Preliminary Report

2021 Tax Preference Performance Reviews

The Legislative Auditor recommends action on four of seven preferences reviewed.

Scott Hancock| Josh Karas | Dana Lynn | Rachel Murata | Pete van Moorsel | Eric Whitaker

WASHINGTON JLARC

July 2021

Tax reviews follow same audit standards, different process than other work

Legislature created Citizen Commission for Performance Measurement of Tax Preferences.

- Five-member body created by Legislature.
- Determines review schedule – considerations include industry groupings, expiration dates, and Legislative direction.
- Takes public testimony and adopts comments on staff work.

JLARC directed to address five key areas

Revenue and economic impacts to the taxpayers and to the government?

Public policy objectives: Intent of the preference and is it being achieved?

Do **other states** have a similar tax preference?

Beneficiaries: What entities are affected and what are their savings?

Required to make **recommendation** to Legislature.

Overview

All reports include:

one page overviews & video summaries

Legislative Auditor recommends action on four preferences:

- Health Benefit Exchange
- Manufacturers' Deferral
- Reduced B&O Rate for Printing and Publishing Newspapers
- Medical Cannabis Tax Preferences

Allow one preference to expire and clarify intent of another:

- Credit for Renewable Energy Program Payments
- Nonprofit Outpatient Dialysis Facilities

One recommendation already implemented during 2021 session:

- Targeted Urban Area Exemption

B&O Tax

Health Benefit Exchange

Scheduled to Expire: July 1, 2023

Estimated 2021-23 Beneficiary Savings: $2.2 million

Legislative Auditor's Conclusion: The preference reduces the Exchange's administrative costs by $1 million per year, allowing it to maximize its funding for operating a health insurance marketplace. The Legislature should extend the July 2023 expiration date or make the preference permanent.

Dana Lynn

July 2021

WASHINGTON JLARC

Income received by the Health Benefit Exchange is exempt from B&O tax

The Exchange

Established to help implement Affordable Care Act.

An online marketplace to compare and enroll in health plans.

- A public-private partnership.
- Funded by appropriations.
- Subject to B&O tax.

Preference is meeting inferred objective

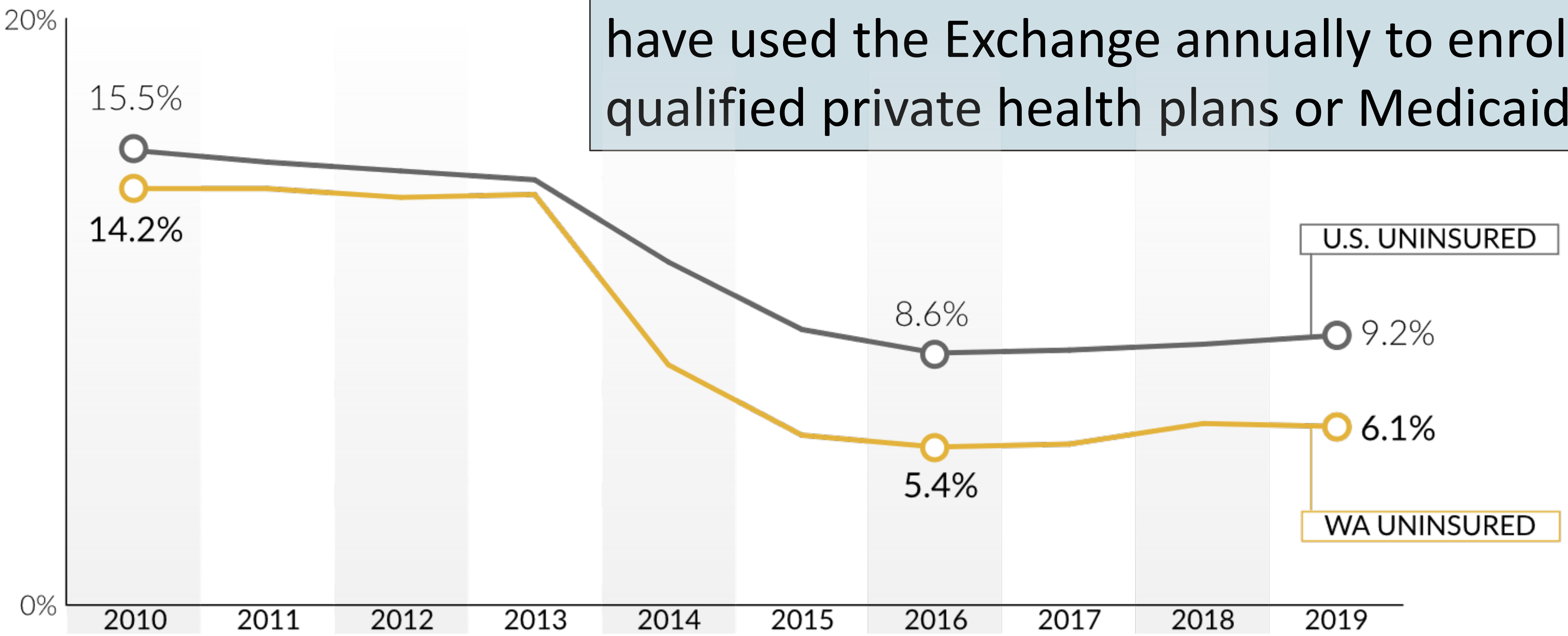
Allows the Exchange to **maximize its total state funding**.

Enacted when the Legislature created the Exchange, **structural** purpose.

Reduces the Exchange's administrative costs **by $1 million a year** or **2%** of total state funding.

Since the Exchange began, WA's uninsured rate has been at least 3% points below US average

Since 2015, 1.6 million or more WA residents have used the Exchange annually to enroll for qualified private health plans or Medicaid.

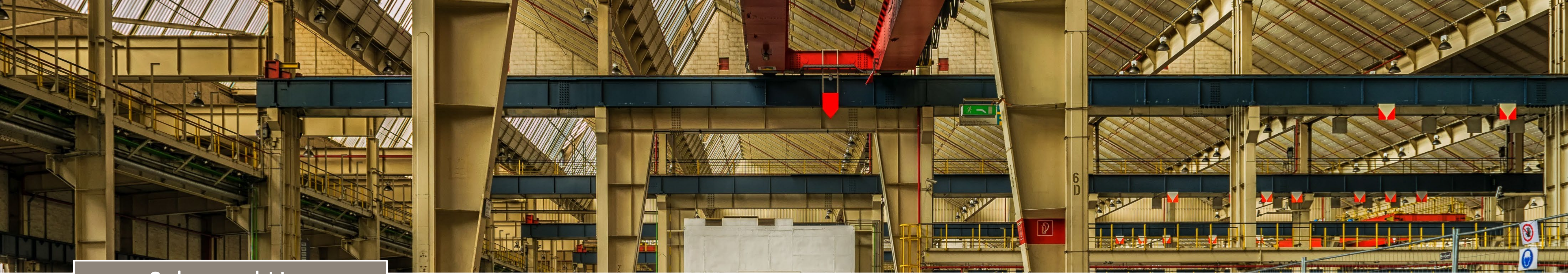


Legislative Auditor's Recommendation

Extend the July 2023 expiration date or make the preference permanent.

Also add a performance statement specifying the public policy objective.

The Citizen Commission should consider if the preference is critical to the tax structure and, if so, exclude it from future reviews.



Sales and Use

Manufacturers' Deferral

Scheduled to Expire: January 1, 2026

Estimated 2023-25 Beneficiary Savings: $240,000-$380,000

Legislative Auditor's Conclusion: Four businesses used the tax deferral and met job goals through temporary construction work rather than permanent manufacturing jobs.

Businesses likely would have built facilities without the deferral.

To increase manufacturing jobs or training, the Legislature should consider modifying the deferral program.

Dana Lynn | Pete van Moorsel

July 2021

WASHINGTON JLARC

Manufacturers defer sales & use tax for up to $10 M spent to:

- Build, expand, or remodel facilities.
- Buy machinery and equipment.

Since 2018, open to 2 businesses a year, one each in Eastern & Western WA.

Businesses have 5 years with no payments, then repay over 10 years.

State portion (6.5%) of repayments to fund job training for manufacturers (Invest in Washington account).

Four businesses have claimed deferral and filed annual tax performance report

MALTBY

BUSINESS:
OSW Equipment and Repair

ACTIVITY:
Dump truck and trailer production

SPOKANE

BUSINESS:
Tainio Biologicals

ACTIVITY:
Agricultural input production

FREDERICKSON

BUSINESS:
Oldcastle APG West

ACTIVITY:
Concrete pavers and consumer product production

WALLA WALLA

BUSINESS:
Cielo LLC, Aluve Winery

ACTIVITY:
Wine production

Deferred **$1.3 million** in state sales and use tax.

18% of maximum amount of state tax that could be deferred.

Legislature set goal for each deferral project to generate at least 20 full-time jobs

- Temporary construction jobs used to build facilities.
- Permanent, full-time jobs at facility within 1 year of facility completion.

All 4 businesses met the job goal through temporary construction work.

None of the businesses created 20 FT manufacturing jobs.

Economic modeling: construction spending supported 122 additional non-construction jobs.

Businesses report they likely would have built facilities without deferral

Businesses state the deferral enabled them to:

- Build earlier.
- Complete more construction.
- Plan for future growth.
- Spread tax liability over several years.

No impacts yet on job training programs

First repayments due by 12/31/2021.

Repayments estimated to peak at $325,000 in 2031.

SBCTC developing plans to use anticipated funding.

Legislative Auditor's Recommendation

Extend the expiration date and modify the program.

Extend the 1/01/2026 expiration date because each business met the legislative goal of creating 20 FT jobs and repayment of deferred taxes is expected to fund future training.

If the Legislature wants to encourage businesses to create and retain more manufacturing jobs, it could modify the preference to:

- Focus on creating more FT manufacturing jobs, not temporary construction work.
- Directly appropriate money to the SBCTC for manufacturing training/apprenticeships.

B&O Tax

Newspaper Printing and Publishing

Scheduled to Expire: July 1, 2024

Estimated 2021-23 Beneficiary Savings: $823,000

Legislative Auditor's Conclusion: The preference provides tax relief to newspaper printers and publishers and saves these businesses money. However, the newspaper industry continues to lose revenue and jobs as it seeks to stabilize financially.

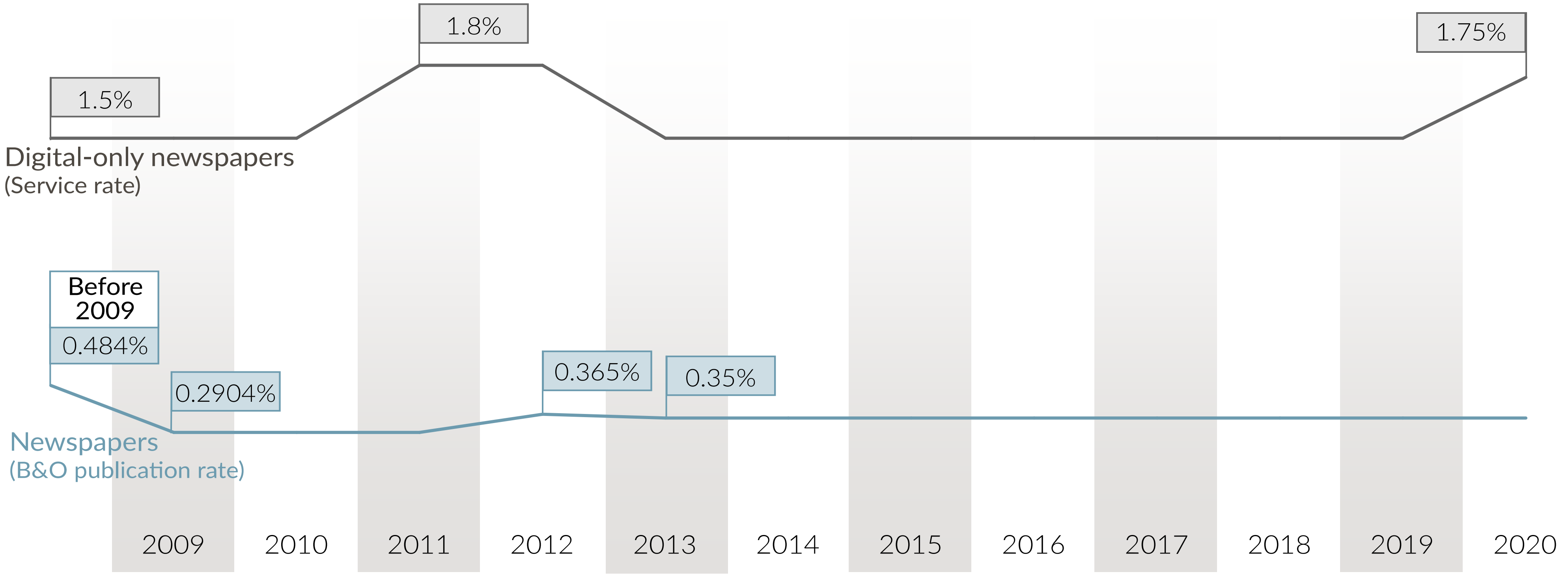
Eric Whitaker

July 2021

WASHINGTON JLARC

Legislature has taken multiple steps to help newspapers

- In 2008, the statutory definition of newspaper was changed to include digital versions of print newspapers.
- The Legislature created this tax preference in 2009.



Preference modified in 2015 to provide financial relief to newspaper printers and publishers

- The Legislature extended the expiration date and added a performance statement.

- Policy objectives:
    - Tax relief.
    - Permanent uniform rate.

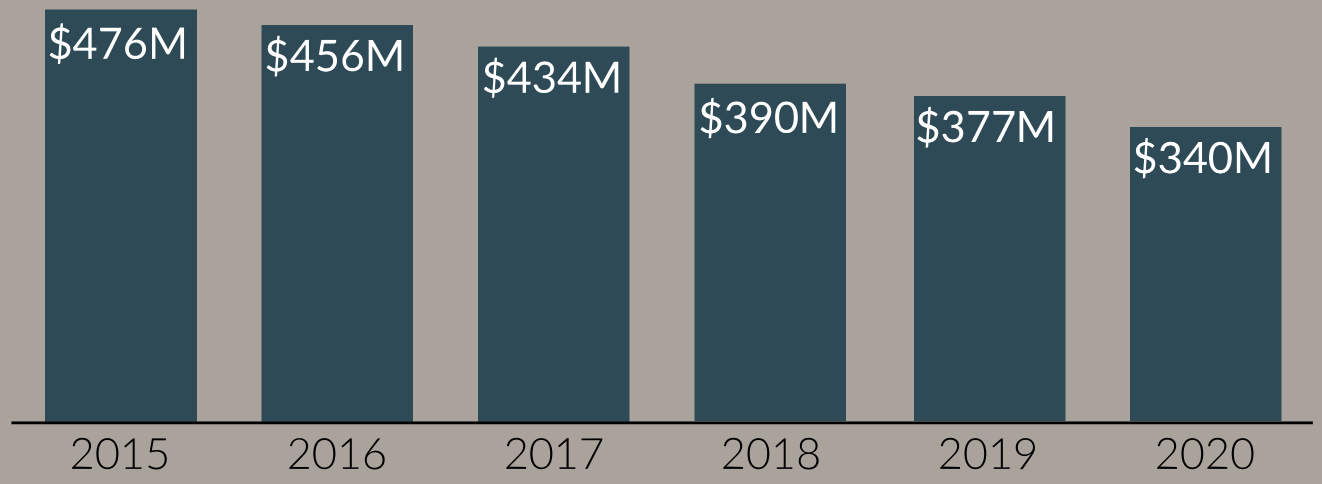
- Metric: Growth in gross revenues over most recent three-year period.
    - Intent: Let the preference expire if revenue grows.

Fewer newspapers are claiming the preference and its overall value is decreasing

- Between FYs 2016 and 2020, the total value of the preference decreased 6.1% annually, on average.
- Newspaper printers or publishers make up 66% of all beneficiaries.
- Definition of newspaper focuses on form and frequency rather than content.

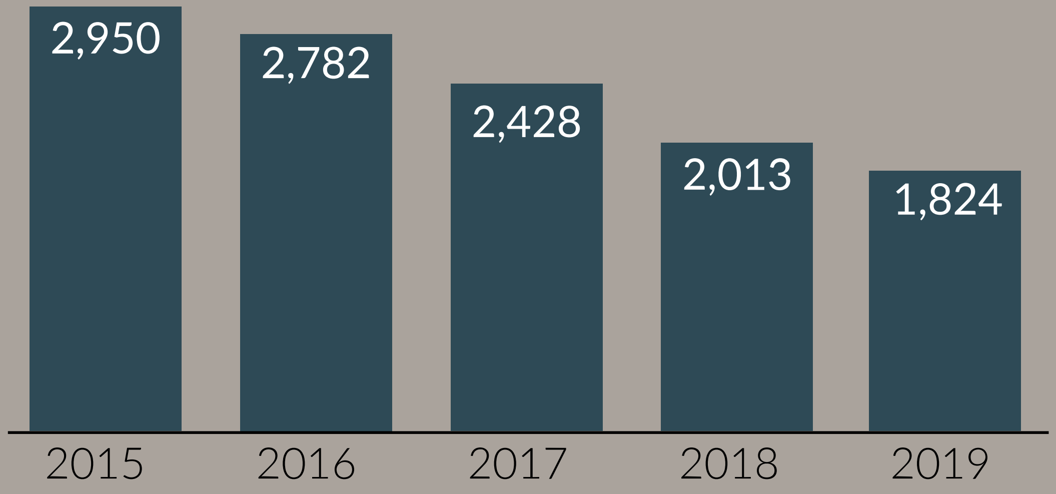
29%

Percent decline in gross revenues at newspapers claiming the preference.



38%

Percent decline in employment at newspapers claiming the preference.



WA newspapers are pursuing other funding opportunities to help mitigate revenue losses

Partnered with entities such as the Seattle Foundation to help fund its news-gathering operations.

Working with community groups to create endowed reporting positions.

McClatchy partnered with Report for America to add positions at its WA-owned newspapers.

Policy efforts in other jurisdictions may serve as a model for WA

- Other states do not limit support to newspaper printer or publishers.
    - NJ’s Civic Information Consortium
    - CO’s Media Project

- Various efforts have been introduced in Congress in recent years.

- As the industry transitions to digital, a preference for producing a physical newspaper may be less helpful.

Legislative Auditor's Recommendation

The Legislature should review this preference to **determine if it provides sufficient relief** to the newspaper industry and **whether additional assistance is needed** as these businesses attempt to stabilize financially.

The preference has been in place for 12 years and the newspaper industry continues to lose revenue and jobs.

If the Legislature is interested in helping the news industry, it should consider additional approaches.

Multiple taxes

Medical Cannabis Tax Preferences

No expiration date

Estimated 2021-23 Beneficiary Savings: $4.9 million

Legislative Auditor's Conclusion:

Seven medical cannabis tax preferences provide tax relief to patients and cooperatives. After 2019 statutory changes, it is unclear how pending taxpayer guidance may affect beneficiary savings.

Scott Hancock

July 2021

WASHINGTON JLARC

Seven preferences for medical cannabis

Preferences vary by:

- Product
- Retailer
- Customer

Objective:

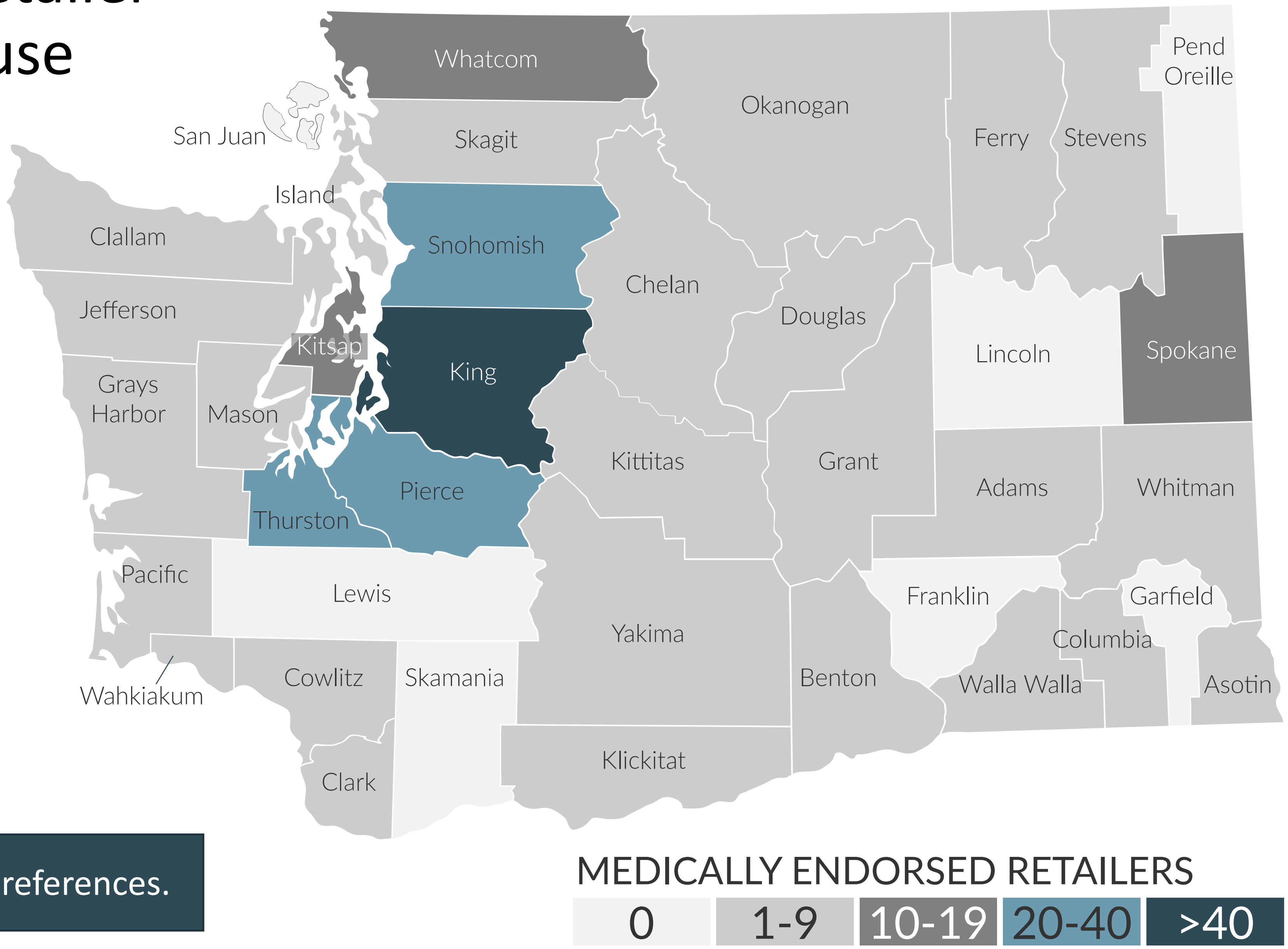
Reduce tax burdens on medical cannabis patients.

Medically endorsed retailers

- Required for six of seven preferences.
- Register patients and caregivers into patient database.
- Issue recognition cards.
- Make exempt sales.

Medically endorsed retailer availability may limit use

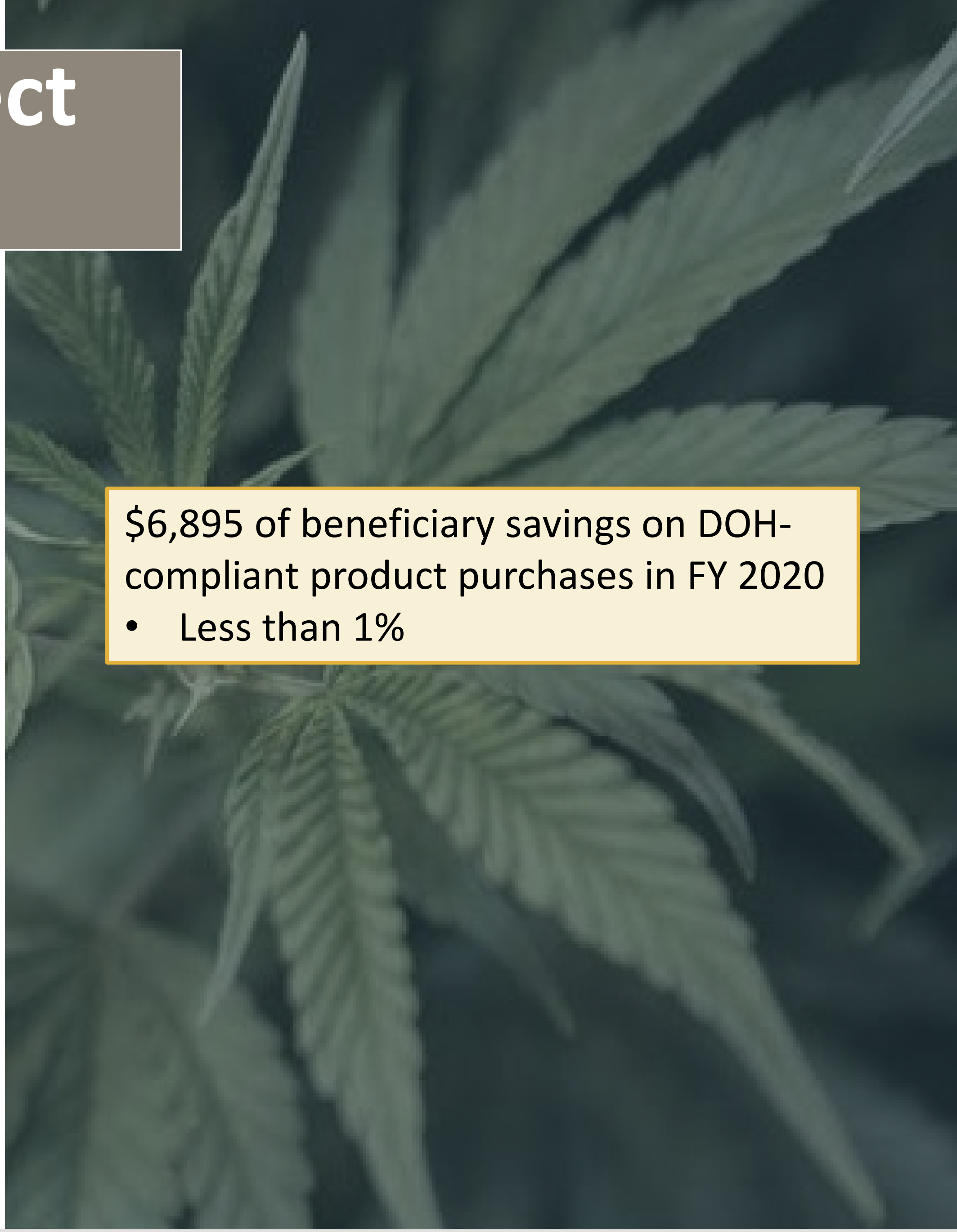
- Available in 32 of 39 counties.
- 275 of 510 retailers had medical endorsements (FY 2020).
    - 205 made exempt sales.
- Recognition cards issued by 188 retailers in 29 counties.



Retailer availability may limit use of the preferences.

2019 statutory change may affect beneficiary savings

- Over 87% of beneficiary savings from one sales tax exemption for qualified patients.
- Exemption was modified in 2019 – no changes yet to guidance or WAC.
  - "…compliant marijuana product…"
- DOR and DOH state they are working to update guidance, WAC.
  - Effects uncertain.



$6,895 of beneficiary savings on DOH-compliant product purchases in FY 2020
- Less than 1%

Legislative Auditor's Recommendation

Continue the preferences.

Because they meet the objective to **provide tax relief** to medical cannabis patients.

The Department of Revenue and the Department of Health should **update guidance** to reflect 2019 statutory changes.

Property tax

Nonprofit Outpatient Dialysis Facilities

No expiration date

Estimated 2021-23 Beneficiary Savings: $4.2 million

Legislative Auditor's Conclusion: Preference provides tax relief to nonprofit outpatient dialysis facilities, which outperform for-profit counterparts on two standard measures. Legislature should clarify its intent.

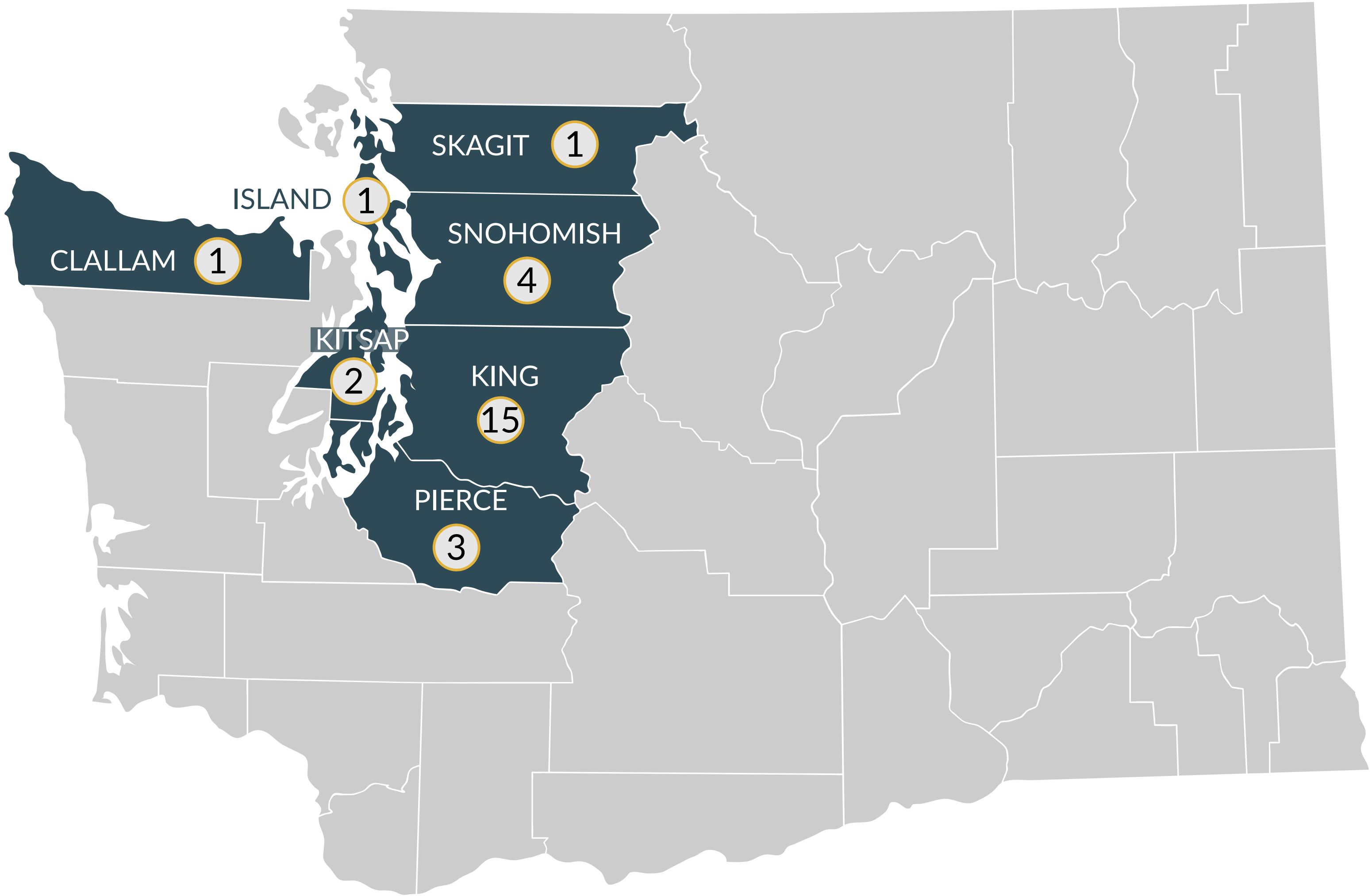
Scott Hancock

July 2021

Property tax exemption for nonprofit outpatient dialysis facilities

- Real and personal property used exclusively by nonprofits for outpatient dialysis treatment.
- Beneficiaries must re-certify each year to maintain their exemption.

27 facilities in 7 counties benefit from the preference



Preference intent unclear

No explicit policy objectives in statute.

Testimony suggested intent is similar to nonprofit hospitals: support charity care.

Medicare, Kidney Disease Program provide coverage and assistance for people diagnosed with ESRD.

Support for charity care not a relevant objective.

Beneficiaries outperform on two measures

More patients on transplant waitlist.	*16.3% vs. 12.2%*
Lower revenue per treatment.	*$397 vs. $480*

Similar performance on other measures.

Legislative Auditor's Recommendation

Clarify

Legislative Auditor's Recommendation: The Legislature clarify the objectives of the preference by including a performance statement.

Estimated beneficiary savings: $4.2 million

Public Utility Tax

Credit for Renewable Energy Program Payments

Expires June 30, 2030 – no new participants

Estimated 2021-23 Beneficiary Savings $27.4 million

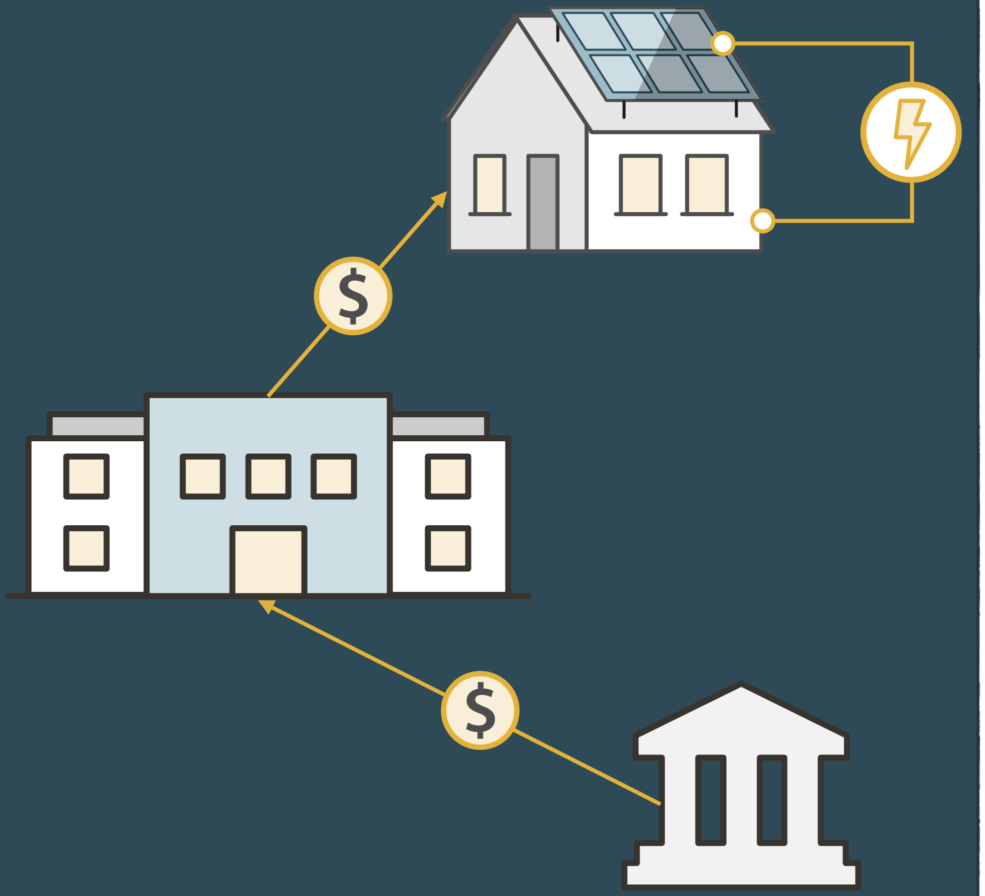
Legislative Auditor's Conclusion: The tax credit program increased Washington's solar capacity and met its solar-related employment target. It did not broaden low-income participation. Solar installations have continued after the program reached its funding limit.

Rachel Murata | Eric Whitaker | Josh Karas

July 2021

WASHINGTON JLARC

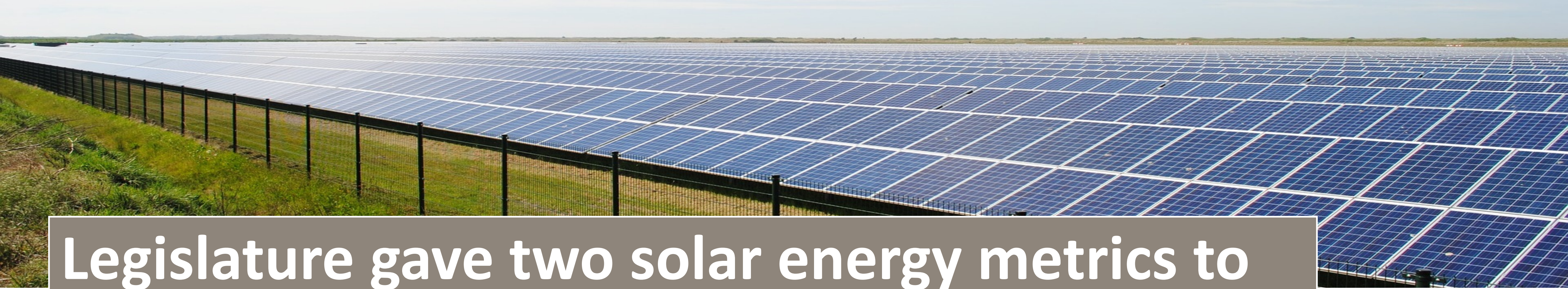
Tax credit for utilities participating in the Renewable Energy System Incentive Program (RESIP)



1. Customers install renewable energy systems (solar panels, wind turbines) and generate energy.

2. Utilities pay customers based on electricity generated, times rate in statute.

3. The state reimburses utilities with a tax credit for the amount paid.



Legislature gave two solar energy metrics to measure the credit

In 2017, Legislature directed JLARC staff to measure:

- 115 megawatts (MW) of solar capacity installed.
- Increase solar-related employment.

Also noted intent to broaden low-income participation through community solar.

87%

of solar capacity target reached

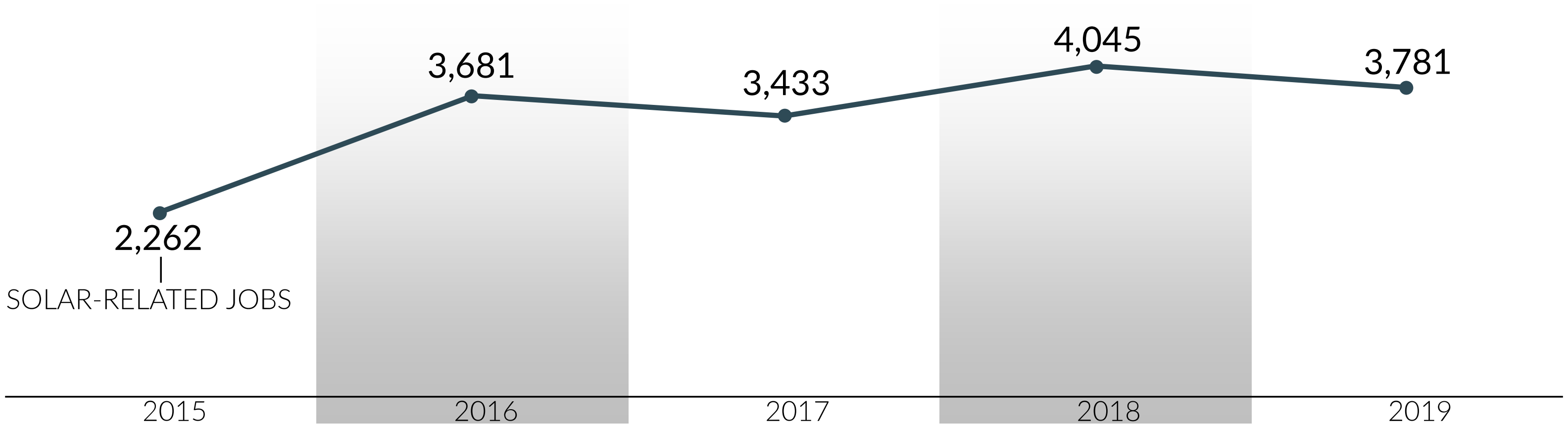
(100 MW out of 115 MW)

- Program includes about 7,500 solar energy systems.
- 202 of those, and 3 anaerobic digesters, installed before the program began.
- Incentive rates ranged from 5 cents to 21 cents.

Solar employment target met

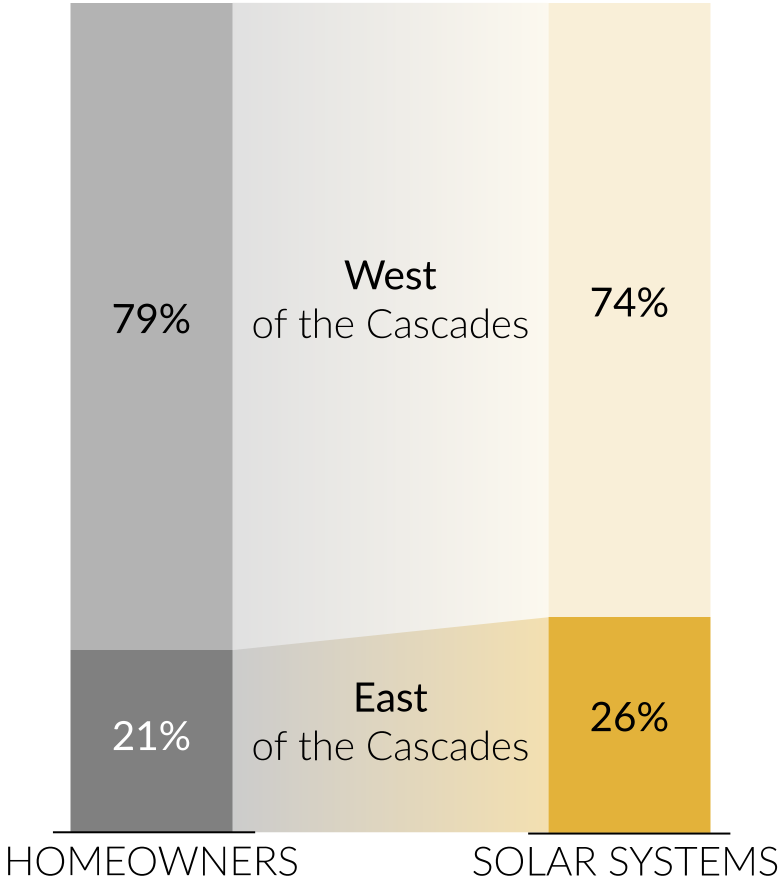
1,519 solar jobs were added

State ranking remained 21st in the nation.



Source: The Solar Foundation

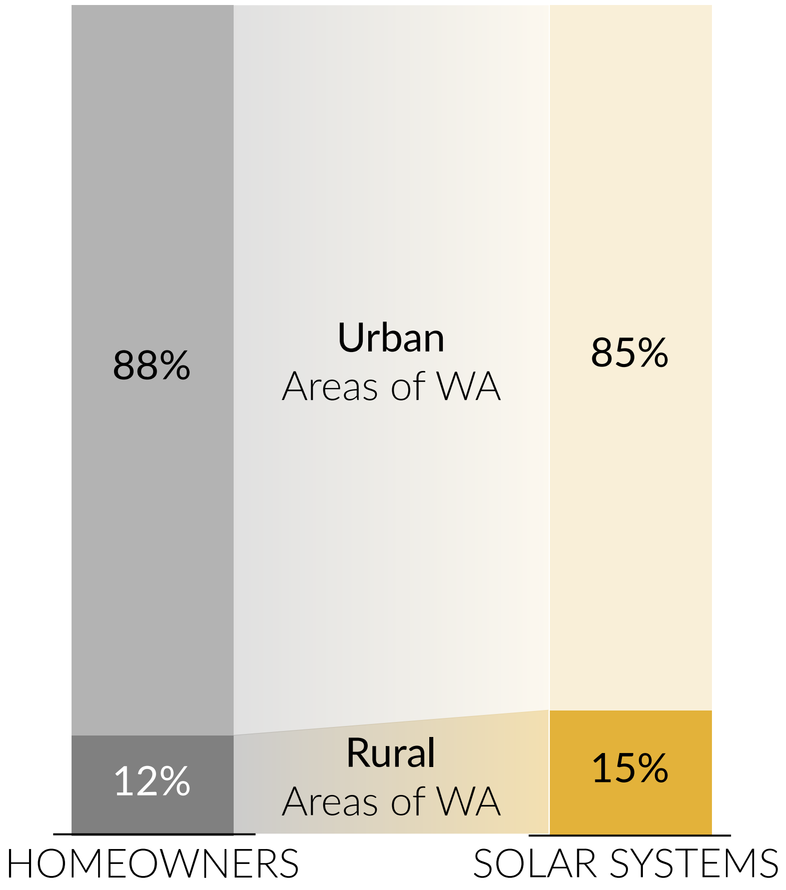
Homeowners **east** of the Cascades more likely to install systems



Counties east of the Cascades have 21% of the state's homeowners but 26% of solar energy systems.

Systems east of the Cascades are 12% **larger** and produce 16% **more energy** relative to their size.

Homeowners in **rural areas** more likely to install systems



Rural areas of Washington have 12% of the state's homeowners and 15% of systems.

Systems in rural areas are 15% **larger** than in urban areas.

Incentive likely caused installations earlier and 32% larger

Staff used dGen model developed by Dept. of Energy's National Renewable Energy Laboratory.

Model estimates incentive may have caused **temporary 12% increase** in installations - reversed when the incentive ended.

Systems in the model were **32% larger** with the incentive in place.

RESIP did not broaden low-income participation

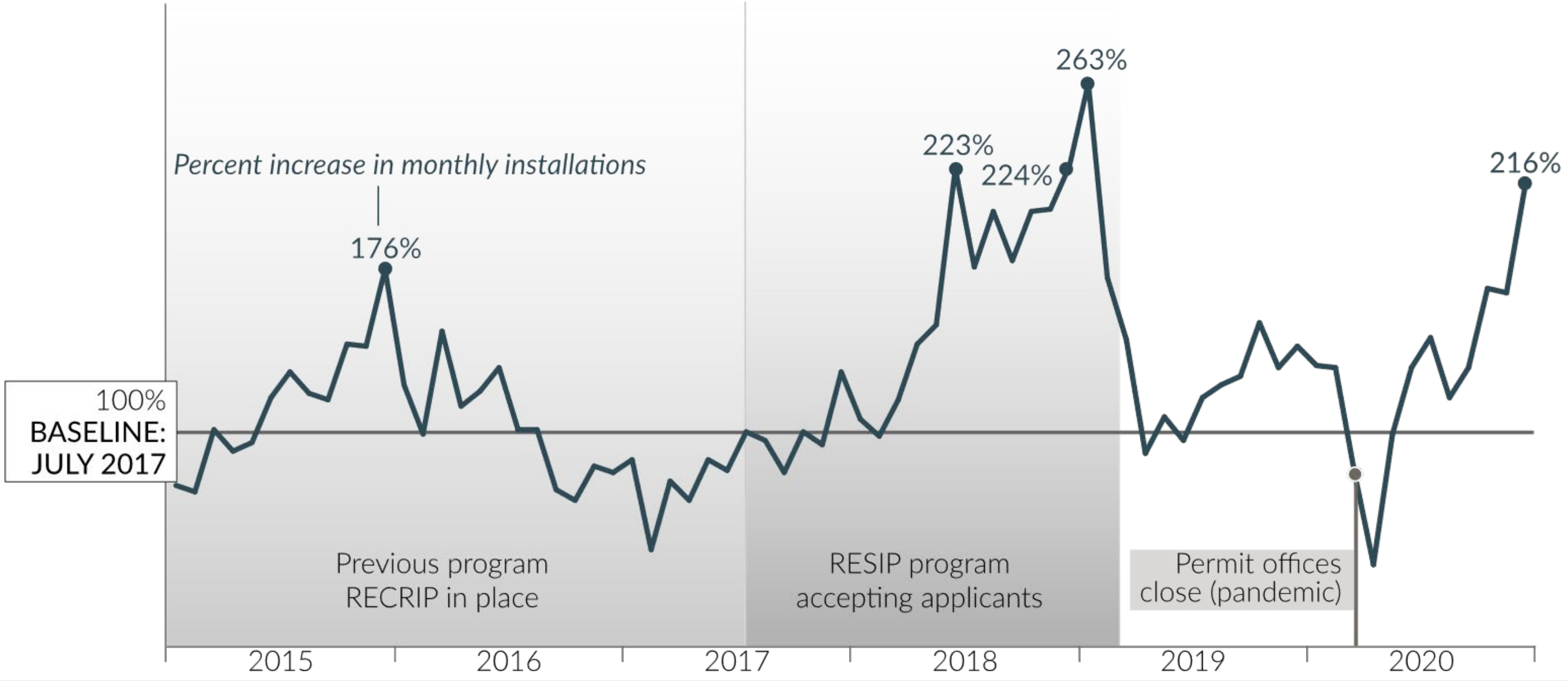
System owners have higher income – 180% the median in their counties.

Community solar **less than 2%** of capacity.

Benefits to participants different from systems on homes or businesses.

Installations have continued after funding limit was reached

December 2020 fourth highest month for new installations.

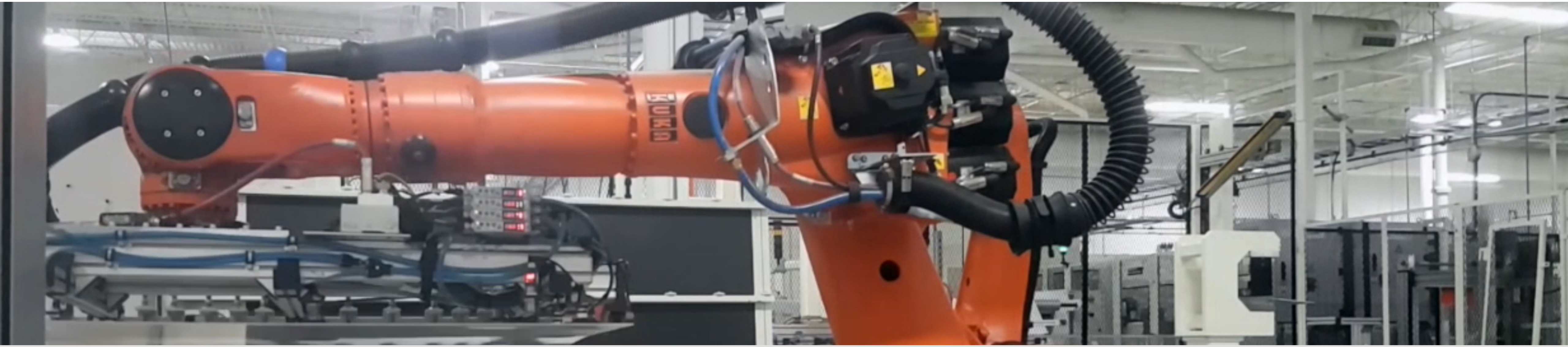


Washington solar employment improved relative to other states

Solar-related employment declined by 216 jobs in 2020 – but state ranking improved.

Washington solar panel manufacturing expanded.

- Bellingham manufacturer added employees and facility



Legislative Auditor’s Recommendation

Allow the credit to expire in 2030.

Because the objectives are **mostly met** and installations **have continued** after the program funding limit was reached.

If the Legislature wants to broaden low-income participation in the production and use of solar energy, it should **consider other options**.

2021 Tax Preference Review | Updated Preliminary Report

Targeted Urban Area Exemption

Scheduled to Expire: December 31, 2030

Estimated 2019-21 Beneficiary Savings: $0

Updated Legislative Auditor's Conclusion:

The Legislature acted on the Legislative Auditor's recommendation to ensure the preference is available by modifying the preference's population criteria and extending the expiration date.

Dana Lynn

July 2021

WASHINGTON JLARC

10-year local property tax exemption was limited by population and geographic criteria to three Snohomish County cities

It was unclear if cities could legally offer the preference.

Snohomish Co exceeded population limits in 2018.

No businesses has applied previously.

No other county met statutory population criteria.

January 2021 Legislative Auditor recommendation: the Legislature should modify population criteria and extend the expiration date if it wants the preference to be available in the future.

2021 Legislature passed ESHB 1386, removing population and geographic criteria and extending expiration date

Legislative Auditor's Updated Recommendation

Continue and review at a later date.

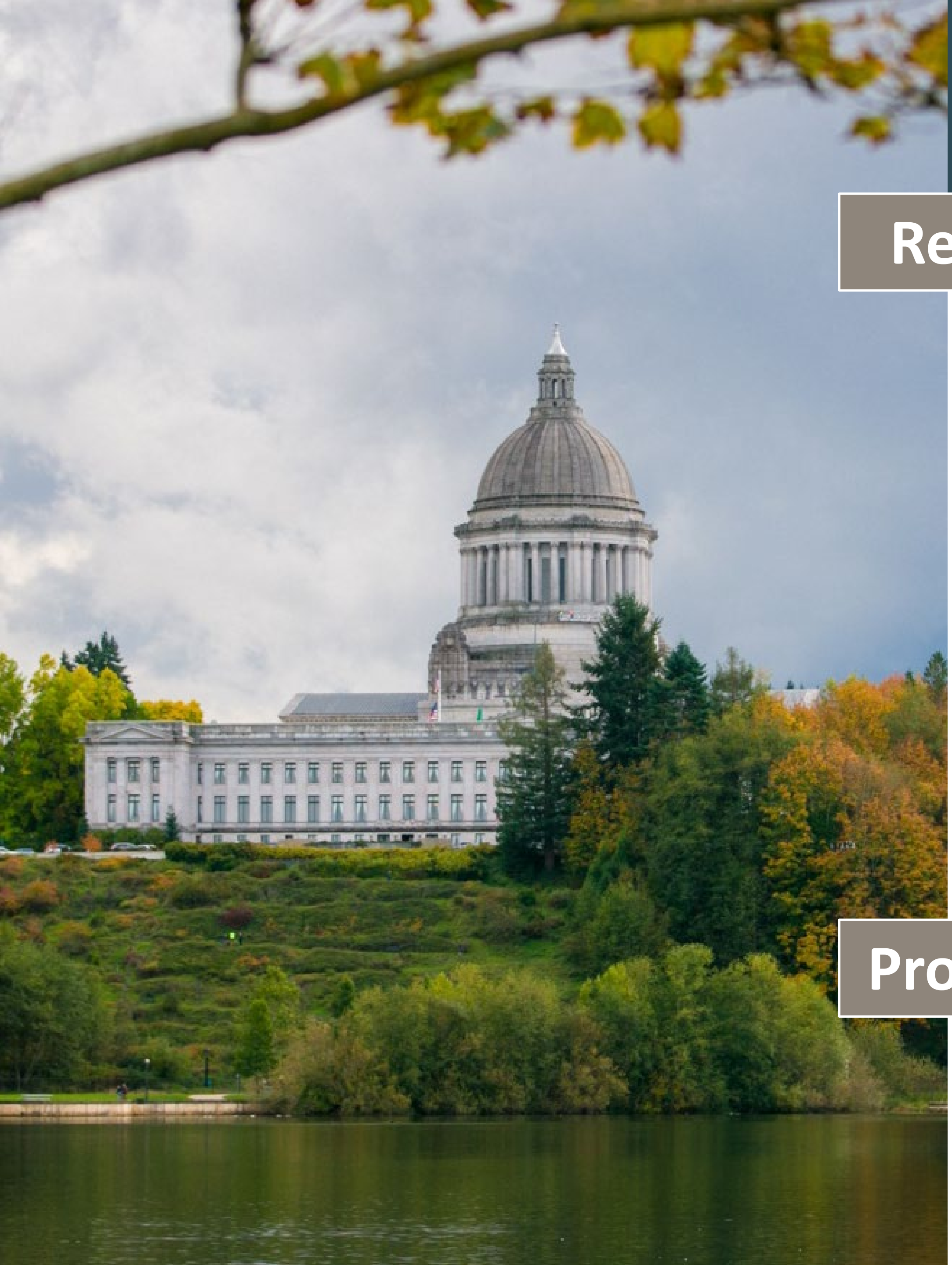
The Legislature amended the preference population criteria and extended the expiration date to December 31, 2030, in response to the January 2021 Legislative Auditor's recommendation.

The Citizen Commission should schedule a review in 2028 to determine if the preference achieved the goals of encouraging new development and increasing family living wage jobs.

Next step: Present to Citizen Commission

July	August	September	October	December
Present preliminary report to JLARC.	Present preliminary report to the Citizen Commission.	Citizen Commission obtains public testimony.	Citizen Commission adopts comments on the report.	Present proposed final report to JLARC.

Full Report: **leg.wa.gov/jlarc**



Contact Us

Research Analysts

Scott Hancock
360.786.5193
scott.hancock@leg.wa.gov

Dana Lynn
360.786.5177
dana.lynn@leg.wa.gov

Rachel Murata
360.786.5293
rachel.murata@leg.wa.gov

Pete van Moorsel
360.786.5185
pete.vanmoorsel@leg.wa.gov

Eric Whitaker
360.786.5618
eric.whitaker@leg.wa.gov

Josh Karas
360.786.5298
joshua.karas@leg.wa.gov

Project Coordinator

Eric Thomas
360.786.5182
eric.thomas@leg.wa.gov

Legislative Auditor

Keenan Konopaski
360.786.5187
keenan.konopaski@leg.wa.gov