russell E & Terra K	$5,150	less than 1%
Lone Tree Point Seafood Co	$3,047	less than 1%
Olson Richard W	$389	less than 1%
Bailey Brad G	$200	less than 1%

Source: DOR Annual Survey, 2008.

Revenue Impact

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

Beneficiaries of the B&O tax exemption saved $3.3 million in Calendar Year 2008. On July 1, 2012, the tax exemption expires and is replaced by the preferential B&O tax rate. Beneficiaries are estimated to save $3.0 million in Calendar Year 2013, a full year under the preferential rate.

The taxpayer savings due to the exemption are calculated based on the general manufacturing and wholesaling rate of 0.484 percent. The taxpayer savings due to the preferential tax rate are based on the difference between the general 0.484 percent rate and the preferential 0.138 percent rate.

Exhibit 29 – Taxpayer Savings for Seafood Manufacturing & Wholesaling Industry

Calendar Year	Tax Treatment	B&O Tax Exemption	Preferential Rate
2008	Exemption in effect	$3,300,000	Not Applicable
2009	Exemption in effect	$3,100,000	Not Applicable
2010	Exemption in effect	$3,300,000	Not Applicable
2011	Exemption in effect	$3,600,000	Not Applicable
2012	Preferential rate at 0.138% begins July 1, 2012	$2,300,000	$1,200,000
2013	Full year of tax at preferential rate	Not Applicable	$3,000,000

Source: DOR Annual Surveys. Tax savings from 2009 through 2013 are estimates based on the Economic & Revenue Forecast Council February 2010 forecast.

Recommendations

Recommendation 1

Because the implied public policy objective of creating and retaining quality jobs is not being fully achieved, and the B&O tax exemption was intended to be temporary, the Legislature should allow the B&O tax exemption for seafood processors to expire on July 1, 2012.

Recommendation 2

To achieve the public policy objective of providing consistent tax treatment to fresh food processors, the Legislature should continue the preferential tax rate of 0.138 percent that becomes effective on July 1, 2012.

Legislation Required: No.

Fiscal Impact: None. No change from status quo.

DAIRY PRODUCTS MANUFACTURERS B&O TAX EXEMPTION AND PREFERENTIAL RATE – SUMMARY

Current Law

This review includes two tax preferences for the dairy manufacturing industry:

1) A business and occupation (B&O) tax exemption for manufacturing dairy products or for selling dairy products at wholesale to purchasers that transport the products out of state in the ordinary course of business. The B&O tax exemption became effective July 1, 2006, and is set to expire on July 1, 2012.
2) A preferential B&O tax rate of 0.138 percent for the same dairy products and wholesaling activities that goes into effect when the B&O exemption (above) expires on July 1, 2012.

To qualify for the tax preferences, dairy products must be manufactured from raw milk or milk by-products. Products that qualify are processed milk, evaporated milk, cheese, yogurt, ice cream, or whey. Dairy products do not qualify if they are used as an ingredient or component of a manufactured product such as milk-based soups or pizza. Ordinarily, dairy products wholesalers that sell their products to instate purchasers owe the wholesaling B&O tax at the rate of 0.484 percent. Dairy products wholesalers are eligible for the tax preferences if they make wholesale sales that are delivered instate to purchasers that then transport the products out of state.

Beneficiaries of the B&O tax exemption must file an annual survey with the Department of Revenue by April 30 each year based on the previous year's activity. The survey is not required for beneficiaries of the preferential rate. The survey provides information on the number of employees; wages by wage bands; and medical, dental, and retirement benefits. The names of beneficiaries and the amount of tax exemption taken may be disclosed.

If the beneficiary fails to file a survey for a previous year, the Department may assess taxes and interest on the amount of exemption taken for the year.

See page A3-11 in Appendix 3 for the current statutes, RCWs 82.04.4268 and 82.04.260(1)(c).

Legal History and Public Policy Objectives

The Legislature has provided preferential B&O tax rates to manufacturers of several fresh food products over the years. Manufacturers of flour received the first preferential B&O rate in 1949, followed by seafood processors in 1959, fresh fruit and vegetable products manufacturers in 1965, processors of dried peas and perishable meat products in 1967, and dairy product manufacturers in 2001. (The tax preferences for seafood and fruit and vegetable products manufacturers are reviewed in separate sections of the report. JLARC reviewed the preference for manufacturers of flour in 2009, and is scheduled to review the other preferences in future years.)

Pre-2001 Manufacturers of dairy products paid the general manufacturing B&O tax rate of 0.484 percent.

2001 The Legislature enacted a preferential B&O rate of 0.138 percent for manufacturing dairy products. Additionally, the exemption applied to wholesalers that sold dairy products to purchasers that transported the goods out of state.

2005 The Legislature changed the preferential B&O tax rate for manufacturers and certain wholesalers of fresh fruits and vegetables products to an exemption effective July 1, 2005. The preferential tax rate for dairy manufacturers remained at 0.138 percent.

2006 The Legislature allowed manufacturers and certain wholesalers of dairy products the same exemption as fruits and vegetables manufacturers, but set the exemptions to expire on July 1, 2012. At that time, dairy, seafood, and fruits and vegetables product manufacturers will pay a preferential tax rate of 0.138 percent, the same rate provided to other fresh food processors.

The implied public policy objectives of the dairy processors' B&O tax preferences are:

4) To create and retain quality jobs;
5) To provide temporary relief through an exemption; and
6) To provide tax treatment consistent with other fresh food processors.

Beneficiaries

The beneficiaries are the 11 dairy products manufacturers that took the tax exemption between 2006 and 2008. Of these firms, three have closed and one was acquired by ConAgra Foods. Darigold received 73 percent of the tax savings.

Revenue Impacts

Beneficiaries of the B&O tax exemption saved $1.5 million in Calendar Year 2008. On July 1, 2012, the tax exemption expires and is replaced by the preferential B&O tax rate. Beneficiaries are estimated to save $1.4 million in Calendar Year 2013, a full year under the preferential rate.

Recommendations

Recommendation 1

Although the implied policy objective of creating and retaining quality jobs is being partially achieved, the Legislature should allow the B&O tax exemption for dairy processors to expire on July 1, 2012, because the B&O tax exemption was intended to be temporary.

Recommendation 2

To achieve the public policy objective of providing consistent tax treatment to fresh food processors, the Legislature should continue the preferential tax rate of 0.138 percent that becomes effective on July 1, 2012.

Legislation Required: No.

Fiscal Impact: None. No change from status quo.

DAIRY PRODUCTS MANUFACTURERS B&O TAX EXEMPTION AND PREFERENTIAL RATE – REPORT DETAIL

Current Law

This review includes two tax preferences for the dairy manufacturing industry:

1) A business and occupation (B&O) tax exemption for manufacturing dairy products or for selling dairy products at wholesale to purchasers that transport the products out of state in the ordinary course of business. The B&O tax exemption became effective July 1, 2006, and is set to expire on July 1, 2012.
2) A preferential B&O tax rate of 0.138 percent for the same dairy products manufacturing and wholesaling activities that goes into effect when the B&O exemption (above) expires on July 1, 2012.

To qualify for the tax preferences, dairy products must be manufactured from raw milk or milk by-products. Products that qualify are processed milk, evaporated milk, cheese, yogurt, ice cream, or whey. Dairy products do not qualify if they are used as an ingredient or component of a manufactured product such as milk-based soups or pizza. Ordinarily, dairy products wholesalers that sell their products to instate purchasers owe the wholesaling B&O tax at the rate of 0.484 percent. Dairy products wholesalers are eligible for the tax preferences if they make wholesale sales that are delivered instate to purchasers that then transport the products out of state.

Beneficiaries of the B&O tax exemption must file an annual survey with the Department of Revenue by April 30 each year based on the previous year's activity. The survey is not required for beneficiaries of the preferential rate. The survey provides information on the number of employees; wages by wage bands; and medical, dental, and retirement benefits. The names of beneficiaries and the amount of tax exemption taken may be disclosed.

If the beneficiary fails to file a survey for a previous year, the Department may assess taxes and interest on the amount of exemption taken for the year.

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Legal History

The Legislature has provided preferential B&O tax rates to manufacturers of several fresh food products over the years. Manufacturers of flour received the first preferential B&O rate in 1949, followed by seafood processors in 1959, fresh fruit and vegetable products manufacturers in 1965, processors of dried peas and perishable meat products in 1967, and dairy product manufacturers in 2001. (The tax preferences for seafood and fruit and vegetable products manufacturers are reviewed in separate sections of the report. JLARC reviewed the preference for manufacturers of flour in 2009, and is scheduled to review the other preferences in future years.)

Pre-2001 Manufacturers of dairy products paid the general manufacturing B&O tax rate of 0.484 percent.

2001 The Legislature enacted a preferential B&O tax rate of 0.138 percent for manufacturing dairy products. Additionally, the exemption applied to wholesalers that sold dairy products to purchasers that transported the goods out of state.

2005 The Legislature changed the preferential B&O rate for manufacturers and certain wholesalers of fresh fruits and vegetables products to an exemption effective July 1, 2005. The preferential rate for dairy manufacturers remained at 0.138 percent.

2006 The Legislature allowed manufacturers and certain wholesalers of dairy products the same exemption as fresh fruit and vegetable, and seafood processors, but set all of the exemptions to expire on July 1, 2012. At that time, dairy, seafood, and fruits and vegetables product manufacturers will pay a preferential tax rate of 0.138 percent, the same rate provided to other fresh food processors.

Other Relevant Background

The first dairy herds came to Washington in 1838. The Washington State Dairy Federation formed in 1892, and the first creamery cooperatives began operations in 1898. The following year, the Carnation Company began to make evaporated milk from a factory in Kent. Darigold, the state's largest manufacturer of dairy products, began in 1918 as a cooperative and now operates six plants in Washington.

In recent years, the grocery industry has consolidated and put pressure on dairy processor costs. In response, the dairy products manufacturing industry has also consolidated to cut costs and remain competitive. The U.S. Department of Agriculture listed 50 dairy processing plants in Washington in 1970, and now lists 10. The number of local independent dairy processors has decreased as larger operations have expanded—for example, ConAgra Foods, one of the nation's largest food products manufacturers, acquired Watts Brothers Dairy in Benton County in 2008.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

The public policy objectives of the dairy processors' B&O tax preferences are:

1) To create and retain quality jobs;
2) To provide temporary relief through an exemption; and
3) To provide tax treatment consistent with other fresh food processors.

To create and retain quality jobs

Although not specifically stated, the public policy objective to create and retain quality jobs can be implied from the type and purpose of information the Legislature required in statute.

Type of information

The Legislature required beneficiaries of the exemption to report in an annual survey on the number of full-time, part-time and temporary employees; the number of employees by wage bands; and medical, dental, and retirement benefits offered to employees. The Legislature permitted DOR to ask additional survey questions "necessary to measure the results of the exemption program." This indicates that the Legislature was interested in factors beyond just the number of jobs created.

Purpose of Information

The Legislature wanted to be able to compare the performance of various tax incentives. The statutory language states the purpose of the annual survey is to assist the Legislature in evaluating how a tax incentive is used in order "to make policy choices regarding the best use of limited state resources." This language is the same for all tax incentives requiring beneficiaries to file annual surveys.

In the 2006 legislation, the Legislature directed DOR to study the effect of the dairy products manufacturing exemption on job creation, job retention, company growth, and other factors. In 2010, the Legislature removed the study language when it repealed duplicate studies for tax preferences that were also being reviewed by JLARC (SHB 3066). However, it can be inferred that the original purpose of this exemption is to create new employment opportunities and to retain existing employment.

To provide temporary relief through an exemption

The Legislature established the B&O tax exemption for dairy processors as a temporary exemption in 2006. In 2010, the Legislature amended the law dealing with fresh food processors, but left intact the provision that allows the exemption to expire, to be replaced by a preferential tax rate on July 1, 2012 (2ESSB 6143). This indicates that the Legislature still intends the exemption to be temporary and the preferential tax rate to replace the exemption when it expires.

To provide tax treatment consistent with other fresh food processors

An express public policy objective is to treat dairy processors consistently with other fresh food processors. This is reflected in parallel legislative actions for fruits, vegetables, dairy, and seafood processors. Beginning July 1, 2012, fresh food processors including dairy processors will pay the same preferential B&O tax rate of 0.138 percent.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

The public policy objective of the exemption to create and retain quality jobs is being partially achieved. When the exemption expires on July 1, 2012, the public policy objective of providing temporary tax relief to dairy processors will have been achieved. The exemption will be replaced by the preferential B&O tax rate of 0.138 percent, achieving the objective for consistent tax treatment with other fresh food processors.

Partially achieving objective of quality jobs

The dairy processors' exemption is partially fulfilling objectives for creating quality jobs. JLARC measured achievement of this objective by comparing beneficiaries of the dairy processors' B&O tax exemption to beneficiaries of five other B&O tax incentives for which annual surveys are required. JLARC compared incentive programs in six ways:

1) The percentage of beneficiaries reporting new jobs in the year they claimed an incentive;
2) The amount of incentive claimed for each new job created (cost per job);
3) The percentage of employees by earning $30,000 or more a year;
4) The percentage of part-time and temporary employees working for beneficiaries;
5) The percentage of employees receiving health and retirement benefits; and
6) Trends in dairy processing employment to determine if jobs are being retained.

Not all beneficiaries of these B&O tax incentives created new jobs in the year they claimed the incentive. Of the 11 dairy processors that claimed the exemption in 2008, five reported creating jobs. (See Exhibit 30.)

Exhibit 30 – 5 out of 11 Dairy Processors Created Jobs in 2008

Incentive Program	Number of Firms Creating Jobs	Total Number of Firms	Percent of Firms Creating Jobs
High Technology	249	485	51%
Timber & Wood Products	32	258	12%
Customized Training	3	7	43%
Fruit & Vegetable Processors	33	104	32%
Seafood Processors	3	16	19%
Dairy Processors	5	11	45%

Source: DOR Annual Surveys, 2008; 2 years are shown for customized training due to disclosure issues.

The amount of incentive claimed per each new job created is $11,914 for dairy processors. This cost per job is low in relation to some other incentive programs. (See Exhibit 31.)

Exhibit 31 – Cost per New Job is Lower for Dairy Processing Than Some Tax Incentive Programs in 2008

Incentive Program	Dollars of Tax Incentive Taken	Number of New Jobs	Cost per Job
High Technology	$22,192,077	3,991	$5,561
Timber & Wood Products	$14,034,043	149	$94,207
Customized Training	$52,993	6	$9,110
Fruit & Vegetable Processors	$5,004,981	463	$10,821
Seafood Processors	$3,290,786	51	$64,530
Dairy Processors	$1,633,703	137	$11,914

Source: DOR Annual Surveys, 2008; 2 years are shown for customized training due to disclosure issues.

Beneficiaries report the number of employees by three wage bands: 1) less than $30,000, 2) $30,000 to $60,000, and 3) $60,000 or greater. Dairy processors paid 86 percent of their employees $30,000 or more, comparing favorably to other incentive programs. (See Exhibit 32.)

Exhibit 32 – Dairy Processors had a Higher Percentage of High-Wage Employees Than Beneficiaries of Other Tax Incentives in 2008

Tax Incentive Program	Total Employment	Number Earning $30,000 or More	Percent Earning $30,000 or More
High Technology	102,075	97,392	95%
Timber & Wood Products	19,965	17,201	86%
Customized Training	1,377	713	52%
Fruit & Vegetable Processors	12,559	4,644	37%
Seafood Processors	2,714	1,519	56%
Dairy Processors	1,561	1,346	86%

Source: DOR Annual Surveys, 2008.

Dairy processors employed a higher percentage of full-time employees (95 percent of all employees) than beneficiaries of most of the other five incentive programs. (See Exhibit 33.)

Exhibit 33 – Dairy Processors Employed A Higher Percentage of Full-Time Workers Than Most Beneficiaries of Other Tax Incentives in 2008

Tax Incentive Program	Percent Full-Time	Percent Part-Time	Percent Temporary
High Technology	83%	2%	15%
Timber & Wood Products	98%	2%	0%
Customized Training	95%	3%	2%
Fruit & Vegetable Processors	78%	15%	8%
Seafood Processors	55%	6%	39%
Dairy Processors	95%	3%	2%

Source: DOR Annual Surveys, 2008.

The Legislature required beneficiaries of tax incentive programs to report the number of employees receiving medical, dental, and retirement benefits. Dairy processors provided coverage to a higher percentage of employees than beneficiaries of other tax incentive programs. (See Exhibit 34.)

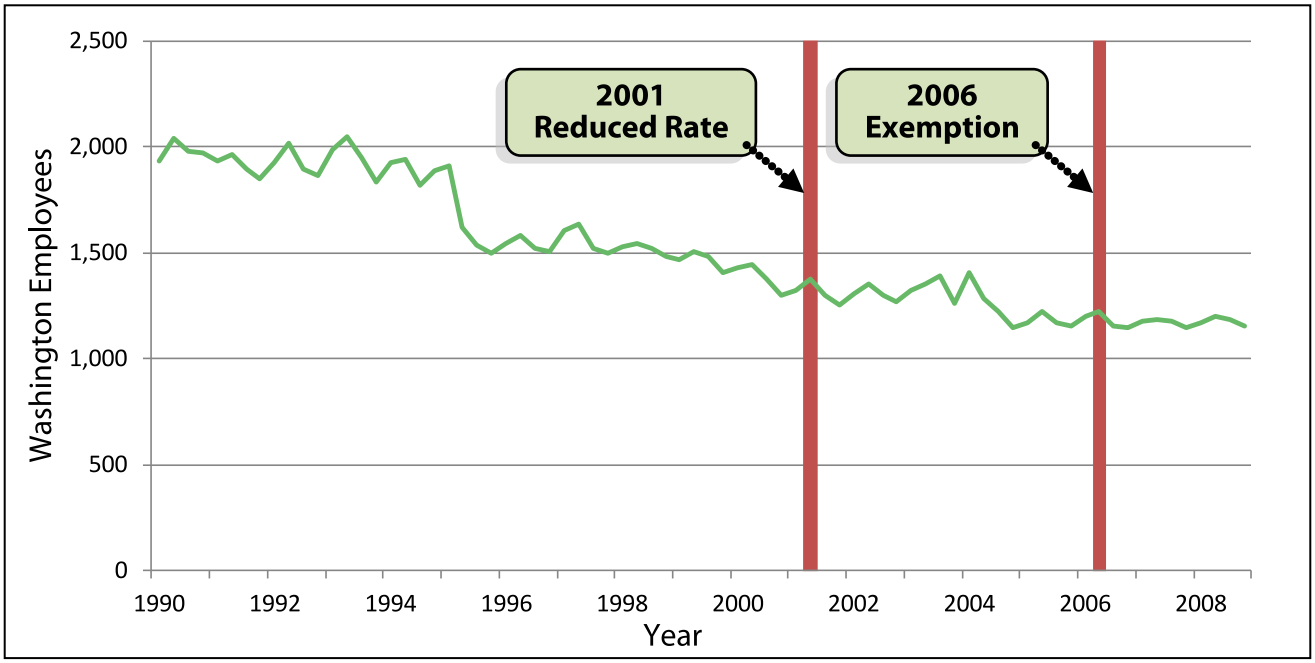
Exhibit 34 – Dairy Processors Provided More Benefit Coverage Than Beneficiaries of Other Tax Incentives in 2008

Tax Incentive Program	Medical	Dental	Retirement
High Technology	81%	80%	71%
Timber & Wood Products	82%	79%	79%
Customized Training	77%	76%	55%
Fruit & Vegetable Processors	56%	54%	51%
Seafood Processors	61%	61%	33%
Dairy Processors	88%	79%	81%

Source: DOR Annual Surveys, 2008.

There is no available data to determine if the beneficiaries of the dairy processing exemption have retained existing jobs. For the industry as a whole, employment has remained stable since 2005. (See Exhibit 35 on the following page.)

Exhibit 35 – Dairy Processing Employment has Stabilized



Source: U.S. Bureau of Labor Statistics, Local Employment Dynamics.

Dairy processors received temporary relief through the exemption

The Legislature's actions indicate the exemption was intended to be temporary. When this exemption expires in 2012, beneficiaries will have received six years of exemption from the B&O tax, and will have saved an estimated $8.9 million.

Tax treatment consistent with other fresh food processors

Fresh food processors have not always received the same tax treatment. The Legislature granted preferential tax rates to food processors one sector at a time over a period of years beginning in 1949. However, on July 1, 2012, several fresh food processors will pay the same preferential B&O tax rate of 0.138 percent. Fresh food processors receiving this preferential rate are manufacturers of flour and oil, processors of dried peas, processors of meat, manufacturers of dairy products, manufacturers of fruits and vegetables products, and manufacturers of seafood products.

Wholesalers of fresh food products do not all benefit from the preferential rate, however. Only wholesalers of seafood, dairy, and fruit and vegetable products receive the lower 0.138 percent rate if they sell to purchasers that transport the goods out of state. Other wholesalers that deliver their products instate pay the general wholesaling rate of 0.484 percent.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

The beneficiaries are the 11 dairy products manufacturers that took the tax exemption between 2006 and 2008. Of these firms, three have closed and one was acquired by ConAgra Foods. Darigold received 73 percent of the tax savings. (See Exhibit 36 on the following page.)

Exhibit 36 – Beneficiaries of Dairy Processors' B&O Tax Exemption—2006-2008

Beneficiary	B&O Tax Exemption	Percent of Total	Taxpayer Status as of 2010
Darigold Inc	$2,323,135	73%	Open
Wilcox Dairy Farms LLC	$358,035	11%	Closed dairy operation
Safeway Inc	$143,882	5%	Open
Pleasant Valley Dairy	$107,879	3%	Open
Watts Brothers Dairy LLC	$66,365	2%	Acquired by ConAgra
Andersen Dairy Inc	$51,985	2%	Open
Mt Townsend Creamery	$48,331	2%	Open
Grace Harbor Farms Inc	$46,222	1%	Closed
Inland Northwest Dairies LLC	$31,443	1%	Closed
Country Morning Farms Inc	$11,940	0%	Open
Smith Brothers Farms Inc	$817	0%	Open

Source: DOR Annual Surveys.

Revenue 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?

Beneficiaries of the B&O tax exemption saved $1.5 million in Calendar Year 2008. On July 1, 2012, the tax exemption expires and is replaced by the preferential B&O tax rate. Beneficiaries are estimated to save $1.4 million in Calendar Year 2013, a full year under the preferential rate. (See Exhibit 37.)

Exhibit 37 – Taxpayer Savings for Dairy Manufacturers & Wholesalers

Calendar Year	Tax Treatment	B&O Tax Exemption	Preferential B&O Tax Rate
2008	Exemption in effect	$1,500,000	Not Applicable
2009	Exemption in effect	$1,500,000	Not Applicable
2010	Exemption in effect	$1,500,000	Not Applicable
2011	Exemption in effect	$1,700,000	Not Applicable
2012	Preferential rate at 0.138% begins July 1, 2012	$1,000,000	$500,000
2013	Full year of tax at preferential 0.138% rate	Not Applicable	$1,400,000

Source: DOR Annual Surveys. Growth in tax savings is based on the Economic & Revenue Forecast Council.

The tax savings due to the exemption are calculated based on the general manufacturing and wholesaling rate of 0.484 percent. The tax savings due to the preferential tax rate are based on the difference between the general 0.484 percent rate and the preferential 0.138 percent rate.

Recommendations

Recommendation 1

Although the implied policy objective of creating and retaining quality jobs is being partially achieved, the Legislature should allow the B&O tax exemption for dairy processors to expire on July 1, 2012, because the B&O tax exemption was intended to be temporary.

Recommendation 2

Because the implied public policy objective of providing consistent tax treatment to fresh food processors will be achieved on July 1, 2012, the Legislature should continue the preferential tax rate of 0.138 percent.

Legislation Required:	No.
Fiscal Impact:	None—No change from status quo.

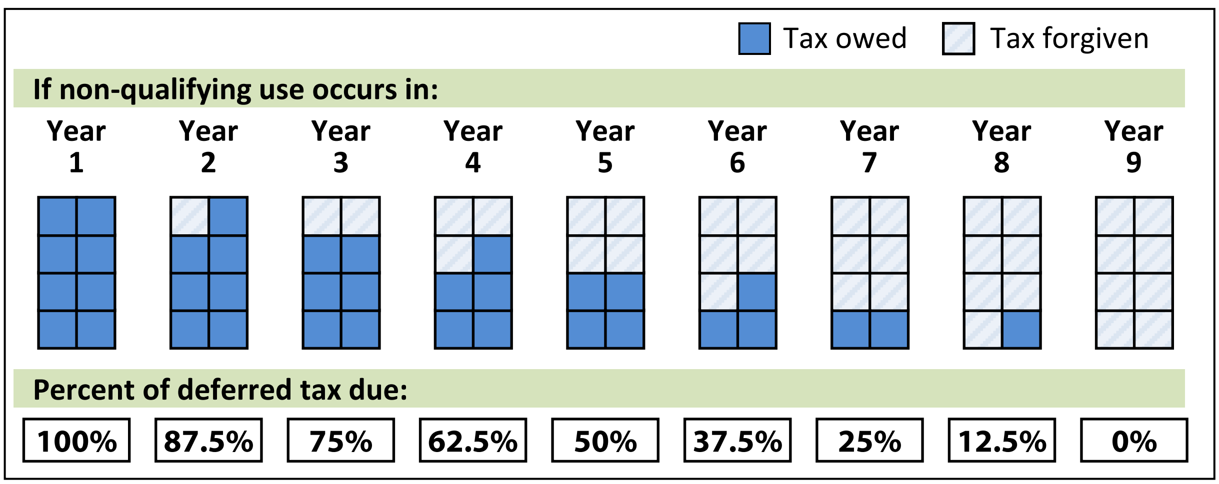
Fresh Food Processors Sales & Use Tax Deferral/Waiver – Summary

Current Law

This tax preference provides a deferral and eventual waiver of state and local retail sales and use taxes on investment in structures, machinery, and equipment for fresh fruits and vegetables, dairy, and seafood products processing, cold storage warehousing, and related research and development. A lessor is eligible for the deferral if the benefit of the deferral is passed on to the lessee.

Application for the deferral must be made to the Department of Revenue (DOR) before initiation of construction or purchase of machinery and equipment. Upon approval, DOR grants a certificate that allows owners to make qualifying purchases and defer the tax payment. The deferred tax is forgiven in one-eighth portions over eight years, beginning in the year DOR determines that the project is operationally complete. If the investment project is used for non-qualifying purposes, the remaining portion of the deferred tax is due. After eight years of eligible use, the sales and use taxes are completely forgiven. (See Exhibit 38.)

Exhibit 38 – Deferred Tax Paid Back if Project Used for Non-Qualifying Purpose



Source: JLARC analysis of statute.

Beneficiaries must file a survey with DOR by April 30 every year for eight years. The survey contains information on total employment, the number of new jobs created, wages, and health and retirement benefits. The survey information is confidential except for the name of the beneficiary and the amount of the deferral. If the beneficiary fails to file an annual survey, one-eighth of the deferred taxes are due plus interest.

Fresh food processors are eligible for investment projects used for:

- Manufacturing fruit or vegetable products by canning, preserving, freezing, processing, or dehydrating;

- Manufacturing seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing process;
- Processing milk and cream, and making cheeses and related cheese products, frozen desserts, and by-products such as whey and casein;
- Cold storage warehouses used to store fresh or frozen perishable fruits, vegetables, dairy, or seafood products; and
- Before commercial sales of the products begin, research and development related to fresh fruits, vegetables, dairy, and seafood product manufacturing, and cold storage warehousing.

See page A3-14 in Appendix 3 for the current statute, Chapter 82.74 RCW.

Legal History and Public Policy Objectives

Washington fresh food processors have expressed concerns about their competitive position for many years. The Legislature responded to these concerns with a number of different tax preferences, including the current sales and use tax deferral on structures and equipment. Before enactment of these tax preferences, fresh food processors paid sales and use taxes on machinery, equipment, construction materials, and related labor and services.

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. The new sales and use tax laws applied to sales of construction materials and equipment, but not to labor and services performed to real and personal property.

1939 The Legislature expanded the sales and use tax base to cover services performed on tangible personal property. Fresh food processors became liable for sales and use taxes on “the installing, cleaning, decorating, beautifying, repairing or otherwise altering or improving” tangible personal property such as machinery and equipment.

1941 The Legislature imposed retail sales tax on services performed on real property. Fresh food processors now owed sales taxes on labor and services related to constructing facilities.

1963 A study conducted by the Washington Department of Commerce and Economic Development and the State Tax Commission found that taxes related to constructing new food processing plants and to purchasing machinery and equipment were higher in Washington than in competitor states (Oregon, California, Idaho, and Arizona).[13]

The Legislature subsequently reduced business and occupation (B&O) tax rates for fruit and vegetable processors in the 1965 Legislative Session. Seafood processors had already received a reduced rate in 1959. Dairy processors received a rate reduction in 2001. (These three B&O tax preferences for fresh food processors are reviewed in separate sections of this report.)

[13] Industrial Tax Loads in Washington and Competing States; A Four Industry Tax Cost Comparison, Department of Commerce and Economic Development and the Washington State Tax Commission, 1963.

2005 The Legislature enacted this sales and use tax deferral for processors of fresh fruits and vegetables, for cold storage warehouses, and for research and development related to such products. The tax preference became effective July 1, 2007, and was set to expire on July 1, 2012.

2006 The Legislature provided the same sales and use tax deferral for processors of dairy and seafood products. The tax preference for these processors was also set to expire on July 1, 2012.

The implied public policy objective is to encourage investment in Washington's fresh food processing industry in order to retain and create jobs.

Beneficiaries

The beneficiaries of the tax preference are the six businesses that claimed the deferral for food processors' sales and use tax during the two years for which data is available. These businesses have added 31 new jobs, according to survey data. Most of the project applications and 90 percent of the taxes deferred are for cold storage warehouses. No seafood processors have claimed the deferral. More fresh food processors may become beneficiaries of this deferral after July 1, 2010, when a similar deferral for rural manufacturers is replaced by a more restricted version.

Revenue Impacts

Beneficiaries of the fresh food processors deferral saved $1.1 million in Calendar Year 2008.

JLARC's analysis assumes that a number of fresh food processors that had been eligible for a similar expiring deferral will apply for this deferral beginning July 1, 2010. As a result, taxpayer savings are expected to grow to $3.8 million in 2011. Applications for this deferral will not be granted after July 1, 2012. Projects take an average of five months from start to finish. Therefore, taxpayers could continue to make tax-free purchases for the full Calendar Year 2012.

Recommendation

Because the amount of investment in plant and equipment and the number of new jobs are less than expected by the public policy objective, the Legislature should allow the fresh food processors deferral to expire on July 1, 2012.

Legislation Required:	No.
Fiscal Impact:	None – no change from status quo.

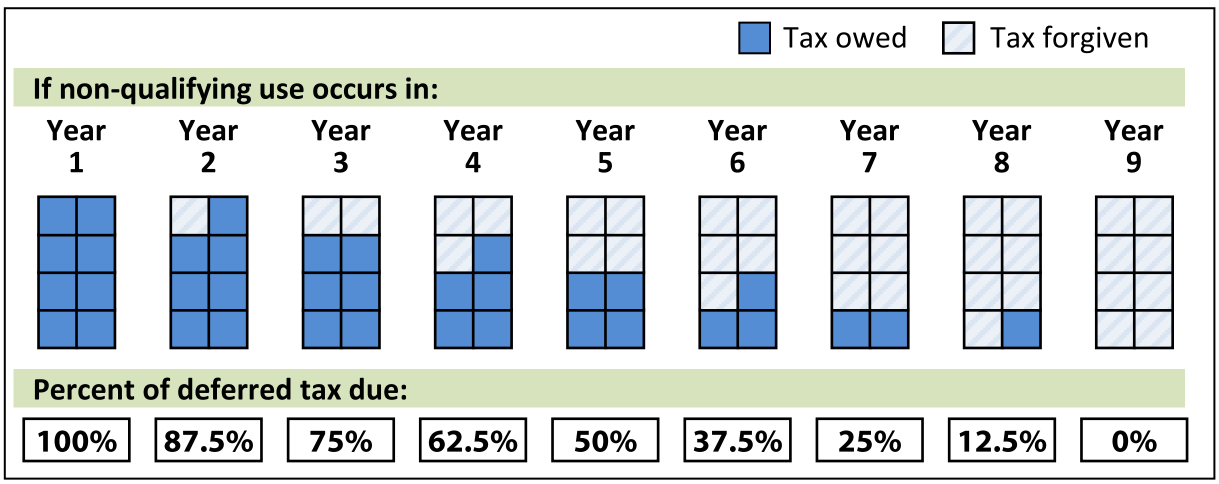
FRESH FOOD PROCESSORS SALES & USE TAX DEFERRAL/WAIVER – REPORT DETAIL

Current Law

This tax preference provides a deferral and eventual waiver of state and local retail sales and use taxes on investment in structures, machinery, and equipment for fresh fruits and vegetables, dairy, and seafood products processing, cold storage warehousing, and related research and development. A lessor is eligible for the deferral if the benefit of the deferral is passed on to the lessee.

Application for the deferral must be made to the Department of Revenue (DOR) before initiation construction or purchase of machinery and equipment. Upon approval, DOR grants a certificate that allows owners to make qualifying purchases and defer the tax payment. The deferred tax is forgiven in one-eighth portions over eight years beginning in the year DOR determines that the project is operationally complete. If the investment project is used for non-qualifying purposes, the remaining portion of the deferred tax is due. After eight years of eligible use, the sales and use taxes are completely forgiven. (See Exhibit 39.)

Exhibit 39 – Deferred Tax Paid Back if Project Used for Non-Qualifying Purpose



Source: JLARC analysis of statute.

Beneficiaries must file a survey with DOR by April 30 every year for eight years. The survey contains information on total employment, the number of new jobs created, wages, and health and retirement benefits. The survey information is confidential except for the name of the beneficiary and the amount of the deferral. If the beneficiary fails to file an annual survey, one-eighth of the deferred taxes are due plus interest.

Fresh food processors are eligible for investment projects used for:

- Manufacturing fruit or vegetable products by canning, preserving, freezing, processing, or dehydrating;

- Manufacturing seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing process;
- Processing milk and cream, and making cheeses and related cheese products, frozen desserts, and by-products such as whey and casein;
- Cold storage warehouses used to store fresh or frozen perishable fruits, vegetables, dairy, or seafood products; and
- Before commercial sales of the products begin, research and development related to fresh fruits, vegetables, dairy, and seafood product manufacturing, and cold storage warehousing.

See page A3-14 in Appendix 3 for the current statute, Chapter 82.74 RCW.

Legal History

The competitive position of Washington fresh food processors has been a concern for many years. The Legislature responded to this concern with a number of different tax preferences including the current sales and use tax deferral on structures and equipment. Before enactment of the tax preference, fresh food processors paid sales and use taxes on machinery, equipment, construction materials, and related labor and services.

1935 Faced with a significant revenue shortfall, the Legislature passed the Revenue Act of 1935, establishing much of the current state tax structure. As part of the act, the Legislature created the retail sales tax and the companion use tax. The new sales and use tax laws applied to sales of construction materials and equipment, but not to labor and services performed to real and personal property.

1939 The Legislature expanded the sales and use tax base to cover services performed on tangible personal property. Fresh food processors became liable for sales and use taxes on "the installing, cleaning, decorating, beautifying, repairing or otherwise altering or improving" tangible personal property such as machinery and equipment.

1941 The Legislature imposed retail sales tax on services performed on real property. Fresh food processors now owed sales taxes on labor and services related to constructing facilities.

1963 A study conducted by the Washington Department of Commerce and Economic Development and the State Tax Commission found that taxes related to constructing new food processing plants and equipment were higher in Washington than in competitor states (Oregon, California, Idaho, and Arizona).

The Legislature subsequently reduced business and occupation (B&O) tax rates for fruit and vegetable processors in the 1965 Legislative Session. Seafood processors had already received a reduced rate in 1959. Dairy processors received a rate reduction in 2001. (These three B&O tax preferences for fresh food processors are reviewed in separate sections of this report.)

2005 The Legislature enacted this sales and use tax deferral for processors of fresh fruits and vegetables, for cold storage warehouses, and for research and development related to such products. The tax preference became effective July 1, 2007, and was set to expire on July 1, 2012.

2006 The Legislature provided the same sales and use tax deferral for processors of dairy and seafood products. The tax preference for these processors was also set to expire on July 1, 2012.

Other Relevant Background

Washington's Fresh Food Processing Industry

Manufacturing of Washington's fresh fruits, vegetables, milk, and seafood began early in Washington's history. The first salmon processing plant on the Columbia River began operations in Wahkiakum County in 1866. In the 1910s, apple growers began to sell their blemished fruit to Puget Sound processors rather than dump the fruit into rivers and ravines. The Washington State Dairy Federation formed in 1892, and the first creamery cooperatives began operations in 1898. The following year, founders of the Carnation Company began to make evaporated milk from a factory in Kent.

More recently, foreign competition and consolidation in the grocery industry have put pressure on processor costs.

A number of plant closures in more recent years have resulted in loss of jobs in fresh fruit processing. AgriFrozen Foods closed plants in Walla Walla and Grandview (2001), and the Ocean Spray bottling plant closed in Grays Harbor (1997). In the year the Legislature enacted the first part of this tax preference (2005), Seneca closed its asparagus plant in Dayton, with a loss of 1,000 seasonal jobs. In March 2010, ConAgra announced layoffs of 250 employees at its Prosser plant.

Fresh Food Processors Benefit from Other Sales and Use Tax Preferences

Fresh food processors qualify for other sales and use tax incentives with similar benefits. These include the rural county manufacturers' deferral, the warehouse and cold storage remittance, and the manufacturers' machinery and equipment exemption. Exhibit 40 shows the characteristics of the tax preference subject to this review and these other similar tax incentive programs.

Exhibit 40 – Food Processors Qualify for Other Sales & Use Tax Incentives with Similar Benefits

				Sales and Use Tax Incentives Apply to:			
	RCW	**Expir. Date**	**Qualif. Locations**	**New Structures**	**Expansion of Structures**	**R&D Facilities**	**Manuf. Machinery, Equipment, Labor & Services**
Current Review							
Food Processing & Cold Storage Deferral	Chapter 82.74 RCW	7/1/2012	Statewide	Yes	Yes	Yes	Yes
Other Similar Preferences							
Warehouse & Cold Storage Remittance	82.08.820 82.12.820	None	Statewide	Cold storage, if at least 25,000 sq ft	Yes, if at least 25,000 sq ft	No	Racking, handling equipment only
Distressed County Manuf. Deferral	Chapter 82.60 RCW amended by ESHB 3014 (2010)	7/1/2020	Distressed Counties & CEZs*	Yes	Yes	Yes	Yes
Manuf. Machinery & Equipment Exemption	82.08.02565 82.12.02565	None	Statewide	No	No	No	Yes

* Community Empowerment Zones. Five counties contain designated CEZs—King, Pierce, Kitsap, Spokane, and Yakima.
Source: JLARC analysis of statute.

Recent Law Change Impacts Fresh Food Processors

Many fresh food processors have been taking a similar deferral available to manufacturers located in one of 32 rural counties or counties containing a community empowerment zone (CEZ) (Chapter 82.60 RCW). The 2010 Legislature passed ESHB 3014 which restricted the deferral to manufacturers located in distressed counties or within a community empowerment zone. With this change, the preference is now only available in 13 counties and within CEZs.

Fresh food processors located outside of a distressed county or a CEZ no longer have a choice of deferral programs after July 1, 2010. To receive tax benefits, they must apply for a deferral under the fresh food processors' deferral/waiver program (Chapter 82.74 RCW). Of the 21 fresh food processors currently taking the rural deferral, 26 would not qualify if they had applied after July 1, 2010.

While food processors will continue to be eligible for tax advantages, some will likely shift to using different preferences. The net effect of this will likely be an increase in beneficiaries to the preference in this JLARC review. However, there should be no net change for the industry.

Public Policy Objectives

What are the public policy objectives that provide a justification for the tax preference? Is the purpose or intent of the tax preference clear?

While there is no explicit intent statement in law for this tax preference, the implied public policy objective is to encourage investment in Washington's fresh food processing industry in order to retain and create jobs.

In the 2005 legislation, the Legislature directed DOR to study the effect of the food processors' deferral on job creation, job retention, company growth, and other factors. In 2010, the Legislature removed the study language when it repealed duplicate studies for tax preferences that were also being reviewed by JLARC (SHB 3066). However, it can be inferred that the original purpose of this exemption is to create new employment opportunities and to retain existing employment.

In testimony before the Legislature during consideration of the tax preference, advocates stated Washington fresh food processors found it difficult to remain competitive and needed tax relief in order to maintain "basic manufacturing jobs" in this state.

The Legislature clearly stated the public policy objective of other sales and use tax deferrals such as the high technology, the rural county manufacturers' deferrals, and the biotechnology and medical device manufacturers' deferral. For these deferrals, the Legislature intended to create new employment opportunities in the state.

Is there any readily available evidence related to the achievement of any of these public policy objectives?

Evidence for evaluating the tax preference is available in applications and annual surveys filed with DOR by beneficiaries. Beneficiaries of this tax deferral must submit an application for deferral with the estimated project costs and the estimated number of new jobs to be created. Each year they must report on the number of new jobs created and the amount of tax deferral claimed.

The number of jobs and the level of participation are less than anticipated. In addition, the amount of taxes deferred per job is greater than for other tax deferral programs.

Amount of investment and number of jobs less than expected

Fiscal notes available to the Legislature at the time of passage in 2005 and 2006 anticipated a much higher level of investment than what actually took place. The fiscal notes, adjusted to match time periods for the applications and surveys, estimated that $13.7 million in deferral amount would be taken in the first 18 months of the program. Instead, beneficiaries reported $1.3 million in the amount of deferral taken for the same time period. Beneficiaries estimated in applications for deferred tax that 91 jobs would be created, but instead reported 31 new jobs once projects were complete. (See Exhibit 41).

Exhibit 41 – Amount of Deferral and Number of Jobs Are Less than Expected for 2007 and 2008

	Expected	Actual
Amount of Deferral	$13.7 million	$1.3 million
Number of New Jobs	91	21

Source: JLARC analysis of fiscal notes on ESHB 2221 (2005) and EHB 3159 (2006); DOR deferral applications and annual surveys.

Cost per job more than other deferral programs

The Legislature wanted to be able to compare the performance of various tax incentives. The statutory language states the purpose of the annual survey for the deferral is to assist the Legislature in evaluating how a tax incentive is used in order "to make policy choices regarding the best use of limited state resources."

In similar high technology, biotechnology and medical device deferral statutes, the Legislature expressed concern that the programs be targeted to provide the "greatest possible return on the state's investment." A convenient way to measure return on investment is to calculate ratio of investment per job created (cost per job). The amount of deferral taken for each new job is higher for the fresh food processors' deferral than for the other deferral programs.

Exhibit 42 – Cost per Job is Higher for Food Processors Deferral Than Other Deferral Programs in 2007 and 2008

Deferral Program	Amount of Deferral Taken	Number of New Jobs	Cost per Job
High Technology	$245,984,985	22,930	$10,728
Rural Manufacturers	$127,613,661	5,832	$21,881
Biotechnology & Medical Device	$1,802,325	83	$21,816
Fresh Food Processors	$1,330,934	21	$63,378

Source: JLARC analysis of DOR annual surveys.

Beneficiaries

Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

The beneficiaries of the tax preference are the six businesses that claimed the deferral for food processors' sales and use tax during the two years for which data is available. These businesses have added 21 new jobs, according to survey data. Most of the project applications and 90 percent of the taxes deferred are for cold storage warehouses. No seafood processors have claimed the deferral. More fresh food processors may become beneficiaries of this deferral after July 1, 2010, when a similar deferral for rural manufacturers is replaced by a more restricted version. (See Exhibit 43 on the following page.)

Exhibit 43 – Beneficiaries of Food Processors Deferral in 2007 and 2008

Name	Deferral Amount	Industry
Kenyon Zero Storage Inc	$265,572	Cold Storage Warehousing
Valley Processing Inc	$57,152	Fruit & Vegetable Processing
Darigold Inc	$91,827	Dairy Processing
Price Cold Storage Inc	$280,511	Cold Storage Warehousing
Douglas Fruit Co Inc	$238,579	Cold Storage Warehousing
CPC International Apple Inc	$397,293	Cold Storage Warehousing

Source: Department of Revenue annual surveys.

Revenue 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?

Beneficiaries of the fresh food processors deferral saved $1.1 million in Calendar Year 2008.

JLARC's analysis assumes that a number of fresh food processors that had been eligible for a similar expiring deferral will apply for this deferral beginning July 1, 2010. As a result, taxpayer savings are expected to grow to $3.8 million in 2011. Applications for this deferral will not be granted after July 1, 2012. Projects take an average of five months from start to finish. Therefore, taxpayers could continue to make tax-free purchases for the full Calendar Year 2012. (See Exhibit 44.)

Exhibit 44 – Taxpayer Savings from Fresh Food Processors' Deferral

Calendar Year	State Sales & Use Tax	Local Sales & Use Tax	Total
2008	$834,888	$306,108	$1,140,997
2009	$465,273	$170,591	$635,864
2010	$1,442,802	$528,998	$1,971,800
2011	$2,795,154	$1,024,833	$3,819,987
2012	$2,784,237	$1,020,830	$3,805,067
2013	$0	$0	$0

Source: Department of Revenue Annual Surveys and the Economic and Revenue Forecast Council February 2010 forecast.

Recommendation

Because the amount of investment in plant and equipment and the number of new jobs are less than expected by the public policy objective, the Legislature should allow the fresh food processors deferral to expire on July 1, 2012.

Legislation Required: No.

Fiscal Impact: None – no change from status quo.

APPENDIX 1 – SCOPE AND OBJECTIVES

2010 EXPEDITED TAX PREFERENCE PERFORMANCE REVIEWS

SCOPE AND OBJECTIVES

OCTOBER 2009

STATE OF WASHINGTON
JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE

STUDY TEAM
Mary Welsh
Dana Lynn
Stacia Hollar
Peter Heineccius

PROJECT SUPERVISOR
Keenan Konopaski

LEGISLATIVE AUDITOR
Ruta Fanning

Joint Legislative Audit & Review Committee
1300 Quince St. SE
Olympia, WA 98504-0910
(360) 786-5171
(360) 786-5180 Fax

Website:
www.jlarc.leg.wa.gov
e-mail:
neff.barbara@leg.wa.gov

Why a JLARC Study of Tax Preferences?

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 580 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 has identified three categories of review, based on each tax preference's estimated biennial fiscal impact:

1. Full reviews (over $10 million)
2. Expedited reviews (between $2 million and $10 million)
3. Expedited light reviews (less than $2 million)

This document identifies the scope and objectives for the second category: expedited tax preference reviews. JLARC is to review tax preferences according to the schedule developed by the Commission, and consistent with guidelines set forth in statute. For the expedited tax preferences, 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 July 30, 2010. These tax preferences were recommended by the Citizen Commission as being subject to an expedited review process:

Brief Description	RCW Citation	Year Enacted
1. Poultry used in production	82.08.0267; 82.12.0262	1961
2. Farm machinery sold to nonresidents	82.08.0268	1961
3. Bailed tangible personal property for R&D	82.12.0265	1961

Expedited Study Scope (cont'd.)

Brief Description	RCW Citation	Year Enacted
4. Vehicles acquired while in military service	82.12.0266	1963
5. Sand & gravel for local road construction	82.08.0275; 82.12.0269	1965
6. Open space & park land	84.36.260	1967
7. Tax incentives for fruit/vegetable processors	82.04.4266; 82.04.260(1d)	2005
8. Manufacturing of certain seafood products	82.04.4269; 82.04.260(1b)	2006
9. Manufacturing of dairy products	82.04.4268; 82.04.260(1c)	2006

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 the purpose or intent of the tax preference clear?
2. Is there any readily available evidence related to the achievement of any of these public policy objectives?

Beneficiaries:

3. Who are the entities whose state and/or local tax liabilities are directly affected by the tax preference?

Revenue and Economic Impacts:

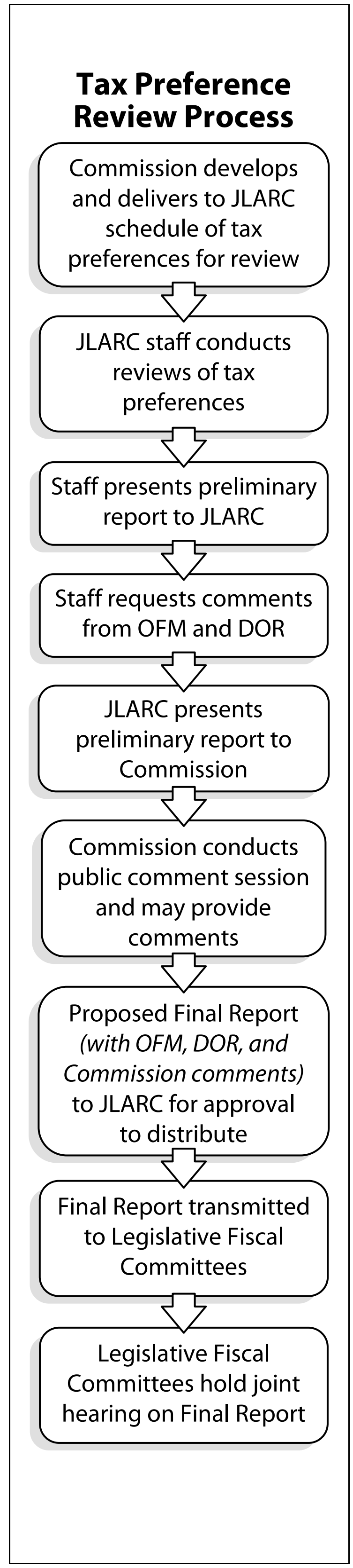
4. What are the past and future tax revenue impacts of the tax preference to the taxpayer and to the government if it is continued?

Timeframe for the Study

A preliminary audit report will be presented at the July 2010 JLARC meeting and at the August 2010 meeting of the Commission. A final report will be presented to JLARC in November 2010.

JLARC Staff Contacts for the Study

Mary Welsh	(360) 786-5193	welsh.mary@leg.wa.gov
Dana Lynn	(360) 786-5177	lynn.dana@leg.wa.gov
Stacia Hollar	(360) 786-5191	hollar.stacia@leg.wa.gov
Peter Heineccius	(360) 786-5123	heineccius.peter@leg.wa.gov



APPENDIX 2 – AGENCY RESPONSES

- Office of Financial Management and Department of Revenue

STATE OF WASHINGTON

August 25, 2010

TO: Ruta Fanning, Legislative Auditor
Joint Legislative Audit and Review Committee

FROM: Marty Brown, Director
Office of Financial Management

Cindi Holmstrom, Director
Department of Revenue

SUBJECT: JLARC PRELIMINARY REPORTS ON 2010 TAX PREFERENCE PERFORMANCE REVIEWS (FULL/EXPEDITED/EXPEDITEDLIGHT)

Thank you for the opportunity to review and comment on the Joint Legislative Audit and Review Committee's (JLARC's) 2010 Tax Preference Performance Reviews.

We appreciate JLARC's efforts and those of the Citizen Commission for Performance Measurement of Tax Preferences (Commission) to continuously review and analyze the state's numerous tax preferences. We believe it is important to systematically 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 also appreciate the opportunity to review the reports and JLARC's recommendations. We have no additional comments on the 2010 reports.

APPENDIX 3 – CURRENT LAW

Poultry Used to Produce Poultry and Poultry Products

RCW 82.08.0267

The tax levied by RCW 82.08.020 shall not apply to sales of poultry for use in the production for sale of poultry or poultry products.

[1980 c 37 § 34. Formerly RCW 82.08.030(16).]

Notes:

Intent -- **1980 c 37:** See note following RCW 82.04.4281.

RCW 82.12.0262

The provisions of this chapter shall not apply in respect to the use of poultry in the production for sale of poultry or poultry products.

[1980 c 37 § 61. Formerly RCW 82.12.030(11).]

Notes:

Intent -- **1980 c 37**: See note following RCW 82.04.4281.

Farm Machinery Sold to Nonresidents

RCW 82.08.0268

The tax levied by RCW 82.08.020 shall not apply to sales to nonresidents of this state for use outside of this state of:

(1) Machinery and implements for use in conducting a farming activity;

(2) Parts for machinery and implements for use in conducting a farming activity; and

(3) Labor and services for the repair of machinery, implements, and parts for use in conducting a farming activity,

when such machinery, implements, and parts will be transported immediately outside the state. As proof of exemption, an affidavit or certification in such form as the department of revenue shall require shall be retained as a business record of the seller.

[1998 c 167 § 1; 1980 c 37 § 35. Formerly RCW 82.08.030(17).]

Notes:

Intent -- 1980 c 37**: See note following RCW 82.04.4281.**

Bailed Tangible Personal Property Consumed in R & D, Experimental, and Testing

RCW 82.12.0265

The provisions of this chapter shall not apply in respect to the use by a bailee of any article of tangible personal property which is entirely consumed in the course of research, development, experimental and testing activities conducted by the user, provided the acquisition or use of such articles by the bailor was not subject to the taxes imposed by chapter 82.08 RCW or chapter 82.12 RCW.

[1980 c 37 § 32. Formerly RCW 82.08.030(14).]

Notes:

Intent -- **1980 c 37**: See note following RCW 82.04.4281.

Vehicles Acquired Out-of-State While in the Armed Services

RCW 82.12.0266

The provisions of this chapter shall not apply in respect to the use by residents of this state of motor vehicles and trailers acquired and used while such persons are members of the armed services and are stationed outside this state pursuant to military orders, but this exemption shall not apply to members of the armed services called to active duty for training purposes for periods of less than six months and shall not apply to the use of motor vehicles or trailers acquired less than thirty days prior to the discharge or release from active duty of any person from the armed services.

[1980 c 37 § 65. Formerly RCW 82.12.030(15).]

Notes:

Intent -- **1980 c 37:** See note following RCW 82.04.4281.

Labor and Services for Mining/Sorting/ Crushing Sand/Gravel/Rock for Public Road Purposes

RCW 82.08.0275

The tax levied by RCW 82.08.020 shall not apply to sales of, cost of, or charges made for labor and services performed in respect to the mining, sorting, crushing, screening, washing, hauling, and stockpiling of sand, gravel and rock when such sand, gravel, or rock is taken from a pit or quarry which is owned by or leased to a county or a city, and such sand, gravel, or rock is (1) either stockpiled in said pit or quarry for placement or is placed on the street, road, place, or highway of the county or city by the county or city itself, or (2) sold by the county or city to a county, or a city at actual cost for placement on a publicly owned street, road, place, or highway. The exemption provided for in this section shall not apply to sales of, cost of, or charges made for such labor and services, if the sand, gravel, or rock is used for other than public road purposes or is sold otherwise than as provided for in this section.

[1980 c 37 § 41. Formerly RCW 82.08.030(23).]

Notes:

Intent -- **1980 c 37**: See note following RCW 82.04.4281.

RCW 82.12.0269

The provisions of this chapter shall not apply in respect to the use of any sand, gravel, or rock to the extent of the cost of or charges made for labor and services performed in respect to the mining, sorting, crushing, screening, washing, hauling, and stockpiling such sand, gravel, or rock, when such sand, gravel, or rock is taken from a pit or quarry which is owned by or leased to a county or a city, and such sand, gravel, or rock is (1) either stockpiled in said pit or quarry for placement or is placed on the street, road, place, or highway of the county or city by the county or city itself, or (2) sold by the county or city to a county, or a city at actual cost for placement on a publicly owned street, road, place, or highway. The exemption provided for in this section shall not apply to the use of such material to the extent of the cost of or charge made for such labor and services, if the material is used for other than public road purposes or is sold otherwise than as provided for in this section.

[1980 c 37 § 68. Formerly RCW 82.12.030(18).]

Notes:

Intent -- **1980 c 37**: See note following RCW 82.04.4281.

Conservation and Open Space Lands

84.36.260

All real property interests, including fee simple or any lesser interest, development rights, easements, covenants and conservation futures, as that latter term is defined in RCW 84.34.220 as now or hereafter amended, used exclusively for the conservation of ecological systems, natural resources, or open space, including park lands, held by any nonprofit corporation or association the primary purpose of which is the conducting or facilitating of scientific research or the conserving of natural resources or open space for the general public, shall be exempt from ad valorem taxation if either of the following conditions are met:

(1) To the extent feasible considering the nature of the property interest involved, such property interests shall be used and effectively dedicated primarily for the purpose of providing scientific research or educational opportunities for the general public or the preservation of native plants or animals, or biotic communities, or works of ancient human beings or geological or geographical formations, of distinct scientific and educational interest, and not for the pecuniary benefit of any person or company, as defined in RCW 82.04.030, and shall be open to the general public for educational and scientific research purposes subject to reasonable restrictions designed for its protection; or

(2) Such property interests shall be subject to an option, accepted in writing by the state, a city or a county, or department of the United States government, for the purchase thereof by the state, a city or a county, or the United States, at a price not exceeding the lesser of the following amounts: (a) The sum of the original purchase cost to such nonprofit corporation or association plus interest from the date of acquisition by such corporation or association at the rate of six percent per annum compounded annually to the date of the exercise of the option; or (b) the appraised value of the property at the time of the granting of the option, as determined by the department of revenue or when the option is held by the United States, or by an appropriate agency thereof.

[2009 c 549 § 1034; 1979 ex.s. c 193 § 1; 1975-'76 2nd ex.s. c 22 § 3; 1973 c 112 § 1; 1967 ex.s. c 149 § 43.]

Notes:

Savings -- 1967 ex.s. c 149: See RCW 82.98.035.

Severability -- 1967 ex.s. c 149: See note following RCW 82.98.030.

84.34.220

In accordance with the authority granted in RCW 84.34.210, a county, city, town, metropolitan park district, metropolitan municipal corporation, nonprofit historic preservation corporation as defined in RCW 64.04.130, or nonprofit nature conservancy corporation or association, as such are defined in RCW 84.34.250, may specifically purchase or otherwise acquire, except by eminent domain, rights in perpetuity to future development of any open space land, farm and agricultural land, and timber land which are so designated under the provisions of chapter 84.34 RCW and taxed at current use assessment as provided by that chapter. For the purposes of chapter 243, Laws of 1971 ex. sess., such developmental rights shall be termed "conservation futures". The private owner may retain the right to continue any existing open space use of the land, and to develop any other open space use, but, under the terms of purchase of conservation futures, the county, city, town, metropolitan park district, metropolitan municipal corporation, nonprofit historic preservation corporation as defined in RCW 64.04.130, or nonprofit nature conservancy corporation or association, as such are defined in RCW 84.34.250, may forbid or restrict building thereon, or may require that improvements cannot be made without county, city, town, metropolitan park district, metropolitan municipal corporation, nonprofit historic preservation corporation as defined in RCW 64.04.130, or nonprofit nature conservancy corporation or association, as such are defined in RCW 84.34.250, permission. The land may be alienated or sold and used as formerly by the new owner, subject to the terms of the agreement made by the county, city, town, metropolitan park district, metropolitan municipal corporation, nonprofit historic preservation corporation as defined in RCW 64.04.130, or nonprofit nature conservancy corporation or association, as such are defined in RCW 84.34.250, with the original owner.

[1993 c 248 § 2; 1987 c 341 § 3; 1975-'76 2nd ex.s. c 22 § 2; 1971 ex.s. c 243 § 3.]

Fruit and Vegetable Manufacturers

82.04.4266

(1) This chapter does not apply to the value of products or the gross proceeds of sales derived from:

(a) Manufacturing fruit or vegetable products by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables; or

(b) Selling at wholesale fruit or vegetable products manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state. A person taking an exemption under this subsection (1)(b) must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state.

(2)(a) "Fruit or vegetable products" means:

(i) Products comprised exclusively of fruits, vegetables, or both; and

(ii) Products comprised of fruits, vegetables, or both, and which may also contain water, sugar, salt, seasonings, preservatives, binders, stabilizers, flavorings, yeast, and similar substances.

However, the amount of all ingredients contained in the product, other than fruits, vegetables, and water, may not exceed the amount of fruits and vegetables contained in the product measured by weight or volume.

(b) "Fruit or vegetable products" includes only products that are intended for human consumption as food or animal consumption as feed.

(3) A person claiming the exemption provided in this section must file a complete annual survey with the department under RCW 82.32.585.

(4) This section expires July 1, 2012.

[2010 1st sp.s. c 23 § 504; (2010 1st sp.s. c 23 § 503 expired June 10, 2010); 2010 c 114 § 111; 2006 c 354 § 3; 2005 c 513 § 1.]

Notes:

Expiration date -- 2010 1st sp.s. c 23 §§ 503, 505, and 514: "Sections 503, 505, and 514 of this act expire June 10, 2010." [2010 1st sp.s. c 23 § 1711.]

Effective date -- 2010 1st sp.s. c 23 §§ 504, 506, and 515: "Sections 504, 506, and 515 of this act are necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and take effect June 10, 2010." [2010 1st sp.s. c 23 § 1712.]

Findings -- Intent -- 2010 1st sp.s. c 23: See notes following RCW 82.04.220.

Effective date -- 2010 1st sp.s. c 23: See note following RCW 82.04.4292.

Application -- Finding -- Intent -- 2010 c 114: See notes following RCW 82.32.585.

Effective dates -- 2006 c 354: See note following RCW 82.04.4268.

Effective dates -- 2005 c 513: "This act takes effect July 1, 2007, except for sections 1 through 3 of this act which are necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and take effect July 1, 2005, and section 5, chapter 513, Laws of 2005, which takes effect April 30, 2007."

[2007 c 243 § 1; 2005 c 513 § 14.]

82.04.260(1)(d)

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

(d)(i) Beginning July 1, 2012, fruit or vegetable products by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables, or selling at wholesale fruit or vegetable products manufactured by the seller by canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables and sold to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

(ii) For purposes of this subsection, "fruit or vegetable products" means:

(A) Products comprised exclusively of fruits, vegetables, or both; or

(B) Products comprised of fruits, vegetables, or both, and which may also contain water, sugar, salt, seasonings, preservatives, binders, stabilizers, flavorings, yeast, and similar substances. However, the amount of all ingredients contained in the product, other than fruits, vegetables, and water, may not exceed the amount of fruits and vegetables contained in the product measured by weight or volume;

(iii) "Fruit and vegetable products" includes only products that are intended for human consumption as food or animal consumption as feed;

Seafood Products Manufacturers

82.04.4269

(1) This chapter does not apply to the value of products or the gross proceeds of sales derived from:

(a) Manufacturing seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing by that person; or

(b) Selling manufactured seafood products that remain in a raw, raw frozen, or raw salted state to purchasers who transport in the ordinary course of business the goods out of this state. A person taking an exemption under this subsection (1)(b) must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state.

(2) A person claiming the exemption provided in this section must file a complete annual survey with the department under RCW 82.32.585.

(3) This section expires July 1, 2012.

[2010 c 114 § 113; 2006 c 354 § 2.]

Notes:

Application -- Finding -- Intent -- 2010 c 114: See notes following RCW 82.32.585.
Effective dates -- 2006 c 354: See note following RCW 82.04.4268.

82.04.260(1)(b)

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

(b) Beginning July 1, 2012, seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing by that person; or selling manufactured seafood products that remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing, to purchasers who transport in the ordinary course of business the goods out of this state; as to such persons the amount of tax with respect to such business is equal to the value of the products manufactured or the gross proceeds derived from such sales, multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

Dairy Products Manufacturers

82.04.4268

(1) This chapter does not apply to the value of products or the gross proceeds of sales derived from:

(a) Manufacturing dairy products; or

(b) Selling manufactured dairy products to purchasers who transport in the ordinary course of business the goods out of this state. A person taking an exemption under this subsection (1)(b) must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state.

(2) "Dairy products" means dairy products that as of September 20, 2001, are identified in 21 C.F.R., chapter 1, parts 131, 133, and 135, including byproducts from the manufacturing of the dairy products such as whey and casein.

(3) A person claiming the exemption provided in this section must file a complete annual survey with the department under RCW 82.32.585.

(4) This section expires July 1, 2012.

[2010 c 114 § 112; 2006 c 354 § 1.]

82.04.260(1)(c)

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

(c) Beginning July 1, 2012, dairy products that as of September 20, 2001, are identified in 21 C.F.R., chapter 1, parts 131, 133, and 135, including by-products from the manufacturing of the dairy products such as whey and casein; or selling the same to purchasers who transport in the ordinary course of business the goods out of state; as to such persons the tax imposed is equal to the value of the products manufactured or the gross proceeds derived from such sales multiplied by the rate of 0.138 percent. Sellers must keep and preserve records for the period required by RCW 82.32.070 establishing that the goods were transported by the purchaser in the ordinary course of business out of this state;

Purpose -- Intent -- 2001 2nd sp.s. c 25: "The purpose of sections 2 and 3 of this act is to provide a tax rate for persons who manufacture dairy products that is commensurate to the rate imposed on certain other processors of agricultural commodities. This tax rate applies to persons who manufacture dairy products from raw materials such as fluid milk, dehydrated milk, or by-products of milk such as cream, buttermilk, whey, butter, or casein. It is not the intent of the legislature to provide this tax rate to persons who use dairy products as an ingredient or component of their manufactured product, such as milk-based soups or pizza. It is the intent that persons who manufacture products such as milk, cheese, yogurt, ice cream, whey, or whey products be subject to this rate." [2001 2nd sp.s. c 25 § 1.]

Fresh Food Processors

Chapter 82.74 RCW

82.74.010

Definitions

Unless the context clearly requires otherwise, the definitions in this section apply throughout this chapter.

(1) "Applicant" means a person applying for a tax deferral under this chapter.

(2) "Cold storage warehouse" means a storage warehouse owned or operated by a wholesaler or third-party warehouser as those terms are defined in RCW 82.08.820 to store fresh and/or frozen perishable fruits or vegetables, dairy products, seafood products, or any combination thereof, at a desired temperature to maintain the quality of the product for orderly marketing.

(3) "Dairy product" means dairy products that as of September 20, 2001, are identified in 21 C.F.R., chapter 1, parts 131, 133, and 135, including by-products from the manufacturing of the dairy products such as whey and casein.

(4) "Dairy product manufacturing" means manufacturing, as defined in RCW 82.04.120, of dairy products.

(5) "Department" means the department of revenue.

(6) "Eligible investment project" means an investment in qualified buildings or qualified machinery and equipment, including labor and services rendered in the planning, installation, and construction of the project. The lessor or owner of a qualified building is not eligible for a deferral unless (a) the underlying ownership of the buildings, machinery, and equipment vests exclusively in the same person; or (b)(i) the lessor by written contract agrees to pass the economic benefit of the deferral to the lessee in the form of reduced rent payments, and (ii) the lessee that receives the economic benefit of the deferral agrees in writing with the department to complete the annual survey under RCW 82.74.040. The economic benefit of the deferral to the lessee may be evidenced by any type of payment, credit, or any other financial arrangement between the lessor or owner of the qualified building and the lessee.

(7) "Fresh fruit and vegetable processing" means manufacturing as defined in RCW 82.04.120 which consists of the canning, preserving, freezing, processing, or dehydrating fresh fruits and/or vegetables.

(8)(a) "Initiation of construction" means the date that a building permit is issued under the building code adopted under RCW 19.27.031 for:

(i) Construction of the qualified building, if the underlying ownership of the building vests exclusively with the person receiving the economic benefit of the deferral;

(ii) Construction of the qualified building, if the economic benefits of the deferral are passed to a lessee as provided in subsection (6) of this section; or

(iii) Tenant improvements for a qualified building, if the economic benefits of the deferral are passed to a lessee as provided in subsection (6) of this section.

(b) "Initiation of construction" does not include soil testing, site clearing and grading, site preparation, or any other related activities that are initiated before the issuance of a building permit for the construction of the foundation of the building.

(c) If the investment project is a phased project, "initiation of construction" applies separately to each phase.

(9) "Person" has the meaning given in RCW 82.04.030.

(10) "Qualified buildings" means construction of new structures, and expansion or renovation of existing structures for the purpose of increasing floor space or production capacity used for fresh fruit and vegetable processing, dairy product manufacturing, seafood product manufacturing, cold storage warehousing, and research and development activities, including plant offices and warehouses or other facilities for the storage of raw material or finished goods if such facilities are an essential or an integral part of a factory, plant, or laboratory used for fresh fruit and vegetable processing, dairy product manufacturing, seafood product manufacturing, cold storage warehousing, or research and development. If a building is used partly for fresh fruit and vegetable processing, dairy product manufacturing, seafood product manufacturing, cold storage warehousing, or research and development and partly for other purposes, the applicable tax deferral shall be determined by apportionment of the costs of construction under rules adopted by the department.

(11) "Qualified machinery and equipment" means all industrial and research fixtures, equipment, and support facilities that are an integral and necessary part of a fresh fruit and vegetable processing, dairy product manufacturing, seafood product manufacturing, cold storage warehouse, or research and development operation. "Qualified machinery and equipment" includes: Computers; software; data processing equipment; laboratory equipment; manufacturing components such as belts, pulleys, shafts, and moving parts; molds, tools, and dies; operating structures; and all equipment used to control or operate the machinery.

(12) "Recipient" means a person receiving a tax deferral under this chapter.

(13) "Research and development" means the development, refinement, testing, marketing, and commercialization of a product, service, or process related to fresh fruit and vegetable processing, dairy product manufacturing, seafood product manufacturing, or cold storage warehousing before commercial sales have begun. As used in this subsection, "commercial sales" excludes sales of prototypes or sales for market testing if the total gross receipts from such sales of the product, service, or process do not exceed one million dollars.

(14) "Seafood product" means any edible marine fish and shellfish that remains in a raw, raw frozen, or raw salted state.

(15) "Seafood product manufacturing" means the manufacturing, as defined in RCW 82.04.120, of seafood products.

[2006 c 354 § 6; 2005 c 513 § 4.]

Notes:

Effective dates -- 2006 c 354: See note following RCW 82.04.4268.
Effective dates -- 2005 c 513: See note following RCW 82.04.4266.

82.74.020

Application for tax deferral

(1) Application for deferral of taxes under this chapter must be made before initiation of the construction of the investment project or acquisition of equipment or machinery. The 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 investment project, the

applicant's average employment in the state for the prior year, estimated or actual new employment related to the project, estimated or actual wages of employees related to the project, estimated or actual costs, time schedules for completion and operation, and other information required by the department.

(2) The department shall rule on the application within sixty days. The department shall keep a running total of all deferrals granted under this chapter during each fiscal biennium.

(3) No application may be made under this chapter for a project for which a refund is requested under RCW 82.08.820 or 82.12.820.

Notes:

Effective dates -- 2005 c 513: See note following RCW 82.04.4266.

82.74.030

Issuance of certificate *(Expires July 1, 2012)*

(1) The department shall issue a sales and use tax deferral certificate for state and local sales and use taxes imposed or authorized under chapters 82.08, 82.12, and 82.14 RCW on each eligible investment project if the investment project is undertaken for the purpose of fresh fruit and vegetable processing, dairy product manufacturing, seafood product manufacturing, cold storage warehousing, or research and development.

(2) This section expires July 1, 2012. [2006 c 354 § 7; 2005 c 513 § 6.]

Notes:

Effective dates -- 2006 c 354: See note following RCW 82.04.4268.
Effective dates -- 2005 c 513: See note following RCW 82.04.4266.

82.74.040

Annual Survey

(1) Each recipient of a deferral of taxes granted under this chapter must file a complete annual survey with the department under RCW 82.32.585. If the economic benefits of the deferral are passed to a lessee as provided in RCW 82.74.010(6), the lessee must file a complete annual survey, and the applicant is not required to file the annual survey.

(2) A recipient who must repay deferred taxes under RCW 82.74.050(2) because the department has found that an investment project is used for purposes other than fresh fruit and vegetable processing, dairy product manufacturing, seafood product manufacturing, cold storage warehousing, or research and development is no longer required to file annual surveys under RCW 82.32.585 beginning on the date an investment project is used for nonqualifying purposes.

[2010 c 114 § 142; 2006 c 354 § 8; 2005 c 513 § 7.]

Notes:

Application -- Finding -- Intent -- 2010 c 114: See notes following RCW 82.32.585.
Effective dates -- 2006 c 354: See note following RCW 82.04.4268.
Effective dates -- 2005 c 513: See note following RCW 82.04.4266.

82.74.050
Repayment of deferred taxes

(1) Except as provided in subsection (2) of this section and RCW 82.32.585, taxes deferred under this chapter need not be repaid.

(2)(a) If, on the basis of the survey under RCW 82.32.585 or other information, the department finds that an investment project is used for purposes other than fresh fruit and vegetable processing, dairy product manufacturing, seafood product manufacturing, cold storage warehousing, or research and development at any time during the calendar year in which the investment project is certified by the department as having been operationally completed, or at any time during any of the seven succeeding calendar years, a portion of deferred taxes is immediately due according to the following schedule:

Year in which nonqualifying use occurs	% of deferred taxes due
1	100%
2	87.5%
3	75%
4	62.5%
5	50%
6	37.5%
7	25%
8	12.5%

(b) If the economic benefits of the deferral are passed to a lessee as provided in RCW 82.74.010(6), the lessee is responsible for payment to the extent the lessee has received the economic benefit.

(3) The department must assess interest, but not penalties, on the deferred taxes under subsection (2) of this section. The interest must be assessed at the rate provided for delinquent taxes under chapter 82.32 RCW, retroactively to the date of deferral, and will accrue until the deferred taxes are repaid. The debt for deferred taxes will not be extinguished by insolvency or other failure of the recipient. Transfer of ownership does not terminate the deferral. The deferral is transferred, subject to the successor meeting the eligibility requirements of this chapter, for the remaining periods of the deferral.

(4) Notwithstanding subsection (2) of this section or RCW 82.32.585, deferred taxes on the following need not be repaid:

(a) Machinery and equipment, and sales of or charges made for labor and services, which at the time of purchase would have qualified for exemption under RCW 82.08.02565; and

(b) Machinery and equipment which at the time of first use would have qualified for exemption under RCW 82.12.02565.

[2010 c 114 § 143; 2006 c 354 § 9; 2005 c 513 § 8.]

Notes:

Application--Finding--Intent -- 2010 c 114: See notes following RCW 82.32.585.
Effective dates -- 2006 c 354: See note following RCW 82.04.4268.
Effective dates -- 2005 c 513: See note following RCW 82.04.4266.

82.74.070

Confidentiality of applications

Applications approved by the department under this chapter are not confidential and are subject to disclosure.

[2010 c 106 § 109; 2005 c 513 § 10.]

Notes:

Effective date -- 2010 c 106: See note following RCW 35.102.145.
Effective dates -- 2005 c 513: See note following RCW 82.04.4266.

RCW 82.32.585

Annual survey requirement for tax preferences

(1)(a) Every person claiming a tax preference that requires a survey under this section must file a complete annual survey with the department.

(i) Except as provided in (a)(ii) of this subsection, the survey is due by April 30th of the year following any calendar year in which a person becomes eligible to claim the tax preference that requires a survey under this section.

(ii) If the tax preference is a deferral of tax, the first survey must be filed by April 30th of the calendar year following the calendar year in which the investment project is certified by the department as operationally complete, and a survey must be filed by April 30th of each of the seven succeeding calendar years.

(b) The department may extend the due date for timely filing of annual surveys under this section as provided in RCW 82.32.590.

(2)(a) The survey must include the amount of the tax preference claimed for the calendar year covered by the survey.

(b) The survey must also include the following information for employment positions in Washington, not to include names of employees, for the year that the tax preference was claimed:

(i) The number of total employment positions;

(ii) Full-time, part-time, and temporary employment positions as a percent of total employment;

(iii) The number of employment positions according to the following wage bands: Less than thirty thousand dollars; thirty thousand dollars or greater, but less than sixty thousand dollars; and sixty thousand dollars or greater. A wage band containing fewer than three individuals may be combined with another wage band; and

(iv) The number of employment positions that have employer-provided medical, dental, and retirement benefits, by each of the wage bands.

(c) For persons claiming the tax preference provided under chapter 82.60 or 82.63 RCW, the survey must also include the number of new products or research projects by general classification, and the number of trademarks, patents, and copyrights associated with activities at the investment project.

(d) For persons claiming the credit provided under RCW 82.04.4452, the survey must also include the qualified research and development expenditures during the calendar year for which the credit was claimed, the taxable amount during the calendar year for which the credit was claimed, the number of new products or research projects by general classification, the number of trademarks, patents, and copyrights associated with the research and development activities for which the credit was claimed, and whether the tax preference has been assigned, and who assigned the credit. The definitions in RCW 82.04.4452 apply to this subsection (2)(d).

(e) If the person filing a survey under this section did not file a survey with the department in the previous calendar year, the survey filed under this section must also include the employment, wage, and benefit information required under (b)(i) through (iv) of this subsection for the calendar year immediately preceding the calendar year for which a tax preference was claimed.

(3) As part of the annual survey, the department may request additional information necessary to measure the results of, or determine eligibility for, the tax preference.

(4) All information collected under this section, except the amount of the tax preference claimed, is deemed taxpayer information under RCW 82.32.330. Information on the amount of tax preference claimed is not subject to the confidentiality provisions of RCW 82.32.330 and may be disclosed to the public upon request, except as provided in subsection (5) of this section. If the amount of the tax preference claimed as reported on the survey is different than the amount actually claimed or otherwise allowed by the department based on the taxpayer's excise tax returns or other information known to the department, the amount actually claimed or allowed may be disclosed.

(5) Persons for whom the actual amount of the tax reduced or saved is less than ten thousand dollars during the period covered by the survey may request the department to treat the amount of the tax reduction or savings as confidential under RCW 82.32.330.

(6)(a) Except as otherwise provided by law, if a person claims a tax preference that requires an annual survey under this section but fails to submit a complete annual survey by the due date of the survey or any extension under RCW 82.32.590, the department must declare the amount of the tax preference claimed for the previous calendar year to be immediately due. If the tax preference is a deferral of tax, twelve and one-half percent of the deferred tax is immediately due. If the economic benefits of the deferral are passed to a lessee, the lessee is responsible for payment to the extent the lessee has received the economic benefit.

(b) The department must assess interest, but not penalties, on the amounts due under this subsection. The interest must be assessed at the rate provided for delinquent taxes under this chapter, retroactively to the date the tax preference was claimed, and accrues until the taxes for which the tax preference was claimed are repaid. Amounts due under this subsection are not subject to the confidentiality provisions of RCW 82.32.330 and may be disclosed to the public upon request.

(7) The department must use the information from this section to prepare summary descriptive statistics by category. No fewer than three taxpayers may be included in any category. The department must report these statistics to the legislature each year by October 1st.

(8) For the purposes of this section:

(a) "Person" has the meaning provided in RCW 82.04.030 and also includes the state and its departments and institutions.

(b) "Tax preference" has the meaning provided in RCW 43.136.021 and includes only the tax preferences requiring a survey under this section.

[2010 c 114 § 102.]

Notes:

Application -- 2010 c 114: "Those provisions of sections 101 through 103, 105 through 109, 111 through 116, 118 through 122, 124, 126 through 128, 130, 132 through 149, and 151 through 153 of this act that relate to annual surveys and annual reports apply beginning with annual surveys and annual reports due in 2011 and thereafter." [2010 c 114 § 203.]

Finding -- Intent -- 2010 c 114: "(1) The legislature finds that accountability and effectiveness are important aspects of setting tax policy. In order to make policy choices regarding the best use of limited state resources, the legislature needs information on how a tax preference is used. In recent years, the legislature has enacted or extended numerous tax preferences that require the reporting of information to the department of revenue. Although there are many similarities in the requirements, and only two distinct accountability documents, there is a lack of uniformity in the information reported, penalties for failure to file, due dates, filing extensions, and filing requirements. Greater uniformity in the data reported is necessary to adequately compare tax preference programs. The legislature intends to create two sets of uniform reporting requirements that apply to the existing tax preferences and can be used in future legislation granting additional tax preferences.

(2) The legislative fiscal committees or the department of revenue are required to study many of the existing tax preferences and report to the legislature at least once. Because chapter 43.136 RCW now requires the joint legislative audit and review committee, with support from the department of revenue, to comprehensively review most tax preferences every ten years and provide a report to the legislature, a number of redundant studies by the legislative fiscal committees and the department of revenue have been eliminated. However, the department of revenue will continue to prepare summary descriptive statistics by category and report the statistics to the legislature each year." [2010 c 114 § 101.]