2011 Tax Preference Performance Reviews

Proposed Final Report
Joint Legislative Audit & Review Committee
January 11, 2012

Mary Welsh, Dana Lynn, and John Woolley
JLARC Staff

2006 Legislature Mandated Reviews

• An “orderly” review of all preferences over a ten-year cycle; this is year five
• Preference: exemption, exclusion, deduction, credit, deferral, preferential rate
• Outlined specific questions to be answered in reviews, including:
  ➢ Public policy objectives
  ➢ Beneficiaries
  ➢ Revenue and economic impacts
• More detail in report
JLARC Staff Work with the Citizen Commission

• Citizen Commission for the Performance Measurement of Tax Preferences:
  ➢ Five voting members: appointed by each of the legislative caucuses and the Governor
  ➢ Two non-voting members: JLARC Chair and State Auditor

• Commission’s duties include:
  ➢ Set the 10-year review schedule
  ➢ Take public testimony on the reviews
  ➢ Comment on JLARC staff analyses

JLARC and Commission Review Staff’s Work

September of previous year: Commission determines schedule for coming year

JLARC staff prepare analysis

July: Present to JLARC

Aug: Present to Commission

Sept: Commission takes public testimony

Oct: Commission adds any comments

Jan: JLARC hears final report; joint hearing in Legislature
## 120 Detailed Reviews Conducted by JLARC Since 2007

<table>
<thead>
<tr>
<th>Analysis Type</th>
<th>Number of Reviews</th>
<th>Beneficiary Savings Est.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Terminate</td>
<td>6</td>
<td>$71 M</td>
</tr>
<tr>
<td>Allow to expire</td>
<td>11</td>
<td>$76 M</td>
</tr>
<tr>
<td>Legislature review/clarify intent</td>
<td>29</td>
<td>$1,638 M</td>
</tr>
<tr>
<td>Continue</td>
<td>74</td>
<td>$44,406 M</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>120</strong></td>
<td><strong>$46,190 M</strong></td>
</tr>
</tbody>
</table>

*Information on other preferences provided by DOR is also available.*

## 25 Detailed Tax Preferences Reviewed in 2011

<table>
<thead>
<tr>
<th>Analysis Type</th>
<th>Number of Reviews</th>
<th>Beneficiary Savings Est.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Terminate</td>
<td>1</td>
<td>$0 M</td>
</tr>
<tr>
<td>Allow to expire</td>
<td>2</td>
<td>$44 M</td>
</tr>
<tr>
<td>Legislature review/clarify intent</td>
<td>8</td>
<td>$616 M</td>
</tr>
<tr>
<td>Continue</td>
<td>14</td>
<td>$1,625 M</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>25</strong></td>
<td><strong>$2,285 M</strong></td>
</tr>
</tbody>
</table>

*Information on 43 other preferences provided by DOR is also available.*
Today’s Presentation Focuses on Citizen Commission’s 2011 Comments

<table>
<thead>
<tr>
<th>Terminate</th>
<th>Allow to expire</th>
<th>Review and clarify</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Repaired goods delivered out-of-state</td>
<td>1. Hog fuel to produce energy</td>
<td>1. Interest on real estate loans</td>
</tr>
<tr>
<td></td>
<td>2. Renewable energy machinery</td>
<td>2. Meat processors</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3. Shared real estate commissions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4. Municipal sewer services</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5. Extracted fuel</td>
</tr>
<tr>
<td></td>
<td></td>
<td>6. Aircraft fuel, exports &amp; commercial use</td>
</tr>
<tr>
<td></td>
<td></td>
<td>7. Limited income property tax deferral</td>
</tr>
<tr>
<td></td>
<td></td>
<td>8. Nonprofit sheltered workshops</td>
</tr>
</tbody>
</table>

Continue

| 1. Boat sales to nonresidents & foreign residents |
| 2. Church camps |
| 3. Display items for trade shows |
| 4. Interest from state/municipal obligations |
| 5. Interstate bridges |
| 6. Investment of businesses in related entities |
| 7. Laundry for nonprofit health care facilities |
| 8. Nonprofit blood and tissue banks |
| 9. Nonprofit day care centers |
| 10. Open space compensating tax |
| 11. Real estate excise tax exemptions |
| 12. **Sales to nonresidents for use out-of-state** |
| 13. Sales or use tax paid in another state |
| 14. State-chartered credit unions |
Hog Fuel to Produce Energy
Sales & Use Tax Exemption

Public Policy Objective?
Legislature did not state; however, it did provide an expiration date.

JLARC Staff Recommends
Allow to Expire
Because the Legislature intended the exemptions to be temporary and did not provide performance goals to guide any other assessment of performance.

Citizen Commission
Does Not Endorse
Because it is unclear that the Legislature intended the preference to be temporary. Legislature should review evidence before determining whether to let preference expire.
Public Policy Objective?
Legislature did not state. Documents from period of enactment suggest purpose was to encourage Washingtonians to buy homes by making loans more available and less expensive.

JLARC Staff Recommends
Review and Clarify
Because it is unclear whether the original public policy objective applies given changes in the lending industry.

Citizen Commission
Endorses and Adds
Legislature should consider whether the preference is essential to maintain competitive residential lending capability for state-domiciled residential real estate lenders.
Meat Processors B&O Tax Preferential Rate

Public Policy Objective?
Legislature did not state. Historical documents suggest Legislature intended to:
- Improve competition for Washington meat processors
- Treat Washington food processors consistently

JLARC Staff Recommends
Review and Clarify
Because the public policy purpose for providing differential tax treatment for meat processors compared to other food processors is unclear.

Citizen Commission
Endorses and Adds
Legislature should determine if preference provides parity with other state tax rates and other geographical differences for meat processors.
Shared Real Estate Commissions
B&O Tax Exemption

Public Policy Objective?
Legislature did not state.
Implied intent not to impose “pyramiding” effect of the B&O tax on the real estate industry.

JLARC Staff Recommends
Review and Clarify
Because it is not clear why the Legislature granted a tax preference to real estate agents and brokers and not to other businesses with similar broker-agent relationships.

Citizen Commission
Endorses and Adds
Legislature should align B&O tax treatment of real estate brokers and agents to brokers and agents in other industries unless there is a compelling reason for differential treatment.
Public Policy Objective?
Legislature did not state. JLARC research found preference likely structured so that:
1) Parties paying aircraft fuel tax were the ones that benefited from tax proceeds.
2) It will comply with Constitutional prohibitions on taxing interstate/foreign commerce and the federal government.

JLARC Staff Recommends
Review and Clarify
Parties that are exempt from aircraft fuel tax now benefit from tax receipt expenditures.

Citizen Commission
Endorses and Adds
The Legislature should state the preference’s public policy objectives and narrow the scope commensurate with the stated public policy objectives.
Limited-Income Property Tax Deferral

Public Policy Objective?

Stated intent is to “(a) provide a property tax safe harbor for families in economic crisis; and (b) prevent existing homeowners from being driven from their homes because of overly burdensome property taxes.”

JLARC Staff Recommends

Because the intended beneficiaries of this preference are not clear in light of the recent economic recession.

Citizen Commission

Endorses and Adds

Legislature should identify measurable evaluation criteria. However, administration costs are high relative to the participation; it might be appropriate to terminate the preference unless the preference can be restructured to assure cost effectiveness.
Nonprofit Sheltered Workshops
Property Tax Exemption

Public Policy Objective?
Legislature did not state.
JLARC infers objective is to encourage employment of persons with disabilities in sheltered workshop facilities.

JLARC Staff Recommends
Review and Clarify
Because public policy on employment of people with disabilities shifted from placement in sheltered workshops to supported work settings along with persons without disabilities.

Citizen Commission
Endorses and Adds
The Legislature should evaluate whether the preference is necessary any longer to encourage employment of persons with disabilities.
Sales of Goods to Certain Nonresidents Sales Tax Exemption

Public Policy Objective?
Legislature did not state.
JLARC infers preference intended to support Washington retailers by removing a disincentive for nonresidents from states with less than a 3 percent sales tax.

Sales of Goods to Certain Nonresidents Sales Tax Exemption

JLARC Staff Recommends
Continue
Because the preference is meeting the implied public policy objective of removing a disincentive for certain nonresidents.

Citizen Commission
Does Not Endorse
Because there is ambiguity regarding Legislature’s public policy objective and the economic benefits and costs. Legislature should review and clarify public policy objectives and evaluate the preference’s economic impacts.
Agency Comments

Department of Revenue, Department of Licensing, and Office of Financial Management reviewed JLARC’s reports and had no comments.

Digest of All 120 Reports Available Online

Summary of Tax Preference Performance Reviews – Review and Clarify

<table>
<thead>
<tr>
<th>What the Preference Does</th>
<th>Public Policy Objective</th>
<th>Estimated Beneficiary Savings</th>
<th>JLARC Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural Products (BBG) / RCW 82.04.330, 82.04.410</td>
<td>Provides a BBO tax exemption for income earned from wholesale sales of agricultural products by agricultural producers (farmers). The exemption does not apply to retail sales of agricultural products by farmers.</td>
<td>The Legislature did not state a public policy objective for this preference. JLARC infers the public policy objectives may have been to: 1. Define the BBO tax base to exclude wholesale agricultural income but include retail sales of agricultural products or processed food; and 2. To support farmers during the financially difficult times of the Great Depression.</td>
<td>$63.8 million in 2009-11 Biennium</td>
</tr>
</tbody>
</table>

Commission Comment: Endorses without comment.
Legislative Action: Bills introduced in 2009 and 2010 but not enacted.

<table>
<thead>
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<tbody>
<tr>
<td><strong>Mary Welsh</strong></td>
</tr>
<tr>
<td>360-786-5193</td>
</tr>
<tr>
<td><a href="mailto:mary.welsh@leg.wa.gov">mary.welsh@leg.wa.gov</a></td>
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Visit JLARC’s website at:  
www.jlarc.leg.wa.gov

Visit Citizen’s Commission website at:  
www.citizentaxpref.wa.gov